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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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Can I depend on my employer's retirement fund for retirement?

Six million South Africans contribute to some kind of employer retirement fund. That number may seem impressive at first glance, but when you consider the full picture, it is certainly not. Four million people are in formal employment but do not contribute to a company retirement fund. Many have made no additional retirement provision in their personal capacity at all.

Add to that the millions in the informal economy and millions more who are unemployed. Then it is clear that South Africa's potential retirement cost burden seems out of balance. Retirement is a painful period financially for the majority of South Africans. When working people are contributing to an employer retirement fund they may be tempted to believe they are guaranteed to live comfortably in their golden years.

But is it wise to sit back and relax if your retirement fund contribution is deducted from your salary every month? Floris Slabbert, a director at Ecsponent Financial Services, a wholly owned subsidiary of Ecsponent Limited, says this would be foolish. "A simple answer to the question of whether you can rely only on your company retirement fund to fund your retirement, is 'no'," says Slabbert.

What are the reasons a company retirement fund may not be enough to see you through retirement?

Not all employees have the option to contribute to a retirement fund

Four out of ten working South Africans earn a "cost-to-company" salary with no benefits package. These millions of workers – most of whom work for small or medium-sized companies – need to make their own provisions for retirement.

Those in the informal sector or self-employed also have to make their own plans. "This is not ideal because the costs of setting up retirement funds and risk cover in your personal capacity are often far more expensive than large employer funds," says Slabbert. "Having a significant amount saved at retirement age is dependent on discipline throughout one's working life. Every year that passes without savings, is a year lost. To try make up for the lost opportunity to earn compounded interest over a long period, becomes very expensive," Slabbert adds.

The costs of managing a retirement fund can be high

South Africa has relatively high retirement fund costs when compared to other countries. With that fact in mind, one then must consider the functions retirement funds perform on behalf of their members. They collect money from contributors, pay out money to retirees, follow up with beneficiaries and they administer investments. All these services come at a cost. There are a host of factors that influence the relative value of the cost. This includes the size of the fund, whether or not contributions are compulsory, how the assets are invested, and the quality of service rendered, etc.

"The higher the costs of investment, the more pressure on the investment manager to achieve returns that outperform the impact of costs and inflation on your investments," says Slabbert. "A single percentage point in fees can make an astronomical difference over 40 years." Some pointers to look out for include the platform fees as well as any administration costs. Note that advisory fees are negotiable and should be evaluated and reviewed annually. Make sure you get the best bang for your buck and don't be fooled by the headlines.

Ask your financial advisor to break down all fees including the underlying fund costs, especially if your retirement fund makes use of a pooled arrangement.

The level and cost of risk benefits can be high

Most South African pension funds allocate a portion of the income they collect to death and disability benefits. While wellness factors and the improved rollout of antiretrovirals for HIV/AIDS has improved life expectancy, mortality projections indicate that deaths of working age employees will outpace new retirements within a few years. The average death benefit of a pension fund member is a multiple of his or her annual salary. Disability benefits consist of either a lump sum or the more expensive option where the beneficiary receives a proportion, such as 75% of the salary.

"It stands to reason that the more money goes towards claims, the less will be left for retirement benefits. The cost of risk benefits ultimately negatively affects the performance of the remaining investment assets in the fund," explains Slabbert.

Investment choices of the trustees

Investment choices make a significant impact on the long-term performance of retirement funds.

All retirement funds must comply with Regulation 28. This means they will invest in funds that carry lower risks. For example, retirement funds may not have an exposure higher than 75% in equities, 30% offshore and 25% in property.

“Many employees have no say over how their investments are managed, such as those who are part of large umbrella funds,” says Slabbert. “On the other hand, there is research which shows that members who do have a say about how investments are managed, often tend for the very conservative and low-risk route.

This introduces a different type of risk. “Managing a fund according to mandate that is too low-risk, will deliver returns below the inflation rate,” Slabbert explains.

Lack of preservation

South African legislation allows employees to withdraw their retirement benefits when leaving an employer.

“A Sanlam Benchmark Study in 2011 found that in their research sample only 2% of people who changed jobs moved their benefit to the new employer’s fund. 9% invested a portion of their pay-out. This leakage has massive negative implications for both individuals and South Africa as a whole,” says Slabbert. If paying a monthly contribution to an employer fund is not enough to ensure a secure retirement, what else can you do?

“Be wise,” suggests Slabbert. “Age-old wisdom warns against keeping all your eggs in one basket.” Instead, Slabbert suggests diversifying your investments so that you have exposure to different types of savings, investments, platforms and asset classes. “It would be wise to speak to a financial advisor and build an investment portfolio that spreads your risk and exposes you to the benefits of diverse investments such as preference shares,” says Slabbert. “What you want to do is have as much money saved by the time you retire as possible. You can then supplement the income you will receive from your retirement fund from these extra assets.”

Don’t stop when you retire

Even in retirement, smart investing can, and should, continue. At retirement, you can take one-third of your retirement fund in cash. You will have to invest the remaining two thirds in an annuity fund. You will need to choose between a life or living annuity, or combination of both, based on your individual needs. Then, investing the remaining one-third to supplement your income and hedge your risk is prudent,” says Slabbert. ***Full Report:*** ***https://www.fanews.co.za/article/employee-benefits/3/general/1221/can-i-depend-on-my-employer-s-retirement-fund-for-retirement/24589***

FA News

31 May 2018

Three things to consider before cashing out your retirement benefits

When you resign.

The decision to cash out retirement benefits when changing jobs is arguably the biggest contributor to many pensioners' dire financial position.

International research suggests that millennials – the generation born between 1981 and 1996 – are most at risk since they tend to change jobs more often than previous generations and will need to overcome the urge to cash out their retirement benefits more frequently.

While there may be instances where it could make sense to cash out retirement benefits, it should be the last resort and it should only be done after carefully considering the long-term implications. Here are some things to ponder.

1. It becomes increasingly difficult to catch up

Although one may argue that at age 30 or 40 there is still a long way to go to retirement, and that you will catch up along the way, it becomes increasingly difficult to do so, due to the impact of compound interest.

Ronald King, head of public policy and regulatory affairs at PSG, says if someone starts planning and saving for retirement at age 20, the individual would need to save 12.5% of his salary. If he only starts at age 30 (because he cashed out), he would need to save 22.5%.

If the same person decides to cash out his benefits at age 40, he would need to save 42% of his salary to be in the same position at retirement, he adds.

Due to other financial commitments, most people would be unable to afford such a high contribution rate.

If someone takes his retirement benefits at age 50, and starts saving anew at that point, he would need to save almost his whole salary to maintain his living standard in retirement.

2. The tax implications of cashing out are significant

Since the regulator wants to encourage people to save for retirement, significant tax breaks are allowed for contributions to retirement vehicles. Not only can individuals claim a tax deduction of up to 27.5% of their total taxable income each year (capped at R350 000), all retirement assets are allowed to grow tax-free while inside a retirement vehicle (pension fund, provident fund or retirement annuity).

But if you cash out prior to retirement when changing jobs, the taxes are punitive.

King explains that only R25 000 of the retirement funds can be taken tax-free when changing jobs – the rest will be taxed according to a sliding scale (see table below).

Taxable Income (R)	Rate of Tax (R)
0 – 25 000	0% of taxable income
25 001 – 660 000	18% of taxable income above 25 000
660 001 – 990 000	114 300 + 27% of taxable income above 660 000
990 001 and above	203 400 + 36% of taxable income above 990 000

Source: Sars

Yet, the most significant tax impact will only become visible at retirement.

Retirement annuity and pension fund investors can take up to a third of their benefits as a cash lump sum at retirement. Provident fund members can (currently) take all their funds in cash at retirement. The first R500 000 will be tax-free.

King says the biggest problem is that those pension benefits taken as a cash-lump sum when resigning will be deducted from the amount that can be taken tax-free at retirement.

"If you take R500 000 during your lifetime when resigning, you won't be entitled to the tax-free amount of R500 000 at retirement."

This means that individuals can pay up to roughly R85 000 more in tax when they retire, because they cashed out when changing jobs, he adds.

3. You can now leave your pension benefits in your former employer's fund

The introduction of default regulations for retirement funds means that funds need to offer in-fund preservation options for employees when they resign. Employees do not have to make use of it (they can opt out) but it may be an attractive option where funds offer good value for money and attractive returns.

King says most people would probably prefer not to leave their money with an employer with whom they no longer have any contact. The alternative is to transfer retirement benefits to a preservation fund or retirement annuity. The costs, underlying funds and tax benefits are the same. The main difference is that in the case of a preservation fund, investors would be allowed to access the funds once before the age of 55. With a retirement annuity, funds can't be accessed before this age.

King says to determine whether a preservation fund or retirement annuity will be the best choice, investors need to consider if they will be tempted to spend funds that are accessible to them. ***Full Report: https://www.moneyweb.co.za/mymoney/moneyweb-tax/3-things-to-think-about-before-cashing-out-your-retirement-benefits/***

Moneyweb
31 May 2018
By Ingé Lamprecht

How to pay zero tax in retirement

Without resorting to any 'clever' structuring.

When an acquaintance recently turned 64, he said he "couldn't wait" for his next birthday.
The people around the table at his birthday party were taken aback. Most people don't look forward to getting older. Why was he so excited?

"Because from next year, I will pay less tax!" he quipped.

He was right, of course. At age 65, individuals get an additional tax rebate. A higher annual interest exemption also becomes available.

The comment sparked a question. What type of income would a couple be able to draw in retirement before they would have to start paying tax? Naturally, there are various ways of reducing one's tax liability, particularly if you use clever structures, avoidance techniques and the like, but what if you kept it simple? In other words, no contributions to retirement annuities or investments in Section 12J venture capital companies – just using the main tax thresholds, rebates and exemptions allowed?

The example below is intended as an illustration and covers the tax year that will end on February 28, 2019. The assumption is that the taxpayer and her spouse are 65 or older, but not yet 75, that they have retired and don't have any additional income beside their annuities and discretionary investments.

Income, interest and tax-free savings
At age 65, the income tax threshold is R121 000 per annum. In other words, an individual would be able to draw an annual income of R121 000 from an annuity without paying any income tax.

The interest exemption is R34 500, and the same individual would be able to draw R34 500 from an interest-bearing investment before the Tax Man would come knocking.

Tax-free savings accounts were introduced on March 1 2015. Assuming the taxpayer contributed the maximum amounts allowed to these accounts every year, the capital value would be R126 000 ((R30 000 pa x 2) + (R33 000 pa x 2)), says Martin de Kock, director at Ascor Independent Wealth Managers.

To keep the calculation fairly simple and conservative, the assumption is that there has been no growth on these accounts and that the return on the investments for 2019 was 7%, giving the investor a tax-free income of R8 820, he adds.

Summary of annual tax-free income calculation	
Income from annuity	R121 000
Interest income	R34 500
Return on tax-free investment @ 7%	R8 820
Total	**R164 320**

This means that the couple could get a tax-free income of around R328 640 per year (R164 320 x 2), which amounts to R27 387 of income each month. Assuming they don't have any debt or rental expenses, no dependents and limited medical overheads, this would be a reasonable amount of money to live on.

Capital gains

Where retirees have share portfolios or other equity-type investments like unit trust funds outside a retirement annuity vehicle, this could also be used to supplement the monthly income of R27 387. These investments are also referred to as discretionary investments or funds.

However, this calculation is somewhat more complex since the tax-free "income" that could be derived by selling shares, would be highly dependent on the capital growth in the portfolio.

Currently, the annual amount above which capital gains become taxable is R40 000. In other words, if the capital gain on shares sold is R40 000 or less, no tax will be payable on the proceeds. Where a share portfolio had good capital growth over a longer period of time, an individual may be able to sell say R100 000 worth of shares before the R40 000 threshold would be triggered. However, if the share portfolio did not perform well and your growth is limited, you may need to sell much more shares or units to generate the tax-free capital gain of R40 000. From a cash-flow perspective, this makes it difficult to use these amounts for planning purposes in an example like this, De Kock says.

Compulsory and discretionary funds

Since pensioners may not be in a position to generate additional income in retirement, and taxes can make a big difference to their situation, it is important to get appropriate, independent advice prior to retirement.

De Kock says from a tax perspective, if could be sensible to create an additional pot of discretionary funds alongside the funds saved in a retirement vehicle like a pension fund, provident fund or retirement annuity leading up to retirement. Individuals would then be in a position to draw an income from their discretionary funds (for example money in a cheque account), which could be utilised without tax implications (this is after-tax money).

This could allow retirees to keep their overall tax rate as low as possible (even zero) during the first few years of retirement, while still allowing funds in the retirement vehicle to grow (assuming it is a living annuity). As the discretionary funds deplete over time, more income could then be drawn from the annuity and at age 75, another tax rebate will become available (albeit a fairly small one).

Ultimately, tax is only one of the various factors retirees need to take into account when structuring their financial affairs. It is no use putting money in a bank account to save a few rand in taxes, if it means the investor will need to forgo significant capital growth. Decisions around tax structuring must make sense within a broader financial plan.

"Doing retirement planning and focusing too much on tax could lead to bad results – beware!"

Moneyweb
1 June 2018
By Ingé Lamprecht

RA top up or tax-free savings account?

Q: Should I use the RA tax benefit, as allowed by Sars, before investing into a tax-free fund? true

I am currently 54 years old and contributing to a pension fund and RA. I am also contributing towards a tax-free fund of R33 000 per year. I am however not using the full 27.5% contribution towards the pension/RA funds on my total remuneration as per Sars. My question: Would it be better to first use the tax benefit as allowed by Sars before investing into a tax-free fund? Financially I am not able to contribute the full 27.5% plus the R33 000.

Dear Reader
Without fully understanding your personal circumstances, it would be difficult to give a definitive answer to your question. We would need a more complete understanding of your current situation; what the long-term requirements would be and more specific information such as income earned, tax paid, time until retirement and amounts currently contributed to the pension plan and retirement annuity.

I am assuming that the pension fund is an employer scheme and that you would like to understand whether it would be preferable to top up your RA or invest in a tax-free savings account. I will explain the main characteristics of the two products and then make some broad suggestions as to how to choose between the two.

Pertinent facts about retirement annuities

1) Contributions are tax deductible – this effectively means that for a 30% taxpayer for every R700 contributed R1 000 will be invested.

2) No taxation on the growth of your investment. Most investments are subject to capital gains tax, income tax and dividend tax. Within a retirement annuity no taxes are paid therefore increasing your returns through the tax saving.

3) You will only have access to your retirement annuity benefits from the age of 55.

4) Retirement annuity investments need to comply with certain legal investment limits which fall under Regulation 28 of the Pensions Fund Act. This limits the amount of equity and currently limits offshore exposure to 30% of the value of your RA portfolio.

5) When you retire you can take up to one third of your RA as a lump sum (or all of it if it's worth less than R247 500). The first R500 000 that you take as a lump sum is not taxed, however anything above this amount is subject to tax at the current rates applicable.

6) When you retire the two-thirds amount must be transferred to a product that can provide you with income and payments made will be subject to income tax. These would include living annuities and guaranteed annuity products. You will not have unfettered access to these funds after retirement.

7) Upon death, the undrawn portion of the living annuity will fall outside of your estate and therefore attract no estate duty.

Pertinent facts about-tax free savings accounts

1) As per the retirement annuity there is no taxation on the growth of your investment, unlike most other investments which are subject to capital gains tax, income tax and dividend tax. Within a tax-free savings account no taxes are paid therefore increasing your returns. ***Full Report:***
https://www.moneyweb.co.za/mymoney/moneyweb-personal-finance/top-up-your-ra-or-invest-in-a-tax-free-savings-account-which-is-best/

Moneyweb
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By Peter Nurcombe-Thorn

How to make your retirement savings last: common myths debunked

When it comes to saving for retirement, making sure your savings last is a common major concern. The best way to address this concern is to know your risks and overcome them.
Shaun Duddy, product development manager at Allan Gray, debunks common myths associated with retirement savings to help investors overcome various risks.

Myth #1: My savings will outlive me
"The simple truth is that many people will live a lot longer than they expect," asserts Duddy. "Based on our current understanding of South African mortality statistics, around 30% of women who retire at age 65 will still be alive at the age of 90."

He adds that this is a sobering reality for investors who think that their savings will last beyond their living years.

Myth #2: I only need to account for 6% inflation in my savings plan
"Although inflation has averaged about 6% over the past ten years thanks to the inflation-targeting efforts of the Reserve Bank, there have also been times, for example in the 1980s, when inflation has spiked to 20%," Duddy says.

Even at 6%, he believes inflation can have a big impact on investors' standard of living.
"Over 30 years, the buying power of R1 000 would be eroded to the point that it only buys goods now costing less than R200, at an inflation rate of 6%."

He cautions investors who are ready to hang up their work boots to ensure that they account for inflation in their retirement planning, as inflation has a very real impact on the purchasing power of their income.

"It is my understanding that of the guaranteed annuities sold in SA today, most do not have inflation-related increases built into them; a sobering reality," he says.

Myth #3: I can draw down more than 4% of capital
A starting income of 6% of capital may not seem like a lot, but once you account for the fact that that income needs to keep up with inflation for say 30 years, the minimum real (after inflation) return required to ensure income sustainability is 5.5% per annum.

“The chances of achieving this level of return are quite a lot lower than you would think. Looking back at very long-term asset class returns doesn’t give a full perspective. While the average return that is likely to be generated by your portfolio over time is important, it is also very important to understand what your personal return experience in that portfolio is likely to be: the ordering of your returns, volatility and the timing of your withdrawals all influence your personal return outcome and therefore the sustainability of your income,” Duddy cautions.

“The reality is that if you start income drawdowns at more than 4% of your capital, the odds of sustainability are not in your favour.”

Myth #4: I can’t afford to take risks
Duddy cautions against being too conservative when it comes to investing your retirement savings.
“Our research suggests that you need a well-diversified portfolio with at least 50 to 60% invested in growth assets, such as shares,” he says. “This may mean you have to stomach some short-term volatility, but if you invest only 30% in equity, it’s unlikely that your retirement savings will last the distance.”

Duddy sums up the three requirements to help you achieve a sustainable retirement income:
1. Calculate 4% of your capital value as a maximum starting income for the year.
2. Increase the resultant rand value only by inflation every year.
3. Invest at least 50 to 60% of your portfolio in equities for growth.

Fin24 News
31 May 2018

Getting ready for comfortable retirement

Sixty-year-old Patrick is finally ready to enjoy his retirement. He was widowed in his 50s and since then he has focused on his job as a superintendent in the South African Police Service.

He has worked in the SAPS for 30 years. He stays in Pretoria with his three children and two grandchildren.

"It's a big moment for me. I've been focused on community safety for so long, it's hard to let go," Patrick says. He plans to travel with his family across SA. Most importantly, he wants to leave some of his money to his family after he is gone.

Option 1:

As a member of the Government Employees Pension Fund (GEPF), when he retires he will receive a once-off lump sum called a gratuity as well as an annuity. An annuity is a regular monthly income that is paid out to a GEPF member until he dies.

This is called a life or guaranteed annuity. Once he has bought his annuity, he does not need to make any further decisions about the product as his terms are set for the rest of his life. This is an ideal option for retirees who prefer the relative security of the guaranteed income.

Advantages
He will receive a lump-sum benefit (gratuity) that he can use to travel and pay for any of his personal expenses or debts. He is guaranteed an income for life. His income will be increased by inflation as measured by the consumer price index.

There is a guarantee period for five years, which means that should he die within five years of his retirement, the income will be paid to his beneficiaries for the balance of those five years. There is no risk of reduced income due to the performance of the stock market. He will receive a medical aid subsidy and funeral benefits.

Capped leave will be paid in the form of a cash amount.

He does not have to make any investment decisions.

Disadvantages
His beneficiaries will not receive any money if he dies five years after retirement. Remember, he wants part of his money to go to his family after he is gone. However, should he die within the five-year period, his beneficiaries will receive the balance of the annuity payments up to the end of the five-year period as a cash lump sum.

If, however, he wants flexibility, choice and potentially higher investment returns, along with the option of leaving his retirement capital to his loved ones, he should consider a living annuity.

Option 2:
Patrick can transfer his pension benefit into a preservation fund
The GEPF will transfer the value of his pension benefit plus any difference between this benefit and what is known as the actuarial interest into a preservation fund.
One benefit of this option is that no tax is payable when the amount is transferred into an approved pension preservation fund.

Thereafter, he can withdraw up to one-third of his pension benefit. His pension benefit will be taxed as below. His contributions made to the GEPF before March 1 1998 are regarded as tax-free and will increase his tax-free lump sum benefit.

Option 3:

Patrick can use the balance of his pension fund (after the one-third withdrawal) to buy an income-providing product, such as a living annuity.

A living annuity is an investment product from which you can draw an income from your retirement savings during retirement. It is intended to provide a regular income to investors who have retired, using retirement savings received on retirement from a pension, provident or retirement annuity fund.

You can select the income you wish to receive from the investment within certain limits. You can choose to receive your income monthly, quarterly, twice a year or once a year. Your income may be reviewed and changed every year.

However, the big drawback is that your income is not guaranteed for the rest of your life and you bear the risk of running out of savings to pay the level of income you need because you do not have enough capital and/or your investments do not perform well.

It is advisable you withdraw a sustainable level of income. Any money left in Patrick's living annuity when he dies will be left to his beneficiaries.

Sowetan

31 May 2018

By Owen Nkomo

INTERNATIONAL NEWS

Is this the end of the great 'gold plated' pension cash-in?

The number of retirees cashing in their "gold-plated" pensions has slowed dramatically amid fears that savers are being given bad financial advice. It follows a sustained boom in savers swapping their guaranteed final salary incomes for cash lump sums following the introduction of the Government's pension freedoms in 2015.

Last year final salary cash-ins peaked, with 100,000 people a year transferring money away from their defined benefit pensions, after receiving advice. But this year the recorded number has dropped for the first time and is down by 34 per cent in the first quarter of this year from 32,478 to 21,482, according City watchdog figures requested by Money Management magazine.

It comes after MPs on the influential work and pensions select committee raised fears that a pensions mis-selling scandal was erupting as unscrupulous advisers were encouraging savers to transfer their money from guaranteed schemes into rip-off funds.

The Financial Conduct Authority has also expressed concerns about the quality of advice people are receiving, and has already banned dozens of firms from accepting fees for such advice.

The worry is that savers who have given up valuable guaranteed income for a lump sum could subsequently see it fall in value if stock markets take a turn for the worse. Research by the Financial Conduct Authority, which regulates pension advisers, found that one in five recommendations given by financial advisers to cash in guaranteed pensions was unsuitable, potentially leaving savers worse off.

In addition only half of such advice meets its standards, it said. Final salary pensions, often referred to as "gold plated" pensions are the most generous form of pension and are now largely unavailable to younger generations because they are so expensive for employers to provide.

But despite this, experts said that in many cases cashing in a final salary pension could still be a worthwhile move. This is because the cash sums savers can swap their guaranteed annual pensions for have risen dramatically since the pension freedoms because of low interest rates.

In the most extreme cases savers are being offered in excess of 50 times their annual pension income to leave their employer pension scheme. For example, someone with a guaranteed pension of £20,000 a year might be offered the chance to swap it for £1 million in cash.

Under current rules savers are required to pay for professional financial advice before cashing in a final salary pension. Many advisers take a percentage of the cash lump sum as a fee for the advice, meaning it can run into thousands of pounds.

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By Katie Morley

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