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Beware of these myths about the two-pot retirement system

The two-pot retirement system will come into effect after the enactment of the Pension Laws Amendment Bill.

Despite wide media coverage of how the two-pot retirement system will work once it is implemented on 1 September, the new way of saving for retirement is still surrounded by various myths that indicate that consumers do not really understand how the system will work. It also does not help that people focus on the money they want to withdraw instead of the main objective of the new two-pot retirement system to preserve your retirement savings to ensure that you can retire more comfortably because you have saved enough. “The two-pot retirement system is primarily designed to encourage long-term savings and preservation of retirement investments,” Gontse Tsatsi, head of Retail Clients at Old Mutual Investment Group, said at the launch of the asset manager’s Long Term Perspectives annual publication in Johannesburg recently. According to the legislation, retirement savings accumulated until 1 September 2024 will go into a “vested component”, which will not be subject to the new rules.

How the savings component will be funded

Thereafter, one-third of pension fund contributions will flow into the “savings component” and two-thirds into the “retirement component”. The two pots refer to how the money will be allocated from 1 September 2024, which is the savings pot and retirement pot. The savings pot will receive once-off “seed capital” from the vested pot of 10% of savings to a maximum of R30 000. “This means that everything saved in a pension fund until 1 September 2024, except for the seed capital, will be treated as it was in the past, governed by the current Pension Funds Act and Fund Rules,” Tsatsi said. “From 1 September the new system will allow people to access what they have accumulated in the savings pot once a year and investors will not have access to the retirement pot until retirement.” Tsatsi emphasised that the purpose of the new system is to enable South Africans to save enough for a comfortable retirement by preventing them from cashing in all their savings each time they change jobs. However, he said, there are several myths about the new system circulating among the public that must urgently be debunked:

#Myth 1: I am finally going to get my pension money

“You will only have access to the money in the savings pot, which will include the seed capital of up to R30 000 before tax at a marginal rate. The Act makes this provision so that investors can access their retirement funds once a year in case of an emergency. “However, he said, making a habit of using your retirement fund

for emergencies is not recommended, as all your pension assets, including those in the savings pot, should ideally be used for retirement.

#Myth 2: I can still access my pension money if I resign?

Tsatsi says the only pension money you will have access to if you resign will be the funds that are in the vested component (from original retirement savings before the Act is effective on 1 September 2024), as well as those in the savings pot (after 1 September 2024). “Money accumulated in the retirement pot after 1 September 2024 will not be available to you if you resign and change jobs. Also remember that if you resign and deplete your component and savings pot, you will have only your retirement pot in the future.”

#Myth 3: There will be no taxes or charges on my withdrawals

There will be a flat administration fee on once-yearly withdrawals from the savings pot, Tsatsi says. However, the major “cost” will come from the taxman. “The withdrawal will be taxed at your marginal tax rate. For example, if you withdraw R30 000 and your marginal tax rate is 26%, the pension fund will deduct tax of R7 800.” In essence, this means that you lose the tax benefit from your retirement savings.

#Myth 4: I can withdraw money at any time in the case of an emergency

Not true, Tsatsi says. “You can withdraw from your savings pot only once a year. National Treasury initially envisaged the savings pot to be used for emergencies, but the final legislation does not stipulate what the money can or cannot be used for.” Withdrawals must be a minimum of R2 000 before tax and “once a year” refers to the tax year from 1 March to 28 February of the following year.

#Myth 5: My pension fund will be a great vehicle for financial emergencies

Although the money in the savings pot may be useful in an emergency, such as when you have lost your job or are about to undergo an expensive medical procedure, Tsatsi said you should only use this route as a last resort, not least because of the high tax you will pay on withdrawals. “Our key recommendation is to have a separate emergency fund, which should be the equivalent of at least three months’ living expenses, funded from discretionary savings.

This can be in a low-risk, interest-bearing unit trust fund. Money can be accessed easily without any hassles or limitations and the only tax charged is on the capital gains,” Tsatsi explained. He pointed out that it is imperative for South Africans interested in withdrawing from the two-pot retirement system to approach it from a well-informed perspective by seeking advice from a qualified financial adviser who can help them plan for the short and long term. “From our Long-Term Perspectives research, it is clear that to truly build wealth, investors need time and must take advantage of the eighth wonder of the world, compounding interest.”

Consumers must remember withdrawals are only for emergencies

He also urges consumers to remember that although the savings pot should be used for emergencies only, constant withdrawals will mean that your lump sum at retirement is depleted and about a third of the life savings will not enjoy the benefits of investment growth and compounding. “When you consider it in this way,

a third is a huge amount," Tsatsi warned. He noted that Old Mutual initially, at the end of 2021, analysed the likely withdrawals from a "segment" perspective. "From this viewpoint, Old Mutual Investment Group/Old Mutual Unit Trusts, catering to middle to high-income clientele, anticipated relatively low withdrawals at the time. "However, over the past three years, there has been a shift, showing the cost burden on clients across all segments, from low to high LSM, due to increases in the prices of fuel, electricity, rates and taxes and interest rates. "While the assumption focuses on the impact on low LSMs, it is important to note that these increases also affect those with housing loans and vehicle financing agreements. Given the process of the two-pot system over the past three years, the initial and current perspectives differ. We now anticipate withdrawals even from the middle to high LSMs." He said Old Mutual's analysis shows that R14.2 billion is in play, with R7.9 billion from retail retirement products and R6.3 billion from occupational schemes.

The Citizen | 15 May 2024

How divorce may impact occupational retirement fund savings

Divorce can significantly affect financial planning, especially concerning occupational retirement fund savings. For advisers, understanding the implications of the Pension Funds Act, the Divorce Act, and matrimonial property regimes is crucial in guiding clients through this complex process. In her insightful article, which we thought would be of interest to our audience, Felicia Hlophe, a Legal Adviser at Allan Gray, explored how divorce influences pension interests and highlighted the critical legal considerations for both member and non-member spouses.

How divorce may impact occupational retirement fund savings

The Pension Funds Act, read together with the Divorce Act, and Islamic law (where applicable), provides that the court granting a decree of divorce may make an order that all or part of the pension interest of the spouse who is a member of a retirement fund must be paid by the fund to the non-member spouse. When it comes to occupational funds, the Divorce Act defines "pension interest" as "*the benefits to which the member would have been entitled in terms of the rules of the fund if their membership of the fund would have been terminated on the date of the divorce* *on account of their resignation from their office.*" Where the member has already resigned or terminated their employment prior to the date of divorce, there is no longer any "pension interest", even if the member has not accessed their benefit from the fund or terminated their membership of the fund. In simple terms, this means that only active members of an occupational fund have a pension interest in that fund and non-member spouses of paid-up members cannot access any portion of the member's benefit in the fund.

Case study

The above was confirmed in a recent High Court case. The judgement stated that the respondent was a member of an occupational fund and "resigned from his employment and exited his retirement fund on 7 May 2021." However, his "pension benefits were still held by the fund" on the date of his divorce from the non-

member spouse, which was made an order of court on 14 October 2021. The divorce order awarded 50% of the member's pension interest to the non-member spouse. However, when the non-member spouse approached the fund with the claim, the fund informed her that a pension interest no longer existed in the fund. The challenge that confronted the non-member spouse was that she was claiming a portion of the benefit that had accrued to the member before their divorce was granted. The court held that "*This means that non-member spouses' access to their member spouse's benefits is dependent, first on divorce, and secondly, on whether member spouses are active in their funds, even though these benefits are still held by these funds…*".

Pension interest and matrimonial property regimes

A member's matrimonial property regime determines whether the non-member spouse can claim pension interest from their fund. It is important for intended spouses to consult with a lawyer and financial adviser to determine which matrimonial property regime is best suited for their needs. In South Africa there are three different regimes:

1. Marriage in community of property

If a member marries without concluding an antenuptial contract, the default is that their marriage will be one of in community of property. In this regime, the member and the non-member spouse each own 50% of the assets and liabilities in the estate (joint estate) and, upon divorce, each spouse has a 50% claim against the other.

2. Marriage out of community of property without accrual

If the spouses do not want to have a joint estate it is imperative that they conclude an antenuptial contract, either with or without accrual. If without accrual, each spouse keeps their respective assets and there is no claim against the other's assets.

3. Marriage out of community of property with accrual.

If accrual is included, at divorce, the spouse with the larger estate (assets less liabilities, subject to exclusions) must pay the difference between the value of her/his estate and the estate of their spouse to the spouse with the smaller estate. The Divorce Act further makes it clear that where the spouses are married out of community of property without accrual and entered into that marriage on or after 1 November 1984, the non-member spouse has no claim for pension interest from the member's retirement savings.

The divorce order process

Before going to court the member may approach their occupational fund with a request for information, which can be both, or either, of the following:

1. Checking the wording used in the drafted order or settlement agreement to determine whether it is appropriate, and that the occupational fund would be permitted to give effect to an order in those terms. It should be noted that a divorce order must:

- Ensure that the retirement fund is identified or identifiable (e.g. "the Allan Gray Umbrella Pension Fund").
- Provide that the non-member is entitled to "pension interest". An order that refers to "interest", "full value" or "retirement interest" may be invalid.
- Provide for the pension interest amount or percentage that must be paid to the non-member (e.g. "50% of pension interest").
- Instruct the fund to make the pension interest deduction.

2. Calculation of the possible pension interest value (for information purposes only).

Once the member and the non-member spouse have agreed on the content of the drafted order or settlement agreement, the court will hand down a divorce order which includes the allocation of pension interest to the non-member spouse. For the occupational fund to process the deduction and payment of pension interest, a copy of the final divorce order (and settlement agreement, if applicable) must be forwarded to the fund as soon as possible.

When would a fund be unable to give effect to a divorce order?

- If the member has terminated employment but has elected to become a paid-up member in the fund; or
- If the divorce order/settlement agreement does not contain the appropriate wording to enable the fund to make a pension interest deduction; or
- If the spouses are married out of community of property without accrual and entered into the marriage on or after 1 November 1984.

When would a fund be able to give effect to a divorce order?

- The member spouse must be an active member of the fund as of the date of divorce; and
- The wording of the divorce order/settlement agreement is competent; and
- The parties are married:
    - In community of property; or
    - Out of community of property with accrual; or
    - Out of community of property without accrual and entered into the marriage before 1 November 1984.

Payment options and tax consequences available to the non-member spouse once the divorce order has been approved. Once the fund has reviewed the court order and determined that it is appropriate, the non-member spouse must decide how they wish to receive their allocation of the pension interest. The Pension Funds Act offers the non-member spouse two options:

Option 1: Receive the amount as a cash lump sum

If the non-member spouse chooses to receive a cash lump sum payment, a tax directive is requested from SARS in the non-member spouse's name. The fund will deduct any tax due from the amount awarded to the

non-member spouse and pay it to SARS before it makes payment to the non-member spouse (this applies to divorce orders issued on or after 13 September 2007 and payable on or after 1 March 2009).

Option 2: Transfer the available amount to another approved retirement fund
If the non-member spouse elects to transfer their benefit to an approved retirement fund, the transfer will be tax-free in both the hands of the member and non-member spouse (this applies to divorce orders issued before or after 13 September 2007, where the election was made after 1 March 2009). Service for members of the Allan Gray Umbrella Fund. Before a court order is granted and finalised, members (and their advisers) are encouraged to send the draft order or settlement agreement along with the applicable marital regime information to info@allangray.co.za. We will confirm whether the wording is acceptable in order for the Allan Gray Umbrella Pension or Provident Fund to give effect to the intention of the parties.

FA News | 15 May 2024

Retirement planning: Important questions to contemplate first

During the five-year period preceding retirement, critical choices on housing, healthcare, and expenses shape your retirement plan's viability. Crafting a robust retirement plan requires years, not months. During the five-year period preceding retirement, critical choices on housing, healthcare, and expenses shape its viability. To ensure the sustainability of your retirement, consider asking yourself the following questions:

Where will I live?
Where you intend to live in your retirement years will significantly impact the rest of your retirement plan, so it is important to give careful consideration to this. Waiting lists for retirement homes and complexes can be very long, so you should do your research, make enquiries, and pay deposits well in advance of your retirement. If you intend to downsize to a smaller retirement home, you will need to consider where you intend to buy, what you could reasonably expect to sell your home for, and how much it would cost to purchase a suitable retirement home.

When deciding where to live in your retirement, consider the following:

- Your proximity to children, grandchildren and family, bearing in mind that if you do not intend to live close to your loved ones, you will need to build travel costs into your post-retirement budget;
- Your proximity to doctors, specialists, hospitals and medical facilities;
- Your safety and security;
- The maintenance and upkeep costs of the home, complex or village;
- Any levies, cleaning services or garden services that you will be responsible for paying;
- Your future travel and holiday plans may require you to consider 'lock up and go' accommodation; and
- Your pets and whether you will be permitted to take them with you.

How much will I spend?

While the rule of thumb in terms of budgeting for post-retirement expenses is between 70% and 80% of pre-retirement expenditure, this is not a perfect science. Besides the fact that annual medical inflation way outstrips CPI, bear in mind that it is incredibly difficult to budget for future expenses such as frail care, step-down facilities and/or private nursing, most of which are not covered by medical aid. In addition to budgeting for your normal living expenses, consider the other possible costs in retirement, such as:

- Travel costs if your family live far away or abroad;
- The costs of renovating or altering your home if necessary;
- Transfer fees if and when downscaling to a smaller home;
- Vehicle upgrades during retirement;
- Large medical expenses, such as hearing aids and wheelchairs;
- Entertainment and hobby costs.

How long will I live?

Longevity statistics can be very misleading because the tables tend to show median life expectancy, which is the age at which half the population is deceased while the other half is alive. The reality, though, is that these statistics have no bearing on how long you will live. To be safe, your retirement plan should assume a life expectancy of between age 95 and 100. Advances in medicine mean that humans are being kept alive for longer with chronic conditions, the treatment of which can be very costly. Ironically, the longer we live, the more likely it is that we will require frail care or home nursing, as natural ageing prevents us from performing acts of daily living. Dementia, for instance, is a disease of ageing, and the longer we live, the more likely we are to suffer from it.

When contemplating your longevity, consider:

- Your current health status and lifestyle;
- Any existing medical conditions or diagnoses that could impact your life expectancy;
- If you retire at age 65, be aware that you could be in retirement for 35 years;
- Give some thought to the possibility that your spouse or partner may pre-decease you, and this will impact your retirement plan;
- Consider building the future costs of frail care and private nursing into your retirement plan.

Will I work?

Many retirees use their formal retirement as an opportunity to launch a second career, start a business or pursue a hobby. Some retirees do so to generate extra income, while others do it merely to remain active and engaged. Very often, retirees choose to implement a tapered retirement, which involves gradually working fewer hours over a couple of years to ease into retirement. Another option is to take on flexible contract work while testing out retirement.

When contemplating your transition into retirement, consider the following:

- You may want to find innovative ways of monetising a hobby or passion, which could take some advanced planning and testing;
- If you plan on starting a new business, ensure that you do not put your retirement capital at risk;
- If you want to stop working completely, give careful thought to how you will fill your days;
- Find out from your employer whether you are obligated to retire at 65 or whether you are permitted to work longer; and
- Find out how your employer feels about working reduced hours or working on a contract basis.

Will I have a purpose?

For many people, being employed or running a business provides a sense of purpose and meaning. Many retirees attest to missing the feeling of responsibility that work brings, the camaraderie with their colleagues, schedules and deadlines, meetings and other work-related activities. Post-retirement depression is particularly prevalent in those who have active and purposeful working careers. Before retiring, it is essential to consider what will give you purpose and meaning in retirement and into what you intend to channel your energy.

Bearing in mind that retirement is a journey and not a destination, give careful thought to the following:

- Do you have a lifelong dream that you have always wanted to pursue or achieve?
- What makes you feel fulfilled and purposeful?
- Do you want to make a difference in someone's life?
- What will make you excited to get out of bed in the morning?

Will I have a support group?

Having a trusted and reliable support group in retirement is important, especially if your immediate family does not live close by. Places of worship, charitable groups, and hobby and interest groups will undoubtedly form an important part of your retirement network, allowing you to engage with like-minded people who understand what you are going through in terms of your transition to retirement. Unlike the brochures, retirement can be an incredibly stressful period, and it is comforting to have people around you who understand the emotional and psychological impact of retirement.

Before retiring, consider:

- How will you remain engaged in society?
- Who will you rely on in cases of emergency?
- Will you be an emotional burden to your adult children?
- Where will you get the opportunity to engage with like-minded people of your own age and life stage?

Moneyweb | 14 May 2024

Keeping the vulnerable safe: The need for specialisation in beneficiary fund management

Beneficiary funds in South Africa ensure death benefits reach the vulnerable, requiring a customised approach and systems, says Jeanetta Hendricks, Fedgroup's Beneficiary Care GM. South Africa has almost three million orphaned children, and six out of 10 children are considered multidimensionally poor. Coupled with low levels of financial literacy (which are dropping, not improving), it's clear the country needs unique solutions to support the vulnerable. In 2009, to address this challenge, the government introduced beneficiary funds, recognised as a pension fund organisation under the Pension Funds Act (No 24 of 1956 as amended in 2008). As a cost- and tax-effective vehicle, these funds manage lump-sum death benefits for minors. There are 24 registered beneficiary funds in South Africa, holding assets totalling R23.37 billion for over 160 000 children. Despite being regulated under the Pension FundsAct, the complex needs of vulnerable children demand a customised, detailed approach rather than just monthly payment.

The right philosophy, paired with the right tech

Fedgroup, a specialist financial services provider, manages funds for numerous beneficiaries through its Fedtrust Beneficiary Fund. "We are not there to only effect an EFT once a month," says Jeanetta Hendricks, general manager of Beneficiary Care at Fedgroup. "We are there to look after our beneficiaries from a more holistic point of view and make sure that guardians are, in fact, taking care of beneficiaries as they should." Fedgroup actively manages beneficiaries' budgets, pays for their medical and school fees directly, and negotiates discounts. The company built its Azurite IT system specifically to handle all aspects of beneficiary care effectively and in real-time. It is the only custom-built, modern end-to-end beneficiary fund system in the country and offers a single view of detailed beneficiary requests and interactions, comprehensive security and disaster recovery systems, integration into the South African Revenue Service (Sars) and banks, automated asset management buy-and-sell instructions, and communication via email, telephone, physical mail, SMS and even fax.

"Would you believe about 40% of requests come to us via fax?" says Hendricks. "This could be a grandmother living in a rural area who does not have an email address but walks to the nearest post office and faxes the required documents to us. This is why it is so important to understand this market." The reduced admin burden that the system unlocks enables stronger personal relationships between staff members and the beneficiaries – a very important part of Fedgroup's philosophy on how it wants to run the business. Technology is vital, but people are even more so, says Hendricks. This means not only arming employees with the correct training but also ensuring that they truly understand what the beneficiaries are facing. That is why all the people in Fedgroup's Beneficiary Care department are either parents themselves, former beneficiaries of the fund, or came from child-headed households.

Efficient management of the finances

On the one hand, a beneficiary fund deals with countless payments every month. On the other, fund administrators must ensure they manage the investments responsibly and efficiently on behalf of the beneficiaries. This requires a fine-tuned liquidity and cash management approach. Hendricks says the Azurite IT system allows Fedgroup to strike the perfect balance. The highly integrated system includes financial transactions and communication with banks and Sars, all of which helps to reduce delays and errors typically associated with using multiple systems. This, together with some proprietary secrets, allows Fedgroup to keep the percentage of assets in cash between 1% and 2%, whereas it can be as high as 40% to 50% among other administrators. Less money in cash means more money invested in higher-growth assets. Of course, it is important that beneficiaries get paid on time, but another element of turnaround is acknowledging payment requests in real-time, says Hendricks "It's about how quickly you can acknowledge their request, or often, more importantly, to let them know if you need additional information. And you need to be able to do this while they are still standing in front of the fax machine," says Hendricks.

Bridging the gap

Once beneficiaries have finished high school, they still face the challenge of many young South Africans: finding gainful employment by having experience in a working environment. To address this, says Hendricks, Fedgroup's Iteke Learnership Programme, which is open exclusively to the company's beneficiaries, does just that. It provides matriculants with work experience, working at Fedgroup, and the tools to make important career decisions. It also exposes the learners to a Seta-accredited tertiary qualification. In fact, around 10% of Fedgroup's total staff are former beneficiaries who have come through this programme. These include project managers, accountants, asset managers, estate specialists and more.

A growing need requires scalable solutions

Hendricks cautions that beneficiary funds are often seen as a simple add-on to retirement fund administration, which could be detrimental to the vulnerable. Looking after a retirement fund and looking after beneficiaries are entirely different prospects. With nearly three million orphaned children relying on these funds, each decision impacts lives directly. This means having suitable systems, ensuring the money is paid on time and to the right service providers and guardians, prioritising communication to simplify requests, and ensuring that the children's futures are protected and supported.

Moneyweb | 8 May 2024

Private pension pots should not be treated like glorified savings accounts…

It is "extremely worrying" that nearly four out of five middle-aged people are raiding their private pension pots before they reach retirement age, says Dennis Reed.

It is extremely worrying that nearly four out of five middle-aged people are raiding their private pension pots before they reach retirement age. This is a gamble on future security in their later years. I can well understand that, during a cost-of-living crisis, there is a temptation to access a readily available lump sum. It is a pity that the Scottish Widows research did not cover the reasons for private pot raids. I would suggest that the size of the raids, with the average being £47,000, is not to cover day-to-day expenses or for a luxury holiday. More likely it is to subsidise struggling children and grandchildren with house purchases, commuter season tickets, or university and nursery fees.

Or even to support their own parents with costly social care. This is a squeezed generation who are forfeiting their own security in retirement to support their families. The UK has an unhealthy reliance on private pension schemes. If you are on the average wage, you are unlikely to have a pension pot which will do much more than supplement the state pension in your retirement. The consumer body, which, estimates that a single person needs £20,000 a year for a comfortable retirement, which would require a pension pot of about £500,000. And the value of private pension pots can fluctuate considerably, dependent as they are on stock market ups and downs. Any dilution of an already inadequate pension pot could have serious consequences down the line. The fragility of private pension schemes is why Silver Voices argues so strongly for a much-improved living state pension scheme.

This aim is doubly important for today’s working generations, who are unlikely to benefit from the gold-plated and inflation-proofed occupational pensions which used to be provided by big employers. Private pension pots should not be treated like glorified savings accounts as they are the guarantee of some security in old age. The Government should do more to warn of the dangers of drawing down from the pension pot before retirement, as the benefits system will be forced to step in, in the end, as pensioner poverty increases.

Express | 15 May 2024

Rise in ultra-long mortgages ‘poses risk to UK retirement prospects

Former pensions minister says data shows buyers increasingly forced to accept terms that stretch into state pension age

Homebuyers are increasingly being forced to “gamble” with their retirement prospects to get on the housing ladder by taking on ultra-long mortgages lasting beyond the end of their working life, it has been claimed. More than a million mortgages that stretch beyond the borrower’s state pension age have been arranged in the last three years, figures show. The data, obtained via a freedom of information (FoI) request by the former Lib Dem pensions minister Steve Webb, show the proportion of home loans arranged to last into retirement increased from 31% in the final quarter of 2021 to 42% in the same period last year. Among 30- to 39-year-olds, who would typically be expected to be taking out their first mortgage, 30,943 home loans were arranged to last beyond state pension age, with 39% of those granted in the last three months of 2023. This compared with 23% two years earlier.

The figures were higher for 40- to 49-year-olds, with 32,305 new mortgages, or 57% of the market, arranged beyond typical retirement age. In 2021 the proportion was 42%. Older age groups were more likely to have home loans that stretched beyond retirement, but the numbers were far smaller. Rising house prices and interest rates have fuelled an increase in the number of borrowers taking on ultra-long mortgage terms in recent years. Arranging a mortgage over a longer period than the traditional 25 years reduces monthly repayments and in some cases means the difference between being able to afford a home and not. Webb, a partner at the pension consultants LCP, submitted an FoI request to the Bank of England after it reported that two in five borrowers had taken out loans that would run beyond state pension age.

The Bank supplied figures for the final quarters of 2021, 2022 and 2023 showing all new residential mortgages issued in those periods. The figures include remortgages, so there could be some borrowers who took a two-year deal and then moved to a new loan in the same period, and so will be counted twice. Webb said that if the figures for all quarters were similar, more than 1m mortgages that went beyond pension age had been issued, and this could cause problems when borrowers reached later life. Although a mortgage taken out by someone in their 30s was unlikely to be their last, he said the risk to retirement depended on what happened over the course of their working life and whether or not they are able to shorten the term.

“The huge number of mortgages that run past state pension age is shocking,” he said. “The challenge of getting on the housing ladder is forcing large numbers of young homebuyers to gamble with their retirement prospects by taking on ultra-long mortgages. “We already know that millions of people are not saving enough for their retirement and if some of that limited retirement saving has to be used to clear a mortgage balance at retirement they will be at even greater risk of poverty in old age. Serious questions need to be asked of mortgage lenders as to whether this lending is really in the borrower’s best interests.”

The Guardian | 13 May 2024

Should I get a living annuity with offshore exposure or stick with my RA?

The decision will depend on your risk profile and income needs.

At 61, I have R4 million in retirement annuities (yielding 7-8% annually). Due to South Africa's political volatility, is it wiser to shift to a living annuity for more overseas investment, aiming for higher returns? Or should I wait, hoping for improved returns in my current retirement annuity, before transitioning at 65?

Deciding whether to retire from your annuities or remain invested is not easy, and I believe your risk profile is a consideration you have to keep in mind.

Retirement annuity recap

A retirement annuity (RA) is a pre-retirement savings vehicle that offers considerable tax benefits.
For the benefit of other readers, I would like to mention that the earliest these funds can be accessed is age 55 (there is no upper age limit). Once an investor has chosen to access these funds – in other words, retire from the RA – they may take a one-third lump sum in cash and are required to move the remaining two thirds (or the full amount) into either:

- A living annuity, which offers more flexibility in terms of investment allocations and income withdrawal amounts, with income paid until your investment is depleted or death, whichever comes first – with any remaining funds going to your nominated beneficiary/ies; or
- A life annuity, which is an investment where the annuitant 'buys' an income for the rest of their life (or that of a second life insured) until the last surviving investor passes away. In this investment, no capital value will be left to beneficiaries after the last investor passes away unless this occurs within the guaranteed term as per the agreement at the onset. You will not be able to choose any funds or offshore allocation within this investment, as this is determined by the administrator itself.

Stay in your RA?

The funds in your RA are subject to the Regulation 28 of the Pension Funds Act, which restricts the amount of offshore exposure you may hold. Currently, the offshore allocation allowance in a retirement annuity is 45%. If your risk tolerance is balanced or more conservative, staying in retirement annuities might be the better option.

Or move the funds into a living annuity?

With a living annuity, you retain control over the investment portfolio. You can choose a mix of local and higher offshore asset allocations, potentially leading to higher growth. Including offshore investments in your living annuity can be a strategy to potentially boost returns. Here's why:

- **Diversification:** Offshore markets offer exposure to different asset classes and economies, mitigating the risk of solely relying on domestic markets.
- **Currency fluctuations:** A stronger foreign currency can magnify returns when converted to your local currency.
- **Limitations of offshore exposure within living annuities:** A recent article on Moneyweb mentioned that certain platforms are limiting offshore exposure within living annuities. Not all platforms have limitations, and these restrictions also differ between platforms. When you decide to invest in a living annuity, keep this in mind.
- **An extra 10-20% offshore boost**
- A 10-20% higher allocation to offshore investments in a living annuity compared to a retirement annuity could translate to higher growth rates than a domestically allocated investment. However, past performance doesn't guarantee future results.
- Offshore markets can be more volatile, meaning your investment value can fluctuate more significantly and with bigger margins.
- Below is an example of a local equity fund first and the offshore equity fund, with the same fund manager but with different mandates:

Fund	Percentage allocation	6 Months	1 Year	3 Years	5 Years
Ninety One Equity Fund I	50.00%	6.51%	-0.21%	5.97%	8.86%
Ninety One Global Franchise FF I	50.00%	8.65%	14.71%	12.49%	14.85%
Total weighted average	--	**7.75%**	**7.44%**	**9.89%**	**12.81%**
FTSE/JSE All Share	--	3.87%	-3.77%	6.55%	8.34%
S&P 500	--	17.65%	29.10%	18.82%	20.62%

Source: Author supplied

Important considerations

- **Risk tolerance:** Living annuities with higher offshore exposure are generally riskier. Carefully assess your risk tolerance before choosing this option.
- **Investment expertise:** Managing a living annuity portfolio requires investment knowledge or a financial advisor's guidance.
- **Income needs:** Living annuities don't guarantee a fixed income. You'll need to manage withdrawals to ensure the annuity lasts your lifetime.

Conclusion

Living annuities with higher offshore exposure offer the potential for greater growth but come with increased risk and complexity. Carefully weigh your risk tolerance, investment knowledge, and income needs before deciding between a retirement and a living annuity with a higher offshore allocation. For more moderate-aggressive investors, the living annuity route will seem to be better, depending on their income needs. Consulting a financial advisor can help you make an informed decision based on your specific circumstances. There is no one-size-fits-all strategy.

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