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INSURANCE SECTOR EDUCATION AND TRAINING AUTHORITY

LEARNER GUIDE

Unit Standard Title:	**Apply technical knowledge and skill to advise an individual on planning for retirement Apply the law of contract to insurance**
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Apply technical knowledge and skill to advise an individual on planning for retirement

Introduction

A secure, comfortable retirement is every worker's dream. Achieving the dream of a secure, comfortable retirement is much easier when you plan your finances. Financial security in retirement doesn't just happen. It takes planning and commitment and, yes, money.

A retirement plan helps you decide what type of lifestyle you would like to have, how much you need to save and how to manage your money after you stop working.

This learner guide will discuss in detail the concept of planning for retirement.

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Module 1

Legislation on retirement planning

This Module deals with:

- The impact of legislation on retirement planning
- Developments relating to retirement funds with reference to current trends
- The implications of changes in legislation on existing retirement plans with a view to proposing an updated financial solution

The impact of legislation on retirement planning

The entire retirement fund saving system in SA is being overhauled. The changes to the regime started a few years ago with the reduction and eventual elimination of certain fund taxes. These taxes were initially levied at 18%.

In a country where government funding for retirees is not high on the priority lists, personal retirement fund savings need all the help they can get. Fund legislation has been complex for the lay person to understand, because each of the three tax structures has its own benefits and tax consequences.

At present, employers may claim as tax deduction contributions to an employee's retirement fund, up to 20% of the employee's pensionable income.

Members of pension funds may contribute up to 7.5% of their pensionable income and members of retirement annuity funds may claim up to 15% of their non-pension funding income.

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	Member	Employer
Pension fund	Maximum of 7,5% of pensionable salary or R1750.	Up to 20% of approved remuneration. (1)
Provident fund	No deduction.	Up to 20% of approved remuneration. (1)
Retirement annuity fund	Greatest of: • 15% of **net** non-retirement funding income; • R3 500 less deductible contributions to a pension fund; • R1 750.	Not applicable. (Employers do not contribute to a retirement annuity.)
Preservation fund	No on-going contributions allowed.	No on-going contributions allowed.

These rules favour higher income earners –the more you earn the higher your deduction. The new regime is likely to place a monetary limit on the amount you may contribute and claim as a deduction.

At retirement, the taxation of lump sums has already been greatly simplified in order to give you far more tax-free proceeds than ever before. Retirement fund lump sum benefits or severance benefits is taxed as follows:

Taxable Income (R)	Rate of Tax (R)
0 – 500 000	0% of taxable income
500 001 - 700 000	18% of taxable income above 500 000
700 001 – 1 050 000	36 000 + 27% of taxable income above 700 000
1 050 001 and above	130 500 + 36% of taxable income above 1 050 000

There has been confusion about whether divorced spouses have access to their portion of a retirement fund immediately after a divorce.

Since September 2007 there has been legislation regulating this, but most pension funds did not allow former spouses access to their share of benefits as they wanted clarity on taxation and benefit calculations.

One of the anomalies of our retirement fund system is that if members of a pension fund or provident fund emigrate before they reach retirement, they have the option to resign from their pension or provident fund, pay the tax, convert their retirement savings to cash and apply for the necessary foreign exchange.

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However, until now, members of retirement annuity funds did not have this option. In terms of their rules they are members until they reach the age of 55. This had negative consequences for younger, mobile and self employed people, for whom retirement annuities are illiquid and inflexible as an investment vehicle. As a result they use other “after-tax” savings mechanisms such as endowments and unit trusts, and forfeit the favourable tax treatment within retirement annuities.

Retirement annuities are again becoming an attractive method to boost retirement capital and will benefit the self-employed people.

At present, employees moving to a new company who wish to preserve their retirement capital, have three main options:

- transferring the capital to the new company’s fund
- transferring the retirement capital to a retirement annuity or
- transferring retirement capital to a “participating” preservation fund, which allows them a once off draw.

In terms of the new legislation, you may be able to transfer your savings to a preservation fund of your choice; transfer between preservation funds; combine preservation funds and retire at any time from the preservation fund after reaching 55.

These major advances in flexible, tax-effective wealth accumulation solutions have allowed investors rapidly to grow their investment portfolios.
Globally, retirement provision is becoming more and more of an individual responsibility.

The Pension Fund Act (24 of 1956) is the statute that provides for the registration, incorporation, regulation and dissolution of pension, provident and retirement annuity funds.

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Pension and provident funds (referred to jointly as *retirement funds*) are non-profit-seeking institutions that administer employees' and employers' provisions for the day when employees are no longer physically or mentally able to work.

***Pension funds* provide pensions for members when they retire (one third of which can be commuted that is, taken as a lump sum)**

***Provident funds* provide lump sums. In addition, both funds usually provide benefits for members on permanent disablement or early withdrawal from the fund, and for a member's dependants in the event of the member's death.**

The Pension Funds Act is designed to protect the interest of members of funds. The burden of the state to provide benefits to employees on disability and on retirement is reduced. All private retirement funds are subject to the Pension Funds Act, except those funds underwritten solely by policies of insurance, which, subject to certain conditions, can apply for exemption from certain portions of the Act.

Because the earnings of employees were at one stage so meager that they hardly covered current expenditure, in early days it was often the case that, when people were no longer able to work, there were no alternative sources of income.

This state of affairs had two results:

- The government instituted a fund in terms of which persons received a small pension on attaining a certain age. These so-called “old-age pensions” were – and still are – small, and barely fulfill basic needs.
- Ex-employees placed their employers under a moral obligation to provide financial aid.

As a result of the second factor, employers sometimes supplied sums from their own current funds to provide for a retired employee. However, as more employees reached an advanced age, greater demands were made on employers' support. These claims often caused embarrassment to an employer either because he did not

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have adequate funds at his disposal at the time or because his money was otherwise committed, e.g. in his business.

The thought then arose that regular sums should be set aside during an employee's working life to make provision for the time when he would no longer be capable of supporting himself. At the same time the need arose for assistance at the death of an employee or when, for medical reasons, he became unfit for work. This, in turn, led to new "moral claims" on the employer for financial aid.

Some employers, especially powerful ones, consequently took upon themselves all these functions, such as the saving of money for old age, providing capital at death, and making an income available on disablement.

As skilled labour became scarcer in modern times, employees chose to work for those employers who offered retirement benefits. So, in order to attract employees, increasing numbers of employers began to institute pension and provident funds.

Meanwhile the burden on government of providing old-age pensions became heavier, *inter alia* because people's life expectancy was increasing owing to progress in medical science. The authorities therefore welcomed the establishment of funds by employers to relieve the burden on the state, and even began actively to encourage pension provision by allowing attractive tax benefits on contributions to funds by employers and employees.

The Pension Funds Act was promulgated in 1956 to ensure the orderly regulation of all matters pertaining to funds. Retirement funds are governed by more than 60 pieces of legislation.

For this module we only look at the following pieces of legislation

- Pension Fund Act 24 of 1956
- Income Tax Act 52 of 1962
- Financial institutions (Protection of funds) Act 28 of 2001
- PF Circulars and directives issued in terms of the above acts

Circumstances under which a fund would be required to register under this Act

A Pension Fund must be registered with the Registrar of Pension Funds in terms of the Pension Funds Act to carry on business and must be approved by the Commissioner for Inland Revenue in terms of the Income Tax Act for tax purposes. The Commissioner cannot approve a fund unless he is satisfied that the rules of the fund provide the following:

- Retirement annuity (RA) funds permit single premium contributions whilst Pension and provident funds do not.
- A member of a RA fund cannot be a non-contributory member of the fund, i.e. where, someone else on behalf of the member makes contributions.
- Not more than one-third of the total value of the fund to which any person becomes entitled, may be commuted for a single payment (i.e. taken as a lump sum,) except where two thirds of the total value does not exceed R50 000 (or the fund is deemed to be a provident fund). The member may only take a maximum of one-third of the fund value as a cash lump-sum, (Possible tax implications) the remaining two-thirds must be used to purchase an annuity or income (often referred to as a pension).
- Adequate security must be provided to safeguard the interest of persons who may become entitled to annuities.
- Taxation laws amendment Act 3 of 2008 provided that the age limit of 70 be removed and as such an individual will not be forced to retire at age pg 70.
- A member can start receiving an annuity before he reaches the age of 55 years if he becomes permanently incapable, through infirmity of body or mind, of carrying on his occupation.
- If the member dies before becoming entitled to payment of an annuity, the benefit payable shall not exceed a refund to his estate or to his dependents or nominees, of the sum of the amounts contributed by him (with or without

Only applicable to Retirement Annuities

reasonable interest thereon - at present the interest rate allowed is 7% p.a. compound) and annuities to his dependents or nominees.

- A member who stops paying his contributions prematurely shall be entitled to either an annuity (payable from the date on which he would have become entitled to an annuity if had continued his contributions) determined in relation to his actual contributions or to be reinstated as a full member under conditions prescribed in the rules of the fund.
- If the fund is wound up, a member's interest therein must be either used to purchase a policy of insurance, which the Commissioner is satisfied provides benefits similar to those provided by the fund or paid for the member's benefit into an approved RA (Retirement Annuity) fund
- No member’s rights to benefits shall be capable of surrender, commutation or assignment or of being pledged as security for any loan.

Developments relating to retirement funds with reference to current trends

Since 1992, the retirement fund industry in SA has been the subject of several investigations and commissions investigating its future.

The Pension Funds Act dates back to 1956, so the industry is still governed by a vintage model, though there have been amendments that have introduced member-elected trustees, the pension funds adjudicator, minimum benefits and surplus apportionment.

RETIREMENT PLANNING VEHICLES: A COMPARISON			
	Provident fund	**Pension fund**	**Retirement annuity**
Administrative requirements	Must be approved by the Registrar	Must be approved by the Registrar	Must be approved by the Registrar

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	(Pension Funds Act). Must be approved by Commissioner of SARS Membership agreement between employer/employee: New fund – employee choice Existing fund – compulsory	(Pension Funds Act). Must be approved by Commissioner of SARS Membership agreement between employer/employee: New fund – employee choice Existing fund – compulsory	(Pension Funds Act). Must be approved by Commissioner of SARS No agreement between employer/employee required
	Fund must be registered	Fund must be registered	Fund must be registered
Deductible Contribution (Employer)	10% of approved remuneration for pension, provident funds and medical aid schemes. In practice up to 20% is allowed if justifiable. Section 11(i)	10% of approved remuneration for pension, provident funds and medical aid schemes. In practice up to 20% is allowed if justifiable. Section 11(i)	No contribution
Deductible Contribution (Member)	Not tax deductible	Deductible with max. of the greater of: - R1 750 Or - 7.5% of pensionable remuneration (limit also applies to	Deductible with max. of the greater of: - 15% of non-retirement funding taxable income; or R3,500 – allowable

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		government employees) Section 11(k)(i) Any disallowed excess may not be carried forward to the following year of assessment. The disallowed excess is allowed as a deduction at retirement.	pension fund contribution; or - R1,750
Arrear	Not tax deductible	R1 800 deductible p.a. Section 11 (k)(ii)(aa) Any excess above R1800 may be carried forward to the following year of assessment.	R1 800 deductible p.a. Section 11 (k)(ii)(aa) Any excess above R1800 may be carried forward to the following year of assessment.
RETIREMENT BENEFIT	Cash Lump Sum		
	Entire amount or surrender value of policy	1/3 of total value (if 2/3 of the total value of the annuity that is due upon retirement is less than R50,000, full benefit) Section 1	1/3 of total value (if 2/3 of the total value of the annuity that is due upon retirement is less than R50,000, full benefit) Section 1

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		"pension fund" (c)(ii)(dd) Balance used to purchase a comp. annuity taxed i.t.o. tax tables.	"pension fund" (c)(ii)(dd) Balance used to purchase a comp. annuity taxed i.t.o. tax tables.
	Tax free portion		
No tax payable on lump sums for individuals with a taxable Income of R46 000 or less. (With effect from 1 March 2008)	Z = C + E – D (Formula B) Where: Z = tax free amount C = R500 000 (this limit applies over the tax payers life time and is applicable in respect of all funds to which the taxpayer belongs). E = previous disallowed own contributions, tax free transfers from public sector funds and divorce order amounts transferred from approved funds. D = total previous tax free deductions	Z = C + E – D (Formula B) Where: Z = tax free amount C = R500 000 (this limit applies over the tax payers life time and is applicable in respect of all funds to which the taxpayer belongs). E = previous disallowed own contributions, tax free transfers from public sector funds and divorce order amounts transferred from approved funds. D = total previous tax free deductions	Z = C + E – D (Formula B) Where: Z = tax free amount C = R500 000 (this limit applies over the tax payers life time and is applicable in respect of all funds to which the taxpayer belongs). E = previous disallowed own contributions, tax free transfers from public sector funds and divorce order amounts transferred from approved funds. D = total previous

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	allowed to the taxpayer in respect of paragraph 5 of the second schedule. Second Schedule	allowed to the taxpayer in respect of paragraph 5 of the second schedule. Second Schedule	tax free deductions allowed to the taxpayer in respect of paragraph 5 of the second schedule. Second Schedule
	Taxable portion		
	Taxed as per table in item 7 of Appendix 1 to the Income Tax Act as follows: The first R500 000 of the taxable amount at 18% The next R500 000 of the taxable amount at 27% and The balance of the taxable amount at 36% Section 5(2)	Taxed as per table in item 7 of Appendix 1 to the Income Tax Act as follows: The first R500 000 of the taxable amount at 18% The next R500 000 of the taxable amount at 27% and The balance of the taxable amount at 36% Section 5(2)	Taxed as per table in item 7 of Appendix 1 to the Income Tax Act as follows: The first R500 000 of the taxable amount at 18% The next R500 000 of the taxable amount at 27% and The balance of the taxable amount at 36% Section 5(2
Retirement Benefit (Public Sector Funds)	All lump sum benefits paid from a public sector fund were all tax-free until 1 March 1998 Thereafter parity	All lump sum benefits paid from a public sector fund were all tax-free until 1 March 1998 Thereafter parity	Not applicable

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	between public and private sector fund taxation. Vested rights are protected by formula C in the Second Schedule to the Income tax Act. If a Public Sector fund is involved, the following calculation must be done:	between public and private sector fund taxation. Vested rights are protected by formula C in the Second Schedule to the Income tax Act. If a Public Sector fund is involved, the following calculation must be done:	

The biggest move has been the conversion of almost all private-sector funds from defined benefit - in which the employer guaranteed the pension - to defined contribution - in which retirement savings are accumulated on an individual basis, similar to a tax-preferred savings account.

Defined-benefit funds sounded like a good idea, but they have not been found to be sustainable. They were like a huge pyramid scheme in which the people who joined the fund later subsidised the earlier members. It was based on the assumption that people would stay with one employer for their whole working lives, which is rarely the case.

Though South Africa does not have the structural problems of Europe, in which a shrinking workforce is supporting a growing number of pensioners, the main problem is at micro level - too few people have sufficient capital with which to retire.

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	Defined contribution fund	Defined benefit fund
Retirement benefit	Roll-up of accumulated contributions plus fund growth.	A percentage of final salary based on years of service.
Risk to the employer	The member carries the investment risk.	Very risky for the employer as shortfalls in the fund must be contributed by the employer.
Administration costs	Cheaper to administer.	Actuarial requirements make administration expensive. Variations (increases) in salaries can have a profound effect on the fund.
Suitability for employer	Small- and medium-sized companies.	Medium to large companies.
Advantage to members and fairness	It favours younger members (entrants). Younger members have more time to accumulate contributions. It is fairer - the member gets what he puts in.	It favours older members (entrants). Old members have a shorter period during which they can accumulate contributions.
Cost of starting up	The initial outlay is small.	Requires a large initial investment outlay.
Strength of the fund	It is not dependent on the ages and the salaries of the members.	The financial strength of the fund depends heavily on the ages and salaries of the members.
Early retirement Penalties	No penalties.	Normally a reduction in benefits for each year by which the earlier retirement is before normal retirement date.
Advantages	The employer's contributions are limited to an affordable level.	The retirement benefits are guaranteed as a percentage of final salary.
Disadvantages	A poor investment return may lower the employee's retirement benefits.	Open-ended contribution liability for the employer.

Theory in practice: All new funds established are funded on a defined contribution basis. These funds can either be pension funds or provident funds in nature.

This is the crucial issue that national treasury aims to address in the consultative process that will lead to an entirely new act. Treasury released its retirement fund reform discussion paper. There has been little controversy about the main aim of the reform, which is to fill the gap between the indigent, who are quite efficiently covered by the state's old age pension of R1 350/month (2014/15), and people covered by occupational pension funds, which cover at least 66% - and up to 84% - of permanent employees in the private and government sectors.

In spite of this, treasury says three-quarters of the population reaches retirement age without a funded pension benefit.

In March 2006, National Treasury issued a discussion paper titled “Contractual Savings in the Life Insurance Industry”. The paper dealt with a number of different

reforms including changes to the structure of commission payable on contractual savings products as well as the enhancement of minimum early termination values of products in order to enhance cost effectiveness and consumer protection. Since then, in February 2008, a further paper has been put out by National Treasury which builds on the reforms suggested in the first paper. This paper is titled ‘Regulatory Reforms: Commission Scales & Minimum Early Termination Values’ and deals specifically with these aspects. Some of the reforms and changes suggested have since been implemented.

To read both papers, visit the National Treasury website, www.treasury.gov.za

Treasury has acknowledged that the main reason people retire with insufficient retirement benefits is that they do not preserve their retirement benefits. It proposes that when people change jobs they will no longer be able to take their accumulated retirement savings in cash but will have to transfer the funds to the new occupational scheme, the NSF or an individual fund, which will be an amalgamation of what is now called a preservation fund and a retirement annuity.

The new legislation will also almost certainly lead to the disappearance of the provident fund, in which there is a single cash payment on retirement - pensions will be payable over the life of the member. The reform proposals have been well thought out, but treasury is not convinced that the incentives to encourage wider use of retirement savings are in place.

The exercise of broadening the net of retirement fund members cannot be divorced from removing some of the disincentives to invest in retirement funds. Tax deductibility will move to 27.5% with limitations of R250 000p.a. for those individuals under 45 and R300 000p.a. for those individuals over 45 years.

There is certainly a danger of over-regulation if treasury's reform proposals are incorporated in the new Pension Funds Act.

It is unsure how it is going to roll out and it is expected that trustees will be expected to advise their members when it is in their interests to switch from the occupational

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scheme to the NSF, yet it is likely that none of the trustees will be qualified to give advice under the Financial Advisory & Intermediary Services (FAIS) Act.

The lack of proper investment strategies should be dealt with after a revamp of regulation 28, which simply sets limits on the extent to which funds can be invested in different asset classes. This is to protect the consumers from advisors investing 100% of their retirement investments into risky investments like equities.

Basically the maximums that retirement premiums can be invested in are: –

- No more than 75% may be invested in equities;
- No more than 25% may be invested in property;
- No more than 90% may be invested in a combination of equities and property;
- No more than 5% may be invested in the sponsoring employer;
- No more than 15% may be invested in a large capitalisation listed equity, and 10% in any single other equity;
- No more than 20% may be invested with any single bank;
- No more than 15% may be invested offshore;
- No more than 2, 5% may be invested in ‘other assets’. Derivative instruments are not defined, leaving them to fall within this ‘other assets’ category.

The asset class limits will disappear for funds with an approved investment strategy. The only exceptions will be the offshore allocation, which will in future be decided by prudential guidelines rather than Reserve Bank regulations, and the allocation to targeted development funds, which features in the financial services charter.

The charter council is expected to recommend an allocation of up to 10% in targeted development investments (TDIs). It is more cost effective for employers who do not want to continue their occupational schemes to move into large umbrella funds such as an umbrella pension fund, with almost 6 000 participating employers.

Umbrella funds are exempt from the requirement to have 50% member-elected trustees. To make umbrella funds more accountable to members, treasury proposes restricting the number of participating employers in each umbrella to just 10.

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There is a requirement that pensions should keep up with inflation and provide benefits for the member's life. And treasury proposes there should be no more than five investment choices available to members. Investors can draw down their capital at between 5%/year and 20%/year, which would mean that in many cases benefits would not be able to keep up with inflation. To date, living annuities have operated in an open architecture environment, and a restriction to five choices would greatly diminish the appeal of the product.
The retirement fund industry is working against the clock to prepare itself for the introduction of a new savings vehicle designed to protect the assets of "widows and orphans" and avoid Fidentia-type scandals in the future.

From 1 January 2009, beneficiary funds replaced umbrella trusts as the preferred vehicle to look after widows and orphans upon the death of a retirement fund member. Unlike loosely-regulated umbrella trusts, beneficiary funds fall under the Pension Funds Act, bringing both protection and recourse to the Pension Funds Adjudicator and the Financial Services Board for stakeholders.

The new fund was legislated for in September 2008 through amendment to section 37C (2) of the Pension Funds Act. The corporate governance requirements for beneficiary funds are extensive.

According to Brendan Peacock and Fairheads Benefit services dated 8th January 2013, the umbrella trust industry is estimated at around R15 billion, following rapid growth over the past decade, largely as a result of AIDS deaths. The average death-benefit payout per beneficiary from a retirement fund is R60 000 and can serve a vital role in educating and sustaining minors. Some 300 000 minors benefit from the industry. Umbrella trusts will continue to run their course alongside the new beneficiary funds, and will still be used under certain circumstances, particular in the case of unapproved benefits.

Beneficiary funds will attract significant interest because of the advantages they offer. Funds will need to comply with Regulation 28 of the Pension Funds Act which provides prudential guidelines for investments. Furthermore, there are tax

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advantages: unlike an umbrella trust, capital transferred to a beneficiary fund is tax-exempt at the beneficiary level, and the beneficiary fund itself is also tax-exempt.

Financial planners and individuals will be interested in a further innovation brought about by the new legislation, namely the ability for retirement fund members to nominate a family, testamentary or umbrella trust as the vehicle to receive a lump-sum benefit upon the member's death.

Extract from the 2013 Budget Speech:

Financial services and retirement reform

In last year's Budget, I indicated the need for South African households to save more. I am now able to announce the following proposals, for consultation before we introduce the necessary legislation later this year:

- Tax-preferred savings and investment accounts will be introduced in 2015.
- Retirement funds will be required to identify appropriate preservation funds for exiting members, who will be encouraged to preserve when changing jobs.
- Retirement funds will be required to guide their members through the process of converting savings into a regular income after retirement, and to choose or establish default annuity products that meet appropriate principles and standards. More competition will be promoted by allowing providers other than life offices to sell living annuities.
- The tax treatment of pension, provident and retirement annuity funds will be simplified and harmonised.
- Governance reforms of retirement funds will also be implemented, with measures in place to ensure trustees of retirement funds are trained once they have been appointed. I intend to call up a conference of all trustees this year to take this process forward.

We are also considering how to encourage all employers to provide appropriate retirement mechanisms for their employees, as part of the broader social security reforms. In implementing these reforms, the vested rights of current members of retirement funds will be protected.

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Let me take this opportunity, to confirm that the Government Employees Pension Fund has remained fully funded despite the turmoil in financial markets in recent years. A 6 per cent increase in civil service pensions will be effected in April this year.

The implications of changes in legislation on existing retirement plans with a view to proposing an updated financial solution

The International Labour Organisation (ILO) reports that only 20 per cent of the world's population has adequate social security coverage, and more than half lack any coverage at all. Many of the developed nations are reforming their pension systems, in particular to deal with such issues as aging population dynamics. South Africa is also considering a more significant social security system, which would aim to provide a pension for all.

What is the government doing?

- Both the National Treasury and Department of Social Development have released discussion papers - the second National Treasury discussion paper and the Social Development paper - with some differences but with substantial common ground.
- An inter-ministerial committee, established by the Minister of Finance, has set up an inter-departmental task force structure that will carry the work forward as rapidly as possible. International input is being sought.
- The whole issue of retirement reform will be subject to extensive discussion through the formal process of NEDLAC, in which the key interest groups of government, labour, business and the community have the opportunity to state their case.
- Private sector providers have a crucial role to play, not only in their capacity as fiduciaries of retirement fund savings, but as contributors to the debate.

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The social security and retirement fund reform is likely to be positive for all South Africans:

- Increasing long-term savings in a disciplined fashion,
- Providing access to regulated simple, cost-effective retirement savings,
- Providing access to related products for those who historically haven't had access.

The exact nature and timing for implementation of the social security and retirement fund reform is not clear at this stage. Government had indicated the target date for implementation as 2010; however some delay has been experienced due to the complexity of the reforms. Industry players are engaging with National Treasury and other key decision makers and will continue to do so as the proposed reforms unfold.

In the interim, retirement fund providers are encouraged not to make inappropriate decisions before the implications of the social security and retirement fund reform are clear. The draft Treasury papers are discussion documents at this stage and, as we have seen, the Second Discussion Paper is significantly different to the first and takes account of a wide range of inputs on complex issues.

A. Predictions

Don't delay savings. There is no sense in delaying savings in anticipation of the new legislation:

- Members of retirement funds are encouraged to continue saving - the impact of reducing their contributions, and therefore their accumulated retirement savings, is severe.
- For those who currently don't have a retirement savings plan, start budgeting and saving for retirement; given compulsory retirement saving will be enforced in the future.

B. A move from stand-alone funds to multi-employer funds?

Internationally, retirement fund reforms have shown a tendency to move from stand-alone funds to multi-employer funds for the following reasons:

- The governance of stand-alone funds is costly: particularly with audit exempt status removal, more onerous trustee requirements and other governance changes.

- There are significant reputation and governance risks associated with a stand-alone fund due to the need to appoint highly skilled trustees and service providers. Trustees may be liable in their personal capacities for breaches of governance.

- The changes brought about by the social security and retirement fund reform are likely to be complex, with many stand-alone funds preferring to outsource these funds. The size of existing stand-alone funds may reduce considerably, particularly if they have a large proportion of people earning below the income threshold, making them less economically viable.

- Apart from the savings in governance costs, there are other economies of scale relating to large multi-employer arrangements, with the costs being 20% to 40% lower than in stand-alone arrangements.

- In multi-employer arrangements some employers may feel as if they are losing control and influence over the funds. For larger funds, this problem can be overcome through agreed levels of customisation.

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Module 2

Assess objectives and provisions to determine a financial strategy

This Module deals with:

- The nature and term of needs and lifestyle objectives to determine capital requirements at retirement
- The nature and term of existing financial provisions to determine the situation at retirement (covered in formative assessment)
- Different assumptions to specific scenarios to propose and substantiate a well argued financial strategy

2.1 The nature and term of needs and lifestyle objectives to determine capital requirements at retirement

There is an interesting article regarding retirement, expectations, goals and income that can be found on http://retirementplaces.co.za/funding/releasing. The following is based on that article.

In a world that is advancing where your retirement plans were commenced before cell phones were developed to maturing when we have electric cars means we will start living in a different world to the one we retire in. Medical technology is advancing and as such life expectancies are extending. This means that you may well have to continue working to age 70 or 80 and consider retiring for 30 years not 20.

The traditional way may not apply when you get to retirement and obtaining the services of a professional financial planner with competencies will assist in making informed decisions.

Consider the following:

A. Reduce your expectations

In your working years you imagine retiring in luxury; however retirement savings are almost always the last thing on your mind. Time goes on and before you know it, you

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have 10 years to save for 20 years of potential retirement. In this situation it is almost impossible for you to retire in the lifestyle that you thought you could. With this in mind, perhaps you need to reduce your expectations.

B. You may need to set more realistic retirement goals

Instead of attempting to obtain additional finances to cover the requirement, you can trim the retirement goal. One way is trimming on lifestyle expectations, moving to a smaller house, getting out of debt, not travelling so much and sticking to a realistic budget. Ideally you want to realise your dreams but if you have not prepared sufficiently, you will not achieve them.

C. Buying a new home

In retirement using the capital value of your now "too large home" could mean that you can now sell the large house to unlock the value and use the funds to downsize to a smaller home for a much lower price leaving you with capital to invest for a retirement nest egg.

D. Increase your income

Investing in a holiday home can provide you with additional income in the form of rental and possibly be sold in retirement to unlock the value to further invest for your retirement nest egg. Investing in shares that are blue chip giving regular dividends is another option to increase income. You can further invest in money market instruments and claim the interest exemption R23 800 (2014/15) that is tax free.

E. Keep working

You might be prepared stay on at your current job until age 65 if that means a more comfortable lifestyle in retirement. But others may still prefer to leave early, choosing instead to work part-time in a different area- perhaps one that pays less but they find more interesting, or involves less stress.

Or you could investigate the possibility of working fewer days per week. Hopefully your company needs your hard-earned skills and will accommodate this request. Not only will you earn vital income, but you allow your investments to grow before tapping into them. This will result in a lower capital requirement when you do finally

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retire. You also can then look at tax-saving strategies that you may have not yet considered. Consider a home-based business? Maybe you and your spouse can start a profitable networking business?

Whatever the case, there's certainly no reason for you to shy away from raising the issue of part-time work as a funding source. In fact, many non-retired people are already considering working in some capacity after they retire and planning to use "earned income"' as their primary or secondary source of retirement income.

It's far better to uncover and discuss options today, while there's still time to strategise, than wait until you are about to retire. Our world is constantly changing - your retirement plans should change with it. Identifying what is important to you and determining when and how to go about realising your objectives is essential if you wish to make the best use of your assets and your time.

F. A Financial Plan

If you have never had a financial plan, now is the time you really need one! Retiring means you now move from a saver to an investor. You have a finite amount of money to invest so that it gives you the best return versus the lowest risk. Better you plan extremely carefully now, otherwise you may have too much life left after your money is spent. There are many aspects of a financial plan to consider and you will need professional advice. The risks of “going it alone” are too great.

Survey shows how much you need to put away Personal Finance Article dated 2nd June 2013 By Bruce Cameron

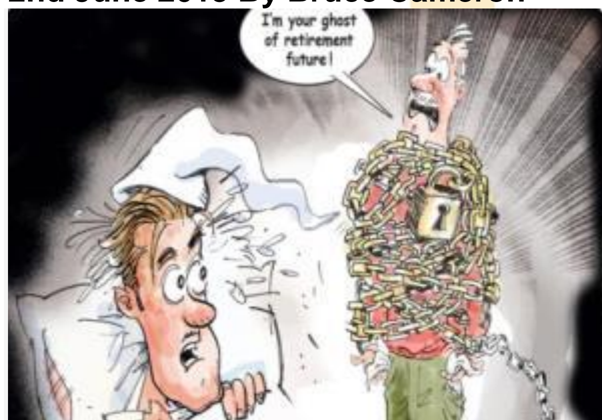

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Illustration: Colin Daniel

There are many different views on the size of the pension – expressed as a percentage of your final salary – that you will need to survive financially in retirement. However, it is clear that most retirement fund members are way off the mark, judging from the views expressed by fund trustees, fund members and pensioners in the latest Sanlam Benchmark Survey.

One of the important factors the survey addresses is the various roleplayers' perceptions of what is sufficient money on which to retire.

According to the survey, only 30 percent of pensioners believe they have sufficient money to sustain their income in retirement. This serves as a major wake-up call for all those who are still – one hopes – planning for retirement.

Unfortunately, the survey found that most people do not plan for retirement; very few display much interest beyond making some choices on joining a fund, and then assume they will be okay when they reach retirement.

According to the survey, one in five members of occupational funds said they experienced difficulty in filling in forms that asked them to choose a fund and an investment portfolio, while one in three members said they did not have sufficient knowledge to select an option. And nine in 10 members never review the decisions they made when they joined the fund.

The survey underscores the fact that most people are simply not going to have sufficient money to retire financially secure. The most commonly accepted measure of how much money you will need in retirement is your replacement rate or ratio (RR for short).

An RR is the percentage of your final salary that will be replaced by your pension. For example, if you earn a monthly pensionable salary (basic pay without allowances, such as a car allowance) of R10 000 and you receive a pension of R7 500, your RR is 75 percent – and 75 percent is the RR that many retirement funds target, based on fund membership of 40 to 45 years.

Although it is fairly simple to define an RR, calculating it is something else altogether.

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The calculation takes many factors into consideration, including:

* How much you earn;

* How much your save towards retirement;

* How much your employer contributes towards your retirement savings;

* The investment returns earned by your savings; and

* The type of annuity (pension) you buy at retirement.

An RR calculation assumes that you will not cash in your retirement savings along the way and that you will not take one-third of your retirement savings as a cash lump sum at retirement.

The Sanlam survey found that trustees of employer-sponsored retirement funds believe that people who earn less than R10 000 a month at retirement can maintain their standard of living with an RR of 76 percent, whereas those who earn more than R10 000 a month require an RR of 73 percent.

Decision-makers of umbrella funds believe that people who earn less than R10 000 a month at retirement require a minimum RR of 64 percent, while those who earn more than R10 000 a month require an RR of 58 percent.

However, the RRs provided by the trustees and decision-makers differ from those that the pensioners surveyed believe are required. The pensioners believe that people who earn less than R10 000 need less in retirement, whereas those who earn more than R10 000 require more, percentage-wise.

Pensioners believe that people who earn less than R10 000 a month should be able to maintain their standard of living with an RR of less than 68 percent, and an RR of 52 percent will provide the minimum income required to survive.

They believe that people who earn more than R10 000 a month at retirement require an RR of 79 percent to maintain their standard of living or an RR of at least 63 percent to survive financially.

Actuary Willem le Roux, an investment consultant at Simeka Consultants & Actuaries, says the reasons for the view that those who earn R10 000 or less require a lower RR could be because of dependence on family and children in old age and on the state old-age grant.

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Le Roux says that nearly everyone in the retirement industry has been using an RR of 75 percent as a rule of thumb.

He says there are good reasons for accepting that pensioners can get by on a lower income. These reasons include:

* Pensioners no longer have to save for retirement;

* Income tax rates are lower after the age of 65, and people over 65 may be in lower tax brackets because they receive a lower income;

* Pensioners normally have no debt to repay; and

* Pensioners do not have employment-related expenses, such as transport costs.

However, Le Roux says, pensioners do face additional medical costs, and their hobbies in retirement can affect their income needs.

The opinions of the various roleplayers, apart from the pensioners, do not reflect the reality of the data provided by the retirement funds surveyed. This reality was detailed by Danie van Zyl, head of guaranteed investments at Sanlam Structured Solutions.

Currently, after the deduction of costs and group life assurance premiums, total member/ employer contributions to non-union retirement funds is 11.98 percent of pensionable salary. This is slightly down on the average of 11.99 percent for the past five years.

At this contribution level, the RR will be only 57.4 percent, which is nowhere near the 75 percent most funds say they target. And importantly, this assumes:

* An investment return of 5.5 percent above inflation;

* That the member will withdraw no money over the 40 years of saving for retirement; and

* No amount is taken as a cash withdrawal at retirement.

Van Zyl says that to achieve an RR of 70 percent, you and your employer have to contribute the equivalent of 14.6 percent of your pensionable salary over 40 years. This translates into having a retirement lump sum equal to 12 times your last annual

pensionable pay cheque.

Only 41 percent of retirement funds provide members with the RR targeted by their fund. However, this is up from 35 percent four years ago.

The RR that your fund targets will probably not be your personal RR. Your RR will be dictated by factors such as:

* How long you have been a member of your existing fund;

* Whether or not you preserved the savings you accumulated in funds to which you belonged previously;

* Your retirement age;

* The returns earned by your savings; and

* What money you have saved outside of your occupational retirement fund – for example, in a retirement annuity.

The main point of the Sanlam survey is that it shows that, in all likelihood, you are not on course to retire financially secure – and you need to do something about that now, whether you are 20 or 60.

Review your savings situation regularly

Everyone who is saving for retirement needs to know the following on a regular basis:

* Your replacement ratio/rate (RR) as a member of an occupational retirement fund. Your fund should provide you with this information.

* Your RR if you take into account your occupational fund savings plus any other retirement savings you may have.

Danie van Zyl, head of guaranteed investments at Sanlam Structured Solutions, says that, to achieve an RR of 70 percent, as a rough guide you need to save an amount that is double your annual pensionable salary after 10 years of contributing; four times after 20 years; seven times after 30 years; and 12 times after 40 years.

* What additional savings you need to make to achieve your required RR. This can be done by increasing your savings to an occupational retirement fund to the

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maximum of 7.5 percent or by investing in a retirement annuity (up to 15 percent of your total taxable income less your pensionable income is tax deductible).

Most people will need the regular assistance of a financial planner (go to an accredited Certified Financial Planner) to get this right and to balance their retirement savings with their other financial requirements, such as risk life assurance against death, disability and dread disease.

Use someone who is qualified to assist you plan

Retirement Budget

When you retire; your income and expenses change and not always for the better. It is vital you set up a budget as you need to save as much as possible. You need to plan for unexpected expenses like medical costs or tax.

You need to plan for your drop in income and the concern that inflation may increase above that of your investment returns. A comprehensive budget will help clarify your situation.

Income Investments

The traditional method of securing a life-long annuity has great merit. It will ensure that you get a guaranteed, inflation-linked monthly income as long as you live. But that comes with concerns. In today's low interest rate environment, your monthly income rate will be low. In an effort to address this, many retirees opt for Living annuities, which have higher risk than other annuities.

Your retirement annuities

The fact is that it is better to take the maximum lump sum you can and re-invest it. As you know, tax is levied on the commutation of monies from RA's.

But did you know there is a way of reducing that tax liability?

If you are able to reduce your income for the two years prior to commuting your RA, you can save considerable tax. Consult with a qualified financial planner in order to investigate this and other options-to reduce your tax liability when you are about to retire.

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Your Will

Make sure that your will is up to date. You need to make sure that your spouse will be protected and that your inheritance planning is both clear and tax-efficient.

There are a number of specific questions you can ask yourself, such as:

- Do you have any major concerns as you are about to retire?
- Do you anticipate making a major purchase at the time you start your retirement that will require a lump sum of capital or a repayment commitment?
- Are you providing, or thinking about providing, some form of inheritance to children or grandchildren while you are still alive?
- Have you discussed your estate plans with your children?

It's not uncommon for people to have this idea, *"Boy, I'm about to retire. I'm going to have all this spare time."*

But what are you going to do with it? You need to know what's important to you and what you want to accomplish in the next year, two years and five years.

You need to make sure you structure financing to do it and use your resources and assets intelligently to help you do what you want to do while you have the health and ability to do it.

In spite of all the bad things you may have read about retirement annuities (RAs), they are essential investment vehicles for most people – provided, of course, you understand what they are and how to derive the maximum benefit from them.

Here are the 10 most important things you need to know about RAs.

Investment choice

Consumers are being offered more and more investment portfolios. The choice can range from a simple managed portfolio with capital guarantees, invested across asset classes and in which you have no say in the investments, to a "fruit salad" of unit trust funds which you must select.

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However, due to the volatility of investment markets in recent years, financial services companies have put together numerous investment portfolios that are aimed at minimising risk and beating inflation.

These portfolios come with various levels of risk. Most of these offerings also come with simple calculators to assess your risk profile. These risk profile calculators can be very misleading. Often they are based more on your psychological approach to risk than your actual financial ability to withstand investment risk. Consequently, people who are psychologically prepared to take high investment risks can land up without sufficient money on which to retire.

There are regulations, issued under the Pension Funds Act, which attempt to limit investment choice and therefore limit the risk to individual investors. These regulations are called the Prudential Investment Regulations (PIRs), and they restrict how much can be invested in the various asset classes, offshore and in specific sectors of the market and/or companies.

For example, no more than 75 percent of your money is allowed to be invested in shares and no more than 15 percent may be invested offshore.

The problem with these guidelines, however, is that they only apply at fund level and not to individuals. While some RA funds insist on applying the PIRs at fund and at individual level, others do not.

In other words, as a member of an RA fund, you may be able to choose an extremely high-risk portfolio, and invest 100 percent of your money offshore or 100 percent in shares.

As well as having a greater choice of investment portfolios/underlying investments, you are also free to switch between investment offerings at any time.

Before you opt for an RA that gives you a wide range of choices, you should consider the following factors:

- Cost. The greater the choice, the more it is likely to cost you, particularly if you switch between options on a regular basis.
- Expertise. Many people have lost huge amounts of money by continually switching into the investment flavour of the month, often because of poor financial advice. The switch often occurs when the sector is booming and they buy in at the top (remember the information technology bubble?). Then, when the sector collapses, investors sell out, only to jump into the next hot stock or sector.

On the other extreme, some investors opt for the most conservative portfolio, which reduces potential returns and the possibility of having a financially secure retirement.

There are a number of issues you should consider when making investment decisions.

These include:

- Retirement saving is a long-term affair. Markets will fluctuate, but the trend historically has been up. Historically, shares have out-performed bonds and cash over the long term.
- You should be neither too aggressive nor too conservative. You should rather select a properly diversified, balanced portfolio in line with the PIRs. Obviously, the further you are from retirement, the more money you can – and should – invest in an aggressive portfolio.
- Costs. You are often charged higher costs if you opt for products that offer you a great deal of choice.

Deductions against retirement fund withdrawal benefits

If the rules of the fund permit it the retirement fund value can remain with the fund and you will be seen as a deferred pensioner .Paragraph 6 of the second schedule shows a number of deductions from a retirement fund withdrawal fund that will be tax free:

1. deduction from a pension fund individual reserve in terms of a divorce order or on members resignation where:

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a. pension fund into any pension fund, pension preservation fund or retirement annuity fund
b. pension preservation fund into any pension fund, pension preservation fund or retirement annuity
c. provident fund into any pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity
d. provident preservation fund into any provident fund, provident preservation fund or retirement annuity fund *(Not pension fund)*
e. retirement annuity into any retirement annuity fund*. (Not pension or provident fund)1*

SA Financial Planning Handbook 2013

Before you choose either an RA or a preservation fund, you must understand the differences between the two.

They are as follows:

- When you transfer your retirement savings to a preservation fund, you need to be aware that different circumstances dictate when you will be able to withdraw your savings from the preservation fund.

  If you are unemployed, your retirement date is that of the pension or provident fund you left. If you join another pension or provident fund, the retirement age of that fund will apply. If you are employed, but you have not joined another pension or provident fund, the rules of the preservation fund will apply. You will not be permitted to withdraw from the fund. In this case, you will normally be given a choice of retiring any time after age 55.

  If you transfer your retirement savings to an RA fund, the rules of the pension or provident fund you left do not determine when you can withdraw your benefits. You will not be permitted to withdraw from the fund. You have a choice of retiring any time after age 55.

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- In most cases, you can make additional contributions to an RA fund. You cannot make additional contributions to a preservation fund, unless they come from the original fund the preservation fund was started with.

- You are permitted to make one withdrawal from a preservation fund before retirement. That withdrawal may only take place after you have transferred your retirement capital to the preservation fund either now or any time in the future prior to retirement. Any deduction by your employer from the amount you transfer to a preservation fund – for example, to repay a loan, cover losses or to fulfill a maintenance or divorce order – counts as the one withdrawal from the fund. Once you have transferred your savings to an RA, you are not permitted to make any withdrawals. You can only retire after the age of 55.

- Provident funds provide lump sums whilst pension funds provide one third as a lump sum and two thirds (balance) as an annuity. With this in mind it is not advisable to transfer provident funds in to a pension fund, pension preservation funds or retirement annuity as you will lose the three thirds lump sum benefit and reduce the retirement benefit to one third lump sum and two thirds annuity. Remember on retirement you have the choice of taking a lump sum and voluntarily choose an annuity (income) from the balance even if it is not two thirds.

- Pension funds, pension preservation funds, provident funds, provident preservation funds or retirement annuities will have the same calculations in determining the tax free portion on retirement or withdrawal.

<u>Retirement fund lump sum benefits or severance benefits</u>

Taxable Income (R)	Rate of Tax (R)
0 – 500 000	0% of taxable income
500 001 - 700 000	18% of taxable income above 500 000
700 001 – 1 050 000	36 000 + 27% of taxable income above 700 000
1 050 001 and above	130 500 + 36% of taxable income above 1 050 000

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Retirement fund lump sum withdrawal benefits

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

- When you withdraw your savings from a retirement fund, you are allowed to place a portion of the money in a preservation fund and a portion in an RA. The transfer of benefits is not taxed. The portion transferred to the RA is not regarded as the single withdrawal you are permitted from a preservation fund.

  In some cases, if you are dissatisfied with your RA fund – say, the administration, costs or something else – you can transfer your savings to another RA, tax-free.

2.2 The nature and term of existing financial provisions to determine the situation at retirement

Over half of pensioners have a shortfall between their income and expenses. The main contributor is taking money out of the system before they get to retirement. You should therefore put the following into consideration:

- The average person requires roughly 65% to 75% of his/her last salary to live comfortably after retirement. If you still have outstanding debt and expect higher medical expenses, you might need to increase this figure. If you want to preserve your capital, it also influences the calculation.
- A rough rule of thumb is that you need 15 times your current annual salary to retire on (if you retire at 65).

2.3 A well argued financial strategy

Before working out how much is needed to fund retirement, clients need to set goals and determine how they want to spend their time in retirement. Without these goals, it is difficult to estimate how much income will be required. A retirement income goal

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of 60 per cent of pre-retirement income is a common benchmark. Factors to consider in preparing for the future include:

A. Salary sacrifice

One of the most tax efficient ways to invest and save for retirement is through salary sacrifice.

B. Spouse contribution

Spouses can work together and save towards retirement.

C. Income streams

For many people, the answer to replacing lost salary in retirement lies in the form of income streams and, in particular, allocated pensions and lifetime annuities.

D. Transition to retirement

For some, the idea of ceasing full-time work abruptly can be quite daunting. This is why a gradual transition to retirement can be a good strategy. It allows people to cut back on their working hours while maintaining their income or accelerating their superannuation savings.

E. Allocated pensions

Allocated pensions are a flexible, tax-effective way to provide income in retirement. Investment earnings are tax-free and pension payments, while taxable under the age of 60 may have a tax-free portion and a tax offset may be available. A range of investment options can be selected.

F. Insurance

Generally, people prefer not to think about possible ill health. But the financial consequences that follow can be significant. The loss of income close to retirement can severely erode savings plans. Long-term disability, and even death, can be even more devastating to families and long-term goals. Being prepared for the financial impact by having adequate life, total and permanent disability, trauma and income protection insurance in place can reduce the impact and ease recovery. Of course, as people approach retirement, their need for insurance changes and therefore insurance requirements should be reviewed regularly.

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G. Estate planning

An important and often overlooked aspect in retirement planning is estate planning. Ensuring assets accumulated over a lifetime go to clients' intended beneficiaries is the main purpose of a good estate plan.

H. Alternatives

If individuals want a better lifestyle in retirement they may decide to:

- choose to save more throughout their working lives
- stay in the workforce longer and retire later
- accept a lower income level in retirement
- sell their home and downsize (this allows access to the capital in the house if a less expensive home is purchased)
- sell their home and rent
- take on a reverse mortgage; or
- borrow from their family.

Save more

By sacrificing a few of life's luxuries now, people can save more. Even if people can't afford to increase their savings by much, a small but regular savings strategy can have a significant effect on their retirement nest egg.

Work longer

Working longer may not be an option for everybody. But the need to work longer is a reality for many prospective retirees, as a result of the recent downturn in investment markets.

Lower retirement income

Accepting a lower income in retirement will help money last longer, but at the cost to lifestyle.

Sell home and downsize

This allows access to the capital in the house if a less expensive home is purchased. However, a downsizing strategy may not be the magic solution to a retirement-

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savings shortfall. The reality is that many clients choose to move to smaller, newer and expensive properties in more desirable areas near the city and coast. Relocation costs could potentially erode a sizeable portion of the released capital. This means downsizers may not have as much left over to live on as they had hoped. However, many people have a sentimental attachment to the family home and do not find this a desirable option.

Sell and rent

Selling the family home to free up capital and then renting a property for the remainder of their lifetime may provide a financial advantage, but it may not appeal to many clients. To lose the security of a “roof over their head” would be unnerving to many.

Module 3

Construct a portfolio for a specific client based on a client's risk tolerance and objectives

This Module deals with:

- A risk tolerance assessment conducted to set an investment strategy
- Appropriate retirement investment vehicles proposed based on risk tolerance, term, liquidity, tax, cost and ability to deal with the consequences
- The agreed strategy implemented and a management plan proposed to allow for review

3.1 A risk tolerance assessment conducted to set an investment strategy

It is not always efficient to manage risks to zero residual risk or a very low residual risk threshold because of the time, cost and effort that will be required, and which could result in the cost/benefit dynamics to become skewed. On the other hand it is also poor management practice to accept risks which create unnecessary exposure for the institution.

Given the aforementioned dynamics it is important for the client to make an informed decision on how much risk the client accepts as part of normal management practice. This level of acceptable risk is known as a "tolerated risk or tolerance level" and establishes the benchmark for the client's risk tolerance.

Tolerance levels may vary by context and are influenced by the following:

- Ability and willingness of the accounting authority / officer to take and manage risks;
- Size and type of client/institution;
- Maturity and sophistication of risk management processes and control environments; and
- Financial strength of the client/institution and its ability to withstand shocks.

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There is no "one-size fits all" approach to establishing the right risk tolerance levels. Practices will differ amongst clients based on the maturity of the risk management practice, available data, management expertise, sector specific dynamics and other pertinent factors. Thus it is advisable to rather follow certain guiding principle rather than "hard and fast" rules.

The typical steps involved in establishing and implementing risk tolerance are:

1. Complete an analysis of the client's ability to physically and financially recover from a significant event (e.g. risk such as human influenza pandemic, inability to supply, credit crunch etc).
2. The above analysis will highlight the need and importance of contingency plans, financial, physical and human resources and the importance of controls. From the analysis determine the tolerance the institution can bear or accept.
3. Management determines the level of tolerance which should then be endorsed by the Accounting Authority / Officer.
4. The risk tolerance levels set by the client will be reflected in the risk rating scales used to assess the risks.
    - An upper band where adverse risks are intolerable, whatever benefits the activity may bring, and risk reduction measures are essential whatever their cost.
    - A middle band (or 'grey' area) where costs and benefits are taken into account and opportunities balanced against potential adverse consequences.
    - A lower band where positive or negative risks are negligible, or the costs associated with implementing treatment actions outweigh the costs of the impact of the risk should it occur.

These levels of risk tolerance will help determine the type and extent of actions required to treat risks, and the level of management/board attention required in managing and monitoring the risks.

Risk tolerance levels can be practically defined through colour coding of a risk likelihood/consequence matrix.

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Most financial planners in SA today use some form of risk profiling questionnaire. In many instances a relatively simple questionnaire is used, probably provided by a product provider. The client will complete it quickly, in many instances with the planners "assistance" since there is a perception that financial planners have done their job in terms of FAIS, once they can show that the client has completed and signed the questionnaire.

In most instances the completion of the risk questionnaire is linked to the selection of one of five investment portfolios ranging from conservative to aggressive, in which the client's entire investment is invested.

Understanding Risk Tolerance

Risk tolerance is one of those concepts about which each one has a slightly different understanding and when asked to define it, one would get answers such as:

"It's the level of volatility an investor can tolerate."

"It is where someone feels comfortable on the risk/return spectrum."

"It is the amount of loss someone will risk incurring."

Different terms such as risk tolerance, risk attitude, risk capacity and risk appetite are used to describe risk related concepts, not necessarily with the same meaning.

To avoid confusion it is necessary to understand what is meant by risk tolerance. Some commentators use terminology such as risk attitude (how much risk the client ***choose*** to take) and risk capacity (how much risk the client can ***afford*** to take - how much money can the client ***afford*** to lose without putting the achievement of financial goals at risk). For others, risk tolerance is a combination of risk attitude and risk capacity. However, for financial planners it is important to distinguish between and understand both the clients' risk attitude (a **psychological** attribute) and their risk capacity (a **financial** attribute). In this document "risk tolerance" is used to mean the psychological attribute.

Since risk tolerance affects how individuals make decisions the following definition probably best describes the fact that the client has to decide between alternative courses of action:

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"Risk tolerance can be defined as the extent to which a person chooses to risk experiencing a less favourable outcome in the pursuit of a more favourable outcome."

Irrespective of any risk profile analysis being completed, risk tolerance can be measured by "ability to sleep at night." Will the client be able to sleep at night or stay up worrying about the investment? This will be the client risk tolerance.

What has research taught us about risk tolerance?

- Males are more risk tolerant than females.
- Risk tolerance decreases with age.
- Risk tolerance correlates positively with income, wealth and education and negatively with marriage and number of dependants.
- Test/re-test studies over periods of 30 to 120 days produced strong correlations between the first and second tests. It provides strong evidence of the stability of risk tolerance. The risk tolerance of clients therefore does not necessarily change as we move between bull and bear markets. However, the client's perception of risk, risk attitude and/or financial goals may change. Personality traits do change, but usually only slowly over time.
- Financial advisors are not particularly good judges when estimating their client's level of risk tolerance. One could not rely solely on a financial advisor's judgment to establish a client's level of risk tolerance. The use of a valid test is therefore advisable.

Financial Planners will need to investigate and take all aspects of risk into consideration and not blindly use the "risk profiling/asset allocator calculator" questionnaires currently found in South Africa.

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3.2 Appropriate retirement investment vehicles proposed based on risk tolerance, term, liquidity, tax, cost and ability to deal with the consequences

There are various types of investments, but you need to think about what your goals are, why you are investing and what the different benefits are before you choose an investment vehicle. The main types available to the person in the street: collective investments, (unit trusts), endowment policies, retirement annuities (RAs), preservation funds, provident and pension funds, and living annuities.

When you buy a car, the type of car you buy will vary according to your needs at the time and the particular life stage you are at. For example, for your first car, as a single-income earner, you might look at a nippy, fast car. Later, when you are married with children, you are likely to prefer a family sedan. When your children have left the nest, you may decide to treat yourself to a convertible.

Similarly, when you consider what type of investment to use, you need to consider the reason for your investment. For example, if you are saving for a medium-term goal and need to receive the proceeds of the investment in, say, five years, you would choose a unit trust instead of an RA.

	Unit Trusts	**Living annuities**	**Endowment policies**	**Retirement Funds**
Risk tolerance	*Medium to High*	*Low*	*Medium to High*	*Medium*
Term	*Medium to Long*	*Long (for life)*	*Medium (at least 5 years)*	*Long*
Liquidity	*High*	*Low*	*Low to Medium*	*Medium*
Tax	*On interest earned – depending on exemptions on marginal tax rate*	*Income drawn is taxable on normal tax rates*	*Taxed at a rate of 30% within the fund (four fund approach)*	*Tax effective – no tax in build up period*

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Cost	*Low – depending on type*	*Medium – depending on factors, e.g. age, occupation*	*Increased premium up to 20% per annum*	*Medium to High depending on age*
Ability to deal with consequences	*Flexible*	*Not flexible*	*Not flexible*	*Not flexible*

On the other hand, if you want to save for your retirement and you know you are not disciplined enough to refrain from making withdrawals, you would choose a type of retirement fund.

A. Unit Trusts

Unit trusts can be purchased directly or via an endowment or life product package where it is the underlying investment. Unit trusts are a flexible investment vehicle, suited to medium to long term investments, because you have easy access to your funds as they are very liquid. The Financial Advisors Development Series identifies the Advantages and Disadvantages of collective investment schemes (Unit trusts):

Advantages

- Reduction in initial capital outlay in order to gain access to more expensive shares previously inaccessible.
- Sharing of up-front and running costs.
- Diversification in terms of asset classes and management company.
- A Manco is obliged by the Act to buy back the investor's units at any time, thereby making the investment liquid.
- Prices are listed in most financial publications, as well as the newspaper, which makes them very transparent from a performance and costing point of view.
- The funds are easily accessible and all management companies are obliged to buy back units. The turnaround is approximately 7 working days.
- When viewed as a long-term investment, the returns normally outperform inflation.

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- Investment may be made on a regular basis via debit order, eliminating the risk of trying to time the market. This is called rand cost averaging. Units are purchased on a regular basis at differing prices. If the market is doing poorly, the price is lower and more units are received for the investment. On the contrary, if the market is doing well, the price is higher and fewer units are received for the investment. Studies have shown that investors using this type of investing pay less for their overall units in the long run.
- Collective investment schemes may also be used in various other investments and offer clients flexibility in respect of structuring traditional products, such as life annuities and retirement annuities.
- Lastly, but importantly, investing in collective investment schemes is simple. It is easy for the layman to understand and offers investors opportunities previously not available.

Disadvantages

- Simplicity and easy accessibility may overshadow the risks of an equity investment. Most funds are exposed to the share market and therefore carry a fair amount of risk. If the investor is not educated about the risks, he could suffer investment loss and poor returns.
- Investing in a collective investment scheme may be costly due to the high initial charges levied every time an investment is made. These charges are discussed below.
- Investors tend to withdraw monies more readily from this type of investment when the need for a luxury item like an overseas trip arises. The fact that the investment is accessible does lend itself to misuse.

If you buy unit trusts directly from someone like Allan Gray Equity there are no minimum investment periods; however there are minimum contributions. At your discretion you can make unlimited withdrawals.

Depending on the type of fund in which you invest, it is considered prudent to leave your money invested for about three to five years to recoup the investment costs and so you can earn a decent return.

- Unit trusts are governed by the Collective Investment Schemes Control Act.

- You can cede a unit trust completely or partially as security for a loan.
- You cannot nominate a beneficiary on a unit trust investment. In the event of your death, the investment will be paid into your estate.
- You pay tax on the interest you earn. "This can be tax effective because, depending on the type of fund, the interest earned may well fall below your tax exemption on interest.

The tax you pay on your returns will depend on the applicable exemptions and on your marginal tax rate. The exemption on interest income for the 2013/14 tax year is R23 800 if you are under 65 years old and R34 500 if you are 65 or older. Any increase in the value of the units is taxed as a capital gain when you dispose of or sell the unit trust or on death. The capital gains tax exclusion amount for individuals for the 2013/14 tax year is R30 000 and in year of death R300 000.

B. Living Annuities (LA)

Living annuities, not to be confused with retirement annuities are used as a post-retirement investment vehicle, and you would typically transfer funds from an RA, pension, provident or preservation fund to a living annuity. These investments are regulated by the Financial Services Board and the Long Term Insurance Act.

- Living annuities are an alternative to traditional annuities. With a traditional annuity, a life assurer guarantees you a fixed pension for life.

  With a living annuity the risk of your capital being sufficient to provide you with an income for life lies with you, because you must choose the underlying investment.

- As with retirement funds, you cannot cede a living annuity as security and it does not necessarily form part of your estate when you die. You can nominate a beneficiary.

- This type of investment has its limitations. You cannot make any further monthly contributions; you cannot access your funds in the form of a lump sum. (You can if the value is R75,000 and below if no previous withdrawals from a LA was made, or if the value is R50,000 or below, and previous withdrawals from a LA were made) , and each year you must draw down

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income at a rate between 2.5 and 17.5 percent of your capital investment. You can only amend the percentage income you draw down once a year on the anniversary of the investment.

The income you draw down is subject to normal income tax rates. It is important to carefully calculate your drawdown rate: if the income level you select is too high, your income may not be sustainable over the length of your retirement.

C. Endowment Policies

If you have trouble being a disciplined saver, you could consider a life assurance endowment (investment) policy, where you are obliged to save and preserve your savings for at least five years.

- These investments are governed by the Long Term Insurance Act.
- The minimum investment term is five years. If you commit to paying a monthly premium and then find you cannot meet the monthly payments, the life assurer can impose penalties.
- You can cede a policy outright as security for a loan or as collateral.
- You can and should nominate a beneficiary on an endowment policy. Because it does not pay into the estate of the deceased, it will not be subject to executor fees. It will be deemed property in the deceased estate and as such be estate dutiable.
- No executor's fees are payable on endowments if you nominate a beneficiary.

If you do not nominate a beneficiary, the money is paid into your estate where it does attract executor's fees. Executor's fees are paid to the executor of your estate and are a maximum of 3.5 percent plus VAT, which amounts to 3.99 percent of your gross estate, and six percent of any income collected after you die. You can negotiate executor's fees when you draw up your will.

Estate duty is payable on the benefits of an endowment policy. The executor of your estate must calculate the net value of your estate after accounting for all the deductions and exemptions allowed by the South African Revenue Service. The first R3.5 million of the assets in your estate is exempt from estate duty. Estate duty is then calculated at a rate of 20 percent of the net value of your estate.

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Endowment policies can be tax-effective if you fall into a high tax bracket. The reason is that the interest, net rental income and foreign dividends are taxed at a rate of 30 percent in the hands of the assurance company.

This works in your favour if you fall into higher marginal tax brackets above 30 percent and have used up your interest exemptions.

The capital gains earned by an endowment fund are subject to capital gains tax (CGT), again in the hands of the life assurance company. No exclusions apply.

Because both income tax and CGT has been paid by the assurance company, you do not have to pay any further tax when you are paid out.

- You are allowed only one withdrawal and one loan during the first five years of the policy, after which you can make withdrawals.
- In the first five years any withdrawal will be subject to early withdrawal penalties by the life assurer.
- Risk benefits, such as life and disability cover, can be added to the policy.
- You make either monthly contributions or invest a lump sum.
- The annual premium you pay can be increased, but not by more than 20 percent a year.

D. Retirement Funds

If you are saving for your retirement, there are four different options available to you: retirement annuities (RAs), pension funds, provident funds and preservation funds.

- Retirement funds are regulated by the Financial Services Board and the Pension Funds Act.
- You cannot cede a retirement fund assets as security for a loan. The reason for this is because you do not own the fund. It is a juristic entity and is not an asset in your estate.
- Although you can nominate a beneficiary, the trustees of the fund have the final say in deciding who will benefit from the policy in the event of your death. The trustees will look at legal dependants, factual dependants and also the beneficiary nomination.

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- The Second Schedule to the Income Tax Act explains that the lump sum from retirement benefits will be paid to the individual or individuals that the trustees decide upon. In this case the lump sum will be taxed in terms of retirement funds withdrawal in the hands of the individual. (He can transfer to a preservation fund to avoid paying tax.) The annuity will be taxed in the hands of whoever receives it. Taking this into consideration, retirement funds do not form part of the deceased estate and are not estate dutiable.
- Increasingly, you have to choose the underlying investment strategy for your retirement savings.

Retirement funds are tax-effective investments, since you do not pay any tax on your investment during the build-up period to retirement.

In the build-up you can deduct contributions up to pre-set limits from taxable income; and the returns are not subject to any tax. Contributions to provident funds are not tax deductible.

When you do retire, the benefits from your retirement fund are taxable, apart from a portion of the lump sum amount, which is tax-free. Page 22 shows the relevant table to calculate the tax payable, but it is important to note that any withdrawal or retirement from any fund is aggregated and calculated using only one tax free amount.

The tax benefit for lump sum withdrawals is cumulative and cannot be claimed more than once. This means that if, for example, you mature an RA at age 55, withdrawing a lump sum of R100 000, this will be deducted for tax purposes when you retire from an occupational fund at age 60. So you will then receive the first R200 000 of your lump sum tax-free.

The portion of your benefit that you use to buy an annuity is taxed at your marginal rate of tax, as and when you receive the monthly pension payments.

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If you withdraw from an occupational retirement fund before retirement, the amount will be subject to tax if you take the cash.

Types of retirement funds

- **Pension funds:** The rules of the fund dictate your retirement date - this is normally between ages 60 and 65. When you retire, you can withdraw up to a maximum of one third of your benefits as a lump sum that is made up of contributions and growth in the fund. The remaining amount must be used to purchase an annuity (pension).

- **Provident funds:** When you retire you receive all your contributions and the associated growth of the investment from the fund. This amount will be paid out as a lump sum and depending on who contributed and took a tax deduction as to what tax will have to be paid on this lump sum.

- **RAs:** These have typically been used by individuals whose companies do not offer them pension or provident fund benefits. However, RAs can also be used by people, who are members of occupational retirement funds, to boost their retirement savings.

You can transfer your RA between administrators. If it is a life assurance (underwritten) RA, penalties may be payable. If it is a unit trust-based RA, penalties are not normally applied. With a unit trust-based RA you also have the discretion to increase or decrease your contributions without limitations.

- **Preservation funds:** You can transfer your occupational retirement fund benefits to a preservation fund if, for example, you are retrenched or resign, thereby protecting the tax advantages. You cannot make additional contributions to a preservation fund. If you want to continue saving money for retirement, you will have to use another investment vehicle, such as an RA.

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If you transfer your funds from a pension fund to a preservation pension fund, when you retire at least two thirds of the benefit must be used to purchase a guaranteed or a living annuity.

If you transfer your money from a provident fund to a preservation provident fund, you can withdraw all the funds available as a lump sum on retirement.

After discussing with the client, you should agree on a specific strategy. The agreed strategy should be implemented and a management plan proposed to allow for review. Review will enable you and the client to determine if the strategy is working. If not, you will be able to select other strategies that will benefit the client.

Module 4

Recommend changes to a retirement plan after an unplanned life event

This Module deals with:

- The impact of an unplanned life event on an existing retirement plan with reference to immediate prospects and future options
- Changes to an existing retirement plan proposed with reference to revised objectives and what can reasonably be achieved within the time horizon.

4.1 The impact of an unplanned life event on an existing retirement plan with reference to immediate prospects and future options

Although investments are of a general nature, for many of us the real essence of our long-term personal investment planning is to ensure a comfortable retirement. This has taken on increased importance in recent years as certain aggravating factors come to the fore in most of our lives. Specific aspects to be considered are as follows:

- **Inflation:** Over the last two decades South Africans have come to realise what inflation can do to the value of their incomes and savings. When one takes into account the fact that most planned retirement income plans are based on a fixed income after the date of retirement the ravages of inflation after retirement can become a very real factor.

- **Longer life expectancy:** Advances in medical science have led to a 30 year old woman of today having a life expectancy that is almost twice that of her alter ego of a century ago.

- **The family structure:** The extended family unit of the past ensured that the aged were cared for by the members of the family that were still able to work. Children, in fact, readily accepted the responsibility of having to look after aged parents or even grand-parents. Nowadays the breakdown of this family structure has resulted in the need for all members of the greater family to be self-sufficient.

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Urbanisation and the stresses of modern living have led to the breakdown of these close family ties and the real need for the individual to arrange for his/her own financial independence.

- **Changing environment:** It is often said that the only two things that are guaranteed are death and change. In South Africa we have unfortunately had to accept that both of these factors are in constant evidence. With the evolution of South Africa into a democratic society the pace of change has accelerated into one of the fastest in the modern world today. This has resulted in major changes in the legislative and regulatory structure of the South African economy. It is imperative that retirement planners are fully aware of the latest changes and ensure that their client's portfolio keeps pace with the latest requirements. Of special importance to the retirement planner should be an on-going monitoring of changes to the Income Tax Act and the implications that these may have on savings vehicles.

- **Fringe benefits:** Fringe benefits like group life assurance, medical aid benefits, company cars and housing assistance have become increasingly popular as part of the remuneration package of employees. The real value of these is often overlooked until such time as the benefits fall away. Upon retirement the employee will no longer be entitled to fringe benefits and thus the loss of these benefits (as part of income) must be taken into account.

- **Job mobility:** It has become the tendency amongst South Africans to change their jobs an average of seven times during their careers. This mobility within the workplace has real advantages in upward mobility but does leave a major shortfall in retirement planning. The ability to build up a substantial retirement benefit from an employer's retirement fund is severely curtailed. Withdrawal benefits received from a previous employer are also seldom invested in a retirement funding avenue - leading to a constant restarting of the retirement plan.

- **Early retirements:** The pace of business, especially in the management field, combined with increased pressure on companies to downscale, has resulted in

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many employees being retired earlier than the general accepted retirement ages of 65 or 60. Naturally this results in a lower pension being available and an increased period during which there is a reliance on the pension earnings (unless other employment is found, which the case in many instances is also.

- **Retirement plan membership base:** Whilst the past few years have seen a considerable increase in the number of people who belong to a pension or provident fund, it is also true that there are an increasing number of people who are either self-employed or in the informal sector, where retirement provision is not a pressing issue until it is perhaps too late.

  There are many ways that your finances could be influenced, and having a financial plan can prevent it. As a bread winner or individual you have responsibilities towards yourself and your loved ones. By adding another person to your life you are responsible for the welfare of another person, and your responsibility's can last for at least twenty years if not for life.

  An unplanned event can put heavy strain on you savings and retirement plans, how will family finances cope if either of you and your partner had to stop working? It is central to the way we live our lives, whether it is to buy something now or to invest in the future, despite its importance we take money for granted until we no longer have it.

  If it is to grow, money must be carefully tended and nurtured. You can make your yearly calendar turn your expenses into savings.

4.2 Changes to an existing retirement plan proposed with reference to revised objectives and what can reasonably be achieved within the time horizon

The days of people remaining with one employer for life are over. Nowadays people change jobs many times during their careers. However what many fail to realise is how many loose ends they need to tie up when changing employers. One of the most important items on your "to do" list when changing jobs is your exit from your

company retirement fund. Unfortunately many people tend to place this at the bottom of the list or overlook it entirely.

This is unwise as the retirement fund investment value often makes up the bulk of a person's financial wealth! If you are planning to resign from your present position, contact your financial planner as soon as possible. He or she can advise on the structure of your new pay package, and help you access cash from your portfolio while you are between jobs. Most importantly, they can advise you on what to do with your old retirement fund benefits.

On exiting your company retirement fund you have four options.

A. Take the Cash

Extra cash is always welcome, but in the case of pension and retirement funds this is not a good idea. Firstly, you will then be tempted to spend your hard-earned retirement savings. Secondly, the cash withdrawal will also be taxed at your average tax rate which may be close to 40% depending on your taxable income. Waiting till retirement age could save you a lot in tax.

B. Transferring to Retirement Annuity Fund

The retirement annuity option is inflexible as you cannot access the funds until age 55. This limits your options later in life, especially if you emigrate.

C. Transferring to a Preservation Fund vehicle

This is what most people elect to do. Preservation fund vehicles are an excellent solution to preserving your pension savings until retirement. The transfer is tax-free. A preservation fund vehicle also offers flexibility as you are entitled to make a withdrawal from the preservation fund prior to your retirement. This could be useful should you have a severe financial emergency or decide to emigrate.

It is important that you and your planner make the correct decision as to the underlying investment within the preservation fund as a poor investment selection may have dire consequences for your long-term financial health.

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Contact your planner at least a few weeks before you leave your old employer. Failure to do so may compromise your preservation fund investment options. By law, you may use only the preservation funds of which your ex-employer is registered as a “participating employer”. This requirement must be satisfied before your last day of work. Contact your financial planner at least a few weeks before your last day at the office and it should still be possible to arrange for your existing employer’s registration in the preservation fund of choice. Most people leave this too late are left with unappealing choices.

D. Transferring the new employer's fund

This is the default for many people, but they put off the paperwork involved in making the transfer. Making a late decision, or no decision, as to your retirement savings is a mistake.

If you have not transferred your pension or retirement fund money into a preservation fund, or a retirement annuity, within six months of your date of exit, the Receiver of Revenue will knock off 30% in income tax.

Getting this reversed can be a painful and lengthy exercise.

Related Group Benefits

You may be able to convert your group life and disability cover on your pension fund into an individual policy without medical underwriting. This could be a valuable benefit if you have health problems and are unlikely to obtain the cover in your personal capacity.

If your new employer does not have a retirement fund with group risk benefits you should give serious consideration to converting your existing cover – your family needs it.

Anyone who is reaching retirement age or has already retired has been battered by bad news lately – particularly if they have broken the basic rules of investment and tried to chase market sectors to get the best returns, instead of following a properly diversified investment strategy. However, even sound investment strategies have failed to deliver, and the overall downward movement has left no one unaffected.

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Many people with five years or less to retirement now face the prospect of having far less retirement capital than they were expecting just two years ago. In many cases, the result will be a lower retirement income than they hoped for. The bottom line is that there is no retirement product that can make up for a shortage of capital at retirement.

Investors whose investment targets will not be met have a number of choices. These include:

- Adjusting your objectives downwards (in other words, being content with receiving a lower amount and subsequently a lower pension);
- Extending your time horizons to enable you to reach the same target. For example, if you planned to retire in two years' time, you would need to postpone your retirement date;
- Increasing your investments. This may include finding another job after retirement;
- Following an aggressive investment strategy in the hope of markets recovering.
- Using a combination of all four strategies

If you are less than two years from retirement, the same broad advice applies, with one proviso. Some product ranges cap the maximum gain at a certain level and these must be avoided. Any form of protection costs money and has an impact on performance, but the investor should not lose exposure to the upside of markets.

Tips for retirees

If you are struggling to keep your head above water in retirement, you may want to consider:

- Selling your home at today's high prices, downsizing to a small property – thereby paying less in rates – and investing the profits in your retirement portfolio. You could also move to a suburb where property prices are lower.

- Tightening your belt and making your rands go further to ensure your capital goes the distance.

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- Getting a job, even if it is not well-paid. A job gives you something to do, stop you worrying about money all day, and provides an income.

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