Retirement seminar

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Agenda

- Accumulation of retirement savings, and conversion to income at retirement
- Questions to ask yourself in retirement planning
- Speaking to a financial advisor
- Options to enhance your expected retirement benefit
- Benefit options at retirement
- Establishing your retirement income needs
- Risks faced in retirement
- Life annuity or living annuity?
- Retirement Workshop
- Questions

The nature of the UCTRF

- **Defined contribution provident fund**
- *Defined contribution*: benefits determined by accumulation of contributions invested with investment return
- *Provident fund*: benefit provided as a lump sum, with member options for conversion into a retirement income

Key contributors to retirement income

- Savings: how much was contributed, for how long?
- Investment strategy: the right balance between returns and volatility (risk)
- Conversion of retirement benefit to income: living or life annuity?

Questions to ask?

- How much do I have?
- How much am I projected to have, and how much extra might I need to consider contributing?
- How much do I need?

How much do I have?

- Your Annual Benefit Statement
- UCTRF website link to the Sanlam Retirement Fund Web
- Register in a few easy steps
- Check your balance whenever you need to

How much am I projected to have?

- Try the Retirement Calculator in the toolbox on the UCTRF website for projected Retirement Benefits based on your chosen options
- Consider how much better the position might be with additional contributions

How much do I need?

- This is a much more difficult question!
- For most members, the Retirement Fund Benefit is the largest asset they will ever own
- Sound management of Retirement Fund assets is crucial because members of a defined contribution fund carry the risks of investment
- Sources of guidance include the retirement calculator and financial advice

Speaking to a financial advisor

- Financial advisor checklist:
  - Ask for referees/clients
  - Necessary FSB & FAIS registration?
  - Preferably CFP-qualified (or with equivalent professional credentials)
  - Independent or affiliated?
  - Relationships/networks with other players in the financial services sector?
  - Ensure costs and commissions disclosed in full
  - Be aware of vested interests; you want impartial advice!

- HR & UCTRF – provide information, not advice

How can I enhance my retirement benefit?

- Increase your DPA
- Additional contributions
- Consider your investment choice
- Reduce your risk cover (provided your dependants remain adequately covered)
- If you were considering early retirement, reorient your goals towards retiring at age 65

Changing your DPA

You may increase (or decrease) your DPA at an annual CoE review. Change will result in:

- a greater (or lesser) UCTRF contribution amount.
- associated increase (or decrease) in the Group Life Assurance cover, disability cover and the Separate Group Life Assurance and matching lump sum disability cover.

Making additional contributions

You can request UCT to make additional contributions to your UCTRF retirement savings (HR152 form):

- 1, 2 or 3% and/or
- 2.67% or 5.33%

These funds go directly into retirement savings; they make no contribution to admin. costs or risk benefits; they will reduce your take-home pay (but maybe by less than you fear, given the tax saving).

Contributions and Tax

- Your total contributions to pension, provident or retirement annuity funds up to the lesser of R350 000 p.a. or 27.5% of gross remuneration or taxable income (whichever is greater) will be tax deductible. The balance will be taxed.
- Amounts over the limits can be carried forward to subsequent years.
- Retirement fund contributions not allowed or applied as deductions or exemptions before death will be a deemed asset for estate duty purposes. This will apply to any-one who dies on or after 1 January 2016, in respect of retirement fund contributions made on or after 1 March 2015.

Investment strategy

Investment portfolio should maximise long-term return subject to acceptable risk. Risk concerns start to dominate as one approaches retirement.

Life Stage Model Default Choice

- Your money is moved to lower risk portfolios in a phased approach as you age

Standard Model "Own Choice"

- You have a choice of the following four portfolios:
  - *Portfolio A : The Income Fund*
  - *Portfolio B: The Smooth Bonus Fund*
  - *Portfolio C: The Balanced Fund*
  - *Portfolio D: The Shari'ah Fund*

What is the Life Stage Model?

Members with 5 years or more to retirement, will initially have all their Funds invested in the Balanced Fund (Portfolio C). As returns from the Balanced Fund are expected to fluctuate from year to year, it is not an ideal portfolio for managing final payment risk. Members are therefore transitioned to the Income Fund (Portfolio A) and Smoothed Bonus Fund (Portfolio B_{LSM}) as they near retirement.

May be inappropriate for:

- Members intending to retire before Normal Retirement Age
- Members intending to retain exposure to the markets through a living annuity after retirement (more on this later)

Why not retire early?

- Thanks to the magic of compound interest, the greatest gains (in Rand terms) on your accumulated savings will occur between the ages of 60 and 65; so you'll have more cash if you delay retirement.
- And because life expectancy reduces with every additional year, every Rand of accumulated retirement benefits will purchase you more retirement income at 65 than at earlier ages; so your income conversion rate is improved.
- The combined effect means a healthier post-retirement income if you delay retirement to 65.

The Case of Careful Kevin

- Kevin is 55 and has worked at UCT for 10 years. He earns R14 000 a month.
- Kevin's DPA is 80% of his CoE. When he joined UCT he transferred his retirement benefit from his previous employer to the UCTRF and he now has R1 000 000 saved in the fund.
- If Kevin retires early at the end of this year he will have saved a total of R 1 095 918 . This will buy him a pension of R4 621 (i.e. **33%** of his CoE).
- If Kevin waits to retire at 65 he will have R2 652 197 which will by him a pension of R 15 298. In today's terms this is the equivalent of R 15 298- i.e. **65%** of his CoE).
- If Kevin also decides to increase his DPA to 100% of CoE and make additional contributions of 8.33% he will have R 3 017 402 which will by him a pension of R17 405. In today's terms this is the equivalent of R 10 302- i.e. **74%** of his CoE).

*Calculations done assuming **no** lump sum taken on retirement and **no** spouse's pension.

Benefit options at retirement

- Cash vs. income
- Type of income (living or life annuity)
- Other options
  - Post-retirement medical aid subsidy
  - Leave pay plus any deferred compensation policies
  - Continuation of death cover (separate 1xDPA) without proof of health; can be used to cover estate duty
  - Other policies and savings outside UCT

Cash vs. income

Lump sum tax rates:

First R500,000	0%
Next R200,000	18%
Next R350,000	27%
Balance above R1,050,000	36%

What you take in cash, you sacrifice in income. But anything converted to income will be taxed, so it's rational to take at least R500,000 in cash (possibly more). This can be converted into an annuity on more favourable terms, if desired (so-called Compulsory Purchase Annuity).

AIPF transfer value tax-free and any other previously taxed contributions, in addition to the above.

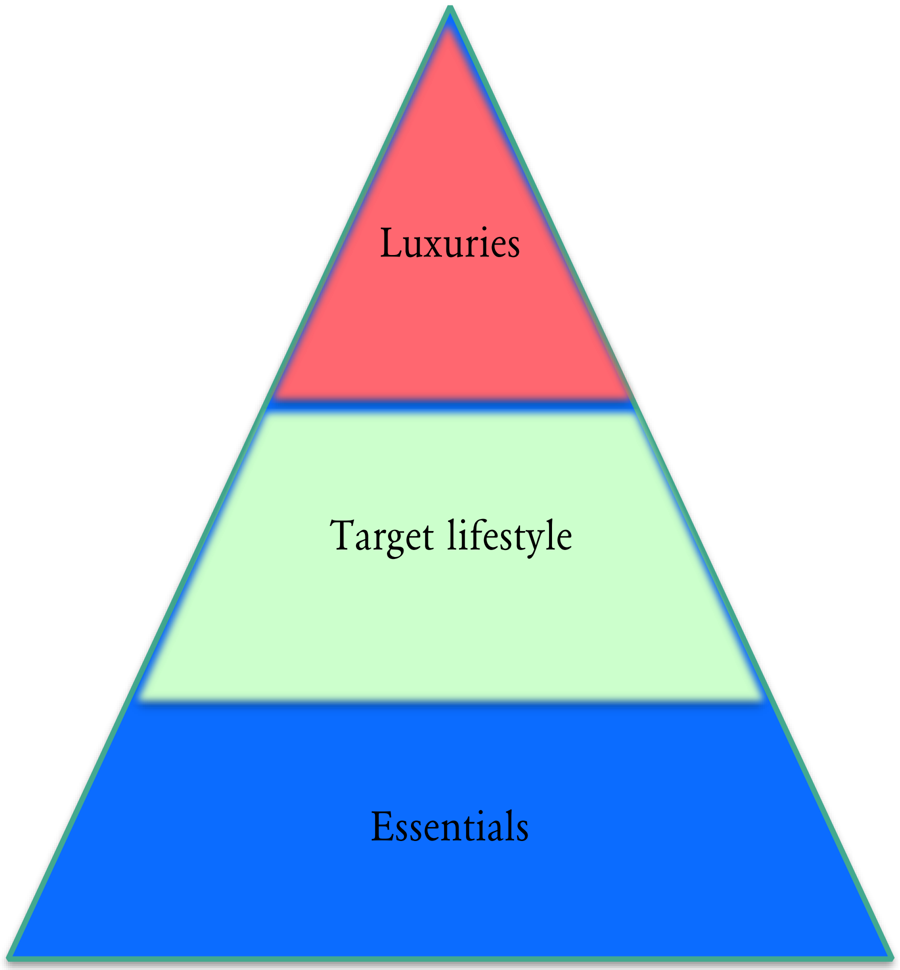
* The first R25,000 of a cash withdrawal will be tax free amount as well any withdrawal lump sum (incl. divorce) taken after 1 March 2009 will reduce the tax free amount of R500,000 at retirement.

Decision-making process

1. What are my income needs in retirement?
2. What are the risks? (What will cause me the greatest regret?)
3. What annuity options are available?
4. Which option best matches my needs and risk profile?
5. What income will this option secure?

Establishing your retirement income needs

- *Essentials*: the bare minimum needed for accomodation, food, clothing, transport
- *Target lifestyle*: what's needed to enjoy the kind of lifestyle you'd like to have, without massive extravagance
- *Luxuries*: holidays, travel, lavish gifts



Change in expenditure at retirement

- Some expenses will reduce:
  - You won't be saving for retirement any longer
  - You won't be travelling to work every day
  - Your home may be paid off, and so on
- Others may increase, especially medical expenses
- Conventional wisdom is that one should aim for a 70%-80% *replacement ratio*, i.e. ratio of post-retirement income to pre-retirement
- But that's a blunt weapon: takes no account of expenses as proportion of income pre-retirement, or escalation in income post-retirement

Risks faced in retirement

- **Longevity risk**: all that healthy living pays off, but you outlive your retirement capital
- **Investment risk**: return on assets insufficient to ensure adequate retirement income
- **Inflation risk**: escalation in income insufficient to match inflation, leading to erosion of purchasing power
- **Default risk**: the institution with which your money is invested, or your annuity is purchased, goes bust- hopefully very remote risk, and prudential regulation *should* protect all or most of your investment

Longevity risk

Here's what an insurance company would be betting on:

Current age	Male expected to live to	Female expected to live to
60	80	85
65	82	86
70	84	87

The increase in life expectancy over the past few decades has been significant, and there is no reason to think it won't continue to improve as medical technology develops. And bear in mind:

There's a 50:50 probability of living *longer* than these ages!

Deferring retirement from the Fund

- Recent legislative changes allow decoupling of retirement from employer from retirement from fund.
- If you don't require income from the Fund when you retire from UCT you have the option to leave your Fund credit invested in the Fund until you choose to retire from the Fund.
- Remember that the later you retire from the Fund the more your pension will be.

Life annuity or living annuity?

This is the biggest decision you'll need to make at retirement, so it's worth spending some time outlining the respective features of each.

When in doubt, be prepared to pay for independent, objective financial advice (and use the earlier checklist to ensure it is indeed independent and objective).

Life annuity

- In exchange for a lump sum, a regular (usually monthly) annuity income is secured
- Once in payment, it is guaranteed for the rest of your life; longevity risk and investment risk are removed from the equation
- You cede control of your retirement assets to the insurer
- Options govern three additional important features of the annuity:
  - The guaranteed period (minimum period for which it is payable, even in the event of your death)
  - Continuation to your spouse after your death
  - The annual escalation in annuity income

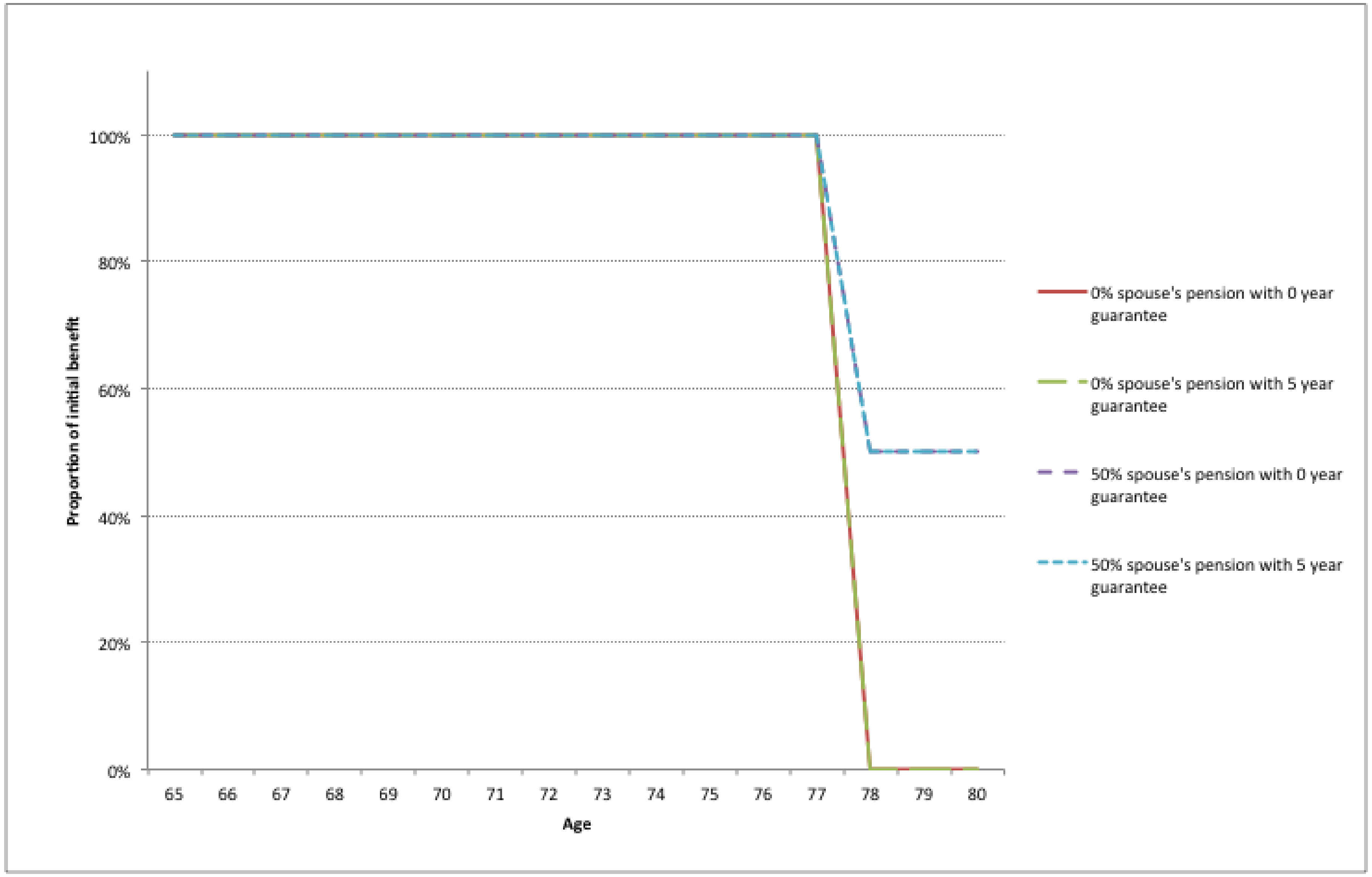
Guaranteed period

- Generally 0, 5 or 10 years
- Don't be confused: this doesn't mean that the annuity is guaranteed only for this period, rather that it is guaranteed to be paid for *at least* this length of time regardless of whether you survive the term
- The longer the guaranteed period, the lower the initial annuity

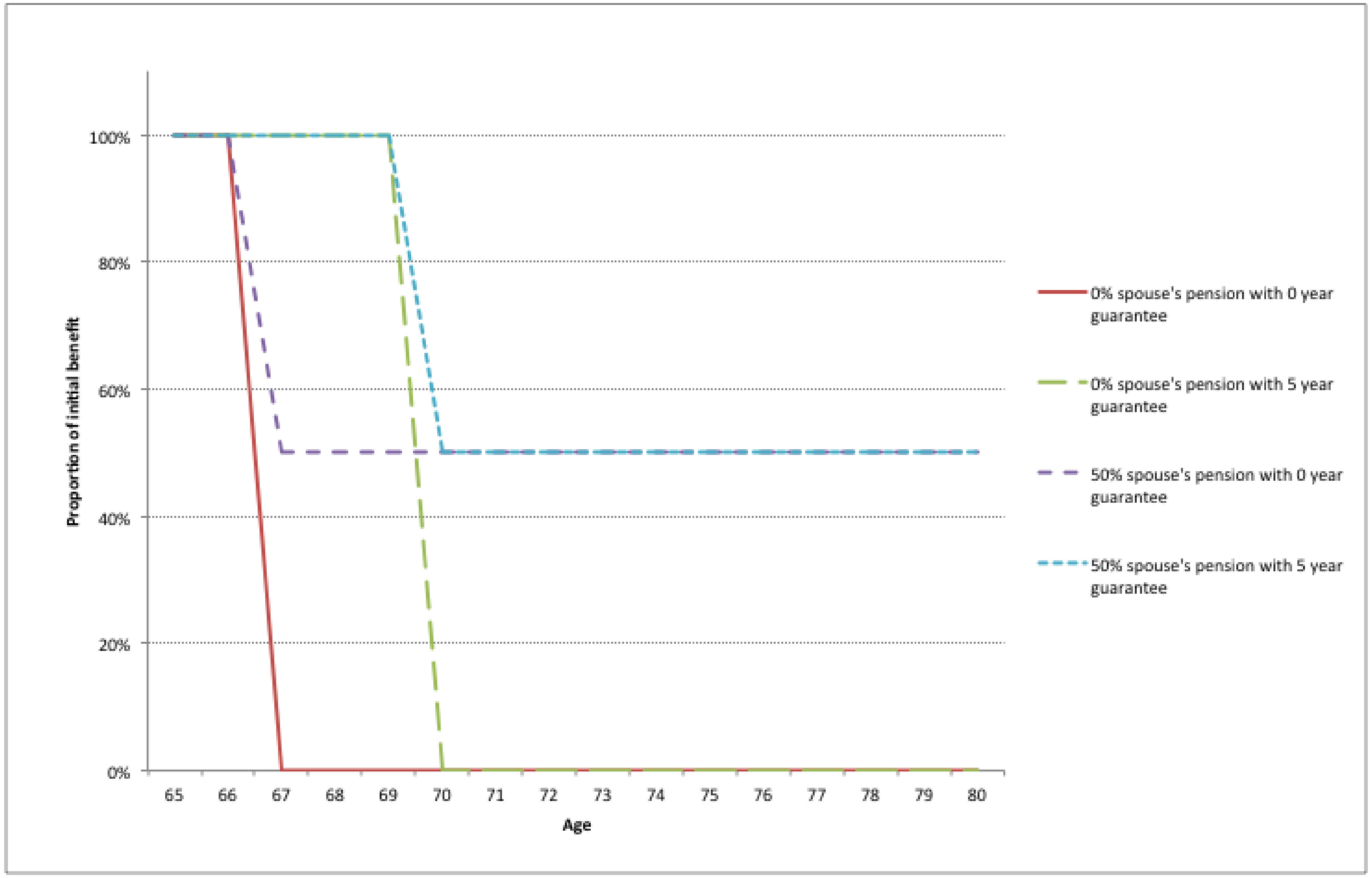
Spouse's continuation

- Governs the proportion of the benefit which will continue to your spouse in the event of you pre-deceasing him/her
- Common choices: 0%, 50% and 75%, though 100% is possible
- The higher the spouse's continuation, the lower the initial annuity
- When combined with a guaranteed period, the full annuity will continue to your spouse for the balance of the guaranteed period if you die before its expiry
- Let's look at some examples to explain how the combination plays out:

Retire at 65, die at 78



Retire at 65, die at 67



Escalation options

Three types of life annuities:

1. Fixed-rate escalation (incl. level annuities), where the level of escalation can be chosen
2. With-profits annuities, where the escalation is declared by the insurer based on the performance of the investments
3. CPI-linked annuities, where the escalation is linked to the rate of inflation as measured by the Consumer Price Index

Level or fixed-rate escalation

- Annuity guaranteed to escalate by chosen rate each year, e.g. 5%
- The higher the escalation rate chosen, the lower the initial annuity
- Escalation not linked to inflation rate, so still exposed to inflation risk (but obviously, a 5% escalation will provide some purchasing power protection, where a level annuity won't)

With-profits annuity

- Monthly pension but able to participate somewhat in the investment markets.
- Annual increases depend on the returns earned on the investment portfolios in which your retirement savings are invested and the original discount rate (PRI rate) used to buy your pension.
- Increases are declared annually.
- Risk of zero increases if investment performance is poor.

With-profits annuity (cont)

- Your increase= bonus rate declared - discount rate.
  - EXAMPLE 1: You purchase a with-profit annuity of 3.5% (discount rate). The Insurer declared a bonus rate for the year of 8%. You will therefore get an approximate increase for the next year of 4.5%.
  - EXAMPLE 2: You purchase a with-profit annuity of 4.5% (discount rate). The Insurer declared a bonus rate for the year of 8%. You will therefore get an approximate increase for the next year of 3.5%
- The higher the discount rate, the higher your initial pension, but the lower your future potential increases. The lower your discount rate, the lower your initial pension, but the higher your future potential increases.

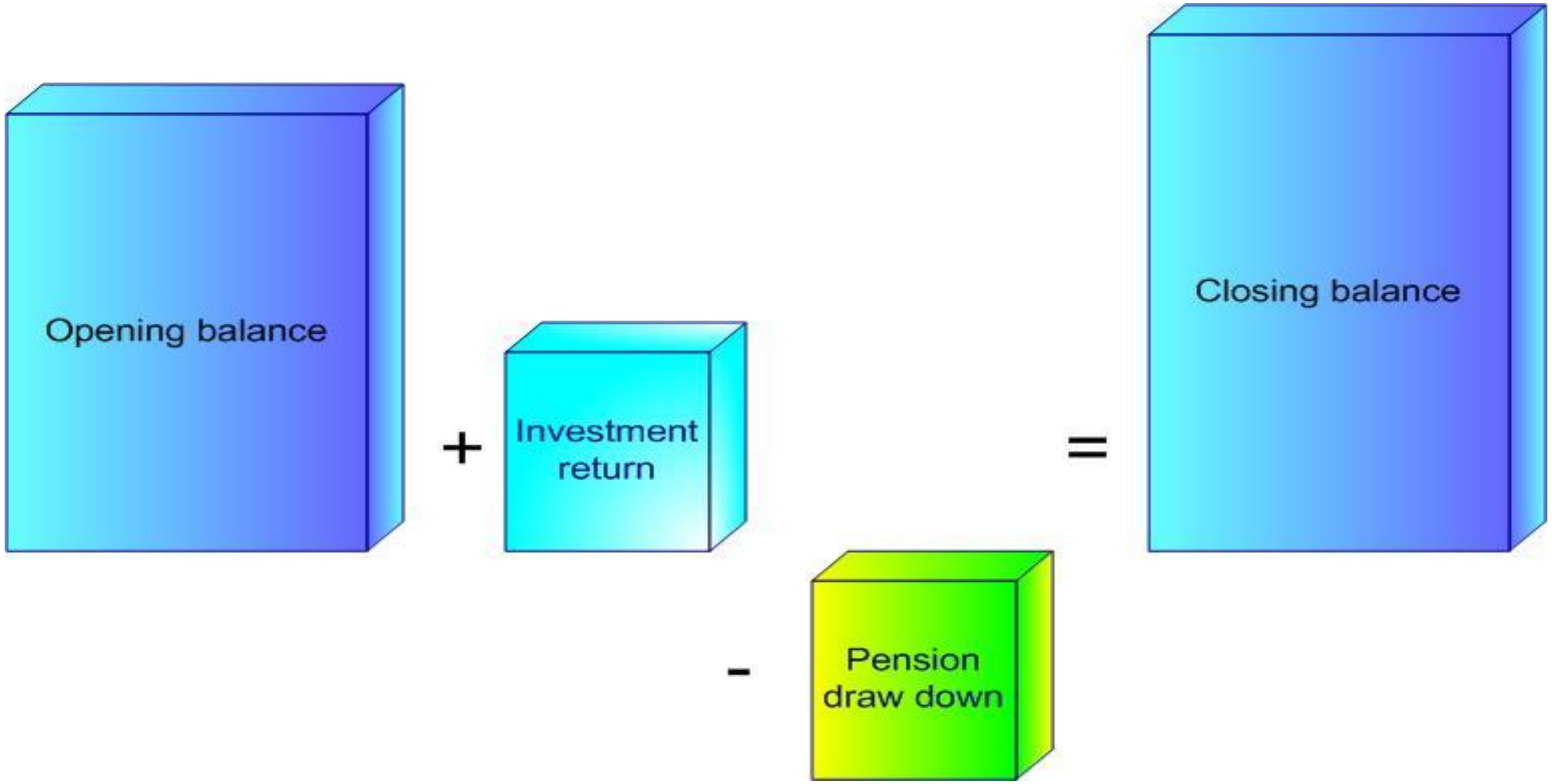
CPI-linked annuity

- Escalations defined in terms of CPI
- Usually 100% of CPI, but alternatives may be selected (e.g. 75%)
- Ensures that annuity income keeps pace with inflation; best protection against inflation risk (although of course the price increase of your personal basket of goods won't necessarily be equal to that of the representative basket measured by CPI)
- Generally offers the lowest initial annuity, because of inflation risk protection

Which is best?

- That depends very much on your outlook and willingness to tolerate risk
- But before you decide which life annuity is best, you need to make a more fundamental decision: should I choose a life annuity at all, or is a living annuity perhaps more appropriate for me?

How does a living annuity work?



Despite the name, a living annuity is not an insurance product, but rather an investment product: there is no transfer of investment, inflation or longevity risk to the product provider.

Living annuity providers

You have two choices:

1. A licensed provider in the market (Linked Investment Service Provider, or LISP); or
2. the UCTRF.

Key features of a living annuity

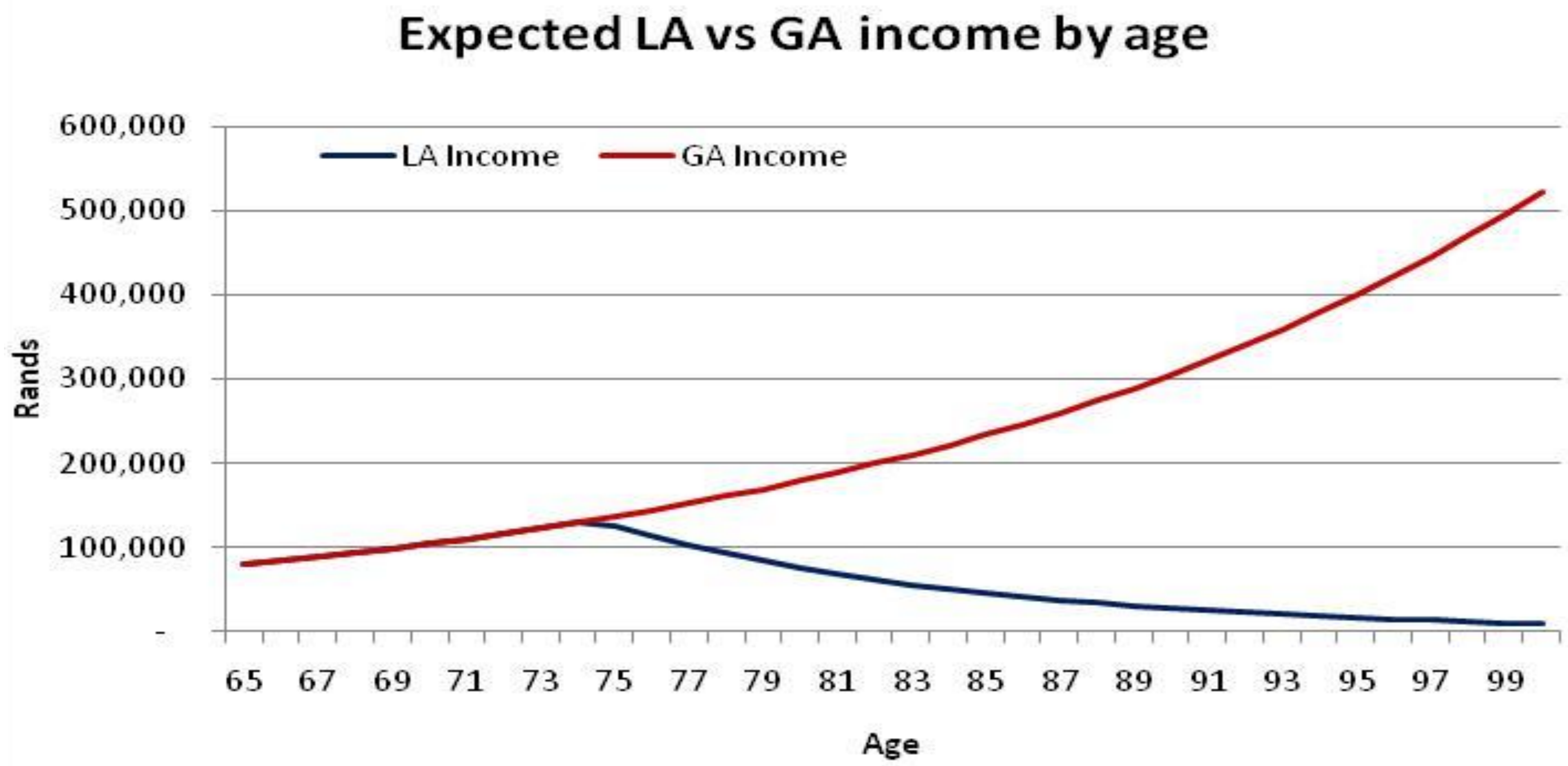
- You have control over how the money is invested (from a range of options offered by the provider)
- You decide on the frequency of payment (monthly, quarterly, half-yearly or annual)
- You decide on your drawdown rate (between 2.5% and 17.5% of the capital per year, subject, in the UCTRF, to constraints imposed by the Actuary)
- You can change your drawdown rate and frequency of payment annually.
- Taking financial advice is advisable!

Key features of a living annuity (cont.)

- You can change your drawdown or investment strategy annually (so this is an *ongoing* decision)
- Your spouse stands in your place after your death, and thereafter other dependants
- You are fully exposed to the risk of longevity, and of facing severe income declines once you hit the 17.5% drawdown limit
- Higher cost structure than life annuities (ongoing advice and administration)
- Not irreversible decision; can be used as a temporary vehicle and a life annuity secured at a later stage

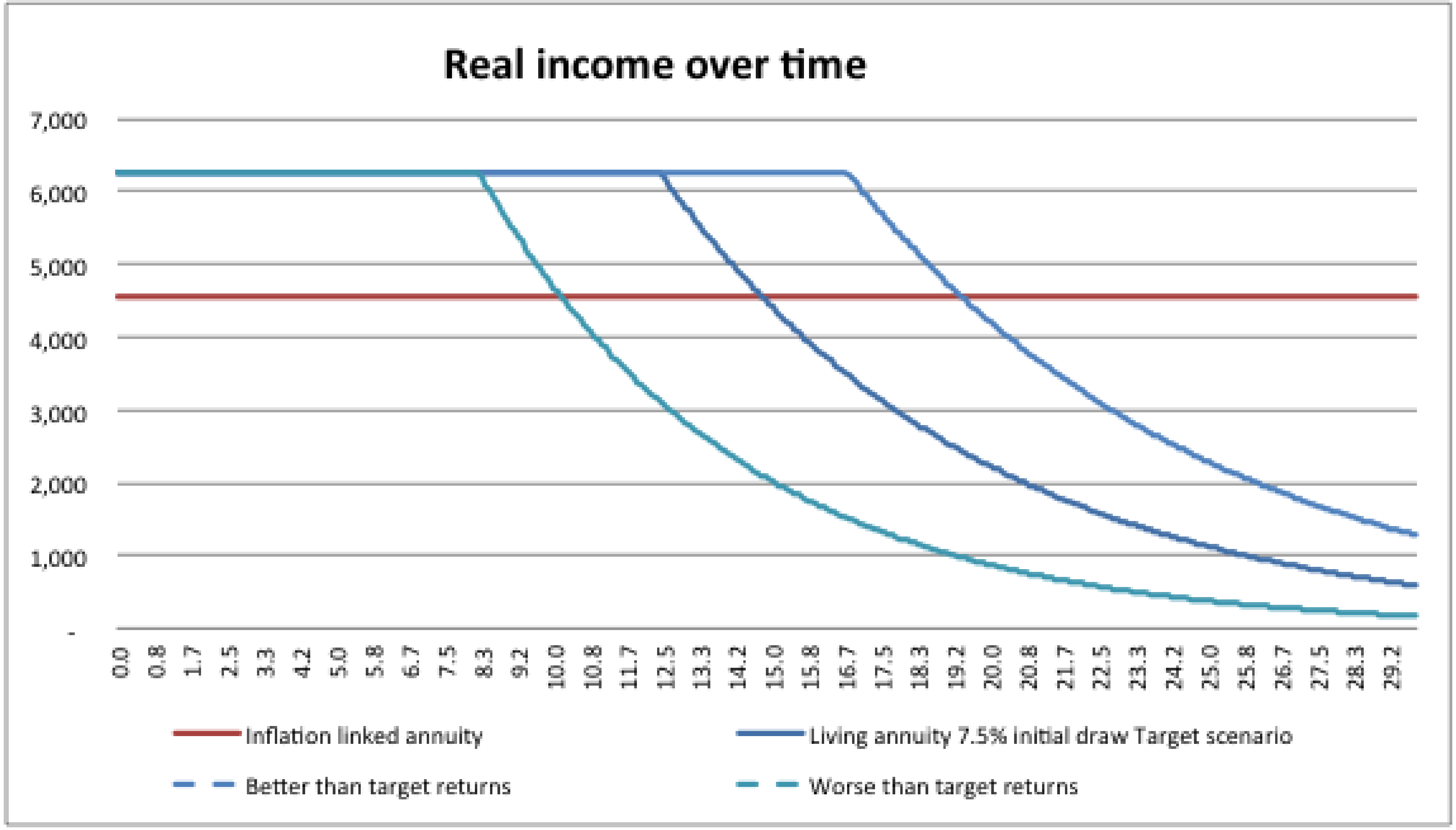
Providing a sustainable retirement income

Life annuities are better vehicles for the provision of sustainable retirement income for life, because of mortality pooling.



Source: Lodhia & Swanepoel 2012: Living versus Guaranteed annuities: In search of a sustainable retirement income

Real income projections: one example



Pros & cons of life annuity

Pros	Cons
Peace of mind: longevity risk transfer	Loss of control over investments and lock-in to product
Protection of purchasing power (esp. if inflation-linked)	Longevity risk transfer comes at a price
No ongoing decision-making responsibility at advanced ages	Limited inheritability (but is this the point of retirement savings?)

Pros & cons of living annuity

Pros	Cons
Flexibility to meet (possibly changing) needs in retirement	Serious risk of outliving your retirement capital!
Investment choice	Need for financial advice on investment and drawdown
Inheritability (while significant capital remains, at least)	Need for ongoing decision-making on annual basis
Useful as a temporary measure, or in ill health	High commissions, advice and management fees

Living annuity costs

Initial costs:

- Take-on fee of LISP
- Initial commission of advisor

Annual costs:

- Administration fee of LISP
- Ongoing advice fee
- Transaction cost for portfolio switches

Investment management costs:

- Annual management fees
- Possibly, performance fees

Living annuity cost comparison

Cost	Retail LISP*	UCTRF
Initial fee	1% of assets	R476
Ongoing administration	0.75% first R250k 0.5% next R500k 0.25% above R750k	R41.95 pm**
First-year comparison based on R1m	R15,000	R979.40***

* Best-case scenario
** Assuming monthly payments are made
*** We expect the monthly admin fee to increase substantially over the next 2 years, to approximately R125, to reduce th e cross subsidy by contributing members.

Which product is best for you?

- You will need reflection, and perhaps financial advice, to make that decision
- Factors:
  - Cost of Life Annuities
  - Inflation
  - Life expectancy
  - Spending patterns
  - Financial needs after you have died
  - Volatile investment markets
  - Other income options in retirement

Additional income in retirement

- For those with additional sources of income, at least for a while, living annuities can be a useful mechanism, with the option to secure a life annuity later (at lower cost) when the additional income ceases.
- (Remember that you can altenatively defer your retirement from the Fund if you don't require any income from the Fund when you retire from UCT.)

Some decision criteria

Consider living annuity if…	Consider life annuity if…
You have more than sufficient retirement capital and want flexibility	You require a known income with no risk
You have access to skilled, trusted and impartial financial advice	You don't want to run the risk of facing a reducing income
You want to leave an inheritance to dep-endants (but note: may be limited later)	You don't have a strong bequest motive
You are comfortable to be involved in decision-making for the rest of your life	You want to benefit from the pooling of mortality risks
You have a shorter-than-average life expectancy	You have normal or longer-than-average life expectancy

Retirement Workshop

- For those of you that will retire at the end this year there will be a Retirement Workshop to assist with the retirement process which includes a comparison of quotes from selected insurers (commission free).
- The UCTRF Office will be sending invitations during the month of August.

Useful information sources

www.uctrf.co.za

hr.uct.ac.za

www.fpi.co.za

Disclaimer

- Any guidance, opinions or proposals expressed by the presenters are for information purposes only and are not intended to be advice as contemplated in the FAIS Act, 37 of 2002.
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Thank you

Questions?