# The South African guide to **Corporate Retirement Funds**

A short guide to help you understand what it means to be a member of a corporate retirement savings fund and how to maximise the benefits of membership.

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## *INTRODUCTION*

*With few exceptions, we all need to save for retirement, that period when we are no longer earning a living. South Africa, like many other countries, does not have a social security net that is strong enough to support you once you stop working.*

*The state does provide an old age grant to those who qualify, but this is a mere R1,890 per month (2021), insufficient to maintain an acceptable standard of living. You cannot, therefore, rely on the state to look after you. Nor should you rely on your children or anyone else to pay your way when you are old. The onus is on you to save enough money to provide for this stage in your life.*

*Unfortunately, few South Africans save enough to afford a comfortable retirement. According to the National Treasury, only 6% of South Africans are on track to do so. For the other 94%, retirement will mean financial hardship, having to rely on family or others to make ends meet, or cutting back on their lifestyle. The latest 10X Investments' research confirms that statistic's continuing relevance.*

*10X research shows that corporate funds are often the first, and sometimes the only, experience that South Africans have with formal retirement saving.*

*Regrettably, the research also shows a shocking level of disengagement among workers regarding their corporate retirement fund. 10X's Retirement Reality Report 2020 found that 60% of respondents knew little-to-nothing about their fund, 11% weren't interested and 35% wished they knew more.*

*Who is to blame for this? Is it the fund members who avoid the topic (for whatever reason) and ignore the communications they receive, as well as all the information available in the financial media? Or is it the fund industry, for failing to make the subject matter non-threatening, accessible and relevant?*

*No doubt, both sides can and must do better if we are to improve retirement savings outcomes in this country. This e-book is part of that effort. It provides an overview of what it means to belong to a corporate retirement fund. The information in this booklet should give readers a basic understanding and help them ask the right questions and make better choices.*

*Corporate retirement fund members who want to know more about their fund should ask their Human Resources manager, who will be able to point them in the right direction, quite possibly the fund administrator or consultant, if they can't answer the questions themselves.*

*This e-book is part of a series of e-books covering all aspects of retirement planning and saving. Other guides in the series are available here: resources.10x.co.za*

CHAPTER 1

# What is a corporate retirement fund?

A corporate retirement fund is a group savings and investment plan. It is set up specifically for company employees, and provides them, or their beneficiaries, with valuable benefits once the member is no longer employed, retires, or passes away. These benefits are usually in the form of a cash lump sum, a regular monthly pension income, or a combination of the two.

An employer-sponsored retirement fund offers structure, discipline and tax benefits.

Contributions are deducted monthly via the payroll and paid directly to the fund administrator. This, in effect, forces employees to adhere to the Warren Buffett maxim: "Don't save what is left after spending; spend what is left after saving". By having savings deducted off your pay upfront, you eliminate the problem of not having enough money to save at the end of the month.

You also have the comfort of knowing that your employer monitors the performance of the fund's service providers (mainly the administrator and investment managers), to ensure you receive good value for your money.

Because your retirement fund contribution is not taxed, and passes through the payroll, you have the immediate benefit of the tax break. If you save on your own accord, through a retirement annuity fund, you may have to wait until you file your tax return to receive the tax benefit.

### 1.1 Legal position

A retirement (pension or provident) fund is a separate legal entity, apart from the employer and service providers. All contributions and investments are held in either a 'stand-alone' or an 'umbrella' fund in the name of the employee.

Funds must be registered with the Financial Sector Conduct Authority (FSCA) and are subject to the rules of the Pension Funds Act (PFA). They must also be approved by the South African Revenue Service (Sars), before members may claim contributions as a tax deduction.

Every fund must appoint a management board to run the affairs of the fund. This is called the board of trustees. Each retirement fund must have at least four trustees. In addition, the fund must appoint a principal officer, to deal with the day-to-day running of the fund.

Employers that belong to an umbrella fund do not have to set up their own board of trustees; this is provided by the umbrella fund. Such employers have the option to set up a management committee, to ensure that service providers adhere to the agreed service level agreement.

### 1.2 Fund rules

Every retirement fund must have a set of fund rules in the form and format prescribed by the Pension Funds Act. The rules are registered with the FSCA and Sars, and are binding on the fund as well as the members, the employer, the service providers and officers of the fund.

An umbrella fund, which pools the investments of a number of employers, will have a set of general rules. Each participating employer will then draw up a set of special rules, which must be approved and registered. This is done with the help of the administrator.

### 1.3 Pension versus provident funds

There are two types of corporate retirement funds: pension and provident. The original objective of a pension fund was to provide employees with a regular income in retirement (an annuity), whereas a provident fund was designed to provide employees with a cash lump sum at retirement.

Historically, pension and provident funds were subject to different tax rules and annuitisation requirements, but with the passing of National Treasury's retirement reforms, these have now been largely standardised.

When members retire, they must use at least two-thirds of their savings to buy an annuity (either a guaranteed or a living annuity) if the fund value is above R247,500. Up to one-third of the fund value may be taken as cash.

Provident fund members with a "vested benefit" can still opt to take this portion entirely as a cash lump sum at retirement. The "vested benefit" refers to their balance at

1 March 2021 and all subsequent investment returns thereon. Contributions made after 1 March 2021 (and returns thereon) fall under the new, standardised rules.

Provident fund members who were 55 or older on 1 March 2021 can still take their entire benefit as a lump sum at retirement, except for contributions (and returns thereon) made to a new employer's provident fund thereafter.

Members who had savings in a provident or provident preservation fund on March 1 2021 should refer to their fund representative to discuss how they are affected.

In both cases, any lump sum taken is subject to the retirement lump sum tax tables.

### 1.4 Stand-alone versus umbrella funds

A stand-alone fund serves just one employer, whereas an umbrella fund combines more than one employer under one legal structure.

This so-called pooling of assets in umbrella funds reduces the average cost per member, due to the economic efficiencies that can be achieved. A standalone retirement fund is really appropriate only for very large employers who do not need to pool assets with others to obtain these benefits of scale.

The other big difference is that with umbrella funds, trustees are appointed by the fund administrator, whereas with a standalone fund, the trustees come from within the organisation. Half are appointed by management and half are elected by members.

For umbrella funds, this has the advantage that fund trustees are usually professionals, more able to fulfil their fiduciary duties as required by the Pension Funds Act. This reduces the risk of falling foul of regulations. The downside is that the individual employers within the umbrella structure don't have their own dedicated trustees but can set up their own Management Committee to review the Umbrella Fund and select their own fund consultant and risk providers and risk benefits, depending on the Fund and Administrator's rules.

The South African retirement industry is heading strongly in the direction of umbrella funds: the number of stand-alone retirement funds in South Africa has almost halved in recent years.

### 1.5 Defined contribution versus defined benefit funds

In a defined contribution fund, the member's benefit is equal to invested contributions (net of any administration costs) plus investment growth (net of any fees charged).
In other words, the retirement benefit equals the value of their final investment.

In a defined benefit fund, the member's benefit is linked to their years of service and salary at time of retirement, based on a pre-determined formula.

These days, almost all corporate retirement funds are 'defined contribution' schemes. The Government Employee Pension Fund (GEPF) is an example of a defined benefit scheme.

Please note that this document covers 'defined contribution' funds only, not 'defined benefit' funds.

# Benefits of saving into a retirement fund

### 2.1 Tax relief

Because it is in the national interest for people to be financially independent once they have stopped working, we are incentivised to save. This is done by way of a tax break: you don't pay tax on the portion of your earnings that you contribute towards a pension or provident fund (up to certain limits).

You may deduct contributions (made by yourself or your employer) up to 27.5% of your taxable income or gross remuneration (whichever is the higher). The 27.5% limit applies to the combined total of such contributions to pension, provident and retirement annuity funds. The overall tax deductible limit is R350,000 per annum. Contributions over the annual rand limits may be rolled over to future years, subject to the limits applicable in those years, or else they are returned tax-free at retirement.

As a member of an employer-sponsored retirement fund, your contribution is deducted from your pay before your salary is taxed. This means that your monthly PAYE tax deduction drops, which softens the impact on your take-home pay.

**Example:**

If your marginal (highest) tax rate is 36% (assuming an annual income of R500,000), for every R100 you put into your retirement fund you get tax relief of R36. In this case, you save R100, but your take-home pay reduces by only R64 because you are paying R36 less tax.

Although you will eventually pay tax when you draw on your savings, this should be at a much lower rate than the marginal tax rate at which you deducted your contributions.

**Example:**

If your savings eventually afford you an annuity income of R350,000 pa (a 70% income replacement ratio on the example mentioned above) this will attract an average tax rate of only 16% (based on the current tax tables, for those over 65). That's a tax saving of R20 for every R100 contributed to your retirement fund in the above example, every year.

The other important advantage is that you don't pay tax on the investment returns earned within your fund, be it on capital gains, dividends or interest. If you save privately, the annual tax you pay on these returns is a cost that lowers the return and value of your portfolio.

### 2.2 Protection against creditor claims

A retirement fund is a separate legal entity that owns the assets in the fund. This means that fund assets are separate from both the assets of the employer and the members. They cannot be claimed by creditors if either the employer or the members become insolvent. This effectively protects the members' retirement benefits within the fund.

However, if a lump sum payment from a provident or pension fund was paid to the member prior to insolvency, this money forms part of their estate and is not protected from creditor claims.

# Benefits of an employer-sponsored retirement savings fund

### 3.1 Lower fees

The fees on a group savings scheme, such as a corporate pension or provident fund, are usually lower than individual private investment vehicles, such as retirement annuities. This is partly due to the benefits of scale, and partly because your employer is in a better position to negotiate with service providers than you are as an individual. It is the benefit of scale that usually makes saving through a group scheme preferable to saving individually using a retirement annuity fund.

### 3.2 Additional Voluntary Contributions (AVCs)

Some fund rules allow members and/or employers to make additional contributions to the fund. Find out if your scheme is one of them. This will enable you to make additional contributions when the opportunity arises (for example, when you receive a bonus or a 13th cheque). It makes sense to contribute as much as you can to your retirement fund, as long as you qualify for the tax relief on your contributions.

If you want to top up your retirement savings but your pension or provident fund does not allow AVCs, or the fund costs are too high (more than 1% pa), you should consider using an Retirement Annuity (RA), which is a retirement fund for individuals, instead. We talk more about the importance of watching your fees in Chapter 5.

Like a pension fund, an RA pays a monthly income on retirement, or early retirement due to ill-health, or a death benefit to financial dependants or other beneficiaries should you pass away before retirement.

You enjoy the same tax relief on contributions to your RA as on pension or provident fund contributions, subject to the annual limit that applies to your total contribution made across all of your retirement savings products.

For more information on Retirement Annuities please see *The South African guide to saving and investing for retirement*

### 3.3 Death benefit

In the event that you die while still a member of a retirement fund, your fund savings will be distributed to your financial dependants. Per Section 37C of the PFA, the allocation is at the fund trustees' discretion. If you have no financial dependants, the money will go to your nominated beneficiaries, as indicated by you in your beneficiary nomination form. It is, therefore, important that you fill out this form and provide a signed copy to your employer. Remember to update this form as and when you have a life changing event, like getting married or divorced, have a new child or your child is out of the house looking after themselves. It is recommended to do a new nomination form annually and provide your HR with a new form and keep a copy safe at home.

If you do not fill out this form, and you have no financial dependants, the money will fall into your estate.

### 3.4 Risk Benefits

Employers may also provide group risk benefits to members of a corporate retirement fund. These benefits, such as cover for death, disability, dread disease (also known as severe illness or critical illness) and funeral, are provided by a separate insurance policy that pays out should the member die, no longer be able to work, or be diagnosed with a critical illness.

The benefits of belonging to a group risk scheme include: automatic cover, reduced costs due to economies of scale, and no medical underwriting requirements up to the free cover limit specified by the insurer. You will be required to do medical underwriting only if your benefit exceeds this limit.

**Life cover:**
If you die in service (before retirement age), your dependants and nominees will receive (in addition to the death benefit) an amount equal to a predetermined multiple of your pensionable salary.

There are essentially two types of cover: approved and unapproved. With approved life cover, the contract is between the retirement fund and the insurer; with unapproved life cover, the contract is between the employer (or the employees as a group) and the insurer. There are differences in regulation and tax treatment between these two types of contracts.

If you have approved life cover, the pay-out forms part of your total death benefit and will be distributed by the fund trustees in terms of Section 37C of the Pension Funds Act.

If your life cover is unapproved, it is typically the employer who decides on the beneficiaries. Usually, they follow your wishes, as specified in your beneficiary nomination form. It is, therefore, very important to keep this up to date, to reflect your latest wishes and circumstances.

**Disability benefit:**
This is an insurance policy between your employer and the insurance company (ie an unapproved benefit). This pays out if you are unable to do your job due to an illness or injury.

There are different types of disability benefits:

- Capital lump sum disability benefit, which pays out a lump sum benefit based on a predetermined multiple of your annual pensionable salary if you become totally and permanently disabled.
- Income disability (also known as income continuation benefit), which pays out a monthly income based on a predetermined percentage (such as 75%) of your monthly pensionable salary.

If you have more than one income disability policy (which is not unusual as you may have taken out a policy privately as well), then the benefit pay-out is apportioned across the insurance companies providing the cover.

Note that whereas you can pay for as much life cover as you wish, your income disability pay-out is typically limited to 100% of your income, irrespective of how much cover you have taken out. This is to avoid the incentive to 'stay' disabled rather than to go back to work.

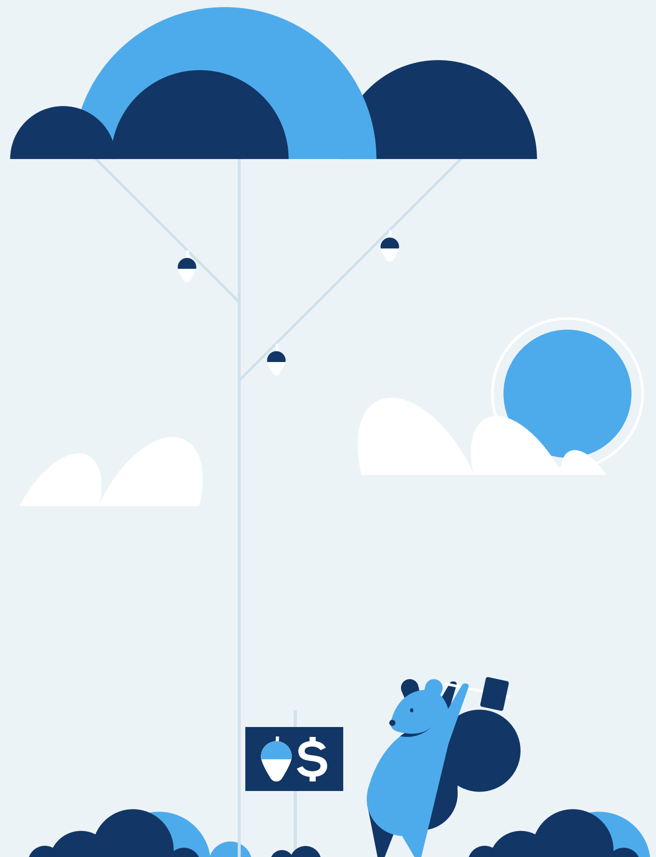
**Funeral benefit:**
This assists with funeral costs. Depending on the policy, the funeral benefit may also cover the death of your spouse, life partner, or your children.

**Education benefit:**
This covers the cost of your children's education should you pass away.

**Dread disease (also known as severe illness or critical illness) benefit:**
This is a lump sum benefit paid to you if you are diagnosed with certain diseases.

It is important to know and understand the benefits provided and the terms and conditions of the insurer for each benefit. It is not unheard of, for example, for a family to struggle with funeral costs, when the costs could be covered by the employer's funeral policy.

If you are not absolutely clear which benefits apply and to whom, ask your HR department for more information.



CHAPTER 4

# How does membership work?

### 4.1 Membership rules

Your membership is automatic.  If you join a company that provides a pension or provident fund, and you are eligible to join in terms of the fund rules, you are required by law to become a member and make contributions according to the fund rules. The fund rules may exclude some categories of workers, such as contract workers, or they may prescribe a waiting period (for example, because the employer has a high staff turnover) before new employees can join the fund.

Section 13A of the Pension Funds Act requires employers to pay over your fund contributions to the administrator within seven days of the end of the month for which they are due. This must be accompanied by a submission which details the fund's name and registration number, employer's details and each member's details regarding the contribution deducted and paid over. This ensures that your contribution is properly credited to your account.

If your employer does not offer a pension or provident fund, you should consider joining an RA fund, a retirement fund for individuals.

### 4.2 Contributions

The contribution rate, which is normally expressed as a percentage of pensionable salary, varies across organisations. Some companies provide one contribution rate option for all employees. Others set up different employee categories and vary the contribution rate by category as defined by the employer and your letter of appointment.

Note that there is no legal obligation on the employer to contribute to the fund, unless specified in the fund rules. From a tax benefit perspective, there is no difference between contributions made by you, and contributions made by your employer.

Remember, for maximum tax efficiency, you are allowed to make additional voluntary contributions to the fund and a retirement annuity up to a maximum of 27.5% of your taxable income, capped at R350,000 per annum.

Your contributions to the fund will be deducted from your basic salary before tax is calculated and deducted. This means that your monthly tax deduction will be lowered accordingly.

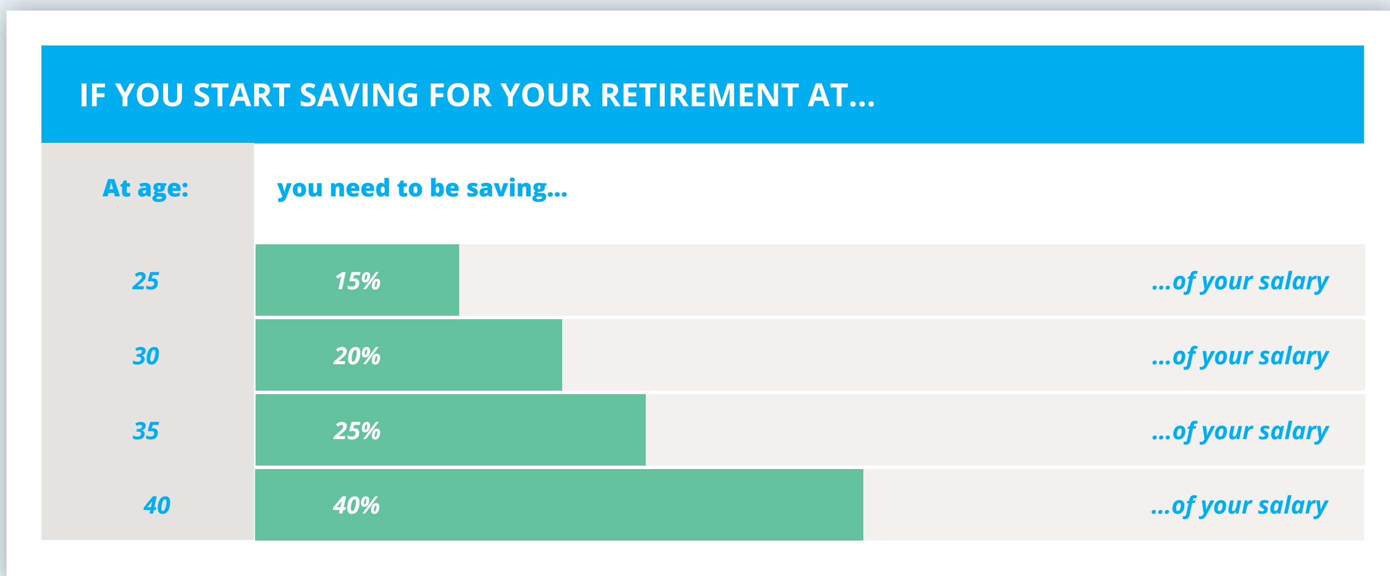
As a rule of thumb, saving 15% of your monthly income is good, more is always better. The 10X Investments formula for retirement savings success is: Save 15% of your salary for your entire working life (an average of 40 years) and invest in a balanced high equity fund that uses index tracking and charges less than 1% in fees.

CHAPTER 5

# What factors affect the value of your fund?

### 5.1 How much you save and for how long

The amount you need to save is expressed as a percentage of your income, which connects your current standard of living to your targeted standard of living in retirement. 10X Investments recommends that you save 15% of your income from the start of your working life until you retire. It is important also to preserve your savings when you change jobs.

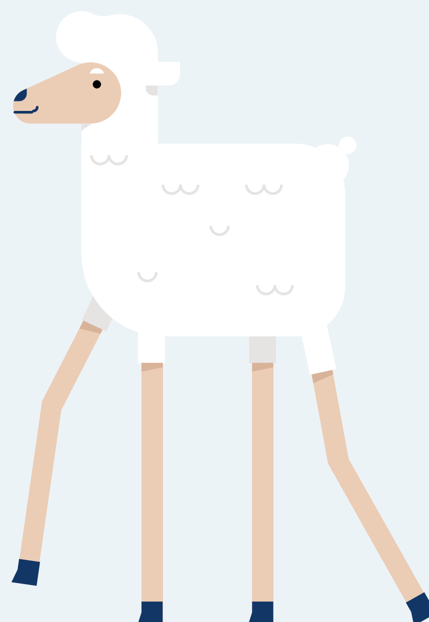


IF YOU START SAVING FOR YOUR RETIREMENT AT...

| At age: | you need to be saving... | |
|---|---|---|
| 25 | 15% | ...of your salary |
| 30 | 20% | ...of your salary |
| 35 | 25% | ...of your salary |
| 40 | 40% | ...of your salary |

If you start saving late you can catch up by increasing the percentage of your earnings saved, as shown in the table above, or working beyond normal retirement age. But be warned, the longer you wait the more difficult it will become to reach your retirement goals. If you leave it very late you will probably need to do more than delay your retirement, you will have to lower your lifestyle expectations.

**TOP TIP**
Raise your contribution rate without feeling too much pain by nudging up the percentage you save when you get your annual salary increase, say, from 15% to 16% or 17%. Within a few years you will be saving 20%



## Compounding

The savings you make earlier in your working lifetime (ie that remain invested for the longest time) work the hardest, thanks to the miracle of compound growth.

Compounding simply means that you earn a return on your savings as well as on the past returns themselves year after year. Like a snowball rolling down a hill and picking up ever-more snow with every rotation, your savings pot will grow faster as it grows bigger over the years.

Give your savings enough time, earning returns on returns, and your nest egg will grow into a very large pot, one that might have seemed totally out of reach when you started.

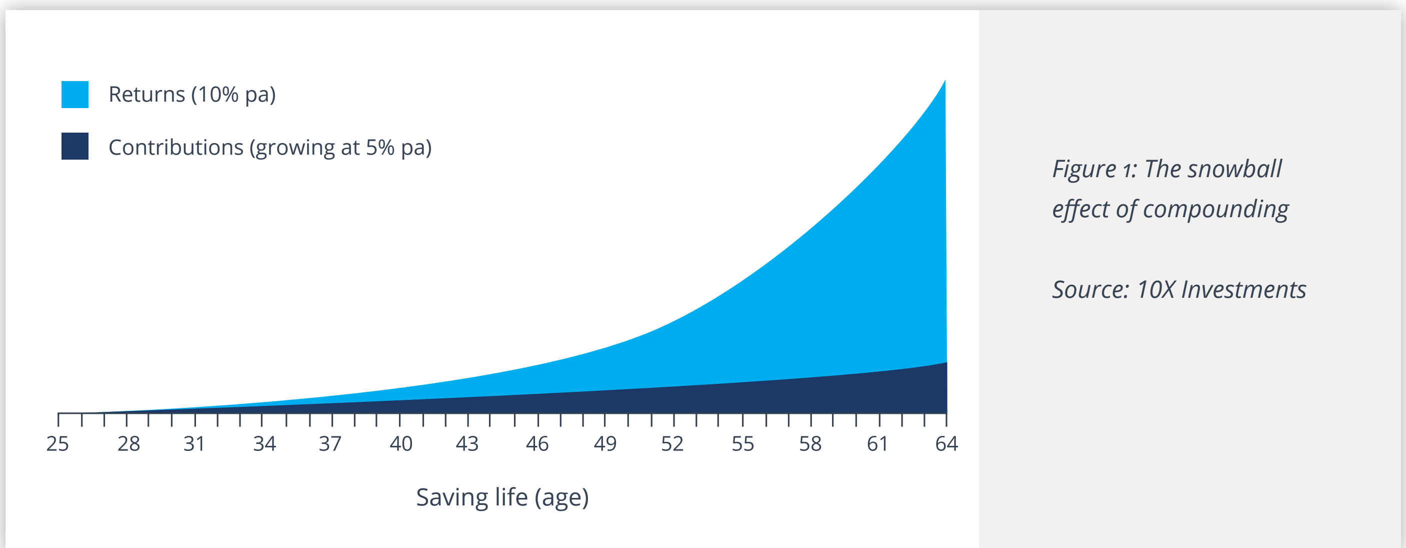



*Figure 1: The snowball effect of compounding*

*Source: 10X Investments*

The graph above illustrates this. The dark-blue area represents your steady annual contributions, and the light blue area is the return earned on your accumulated savings (10% pa in this case).

Early on, the return is just a tiny fraction of your total savings, and it takes quite a few years to become significant. Returns equal contributions at around age 40, after 15 years of saving and investing.

But another 15 years on, returns are already 3 times contributions, and at the end of the 40-year savings period, returns are almost six times the value of contributions.

The point is that it takes some time for compounding to become a powerful force. The big acceleration happens after around 20 years. Therefore, to get the full benefit, you need to start early and continue to save and remain invested for as long as possible.

**Use the Online Retirement Planner**

*Calculate your retirement goal.*

**Looking Peachy!**
You're on track for a fruitful retirement

Total Savings | Monthly Income

Projected R3.64m

Your Goal R3.06m
EXCEEDED BY R545.570

Adjust Outcome

Contribution p/m
R2,000.00 (of salary)

Current Savings
R3

Retirement Age
65

More adjustment >

Recalculate

Continue

### 5.2 The fees you pay

10X market research indicates that most South African retirement savers don't know what fees they are paying. A good many believe there is no fee. The fee paid on an investment might be difficult to find (and almost impossible to understand), but you can be sure there will be a fee.

This widespread lack of awareness about fees is a big problem. The fee you pay is one of the most important factors in your long-term savings outcome. **Just a 1% pa fee saving over 40 years increases your retirement pot by around 25%!** Again, this is compounding at work, but now working against you.

**FEES! FEES! FEES!**

- Fees are confusing and sometimes obscure. You may be paying for fund advice, administration, investment management, investment performance and platform fees. These costs can be expressed as a fee per member, a percentage of assets, a percentage of salary, or a combination of these.
- There are all-in fees, or they can be calculated separately. Some fees, such as for investment performance, are determined by complex formulas.
- Some fees may be charged at either a fixed rate or as a percentage of your salary (for example, the monthly administration charge). Other fees, such as for investment management, are charged as a percentage of your investment value.
- Deductions related to your risk benefits are usually calculated as a percentage of your pensionable salary, although some may also be at a fixed rate (eg your funeral benefit). Note, however, that these risk charges (which reduce the amount invested in your retirement fund) do not fall under the category of fund fees.
- If the fee is calculated as a percentage of assets, those with more money saved will pay more than those with less money saved. If it is based on a percentage of salary, those who earn more pay more.
- Note that the lower your contribution rate (as a percentage of your pensionable income), the higher the percentage of your contribution that is lost to admin fees.

### The ASISA Retirement Savings Cost Disclosure Standard

It can be tough to get to the bottom of your fees. For now, someone at your organisation or an employee benefits officer at the fund should be able to give you a breakdown of what you are paying. Ideally, you are not paying more than 1 percent of the value of your assets in total.

The good news is that, from October 2020, umbrella fund members will be able to assess the fee impact far more easily. This is when the ASISA (Association for Savings and Investments South Africa) new Retirement Fund Standard "Effective Annual Cost (EAC) for Individual Fund Members" comes into force.

This requires fund administrators to present all relevant costs (based on certain assumptions) in a standardised manner. The standard template reflects four separate charges and will quantify how they are likely to reduce the return over different investment periods (ranging from 1 year up to 10 years).

The categories of charges are as follows:

- Investment management
- Advice
- Administration
- Other, which includes regulatory, compliance and governance costs

The RSC (Retirement Savings Cost) is calculated separately for each of the four components and then totalled to derive the RSC for the umbrella fund as a whole. The total RSC is expressed as a percentage of the investment amount.

### Investment value lost to fees

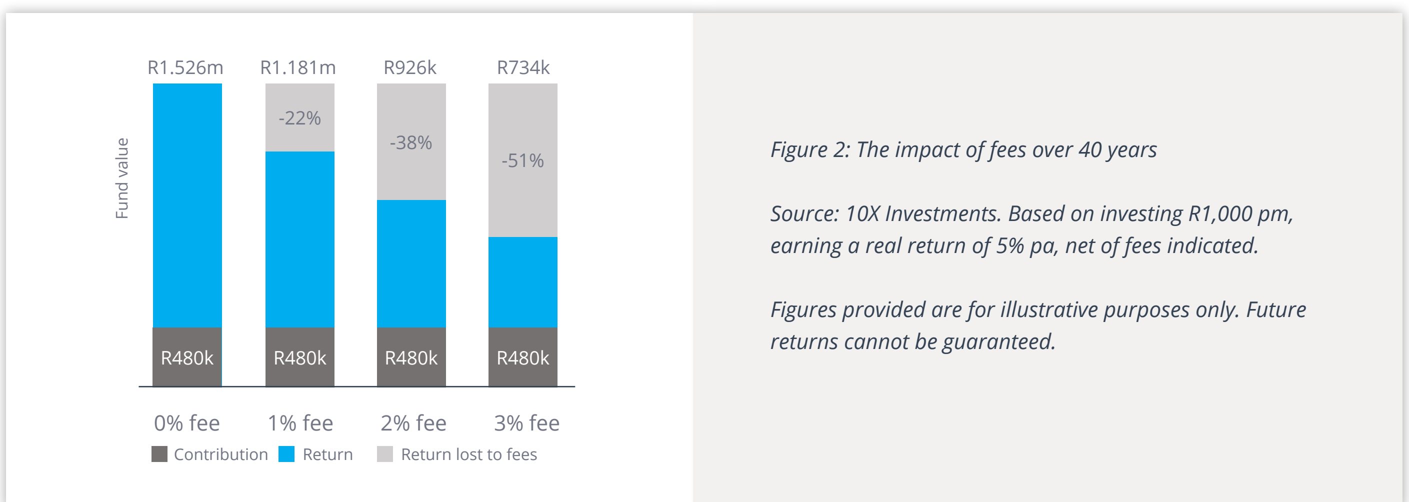



*Figure 2: The impact of fees over 40 years*

*Source: 10X Investments. Based on investing R1,000 pm, earning a real return of 5% pa, net of fees indicated.*

*Figures provided are for illustrative purposes only. Future returns cannot be guaranteed.*

The graph above illustrates the dramatic impact of fees on long-term investment growth. The calculations assume an investor is contributing R1,000 per month towards a retirement fund (40 years). The investment delivers a real (after-inflation) return of 5% pa over the investment period. The dark grey portions of the bar show that in each of the four fee scenarios (0% pa to 3% pa) the investor contributed the exact same amount (R480k) over the 40 years. Without fees, the investor would have accumulated a total value of R1.5 million in savings (in today's money). But the payout reduces dramatically as the annual fee increases. On the right side of the graph, the investor contributing R480k over the same 40-year period would have received about R734,000, almost 40% less than if they had paid just a 1% fee.

### 5.3 Your asset mix

Besides fees, the other big factor that determines your investment return is the asset mix in your portfolio, that is to say the proportion in which you hold the main asset classes. Although there appear to be myriad types of investments most, if not all, of your retirement savings money will be invested in the plain-vanilla variety: company shares (also called equities, stocks or shares), bonds, property shares and cash.

Shares (domestic and foreign) and property are classified as growth assets, whereas bonds and cash are regarded as defensive assets.

- Equities (the stock market) have historically generated the highest real (after-inflation) returns over time – approximately 7% pa over the past century. The high return compensates investors for the higher uncertainty (risk). Share prices move daily and can change significantly (up or down) over very short periods. You are never sure what you will realise on your share investments until you sell them.

- Property shares earn mainly rental income and have historically delivered similar returns to company shares. Long-term lease agreements with escalation clauses deliver a more predictable return than other businesses, but these investments are still subject to the vagaries of the economic cycle and investor sentiment.

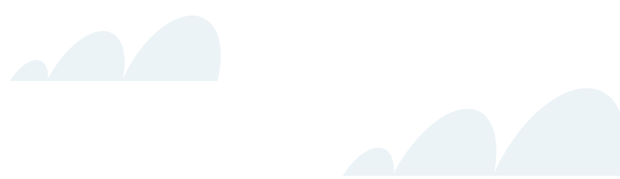
- The long-term real return from bonds (money lent to the government or other entities) has been considerably lower over the same period (around 1-2% pa), but with lower variability than shares over the short term (one year or less). In other words, the short-term return from bonds is far more predictable than that of equities.

- Cash returns (in saving or money market accounts) are even lower over time, typically generating a real return of only around 1% pa. Your risk with cash is very low – you can be almost 100% sure you will receive all you put in, plus accrued interest. This certainty enables investors to preserve capital in the short term.

Note that there are other, less frequently used asset classes, including private equity (effectively unlisted shares) and commodities (such as oil and gold). These so-called 'alternative asset classes' are beyond the scope of this guide.

Although there are seemingly an infinite number of different asset mixes, your portfolio will typically fall into one of four broad categories:

- High Equity: around 75% in growth assets
- Medium Equity: around 60% in growth assets
- Low Equity: around 30% in growth assets
- Defensive: around 10% in growth assets



**Regulation 28 of the Pension Funds Act**

Regulation 28 of the Pension Funds Act limits the extent to which retirement funds may invest in individual assets and asset classes. The main purpose is to protect retirement investors from the effects of poorly diversified investment portfolios. This is done by limiting the maximum exposure to different assets and asset classes.

The main consequence for retirement fund members is that no more than 75% of their portfolio may be invested in company shares (local and foreign). The fund may, however, also invest up to 25% in property shares.

The other significant restriction is that no more than 30% of the portfolio may be invested offshore (plus another 5% in Africa).

## Investment risk as it affects you

In deciding on the appropriate asset mix, risk is an important consideration. All too often, risk is discussed in the context of how much of the market's ups and downs you can bear, and how much of a short-term loss you can bear emotionally. In the context of a life-long retirement plan, that is not helpful. As a long-term investor, you need to view investment risk with your goal and time horizon in mind.

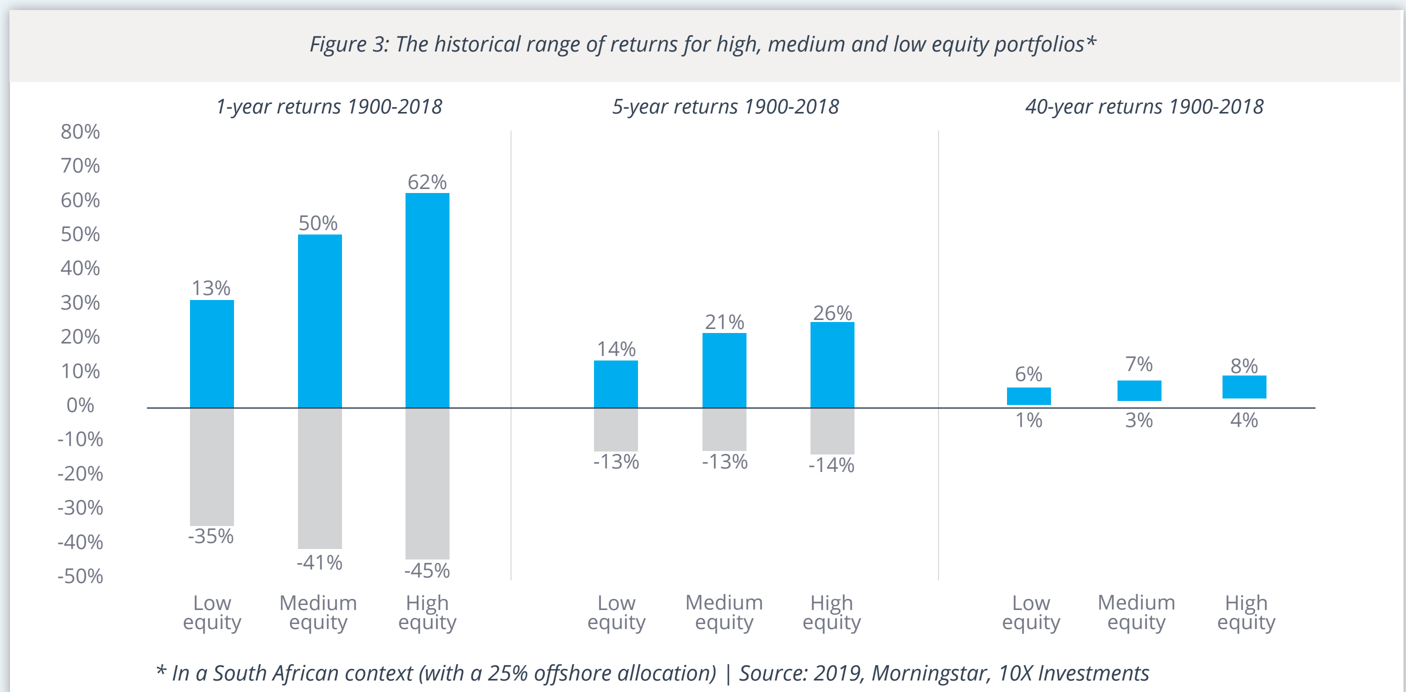
Once you do that, you realise that your biggest risk is not what the stock markets do this year, but failing to retire with enough capital. From this perspective, your two major risks are:

1. Failing to generate a high real return over most of your investment term.
2. Failing to preserve capital in real terms over the last phase of the investment term.

As a long-term investor you should expect (but not worry about) economic cycles and short-term volatility in the share market. Rather focus on the high real return you are likely to earn from equities over time, and therefore maximise your exposure to this asset class (to the extent permitted by Regulation 28 of the Pension Funds Act).

Figure 4, below, shows the historical range of returns for high, medium and low equity portfolios in the South African context (with a 25% offshore allocation) over time horizons of 1, 5 and 40 years. The returns shown are real (ie after-inflation).

*Figure 3: The historical range of returns for high, medium and low equity portfolios**




** In a South African context (with a 25% offshore allocation) | Source: 2019, Morningstar, 10X Investments*

**The 1-year returns** from 1900 to 2018 show that the historic range of returns for high equity portfolios are significantly more volatile than for low and medium equity. The worst year (historically) for a high equity portfolio was -45%, compared to -35% for low equity. Hence the need to reduce the allocation to volatile/growth assets when managing short-term risk.

The range of return **over 5-year periods** shows that high equity portfolios have the potential to generate significantly higher returns without presenting much more volatility risk than a low or medium equity portfolio. As the risk for long-term investors is to earn an inadequate return, you are best served with investing in a high equity portfolio if your time horizon is longer than five years.

**Over 40 years**, high equity portfolios have generated the highest returns, with less downside risk than low or medium equity portfolios. We say this because the lowest return for a high equity portfolio over this period (4% pa) is higher than the lowest return from either the low or medium equity portfolio.

Although future returns are uncertain and are not guaranteed, the above presents a strong case that long-term investors are best served by a high equity portfolio.

## Portfolio considerations as you approach retirement

The product you choose to invest your savings in once you have retired (see Chapter 8) will have a bearing on your risk tolerance.

If you plan to select a guaranteed annuity, share market volatility becomes an important consideration during the last five years prior to retirement. You cannot afford to lose 30% of your retirement asset in a market crash near the end, as you do not have enough time to recover. You would, therefore, look to steadily reduce your equity market exposure over the last five years to retirement. Some retirement funds, like 10X, use a so-called life-staging approach to transition your portfolio from growth to defensive assets and protect you from volatility risk near retirement.

However, if you plan to select a living annuity, you will remain invested in the markets after retirement. You will still be a long-term investor, and your focus will then be to lower your risk of outliving your savings. You would then look to maximise your long-term investment return by remaining invested in a high equity portfolio.

## Diversification

Don't put all your eggs into one basket, the saying goes. That is never truer than with retirement investing, because you don't want your retirement income to be tied to the fortunes of just a few investments.

Diversification has been called the one free lunch for investors because a well-diversified portfolio, regularly rebalanced, will on average yield a higher return, with less volatility, than a concentrated portfolio.

In practice, a diversified portfolio means that you will invest in a portfolio with different asset types (ie company shares, property shares, bonds and cash). Within each asset class, you will hold a broad variety of securities. For example, you will hold a large portfolio of shares, which will all react differently to market developments. That is achieved by owning shares that operate in different sectors of the economy, or in different parts of the world, that are exposed to different currencies, or that respond to different investment fashions.

Your typical South African multi-asset retirement portfolio offers exposure to local and international shares, local and international property, local and foreign bonds, and local and international cash.

## Investment style

There are two broad styles of selecting that mix: indexing and active management. An index fund tracks the performance of a pre-determined index, such as the FTSE/JSE All Share Index, by mirroring the share make-up of that index. The investment earns the return generated by that index – no more, but, importantly, also no less.

The alternative, an actively-managed fund, will try to do better by deviating from the index composition, underweighting (or avoiding) some shares and overweighting others. This is known as 'stock-picking'. Individual actively-managed funds do beat the market every so often, but only around 10% manage to do so over longer time periods, after taking account their higher fees. With no way to identify these winners beforehand, the odds of coming out ahead with an active manager are low.

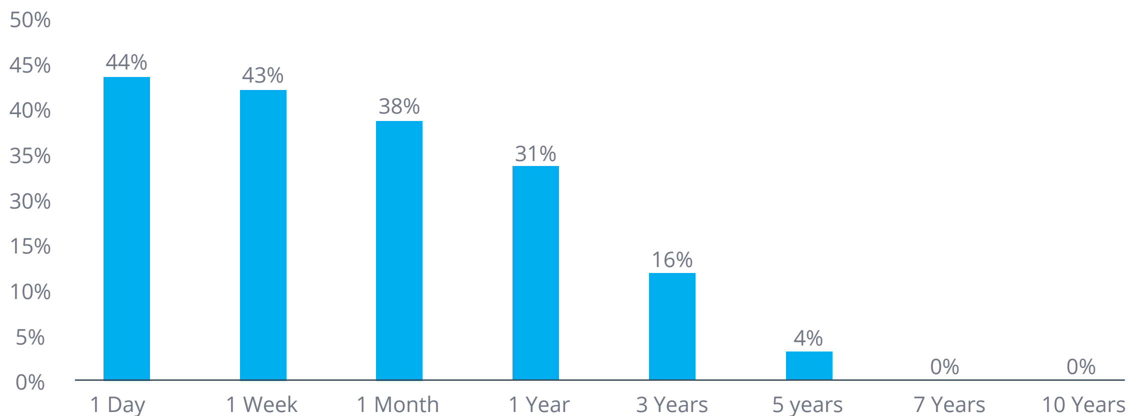
## Don’t let short term market fluctuations distract you

Your investment objective is to maximise your investment return over your investment period, in all reasonably expected market environments, to give yourself the best chance of achieving your retirement goal. Your focus must be on the long-term return, not on the return over the next month or the next year.

Many long-term investors make the mistake of attaching great importance to short-term results (anything less than five years). Short-term results are largely random, which is why no one can reliably predict short-term investment returns.

Unfortunately, most of us often hear about short-term returns and analysts’ views about them. While these have zero predictive value, they have a huge psychological impact on how people invest their long-term savings. You risk earning poor long-term investment returns if you make decisions based on short-term investment returns. Figure 5 shows that as your investment time horizon increases from 1 day to 7 years and beyond, your chance of a negative return decreases from 44% to 0%.

*Figure 4: Chance of negative returns over different time periods - SA Equity*
*Source: 2019, 10X Investments; Datastream; Dimson, Marsh and Staunton. 1 Day to 1 Month 1973-2018, 1 Year to 10 Years 1902-2018*




**Please note that past performance is not indicative of future returns*

CHAPTER 6

# The buck stops with you

### 6.1 Individual responsibility

Even if your employer offers a pension or provident fund, they are not responsible for your retirement savings outcome. This responsibility is yours. It starts with choosing a prudent (that is to say, adequate) savings rate, ideally 15% of income or more.

Still, employers, together with their fund consultants, should do as much as they can to ensure that employees have easy access to all relevant information that is easy to understand. This will go a long way to help engaged retirement savers make informed decisions.

### 6.2 Investment choice

Many retirement funds offer members investment choice, allowing them to choose from a selection of investment managers and funds.

Choice is usually a good thing because it promotes competition and innovation. But it becomes problematic when we are unsure of what we need or want, or when exercising a choice requires expertise or relates to unpredictable future outcomes. Choice can then become very expensive, in terms of the cost of advice and/or the opportunity cost of choosing poorly.

This makes the issue of choice in retirement funds controversial, not only because few employees are willing to exercise it, but because those who do, often make poor choices. They may choose funds based on their own risk tolerance, which may cause risk-averse employees with a long-term horizon to invest too conservatively, or risk-tolerant employees with a short-term horizon to invest too aggressively. Or, they choose fund managers based on past performance, or an investment strategy that worked well recently. They might also try their hand at market-timing, or switch funds often. All these practices are likely to lead to a sub-optimal outcome.

A further problem with choice is that it does not come free – the administration charge is loaded with the cost of providing choice. This cost is charged to all members, whether they exercise it or not. To the extent that the majority of members do not exercise choice, it is an unnecessary and avoidable cost.

### 6.3 The default investment portfolio

Members who are unable or unwilling to choose are invested in a 'default fund'. From past research it appears that around 80% of employees typically end up in the default fund.

Since 1 March 2019, all retirement funds are obliged to offer a default portfolio that meets the criteria of Regulation 37 of the PFA. Such default portfolios must accordingly be "appropriate" for members. They require clear communication on composition and performance. Fees and charges must be "reasonably priced and competitive" and adequately disclosed. The fund must consider both active and passive investment styles. The default portfolio does not permit complex fee structures.

### 6.4 Member communication

Fund members typically receive documentation and information regarding their fund, such as welcome packs, benefit booklets and benefit statements. You should study these carefully. Ideally, you will receive regular statements that give a simple, clear view of your investment, your investment performance, your insurance benefits and the fees paid. If you do not understand something, ask questions.

10X Investments' fund members can access everything they need to know about their investment at any time via the online investor portal, My10X. In addition to accessing information about their investments, 10X fund members can view and even adjust their retirement goal, as well as see their progress towards achieving it.

### 6.5 Complaints and disputes

If you have a complaint or dispute regarding the administration of your retirement fund, the investment of its assets, or the application of its rules, you (or, on your death, your dependants or beneficiaries) may lodge a written complaint to the fund.

Section 30A of the Pension Funds Act prescribes the procedure to be followed in lodging a complaint.
The complainant must first make a formal written complaint to the respondent (which may be the fund or the employer) and request a resolution. The respondent then has 30 days to resolve the complaint.

If the respondent fails to resolve the complaint satisfactorily within 30 days, the complainant can escalate the matter to the Pension Funds Adjudicator .

For more information on the complaints process, a complaint information checklist and downloadable forms, please visit https://www.pfa.org.za/complaints

# You are leaving your employer. What now?

You can access your savings only when you leave your employer, either on retirement, resignation, retrenchment, or dismissal. Retirement is covered in Chapter 8. In the other cases, you may opt to:

1. Leave your savings in the current fund as a paid-up benefit. There are no additional costs or tax implications. You can decide what you want to do with your savings at any later date.
2. Transfer your savings tax-free to:
   - A preservation fund
   - A retirement annuity fund
   - Your new employer's retirement fund
3. Cash out your benefit, which will be subject to tax.
4. Any combination of options 2 and 3.

| At retirement | Early withdrawal | Tax rate |
|---|---|---|
| R0 – R500,000 | R0 – R25,000 | 0% |
| R500,001 – R700,000 | R25,001 – R660,000 | 18% |
| R700,001 – R1,050,000 | R660,000 – R990,000 | 27% |
| +R1,050,000 | +R990,000 | 36% |

*Figure 5: Retirement and withdrawal lump sum tax tables*

*Preserving accumulated savings until retirement increases the tax benefit you will receive at retirement. These lump sum tax concessions are greatly reduced if you cash in early, as the table on the left illustrates (the additional tax on the first R1,050,000 would be R94,500).*

## Severance benefits on retrenchment

Special tax rates apply to **severance benefits**, based on the retirement lump sum tax table. To take advantage of this concession, your retrenchment must be recognised as such by the law. The portion of retrenchment benefit taken in cash from a fund will be subject to the retirement tax tables regardless of whether you are voluntarily retrenched or not.

Note that leave pay and pro-rata bonuses paid out at that time do not form part of a severance benefit and are subject to normal income tax.

To qualify for this special "severance" tax rate, the employer must pay you a lump sum as a result of your employment having been, amongst other things, terminated or lost, for example if:

- The employer stops (or intends to stop) trading; or
- The employer embarks on a general reduction in personnel (not applicable to restructuring of employees).

It is important to understand that this severance benefit is, for tax purposes, treated as a retirement lump sum payment. This has the following consequences:

- The employer must submit a tax directive application to Sars before the lump sum amount can be paid.
- The amount taxed in terms of the retirement lump sum tax table is reduced by previous lump sum benefits received.
- The lump sum benefit received reduces the lump sum tax benefit available to you at a subsequent withdrawal or at retirement from a retirement fund.

Although your severance benefit is taxed as a retirement fund lump sum, you cannot preserve your severance benefit in your employer's retirement fund, or in a preservation fund. However, you can invest your (after-tax) pay-out in a retirement annuity fund.

The retrenchment benefit refers to the withdrawal from your employer's retirement fund at retrenchment (as per the above criteria). Such a retrenchment benefit is also taxed per the retirement lump sum tax table, again subject to the cumulative value of any previous retirement fund withdrawals made.

**Important caveat:** You can transfer this benefit to a preservation fund, but if you do it loses its "identity" as a retrenchment benefit. Although you will be entitled to make one full or partial withdrawal from the preservation fund before retirement (earliest age 55), this will be taxed as a normal withdrawal from the preservation fund, per the withdrawal lump sum tax table: the first R25,000 is not

taxed, the balance to R660,000 is taxed at 18%, the balance to R990,000 at 27% and the remainder at 36%.

This is an important consideration! If you choose to preserve your retrenchment benefit with the intention of accessing this money before retirement, you lose out on the tax-free portion you could have enjoyed, either at the time of retrenchment or at retirement.

### Aggregation principle for lump-sum tax

Your fund administrator (or your employer, in case of a severance benefit) will request a tax directive from Sars to determine the tax that is to be deducted from your lump sum payment.

In calculating lump-sum tax, Sars considers previous lump sums you received since 1 October 2007 (in respect of retirement benefits) or 1 March 2009 (in respect of withdrawal benefits). Sars aggregates all these lump sum benefits and calculates the tax that would now be due on that aggregate amount (using either the withdrawal or a retirement lump sum, depending on the nature of the current lump sum). The tax that relates to previous lump sums is then deducted to arrive at the tax payable on the current lump sum.

How does this work out for you in practice? Assume that you receive a R1,5m lump sum on retirement, but some years ago, you took a R500,000 withdrawal when you changed jobs. Only R25,000 of that withdrawal was tax free, the rest would have been taxed at 18% (R85,500).

However, in determining the tax payable on the R1,5m retirement lump sum, Sars adds in the previous R500,000 you received, and calculates the retirement lump sum tax on R2m. That number is R472,500.

Sars then deducts the tax that would be due on the first R500,000 (paid out previously) per the retirement lump sum tax table. As no tax is due, you owe Sars R472,500.

The point is, by taking the R500,000 early withdrawal, you no longer qualify for the R500,000 tax-free portion at retirement.

Watch the video
**Why should you preserve your savings**

### Think preservation!

In its retirement reform initiatives, National Treasury wanted to make the preservation of retirement savings compulsory. This met with stiff resistance from the unions, and failed to pass, but it is now the default outcome when you change jobs: your savings stay invested with your incumbent fund administrator until you request a transfer, or a withdrawal.

Preservation, either by keeping your savings as a paid-up benefit with your old fund, or by transferring to your new employer's fund, or by transferring to a preservation or RA fund, is the sensible option when you change jobs.

Of all the retirement savings mistakes you can make, cashing in your benefits when you change jobs is surely the biggest. You not only lose your savings and pay more in tax, but the returns those savings would have generated over the subsequent years and decades. As you learnt earlier, it is the lost return that will undo your retirement plans. So avoid the temptation to cash in!

**Preservation funds, the basics**

A preservation fund enables members to preserve their accumulated retirement savings when they leave an employer. Preservation funds are designed for individual savers – the contract is between the individual and the fund provider.

The member cannot make contributions to a preservation fund, only transfers. Each transfer to a preservation fund is a separate event. The member may make one – full or partial – withdrawal from the preservation fund in respect of each transfer into that preservation fund before retirement. The balance can be accessed only at retirement. The earliest retirement age from a preservation fund is 55.

The importance of thinking hard before you cash in your retirement savings is difficult to over-emphasise. At the very least you should read this e-book before you make that decision: What to do with your retirement savings when changing jobs

**What to do with your retirement savings when you change jobs.**

*Download the e-book*

CHAPTER 8

# Retirement

Your normal retirement age, typically between age 60 and 65, is set by your employer. With their consent you may retire earlier or, indeed, continue working after your normal retirement date and delay taking your retirement investment.

Again, you have different options available to you when you retire from your employer:

1. You may defer your retirement from the fund i.e. leave your savings in the fund until you decide to retire from the fund and exercise an option. It might be that you have an income from another source, or just don't wish to draw from this pool of savings at the moment.
2. You may transfer your benefit to a preservation or retirement annuity fund in your own name, for similar reasons stated in point 1.
3. You may opt for a guaranteed or a living annuity, as explained below.
4. If you belong to a pension or provident fund, you may opt to cash out a portion of your benefit,up to a maximum of one-third.
   of your savings (if the fund value is above R247,500). If the fund value is less than R247,500 you can take the entire benefit as cash. Any portion taken in cash will be subject to tax, as per the retirement lump sum tax table in Chapter 7.
5. If you belong to a provident fund, you can also take your entire "vested" benefit (see section 1.3) as a cash lump sum, also subject to tax.

**Understanding which products will pay you a regular income in retirement**

Let's imagine for a moment you have successfully implemented your savings plan and reached your retirement goal. Congratulations! You now need to figure out what to do so that you can earn an income in retirement.

You can choose between two annuity products to pay you a regular income in retirement. The first is an insurance-type product called a guaranteed annuity and the second is an investment-type product called a living annuity.

### Guaranteed annuities:

The guaranteed annuity (GA) is an insurance product (policy). It provides you with a specified monthly pension for the rest of your life. You must purchase this annuity from a life assurance company. It effectively insures you against longevity risk (the risk that you outlive your savings) as well as investment risk (earning insufficient return on your capital to pay your pension).

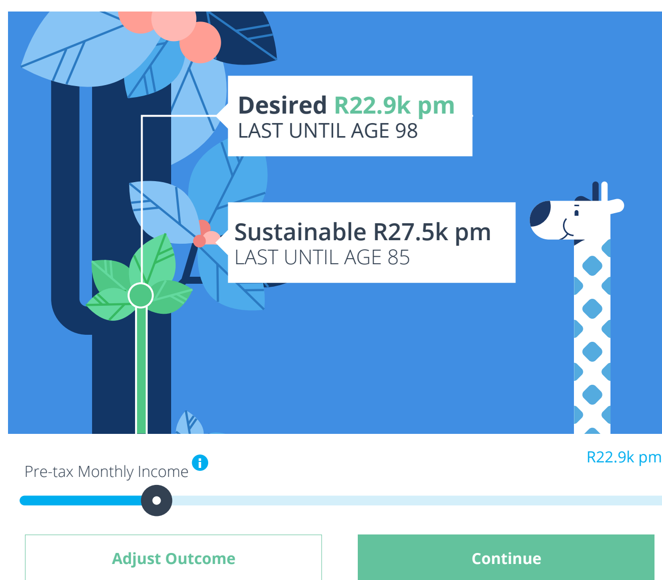
The full pension is paid until you die. The drawback is that your capital dies with you, and no money passes on to your heirs. That is your risk: you (or, rather, your heirs) forfeit your savings in the event that you die sooner than expected (unless a guarantee or life assurance is built into the contract).

### Living annuities:

A living annuity (LA) is more flexible than a guaranteed annuity and therefore gives you more control over your investments. A living annuity allows you to: choose the portfolio you want to invest in, choose the income you wish to draw every year (within limits), and leave an inheritance (the remainder of your capital) for your nominated beneficiaries when you pass away.

However, with this flexibility comes greater risk and responsibility as the onus is now on you to secure an adequate income for life.  If you make poor decisions, you may very well outlive your savings.

One of the big decisions you will have to make is what percentage of your total investment you will draw annually as an income. This is known as your draw-down rate. Legally this must be between 2,5% and 17,5% of your remaining capital each year.




The 10X Living Annuity calculator is designed to help retirees figure out:

1. How much money they will get per month
2. How long their investments will last

**Use the 10X Living Annuity Calculator**

*See how much income you can draw each month to last your retirement years.*

**How to claim your retirement fund benefit**

As discussed in Chapter 7, you can claim your retirement fund benefit when you leave your employer (through resignation, dismissal, retrenchment or retirement).

To claim your benefit, you must get a withdrawal notification form from your HR department, complete it and return with required supporting documents (proof of banking and ID) to your HR department. On the form you will indicate what you want to do with the money.

Your employer will counter-sign the form and forward it to the fund administrator for processing. The fund administrator will not accept a withdrawal form if this has not been signed by your former employer.

Your pay-out period will depend on your administrator, and your fund rules. It normally takes between 4 and 12 weeks, from the time your fully completed documents are received, or your final contribution (whichever is the later).

Note that the clock only starts ticking once the administrator has received your last contribution, or your instruction form, whichever is the later. If you resign near the beginning of the month, it will take almost a month before the administrator receives your final contribution. The pay-out process only starts at that point.

**Bargaining Council funds** may have a waiting period before your benefit is paid to you, in case you should join another company in the same industry (in which case your claim will not be paid out). You can withdraw from an industry fund only when you leave the industry.

Bargaining councils are established when employer and employee bodies (unions) in a particular industrial sector and geographical area agree to come together to engage in collective bargaining for a predefined group of employees. Once registered, a bargaining council has a range of powers and obligations.  Section 28 of the Labour Relations Act gives registered councils the power "to establish and administer pension, provident, medical aid, sick pay, holiday, unemployment and training schemes or funds or any similar schemes or funds for the benefit of one or more of the parties to the bargaining council or their members".

If you are a members of a bargaining council fund, for example the Metal Industries Provident Fund, and you change jobs within the metal industry (to another employer who is a party to or covered by the same bargaining agreement) your fund will not be paid out. To ensure that exiting members have not changed jobs within the industry, there is a waiting period before the payout is done, which will be specified in the fund rules.

CHAPTER 9

# The 10X Living Annuity

We have seen that to make your retirement savings last throughout your retirement, you need to minimise fees, maximise returns (in terms of your choice of portfolio and investment style), and draw a sustainable income. These features are incorporated into the tools and the design of the 10X Living Annuity, to help you make the most of your savings.

The 10X Living Annuity charges a maximum fee of 0.87% (including Vat), which reduces for amounts above R5m. There is no separate charge for advice or administration.

The 10X High Equity portfolio provides a well-diversified, high-growth asset mix, with exposure to both local and international equity markets. 10X uses index funds to achieve competitive returns.

The 10X Retirement Income Calculator will help you determine your sustainable income, given your savings, age, gender, expected drawdown terms and choice of portfolio.

| Investment Value | 10X fee pa (No VAT levied on LAs) |
|---|---|
| First R5 Million | 0.86% |
| Next R5 Million | 0.57% |
| Next R10 Million | 0.40% |

Remember that being a member of a corporate retirement savings fund does not absolve you of responsibility for ensuring that you can retire with dignity. The buck stops with you. No one else will take responsibility for setting you up for a decent retirement.

Check that your own retirement is on track by filling in your details on our retirement calculator.

Good luck on your retirement journey. For more tips, resources and motivation to help you on your way please join us on social media and visit our blog and website.

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**10X blog:** 10x.co.za/blog

**10X website:** 10x.co.za

## Glossary of key terms

**Active management** This is an investment style that aims to beat the return of a stated benchmark or index by under-weighting (or avoiding) some shares or asset classes and over-weighting others. Active investing costs more than index tracking without delivering superior results for the average investor.

**Bonds** represent debt obligation by governments, companies and other organisations, who issue these bonds to raise money. The issuers pay interest and repay the capital according to each bond's specific terms.

**Defensive assets** include cash and bonds. They are generally seen as less risky and are more likely to generate lower levels of return in the long run when compared to growth assets.

**Draw-down rate** In the context of living annuities, this represents the percentage of the outstanding capital at policy anniversary date that is paid to the living annuity holder.

**Equities** In the case of the e-book, equities refer to stocks (shares in a company) that are traded on a stock exchange (like the JSE). Equities deliver returns in the form of dividends declared by the company directors and changes in the share price. Equities deliver less predictable returns than bonds.

**Growth assets** include investments such as shares (equity) and property. They tend to carry higher levels of risk and have the potential to deliver higher returns over longer investment time frames.

**Guaranteed annuity (GA)** is an insurance product that you buy from a life assurance company. The life assurer guarantees to pay you a specified monthly pension for the rest of your life. This effectively insures you against longevity risk (the risk that you outlive your savings) as well as investment risk (using up your money too soon due to poor investment returns).

**Income replacement ratio** This is the fund member's gross income after retirement as a percentage of their gross income before retirement. Someone who earned R600,000 per year before retirement and receives an income of R450,000 after retirement will have an income replacement ratio of 75 percent.

**Index tracking** This refers to an investment style also known as 'passive investing'. Index funds track the performance of a pre-determined index, such as the FTSE/JSE All Share Index, by mirroring the composition (share make-up) of that index.

**Investment return** This is money returned on an investment, as a percentage of the original investment. Returns measured over periods longer than one year are typically expressed in annualised terms.

**Living annuity** A living annuity is a post-retirement investment vehicle that gives the holder the freedom to manage their own savings and (within limits), choose their annual income.

**Pension fund** This is an employer-sponsored retirement fund, not available to individuals saving in their own capacity. On retiring from the fund, members may take up to one third of the money as a cash lump sum (subject to tax). The remainder must be used to purchase an annuity, unless the entire fund balance is less than R247,500.

**Portfolio** refers to a grouping of assets such as shares, cash, bonds and property.

**Preservation fund** is a tax-efficient investment vehicle designed for individuals who wish to invest the proceeds of their company-sponsored retirement plan when they leave a their employer instead of cashing in their savings.

**Provident fund** This is an employer-sponsored retirement fund and not available to individuals saving in their own capacity.  On retiring from the fund, members may take up to one third of the money as a cash lump sum (subject to tax). The remainder must be used to purchase an annuity, unless the entire fund balance is less than R247,500. Vested benefits are excluded from these annuitisation requirements.

**Retirement annuity (RA)** is a pension fund for individuals, which is generally set up with an asset manager. Retirement annuities are tax efficient because contributions are tax deductible. When the investor retires, he or she must use at least two-thirds of their fund balance to buy either a guaranteed annuity or a living annuity if the balance exceeds R247,500.

**Risk benefits** are insurance products that pay out in certain scenarios, for example life cover for the family/beneficiaries should the member die, disability cover should the member be unable to work, funeral cover for burial expenses for the member and, sometimes, their family.

**Standalone fund** is a corporate retirement savings fund that serves just one employer.

**Umbrella fund** is a corporate retirement savings fund that combines members of staff of more than one employer under one legal structure.

**Vested benefit** refers to the provident fund member's balance at 1 March 2021, and all subsequent investment returns thereon. Contributions made after 1 March 2021 (and returns thereon) are not part of the vested benefit, except for members who are 55 or older on 1 March 2021. These members can still opt to take their entire benefit as a lump sum at retirement, except for contributions (and returns thereon) made to a new employer's provident fund thereafter.

**List of tools and resources found in this e-book**

Calculators: https://www.10x.co.za/calculators

10X Blog: https://www.10x.co.za/blog

Tax tips: https://www.10x.co.za/retirement-annuity-and-tax

Preservation e-book: https://campaign.10x.co.za/preservation-fund/guide-to-moving-jobs

Approaching retirement e-book: https://campaign.10x.co.za/the-10x-retirement-guide

LA eBook: https://resources.10x.co.za/living-annuity/making-your-savings-last-in-retirement?

Educational Videos: https://www.youtube.com/playlist?list=PL7R6c273K31AK1Yd57cAERTU2oLvbEjgC

**10X Investments manages more than R10bn in assets for industry-leading clients**

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