Moneyweb - Reader Question
Are my Pension plans wise?

Moneyweb is South Africa's leading online source of investment information.

Since February, Michael Haldane has had a *Moneyweb "Click an Advisor" profile*. Often Moneyweb receives personal finance and financial planning questions from its readers. Recently we were asked to answer the following question from a Moneyweb reader:

"I would like advice if I take out my pension to pay my outstanding bond of the 1/3 and invest my 2/3 in living annuity with a draw down rate of 2.5%. I am 62 and am working on contract till end of this year. I will then be able to save my bond payments and when retired fully have some savings capital for a rainy day. My 2/3 living annuity I will change to annuity for life when fully retired. My mom side life expectancy is 85 so therefore change to income for life. I would like to know if there is anything else you can advise me on? My pension amount is around 900 000 and my bond R200 000. I intend to put my bond payments into a tax free savings. I want to invest my 2/3 into living annuity with lowest draw down rate of 2.5% for now while working. I will convert it into income for life once fully retired. Is there any costs for transferring this?"

Below was our response:

With regards to your plan we would agree with your decision to want to settle your bond, in our opinion it's important to not have any debt worries when you officially retire.

With the plan you have laid out there are just a few key points that we would like to highlight as important and that you may not have taken into consideration:

1. Retiring and Retirement age:

When retiring from a pension or retirement savings it's important to know what the actual product is you are retiring from. The reason this is important is if you are retiring from a company Pension or Provident fund the company fund rules will advise what the retirement age is for employees. If the product you are retiring from is a Retirement Annuity or a Preservation fund you can retire from age 55 where you then can convert these investments into a Life or Living annuity to draw an income for retirement. Please also note a Pension fund and a Provident fund are different and have completely different rules at retirement so the break down you have provided is going by the rules of a pension fund.

2. 1/3rd allowable cash portion:

The maximum allowable cash portion you can withdraw is 1/3rd and the remaining 2/3rd are required to go into either a life or living annuity. The cash portion that you withdraw please note is taxable, but you can draw up to R 500 000 tax free Please be advised that any previous retirement withdraws be it pre or post retirement will affect the tax-free portion amount at retirement. When SARS receives the notification of the withdraw please also be advised that any taxes owed to SARS will be deducted from the cash portion before its paid over.

If you are just drawing the cash value of R 200 000 which is your outstanding bond amount, this should not be taxable as it is below the tax-free limit of R 500 000 and talking into account you have not drawn previously from a retirement saving and you have not received any severance package.

3. Living Annuity vs Life Annuity:

You have mentioned that you would like to convert your Living Annuity to a Life Annuity when you officially retire. This option would be entirely up to you and would like to highlight some of the important difference that we consider assisting clients in making an informed decision:

Living annuity:

- Can draw an income of between 2.5% and 17.5% per annum (income change can only be done on anniversary date of the investment).
- Can nominate beneficiaries so on your death this will be paid to you beneficiaries and does not form part of your estate.
- Can select which funds you would like to be invested in and can have offshore exposure as there are no regulation limits attached.
- From the providers we have dealt with there has been no fees charged to transfer to a Life Annuity, but this may also just depend on the investment company.

Life annuity:

- The investment company will determine the income you will receive.
- You are unable to select beneficiaries. This option may be a disadvantage if you are to pass away early in retirement.
- No changes can be actioned in a Life Annuity once it is initiated (you cannot make changes in terms of the income you are receiving or convert it back to a living annuity).
- You are able to add guarantees onto these investments, but this then can come at an extra cost and so potentially decreasing the income you will receive.

Life Annuities have changed recently with adding on certain benefits, but it would be advisable that when the time comes, and should you wish to convert it would be advisable to discuss this with advisor who can analyse the differences and advise accordingly to your needs and requirements.

4. Tax free Savings:

Investing your bond payments into the tax-free saving is a great idea. Please just be aware on the limits and restrictions in terms of contributions made to these investments.

The limits are:

- Maximum of R 33 000 lump sum per year.
- Maximum debit order of R 2 750
- Life time limit R 500 000

Please ensure that when investing the bond payments into a TFSA, it does not exceed the maximum debit order value (R2750) as SARS will charge a penalty.

In terms of additional advice, should you not require the income you are drawing from your Living Annuity while you are still working, you could consider investing it into a well-managed Unit Trust Investment. This investment is a liquid type of investment so when you retire, and should you require additional funds you are able to make a regular withdraw or you are able to withdraw the full value invested.

There are many things to consider and we do recommend that you contact a financial advisor who will comply a proper financial planning analysis and provide you with the most appropriate solution to meet your requirements.

Disclaimer: Please note that the above has been drafted purely on the scenario provided by this reader and our recommendations herein are based on the circumstances provided and should not be construed as complete and comprehensive investment planning advice

Contact Us

Global & Local
The Investment & Retirement Specialists

175 Barry Hertzog Avenue, Emmarentia, Johannesburg 2195

T | +27 11 486 2500

info@globallocal.co.za
globallocal.co.za