APRIL / JUNE 2017 VOL 20 No 2

Pensions World SOUTH AFRICA

- Key trends shaping the employee benefits landscape in 2017
- Seven reasons to reject National Treasury's revised default portfolio regulations
- Retirement matters: WHAT is your number?
- Sound investment decision-making requires a long-term focus

www.lexisnexis.co.za

LexisNexis®

Retirement matters: WHAT is your number?

We are constantly measuring our wealth and health. The number of steps we take per day, our average heart rate per session, our smart shopper points, rewards, e-bucks, share portfolios . . . name it and we measure it.

But how often do we look at or know whether we are on track for arguably one of the most important events of our lives, that event known as "Retirement"? And more importantly – do we know what to measure or even how to get there?

Confirmed in the Sanlam BENCHMARK Survey 2017, the two most important questions and burning issues in the financial planning process are:

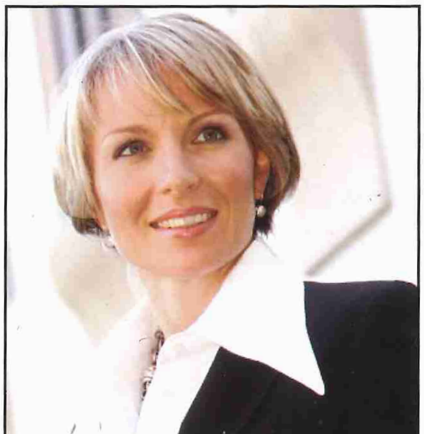
- Exactly how much should I retire with? What is the final amount?
- How much must I save (monthly/annually) to retire comfortably?

Why are people so confused? In the Sanlam BENCHMARK Survey 2017, 100% of funds indicated that their funds have a stated target pension (expressed as a NRR or PPR) that trustees actively work towards. Let's start by reminding ourselves what a NRR is. NRR is a Net Replacement Ratio and it is the percentage of a member's pre-retirement income that is paid out by a pension plan upon retirement, divided by his pre-retirement salary. It is a common measurement that can be used to determine the effectiveness of your pension plan. But is this measure effective if 40% of funds in the Sanlam BENCHMARK Survey 2017 believe that NRR is not a suitable measure for determining whether a member is on track for retirement? The main reasons being that members do not understand the measure and the fact that there are too many variables and assumptions used in the calculation of the ratio. One of the biggest areas of concern is that most of the funds define pre-retirement salary as "pensionable remuneration", also referred to as PEAR, which can be any percentage and is normally less than 100%.

It could be argued, therefore, that NRR is not a suitable measure for determining whether an individual is on track for retirement. **So what should your number be?**

An easy number/measure for members to understand the exact amount that should be saved, is to express your retirement savings as a multiple of your current salary at different points in your life:

The question is: What multiple of current salary should a member save, assuming a retirement age of 65 years, with the following assumptions:



Karen Wentzel
Head of Annuities
Sanlam Employee Benefits, FIA, FASSA, CFP®

- A member saves 15% per year of annual salary (including the annual bonus/13th cheque);
- investment returns of 10% per year;
- salary increases of 6.5% per year;
- in the event of a married couple, both members contribute towards retirement savings.

Based on the assumptions above and a goal that a member should have a multiple of 15 times his/her final salary saved at retirement, the following table sets out some goalposts along the road to retirement:

Years worked	Multiple of current salary saved
5	1.2
10	2.3
15	3.7
20	5.3
25	7.2
30	9.4
35	12.0
40	15.0

And remember that 15 is more than just a number. Currently for each R1 million that a 65 year old member saves, a male will receive a monthly pension of around R 6 000 per month and a female (because of the longer life expectancy) will receive around R 5 400 per month, growing with inflation every year. So to invest in an inflation-linked annuity at the age of 65, a member would need to have saved 15 times their final salary by age 65 to afford to buy an annuity that will replace their salary.

What if you haven't started saving at age 25?

For those members who have not yet started saving by the age of 25, saving only 15% per year will unfortunately not lead to a multiple of 15 times your final salary at retirement. The late starters will need to save much more every month. The following table sets out the percentage of salary needed to be saved if you are starting to save for the first time at later ages:

Start saving at age	Percentage of salary needed to save
25	15%
35	24%
45	43%
50	60%

In what products should you save for retirement?

For the current group of Generation Z (millennials) who don't have any idea of what a Defined Benefit regime is, who don't know anything about net replacement ratios (NRRs) and who are moving on to a new mind-set of flexibility and choice, they should consider a combination of products. You may consider saving not only in a traditional pension or provident fund, but also supplement your retirement savings with retirement annuities, a tax-free savings account, retail government bonds or an ordinary unit trust, which will give you (and especially Generation Z) more flexibility in terms of investment choice and accessibility to their investment.

Other methods to boost retirement investment

1. The first golden rule is to never cash out your retirement savings when changing jobs. This is still the biggest mistake that members make during their lives. Do not be tempted to access your money to pay off debt, buy consumables or upgrade your lifestyle. Do not even cash in your allowable third of your pension fund or retirement annuity, as the long-term need for a higher monthly pension is much more valued than the short-term luxuries that you are going to buy with your money.

2. Retirement savings should be as important a financial priority as a well-deserved holiday, rather than just a nice-to-have budget item. Know exactly what percentage of your monthly salary and annual bonus you have to save, and put in place an automatic debit order to keep you from the temptation of spending your salary on consumables.

3. Invest wisely, tax efficiently and know exactly what you are paying in fees. Seek advice from a certified financial advisor and be sure to invest according to your investment time horizon. Investing for retirement is a very long-term goal, so make sure you are sufficiently invested in aggressive assets (such as equities or listed property) to give you inflating-beating investment returns of at least 10% per annum after fees.

If you don't have a goal, there is nothing to aim for. Make sure that you know what your "final number" is and make the best effort to stick to the plan to achieve it.

These rules of thumb discussed may not account for all personal circumstances. A sudden spike in your salary may mess up your multiples for a year or two, but be sure to have your retirement savings goalposts in place. Allocate any extra cash to retirement and not to a luxurious lifestyle. This is the best possible gift you can give yourself in your golden years. ❐