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See that you're saving enough for an adequate pension

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National Savings Month brings increased awareness of the benefits of saving and may prod you into doing a valuable check on whether you are saving enough to provide a reasonable pension in retirement.

Ideally, you should get a thorough analysis from an independent financial adviser who will use software and assumptions to project just how much you will have by the time you get to retirement age, what kind of income these savings will provide, and how long that income will last.

A good adviser will even make provision for irregular expenses in retirement, such as replacing your vehicle or having a major medical procedure.

But for a rough guide that may spur you into doing a more detailed analysis, you can use a rule of thumb to check if you are on track to reaching your retirement goal.

Recently, Allan Gray and Sanlam set out rules of thumb on how much you should have in your pension, provident or retirement annuity fund or funds to generate a reasonable pension.

Sanlam, in its Benchmark retirement fund survey, suggests that you target savings equal to 15 times your final annual salary (before tax) in the year you retire, to provide a pension equal to 75% of the salary you are earning before retirement.

Underlying assumptions

At a recent presentation to investors, Allan Gray said its rule of thumb is higher — 17 times your final annual salary (before tax) to give you an income equal to about 75% of your salary at the retirement age of 65.

The different multiples are a result of different underlying assumptions, particularly about the cost of providing a pension.

Allan Gray deals mostly with investors who in retirement draw a pension from investments in a living annuity and take on the risk that the investments will fund the required income.

Sanlam's rule of thumb assumes that you will use an inflation-linked guaranteed annuity to provide a pension. This guarantees that you will receive a pension that increases with inflation for life.

Sanlam Employee Benefits head of annuities Karen Wentzel says that for every R1-million you have saved at retirement, a man can currently get a pension of R6 000 a month, increasing each year with inflation, and a woman can get R5 400.

The difference is because of the longer life expectancy of women.

Sanlam says you can check whether you are on track to have 15 times your final salary at retirement by ensuring you have saved a certain multiple of your salary after every five years you have worked.

If you are not on track, you have only three options:

- Save more;
- Retire later; or
- Live on less than 75% of your final salary when you retire.

Targeting a pension equal to 75% of your final salary — a standard for retirement funds — is called your net replacement ratio. It is lower than your final salary because you are expected to have reduced expenses.

The statement you get from your fund may even inform you what percentage of your current salary your savings will provide as a pension, assuming you continue to save at that level until retirement and earn the average returns the fund assumes you will enjoy.

Your working life

The assumptions are that:

- You and your employer — if you belong to an employer-sponsored pension fund — contribute 15% of your income a month;
- You earn a particular return on your savings in your fund — Sanlam, for example, uses 10% and Allan Gray 11%;
- You do not withdraw your money throughout your working life; and
- You contribute to the fund for 40 years — your entire working life if you start working at age 25 and work until age 65.

But people's lives often are not that perfect.

- Many of us start working or saving later, stop working for a few years or retire early, and therefore do not contribute for 40 years;
- Many of us do not contribute as much as 15% of our income;
- Returns may be higher or lower than those the rule of thumb assumes.
- Many of us need to or are tempted to withdraw our savings when we change jobs — one sure way of taking your retirement savings journey off track.

Scary numbers

Sanlam's Benchmark survey includes some scary numbers on how much you need to increase your contributions if you start saving late in your working life in order to provide enough for a pension equal to 75% of your final salary at 65.

For example, if you begin saving only at the age of 35, you will need to save 24% of your salary to have enough to live on once you stop working.

If you begin saving at the age of 50, you will need to put away 60% of your salary, which is likely to be impossible for most people.

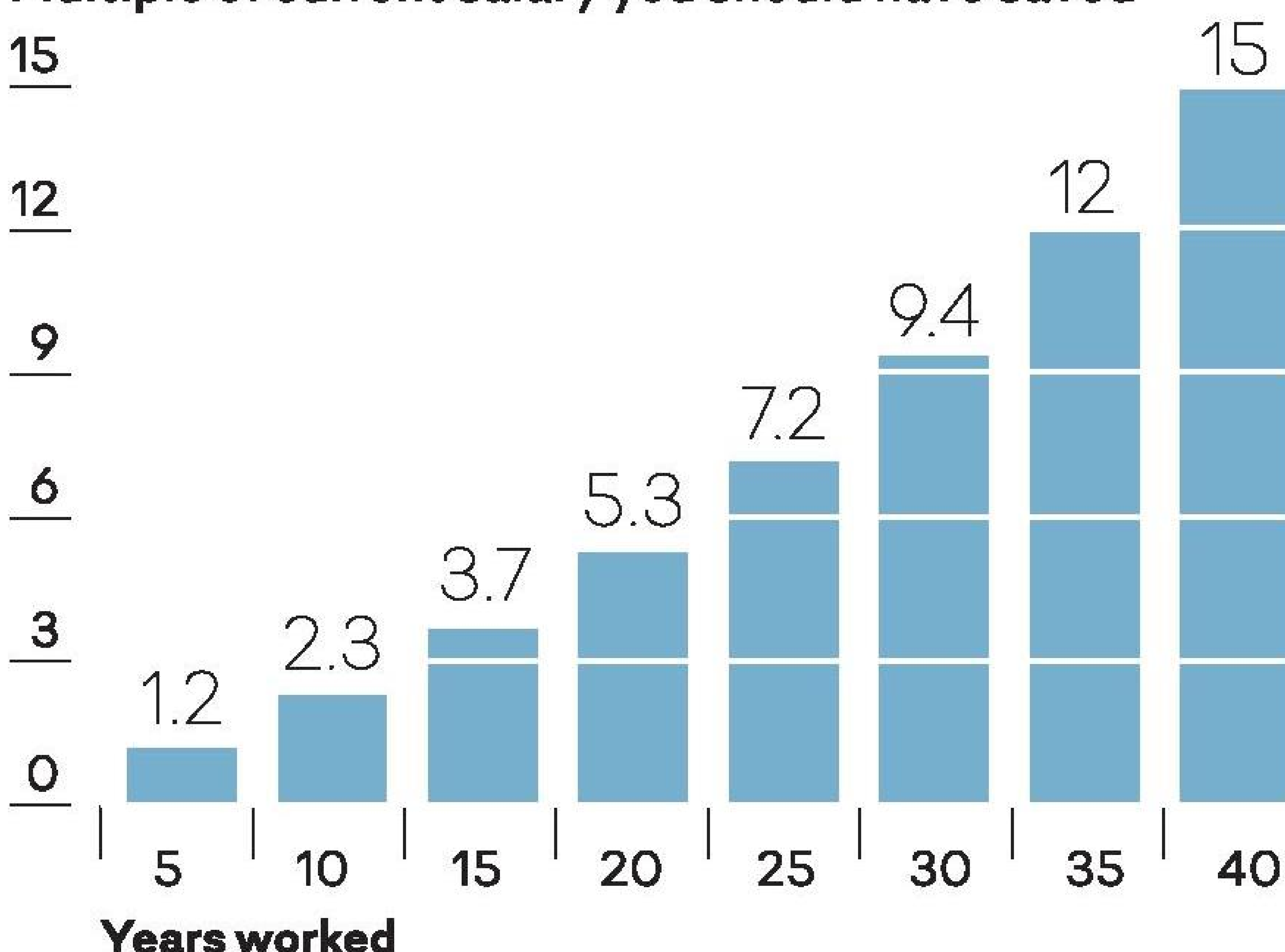
This means that if you are 50 and haven't started saving, you will probably have to work longer or settle for less than 75% of your final salary as a pension.

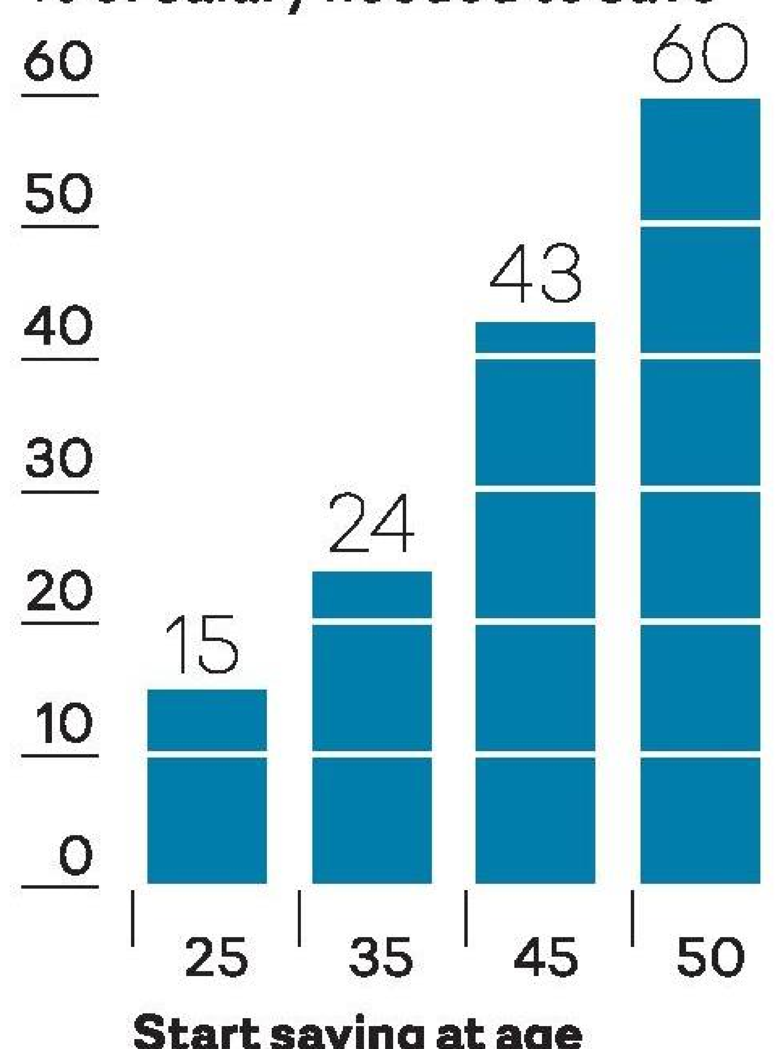
Rules of thumb are great as a rough guide, but you may need to save more or less money depending on your circumstances.

For example, you may need more if the returns you have earned to date have been poor or you receive a large increase, especially late in your career, and want your retirement savings to provide a correspondingly higher pension.

On the other hand, if you are in poor health, your retirement needs could be lower.

How to keep your retirement savings on track





Graphic: Ruby-Gay Martin Source: Sanlam Employee Benefits