The gift of not being dependent

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As we get older, we start to think about what we'll be leaving as an inheritance to our children. An inheritance can give them that financial boost at a time of their lives when they need it most. However, the current reality is that the gift of merely 'not being dependent' after retirement is a much more realistic goal.

As part of this year's BENCHMARK survey, 16 independent employee benefits consultants were asked about Net Replacement Ratio (NRR) as a measure of determining whether or not an individual is on track for retirement. The idea behind a NRR is to project, based on various factors and assumptions, what portion of an individual's salary he/she will be able to "replace" with their retirement savings at retirement. The industry target NRR is 75%, since certain expenses will cease after retirement, such as having to save for retirement, having to travel to work, etc. A targeted NRR of 75% suggests that your goal should be to replace every R10 000 you earned before retirement with R7 500 after retirement. Think about your personal circumstances; would you be able to retire on a monthly income of 75% of your current salary?

The jury is still out on whether a NRR is a suitable measure for projecting members' retirement outcomes. The major arguments against this measure relate to other savings provisions that might not be taken into account. However, that is a debate for another day. If your retirement fund is the primary vehicle used to save for retirement, your NRR should give you a very good indication of the income you'll be able to retire on.

The consultants that were surveyed considered a NRR of 50% - 60% a more realistic goal. Thus a NRR of 75% would be good however, the reality is that this is not easily obtainable. The concerning part though is that consultants believe that members of retirement funds are destined for a NRR of 15% - 40%, based on their current actions. Thus, based on their experience, consultants believe that the majority of retirement fund members will only be able to retire on somewhere between R1 500 and R4 000 for every R10 000 they earned before retirement.

From the research it is clear that the bulk of retirement fund members are not making sufficient provision for retirement. Employers believe that on average only 18% of their retirees are able to maintain their current standard of living in retirement. What will the other 82% of retirees do? Scaled down on their standard of living or become financially dependent?

What now?

What options are available to someone who has not made sufficient provision for retirement? There are various options available to improve retirement outcomes such as preserving withdrawal benefits, delaying retirement, etc. The one that will be focussed on in particular is increasing contributions towards a retirement fund. If someone is not already contributing the maximum tax-deductible amount towards a retirement fund, that is 27.5% of remuneration to a maximum of R350 000 annual contributions, they should strongly consider this option.

Did you know that if a person (paying tax at a marginal rate of 26%) makes a constant monthly contribution towards a retirement fund, and those contributions grow at 9% pa, it is possible after 5 years to have an investment amount that is the equivalent to earning 20% on a product that is not tax deductible?

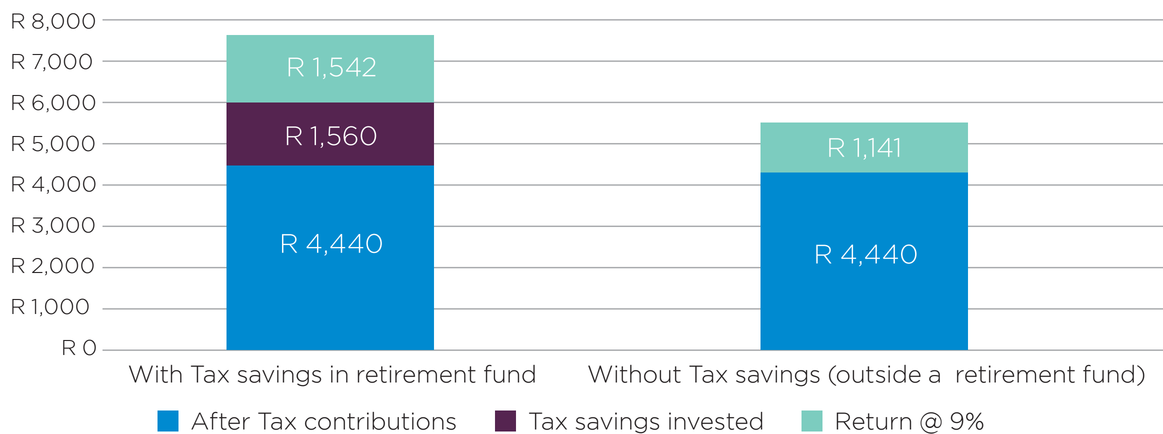
To illustrate the point, certain assumptions have to be made:

- An environment where the average return is about 3% above inflation of say 6% (that is, an environment where the average investor earns 9% on savings).
- An investor for whom the marginal tax rate is 26% (that is, for every additional R100 this investor earns, R26 tax is deducted).
- An investor that is not contributing the maximum tax-deductible amount towards a retirement fund (that is, 27.5% of the greater remuneration for PAYE purposes or taxable income up to a maximum of R350 000).
- Reduced taxes, resulting from contributions towards a retirement fund, will be immediate.

If R100 is contributed towards a retirement fund, that R100 is no longer taxable and will be invested in full towards your retirement. However, if that R100 is not contributed towards a retirement fund and used to increase your take-home pay, it will be taxable at the marginal rate (26% in this example) which means that take-home pay will only increase by R74. Put simply, if it is invested in an alternative savings product after tax has been deducted, only R74 will be invested.

Therefore, if R100 is invested monthly at a rate of 9% pa (compounded monthly), the value in five years' time would be R7 542.

Comparison between investing in a retirement fund vs. non-tax deductable product over 5 years



To have R7 542 after five years with a monthly investment of R74, that investment will have to earn approximately 20% p.a.

Do you know of any product that will grow at 20% pa for five years in an environment where the average investor can only earn 9%?

Can you afford to make additional monthly contribution towards your retirement fund? I believe that this is the wrong question. The question should be: **"Can you afford not to make an additional contribution towards your retirement fund?"** Or "Can your children afford you not to make an additional contribution towards your retirement fund?"