11 reasons to invest in a retirement annuity (RA)

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Retirement annuities remain a popular investment vehicle with many South Africans for good reason.

“A retirement annuity is a long-term savings vehicle aimed primarily at people providing for their retirement. To prevent people from relying on the government to provide for them in their old age, there are legal restrictions on withdrawing funds from RAs. But there are also tax advantages to offset the lack of access to funds,” says Rowan Burger, Head of Investment Strategy at Liberty Retail SA. “Tax benefits are just one of the ten reasons that you should consider a retirement annuity”:

1. Preparing for retirement

An RA helps you to build up capital during your working years so that you have enough income to enjoy the same standard of living when you retire.

2. Ensuring sufficient savings

The rule of thumb is that if you save 15% of your salary over 35 years, you will receive 75% of your salary as a pension, given reasonable returns.

The problem is that your pensionable salary (the amount that your 15% pension contributions are calculated on) is usually about only 70% of your total salary benefits which include, for example, a bonus, car allowance, medical aid and other benefits. This means that you could retire on 75% of 70% of your salary!

It is important to save for these ‘extras’ as they do help us meet our current living expenses.

For example: if your monthly package is R20000, you would need to retire on the equivalent of R15000 (75%). But your pensionable salary is significantly less at R10500 (75% X R20 000 X 70%).

By investing 15% of your non-pensionable income into a retirement annuity, you can make up the savings gap. A starting point is to always invest 15% of your bonus tax-free into an RA.

3. Tax benefits

You can invest up to 15% of your total income (less any amount that may be used for other pension fund contributions) tax-free. Not only can you invest with before-tax money, but you do not have to pay capital gains tax or income tax on your retirement investment.

Your investment growth will be higher over the long-term as the growth remains in the policy and will usually offer you a better after-tax return than other types of saving.

When you retire, you can take one-third of your investment as a lump sum. Of this the first R300 000 is tax-free with a favourable tax-rate for higher amounts. The remaining two-thirds of the retirement annuity is invested in an annuity to provide you with income during your retirement.

4. The power of compound growth

Because you are saving over a long period, your money starts to work for you as you earn interest on the interest. If you save consistently over 30 years, less than 35 cents of each Rand of income you receive will come from the contribution you paid in. The balance will come from the growth earned on your contributions and savings in retirement.

5. Disciplined savings

You do not have access to your retirement annuity savings until the age of 55. This may sound like a disadvantage but it removes the temptation to dip into or deplete your savings while you are working. A 25-year old needs about 15% of his/her salary through their working lifetime to secure an adequate pension. If they cashed in their savings at 35, they would need to save 25% to get to the same benefit. Starting from a zero base at 45 requires an incredible 47%! The only remedy here would be to retire later.

6. Long-term growth

As markets fluctuate during different economic cycles, your consistent contributions will average out this variability. You also draw your pension over a (hopefully) prolonged period. Therefore, what happens in a turbulent investment market is of less concern to you. The average investment manager has delivered returns which are 11% above inflation over the last 5 years, despite the recent global economic crisis.

7. Supporting your dependants

If your dependents are left to cope without you, your retirement annuity can provide a source of income for those you leave behind, especially if you buy death cover on your policy. The cash benefit from a retirement annuity falls outside your estate, so if you die and are insolvent, your benefit is paid to your family rather than your creditors.

8. Room to grow your savings

While pension funds generally require a contribution that is a fixed percentage of your salary, RAs offer more flexibility. Many people recognise the need to save but struggle in the short term to meet financial obligations.

A retirement annuity allows you to slowly increase your contributions over time. For example, you could take 3% from each of your next five years' salary increases to get to the full 15% contribution. You can also invest a portion of your bonus each year as a lump sum contribution.

9. Diversified portfolio

You have access to different asset classes in a retirement annuity. You can invest 20% of your savings offshore without needing Reserve Bank clearance. You can also invest in other types of portfolios through your RA, such as direct property, private equity and fund of funds.

10. Freedom of choice

With many retirement annuities, you can choose your underlying investment giving you some flexibility in how your contributions are invested and therefore how they grow.

11. Contact Dave on 086-136 0305 to sort out your RA or send a reply email