Time is against you if you don't plan for what happens in retirement
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 By Bruce Cameron

Too many people, retirement funds and financial advisers focus on building wealth before retirement, paying little or no attention to what should happen in retirement. This was the basis of a presentation by actuary Karen de Kock, the head of annuities at Sanlam Employee Benefits, at the recent Sanlam Employee Benefits retirement survey seminar.

De Kock says a lack of attention to what happens in retirement is extremely dangerous, because the harsh reality is that people are living longer. It is absolutely essential that members of retirement funds are assisted to "not outlive their cash", she says.

Interestingly, only about 40 percent of people who start work at the age of 20 will actually draw on their retirement savings. There are many reasons for this, from motor accidents to the high incidence of HIV/Aids and tuberculosis in South Africa.

But those of us who do make it to 60 have a fairly good chance of living into our 80s, particularly if we are middle- to high-income earners. This is because the wealthy normally have better lifestyles and can afford proper medical care.

So while you may think, when you are younger, that because you have less than a 50:50 chance of reaching retirement you do not need to concentrate on saving for retirement, you should ask yourself what would happen if you lived to 100. If you did, you would work and save for 40 years and then spend your savings for 40 years. Kind of scary!

And do not think that 100 is an outside chance. It is not, particularly if you make it to 60.

At the seminar, De Kock pointed out that someone born in Europe between 1950 and 1955 could expect, on average, to live for 66 years, against the 38 years for someone born in Africa.

If you were born in Africa between 1995 and 2000 your life expectancy rises to 54, and for a European it goes to 73. Now remember, these are averages, so a fair number of us are going to make it well beyond the average. (South Africa's population has a first world and a third world component, so a lot of people in this country will not reach retirement. The life expectancy of those people in South Africa who reach retirement can be compared to those in first world countries, such as those in Europe.)

So not only is it important to save and invest correctly for retirement, but it is equally important to structure your finances correctly in retirement.

And herein lies the problem that was highlighted by De Kock. She says currently there is a tendency for short-term financial planning in retirement versus the reality of living longer. And on top of this there is a lack of knowledge about planning for retirement during our working years.

More sobering truths
Other scary facts revealed in the Sanlam retirement survey are that, despite the improvement in the quantity and regularity of information provided by retirement funds to their members, the reality is that:

- About 33 percent of senior employees and 88 percent of other employees do not have much of a clue about what their funds are telling them. I am not surprised by this finding.

I am constantly shocked by how many people do not know that a retirement annuity (RA) is a tax-incentivised vehicle to save for retirement, whereas an annuity is any regular payment you will receive from a lump sum investment, including a pension. Annuity and RA are often used incorrectly as interchangeable terms.

- Only 14 percent of retirement fund trustees and employers want to be involved with your financial affairs after you retire. The consequence is that they are not particularly concerned about what you do with your retirement savings in retirement - feast or starve.

De Kock says the issue of what happens to you financially in retirement should be of concern to both you and your fund trustees.

"Why focus on just optimising retirement savings if it all goes wrong post retirement?" she asks. This, De Kock correctly says, is a case of short-term thinking versus longer-term living.

Other risks
Longevity is not the only risk to a financially secure retirement. The other risks are inflation, investment markets (as highlighted by the recent market meltdown) and even the type of pension product you select. De Kock gave a few examples.

Say you retired with R2 million that generated a non-guaranteed monthly income of R9 670. If the value of your R2 million dropped by 15 percent in a market crash, your pension would fall to R8 215 a month.

If the R2 million took a 30-percent knock (something that did not seem realistic only two years ago but is now frighteningly realistic), your pension would drop to R6 760 a month.

Then De Kock did something even more scary: she compared the pension received with what could have been your final pay cheque .

Pensions are often defined in terms of an income replacement ratio (IRR) of your final salary. The IRR is simply the percentage of your final salary you will receive as a pension.

So if your final monthly pay cheque was R20 000 at a pension of R9 670, your IRR would be 48 percent. If your pension reduces to R8 215 because of a 15-percent market knock, your IRR would be 41 percent. And in the 30-percent scenario, your IRR falls to 34 percent.

Then there is the effect of longevity in retirement. De Kock assumed in her example that you could have foreknowledge of when you would die and that investment markets would be stable, allowing for inflation-linked pension increases.

If your R2 million had to last until age 70, you would receive an IRR of 52 percent. Live to age 80 and the IRR becomes 37 percent; if you live to 90, the IRR drops to 33 percent for the entire period of your retirement.

By now, I think the point has been well made. It is for these reasons that you need to understand exactly what to do with your money in retirement, the rate at which you spend it and why you have to be very careful about how you invest it.

The easiest solution is to buy a guaranteed pension from a life assurance company. But if you do, what type of annuity should you buy? A level annuity that will give you a good starting point? I think not, because if you do live for a while, inflation will ravage the buying power of your pension.

I am not going to detail the annuity options you have at retirement. The point is that sound financial planning is as essential after retirement as it is before retirement. This includes choosing the right, cost-effective products that will give you a real after-inflation return at the lowest possible risk in your retirement years.

Incidentally, the Sanlam retirement survey is an outstanding piece of work. You can have a closer look at it by going to www.sanlambenchmark.co.za

- *Bruce Cameron is the author of* Retire Right *(Zebra Press), which is now in its second edition.*