UCTRF

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Retirement Options
Guide

June 2018

UNIVERSITY OF CAPE TOWN
IYUNIVESITHI YASEKAPA • UNIVERSITEIT VAN KAAPSTAD

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Welcome

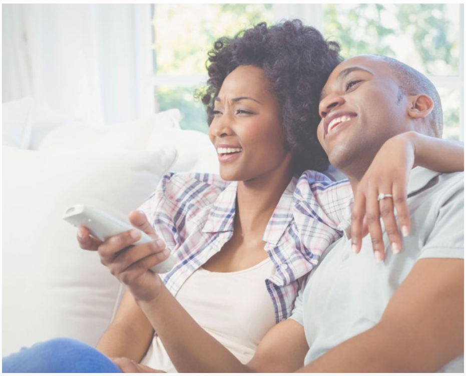
Dear Member

When you retire there are a few difficult choices to be made. Probably the most important and permanent will be which annuity (pension) to choose. ***Please remember that sometimes your decision is final and cannot be changed once you are on retirement, so choose carefully and make sure you understand your choice.***

In this booklet you will find an overview of some of the options available to you (there is a comparison of the different options at the end).

Please note

These options are the pension plans generally available in the market, but that the plan most suited to you will be determined by your specific circumstances. This document cannot be regarded as financial advice and you should seek such advice from a FAIS-licensed advisor before deciding on a course of action. The purpose of this note is to provide you with information to enable you to interact appropriately with your financial advisor.



Options available at retirement

When retiring from employment at UCT, you can choose to either retire from the UCTRF (i.e. take your retirement benefit at that point) or to defer retirement from the UCTRF (i.e. only take your retirement benefit at a later stage).

If you opt to defer retirement from the UCTRF you will become a 'Phased Retiree'. In this case your money will remain invested in the UCTRF until such a time that you choose to retire from the UCTRF, at which point the retirement benefit will be payable. As a "Phased Retiree" you will not be able to make further contributions to the UCTRF, and you will not be covered for any of the risk benefits. You will still be able to make investment choices and switch investments. If you should pass away while being a Phased Retiree, the provisions of Section 37C of the Pension Funds Act will be applied. Please remember that if you become a Phased Retiree, you must keep the UCTRF informed of your contact details so that any communication can reach you. Retirement from the UCTRF still requires two full calendar months' notice.

When you choose to retire from the UCTRF (whether this be at the point of retirement from UCT, or when you choose to retire if you are a Phased Retiree), you can take all or part of the retirement benefit as a cash lump sum. Any part that is not taken as a cash lump sum must be taken as an annuity (pension).

Such as an annuity may be in the form of:

- a Living Annuity from the UCTRF, or
- a Life Annuity and/or a Living Annuity from an external provider.

The tax and other implications of these options are discussed in this note. It is important to understand the differences clearly in order to make an informed decision at retirement in terms of how much cash to take as a lump sum as well as which type of annuity is best for you.

Tax implications of the options

What if I take a lump sum? Will I pay tax?

An amount of up to R500 000 received by way of lump sums, including any bonus or leave gratuity, etc. is free of tax, to the extent that the R500 000 has not yet been used (e.g. at a previous retrenchment). Legislation allows for lump sum amounts paid on retrenchment to be taxed according to the same table as used for retirement benefits. As these amounts from the employer and from the UCTRF will be aggregated, the exemption to be enjoyed will be R500 000 over your lifetime in respect of all such lump sums received.

Tax relief is only calculated by SARS at the end of each tax year . This will also only be considered if no other tax-free options were already afforded to the retiree.

In addition, when you retire, you will not pay tax on the original amount of your AIPF Transfer Value (if applicable), assuming that you take this amount as part of a lump sum benefit from the UCTRF. You will only pay tax on its investment growth.

When you retire, you will pay tax on the sum of this retirement fund lump sum benefit and any retirement fund (or other) lump sum withdrawal benefits received by or accrued to you prior to this event, calculated as follows:

- Aggregate benefit not exceeding R500 000 – 0%
- Exceeding R500 000 but not exceeding R700 000 – R0 plus 18% of amount exceeding R500 000
- Exceeding R700 000 but not exceeding R1 050 000 – R36 000 plus 27% of amount exceeding R700 000
- Exceeding R1 050 000 – R130 500 plus 36% of amount exceeding R1 050 000.

Example: Calculation of tax-free lump sum

Member elects to take R750 000 lump sum from his/her retirement benefit (assuming this is the only lump sum to be received by the member):

AIPF transfer value (as applicable):	**R 125 200**
(This R125 200 will be tax free)	

The remaining R624 800 (R750 000 less R125 200) will be taxed as follows:

R500 000 at 0%	R 0
R124 800 at 18%	R 22 464
Total tax	**R 22 464**

In this case the retiring staff member will receive a cash lump sum of R727 536 after tax (R750 000 – R22 464), provided she or he has not "used up" any of the tax-free allowances in respect of any other retirement fund withdrawals from other funds or other employers. (This includes any pay-outs from preservation funds or retirement annuities he/she might have.)

What if I choose a monthly pension? Will I pay tax?

If you choose to take a monthly pension, no tax is payable on the value used to purchase the pension. Tax will, however, be deducted from the monthly pension you receive at the applicable tax rates for that tax year (as if you were earning a salary).

There are exceptions to this, such as where you use part or all of a lump sum retirement benefit amount (after any tax payable) to purchase what is known as a voluntary purchase annuity, where a portion of the pension is tax-free income in your hands.

Voluntary purchase annuities

A cash lump sum received by a retiring member (after the deduction of tax in terms of the Second Schedule of the Income Tax Act) can also be used to purchase an annuity.

Such an annuity is regarded for tax purposes as a "voluntary purchase annuity" and only the interest portion of the monthly annuity payment (rather than the entire annuity) is taxable in the member's hands. (SARS have a formula for determining the interest portion.)

The lump sum

Some factors to consider when taking a lump sum

In deciding how much cash to take, you should at least consider the following, as well as any other personal circumstances:

a. any debts that should be repaid (e.g. house bond);
b. your tax position;
c. future accommodation plans, particularly in the event of old age and the need for frail care;
d. your marital status and/or the need to provide for other financial dependants;
e. your state of health (and that of any financial dependants you may have) and future medical costs;
f. any current and future anticipated cash needs that require funding (e.g. overseas trip, replacement of car, children's education, purchase of property);
g. any other investments you have outside the UCTRF;
h. other sources of income (e.g. maintenance payments, retirement occupation, leave pay, other investment income);
i. any life assurance policies that would make provision for dependants in the event of your death after retirement; and
j. importantly, the reduction in future income (pension) that will result from taking part of your benefit in the form of cash.

Calculating the impact of these factors is complex and a FAIS-licensed advisor will be able to help you decide how much to take in cash and how much to take in the form of an annuity.

Investment of the lump sum

In general, you should not take more of your retirement benefit in the form of cash than you need to, thus leaving as much as possible to secure an income that will last the rest of your life. You may, however, wish to take some cash to hold for when unexpected expenses arise. The most appropriate vehicle for the investment of such a cash lump sum will generally depend on the likely time horizon before cash is required.

The choice of vehicle to use for such investments is complex (e.g. unit trusts or endowment insurance policies) and financial advice from a FAIS-licensed advisor should be obtained in this regard.

Annuity options available on retirement

The two main types of annuities available are a **Life annuity** or a **Living Annuity.**

1 LIFE ANNUITY

In the case of a Life Annuity, you pay over an amount to an insurer in return for a pension. The amount of initial pension that you will receive is set by the insurer (as set out in a quotation and based on the terms and pension increases which you choose), and the pension is guaranteed to be paid for the rest of your life.

2 LIVING ANNUITY

This works somewhat like a bank account. You decide where the money is to be invested, and how much of this money you want to take as a pension in each year (minimum 2.5% and maximum 17.5% of the capital value). If you take too much out too quickly or the investment markets have poor performance, or you live longer than you thought you would, the "account" may decrease to such an extent that the income provided is insufficient to support you. A living annuity can be purchased from the UCTRF or from a registered insurer.

1 More about Life Annuities

The advantages and disadvantages of a **Life Annuity** are shown in the table below:

Advantages	Disadvantages
Pension is guaranteed to be paid for life, and in accordance with your wishes as regards guarantee term and provision for your spouse.	No flexibility in level of pension, once the pension has been set up.
You can specify a guarantee term of (e.g.) 5 years, which means that the pension is guaranteed to be payable to your dependants even if you and your spouse both die before the end of the guarantee term.	If you and your spouse both die after the "guarantee term" has ended, no benefits are available for your dependants or estate.
You don't have to make any management decisions except at the point of retirement. At this point you decide the "guarantee" and "spouse reversion".	No possibility of exit.

This may be a good option for you (compared to the Living Annuity) if any of the following apply:

- You want a guarantee that your pension will be paid for the rest of your life and not run out.
- You are in good health and expect to live longer than most people of your age. (Note that, if you qualify for an enhanced underwritten annuity, this may be appropriate even for those in ill health.)
- Your children are not financially dependent on your estate, or will be financially independent within the next few years.
- You don't want the responsibility of making decisions about your pension (investment and amount) continually until you die (possibly at the age of 90+).

Life Annuities – purchased from an insurer

There are a number of different options available in respect of Life Annuities from insurers. The key decision areas which will determine the terms of the annuity are as follows:

1. **Guaranteed period for the payment of the annuity** – Life Annuities can be purchased with no guaranteed period, or a specified guaranteed period.

   Where no guaranteed period is chosen, the annuity ceases immediately on death of the annuitant. Where a guaranteed period is chosen (e.g. 5 or 10 years) then, on death of the annuitant before the expiry of the guaranteed period, the full amount of the annuity (together with any increases the Insurer grants thereon) will continue to be paid for the balance of the guaranteed period. The longer the guaranteed period selected, the lower the starting level of the pension (for a given amount of capital available to buy the annuity).

2. **Annuity on death to the surviving spouse** – the annuity can make provision for a pension to continue to a surviving spouse or life partner after the death of the annuitant. The initial pension will be lower (for a given amount of capital available to buy the annuity) if a spouse's pension is allowed for. The spouse's pension will usually be expressed as a percentage (e.g. 75%) of the original pension, because your spouse's income needs may be lower after your death. In the event of an annuitant's death before the expiry of the guaranteed period, the full annuity will be payable for the balance of the guaranteed period before reducing.

3. **Future pension increases** – the annuity can be level or provide for annual pension increases. An annuity that provides annual increases will initially be lower than an annuity that remains level (for a given amount of capital available to buy the annuity). If you purchase an annuity you must consider the impact of future inflation on fixed incomes and avoid the temptation of choosing a higher initial pension that does not provide for future increases (as you then take on significant inflation risk).

4. **Enhanced Life Annuities** – With most financial products, you get penalised for being in poor health through higher premiums or reduced cover. However, if you have

poor health and lifestyle factors, you may benefit from a certain type of annuity. This type of annuity is called an enhanced, or impaired, life annuity.

With an enhanced annuity, the insurer will take the following unique circumstances of each individual into account, when quoting the guaranteed starting annual income:

- **Socio-economic** – highest level of education and total annual income at date of retirement
- **Lifestyle** – things like smoking and consumption of alcohol
- **Health** – past and current physical health

The reason that these personal factors are important, is that if an individual has a low socio-economic status and / or poor lifestyle and health circumstances at retirement, they are, unfortunately, not likely to live as long as the normal life expectancy. If this is so, the insurer will then increase the guaranteed starting annual income.

There are four types of Life annuities, which differ in the pension increases which are awarded to pensions:

Inflation-Linked Life Annuity

*You pay over an amount to an insurer in return for a pension (the initial amount is set by the insurer at the time of purchase) which will increase **with inflation** every year and will be paid for the rest of your life.*

Pension increases are guaranteed to keep up with inflation and are not linked to investment performance. Pensions never decrease.

Lowest Initial Pension

Good option for you if:

- You want certainty around the amount of pension which you will receive, be protected against inflation and know that this will be paid for as long as you live.
- Future investment performance is poor.
- This is your only source of income in retirement.

Fixed Escalation Life Annuity

*You pay over an amount to an insurer in return for a pension (the initial amount is set by the insurer at the time of purchase) which will increase at a **fixed %** every year and will be paid for the rest of your life.*

Pension increases are fixed at the determined percentage – (typically 5% is used). In this way, some inflation protection is provided.

Higher Initial Pension

Good option for you if:

- You have a short life expectancy post-retirement.
- You have alternative inflation linked income in retirement.

With Profits Life Annuity

*You pay over an amount to an insurer in return for a pension (the initial amount is set by the insurer) which will increase **as determined by the insurer** every year based on investment performance and will be payable for life.*

A key point to consider is the post-retirement interest rate (PRI) which determines the size of the initial pension and future increases. Pension increases (determined by the insurer) depend on investment performance: from 0% in poor years, to above inflation in good years. Generally, the PRI represents the minimum return that underlying investments must earn for the starting pension to be paid. Each insurer's PRI targets long-term increases, commonly expressed as a percentage of targeted inflation protection. But different insurers have differing targeted inflation protection for the same PRI. So it is important to select PRIs from different insurers that target (not guarantee) the same inflation protection (e.g. 100% of inflation) so that they are comparable. Both starting pension and expected future increases should be considered.

Higher Initial Pension

Good option for you if:

- You are willing to tolerate the possibility of lower than inflation pension increases in return for the possibility of higher than inflation pension increases. You want a pension that will be paid for as long as you live.
- Future investment performance is good.
- You have alternative inflation linked income in retirement.

Level Life Annuity

*You pay over an amount to an insurer in return for a pension (the initial amount is set by the insurer at the time of purchase) which will **never increase** and will be paid for the rest of your life.*

There are no pension increases. Ever. So your pension loses purchasing power at the rate of inflation.

Highest Initial Pension

Good option for you if:

- You have a short life expectancy post-retirement.
- You have alternative inflation linked income in retirement.

If you are in poor health or have some risk factors, you may benefit from an impaired life / enhanced annuity. In this case, the initial pension is higher than with a traditional annuity as the Insurer takes your lower life expectancy into account when calculating your pension.

2 More about Living Annuities

This works somewhat like a bank account. You decide where the money is to be invested, and how much of this money you want to take as a pension in each year (minimum 2.5% and maximum 17.5% of the capital value). If you take too much out too quickly or the investment markets have poor performance or you live for longer than you thought you would, the "account" may decrease to such an extent that the income provided is meaningless.

Living Annuities are very flexible products and offer many attractions to the sophisticated investor. They do, however, have some significant challenges.

The advantages and disadvantages of a Living Annuity are shown below:

Advantages	**Disadvantages**
You control the amount of pension which you take – so you can adjust it to changing needs.	You may take too much pension and end up with too little money to last until your death.
You have full control and make active decisions.	You have full control over where the money is invested and pension amount – will you be able to make sound decisions when you are older?
You gain fully from good investment performance.	You lose fully from poor investment performance.
When you die, the remainder of the "account" is paid to your dependants or nominees.	You may live longer than expected, ending up with too little money to last until your death.
You can exit and buy a Life Annuity later.	Drawing too much, or poor investment performance, may result in a decreasing pension.

This may be a good option for you (compared to a Life Annuity) if:

- You are willing to tolerate the possibility that your pension may run out at some point before your death, AND
- You are happy to carry the responsibility of making decisions about your pension (investment and amount) continually until you die (possibly at the age of 90+), **AND**
- One or more of the following applies to you:
    - you have an alternative source of income in retirement, and/or
    - you will continue to work in retirement, and/or
    - you are in bad health and have a shorter life expectancy than most people (less than say 10 years), and/or
    - you need to leave something for your estate because your children will depend on this for their survival if you die, even if this happens many years in the future.

In summary, with a Living Annuity, you make the decisions (around where the money is invested and how much annual pension you take), have the most flexibility and have the least guarantee that your pension will last until your death. **You bear the investment risk and the risk of living too long!**

It is **your responsibility** (in consultation with your financial advisor) to ensure that the income level selected is at a level that will be sustainable for a lifetime. The income drawdown relative to the investment return on the capital to achieve this, needs to be carefully managed.

More detailed information about managing the investments and drawdowns is available on the website.

Speaking to a competent financial advisor is invaluable in helping you to decide whether a Living Annuity is the right choice for you, and if so, to help you to manage the risks involved. Apart from explaining both the advantages and the risks of a Living Annuity, a financial advisor must explain and compare these advantages and risks against conventional annuities, where a long-term Insurer carries the full investment risk and the risk of the annuitant living longer than expected.

Living Annuity from UCTRF vs Living Annuity from an Insurer

You can take a Living Annuity either from the UCTRF, or from a registered Insurer.

The differences between the two are illustrated below:

UCTRF	Insurer
Stay invested in the UCTRF and UCTRF portfolios Portfolio A, B, C and D	Wide investment choice
Lower fees	Higher fees
Reg 28 compliant	Not Reg 28 compliant
S37C death distribution*	No S37C death distribution**
Cannot mix with other annuities	Can mix with other annuities
Can transfer to Insurer later	Cannot transfer back to UCTRF later

** This means that the UCTRF Board must make the final decision on how your benefit will be distributed to your beneficiaries when you die.*
*** This means that your benefit will be distributed to your beneficiaries in accordance with your wishes as set out in your nomination form.*

Living Annuities from Insurers are generally more costly than from UCTRF, as shown in the following comparison **(table based on a capital amount of R1 million).** The Insurer charges are indicative of the level of charges levied by Insurers:

Cost item	UCTRF	Indicative Insurer's cost
	Cost basis (including VAT)	*Cost basis (including VAT)*
Annuity payment fee	R536 initial management fee R13.45 per payment	This fee is subsidised from the investment fees
Annuity administration fee	R112 per month	0.75% first R250k 0.5% next R500k 0.25% above R750k
Investment fees	0.2% to 0.9% p.a. of market value of assets (depending on portfolio chosen by member)	0.5% to 1.5% p.a. of market value of assets (depends on portfolio chosen by member)
Switching fees	One free switch p.a. between 1 July and 30 June; R518 thereafter	Insurers now commonly allow free switching

Cost item	UCTRF	Indicative Insurer's cost
	Cost basis (including VAT)	*Cost basis (including VAT)*
Advisor's fees	Not applicable	Negotiable up to 1% p.a., but Insurers may also accept "direct clients" where no advisor is involved
First-year comparison based on R1m	R2041.40 plus investment fees	R15 000 plus investment fees

This is general information describing the different types of annuities. You should consult a FAIS registered financial advisor to help you decide which pension type would be most appropriate for your needs.

In summary:

- **Living Annuity** – you make the decisions (around where the money is invested and how much annual pension you take), have the most flexibility and have the least guarantee that your pension will last until your death. You bear the investment risk and the risk of living too long!

- **With Profits Life Annuity** – pension which is guaranteed to be paid for life. The initial pension amount is determined by the Insurer. The pension increases are determined by the Insurer and are linked to investment performance – the pension can never be reduced. You bear some of the investment risk, but the Insurer bears the longevity risk (i.e. the risk that you will live longer than expected).

- **Inflation-Linked Life Annuity** – this is a pension which is guaranteed for life. The initial pension amount is determined by the Insurer and is guaranteed to increase with inflation. The Insurer bears both the investment and the longevity risk.

- **Fixed Escalation Life Annuity** – this is a pension which is guaranteed for life. The initial pension amount is determined by the Insurer and is guaranteed to increase at a fixed percentage. The Insurer bears both the investment and the longevity risk. You still bear some inflation risk.

- **Level Life Annuity** – this is a pension which is guaranteed for life. The initial pension amount is determined by the Insurer but never increases. The Insurer bears both the investment and the longevity risk. You bear all inflation risk.

Comparing your options at retirement

	Guaranteed Level Annuity	Guaranteed Escalation Annuity	Full inflation-Linked Annuity;	With-Profit Annuity	Living Annuity
Increases		✔ *Guaranteed fixed rate but can be too low*	✔ *Inflation (CPI) increases*	✔ *Will depend on investment performance (bonus rate less discount rate*	✔ *Yes, but not guaranteed; depends on investment performance and capital available*
Guaranteed Period Option	✔	✔	✔	✔	✔
Spouse's Pension Option	✔	✔	✔	✔	✔
Capital available for my other beneficiaries					✔
Pension paid until death	✔	✔	✔	✔	

The most common pension (annuity) options available are:

A Life Annuity

- A guaranteed level annuity;
- A guaranteed escalation annuity;
- A full inflation-linked annuity;
- A with-profit annuity; and

Can be for a fixed period or for life, with or without a spouse's pension.

A Living Annuity

- A UCTRF Living Annuity;
- A Living Annuity provided by an external provider.

Things to know and consider when buying an annuity

- Pensions with no increases might look attractive in the beginning but after 4 to 5 years you start to fall behind the increase in the cost of living and you might not have enough pension to survive on.
- Stability of the Insurer over the long term.
- Any escape clauses by the Insurer in his contract with you.
- Fees charged by the Financial Advisor and Insurer.
- Whether your initial pension will be affected by interest rate changes, as you might get a quotation a few months before you retire, but by the time you retire, the initial pension will have changed due to interest rate changes.
- If you do not include a spouse's pension and your spouse does not get his/her own pension, they might be destitute when you pass away.

The above is general information only. You should consult a FAIS registered financial advisor to help you decide which pension type would be most appropriate for your needs.

Contact us

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