



FROM THE CEO'S DESK

Just as we, the SAS's (South African sceptics), began to discount the fact that Julius would get away scot-free the ANC has gone and done it again. They are hammering him, apparently having let him measure out his own noose. Whilst all is not well in our economy and we remain hamstrung by the rather frustratingly entrenched issues of poor productivity, crime and crazily low levels of both savings and education, we can reflect on certain critical political issues and wonder if we give the ruling party enough recognition for its somewhat pragmatic approach to progress.

I was at a breakfast presentation and listened to the enigmatic JP Landman (well known economist, lecturer and husband to Carte Blanche's Ruda) who succinctly reminded the audience of some of these key issues, and of our initial, and typically, fear infused reactions followed by a whole lot of worry, waiting for the inevitable, but which frustratingly doesn't happen. Until next time the sceptics remind us, of course!

What are the key issues I am referring to? Well for starters, the Malema process, followed by the mining and farmland debate which has moved from an ideological to a pragmatic process. Also the fear of a major move to the left, forecast after Polokwane resulted in no policy change of any substance within the body politic. Another issue was labour's insistence that labour broking be banned. The Minister has now said that there is a need for labour brokers to be accommodated in the system. The jury is still out on the very controversial Protection of Information Bill, but watch this space for a softer landing than we fear. Actually, as an aside, I sometimes agree that with the shoddy quality of information and the continued need for retractions and apologies from the media, an Act of this nature or some form of censure might get Editors delivering accurate and responsible reporting.

As I have noted before in previous editorials, I am not politically active and regard myself as a pragmatic capitalist. What we need to do is support that which makes long term sense and oppose that which destroys value, confidence and capital. This brings me to my next point. The debate, both

in the world and in South Africa, has moved from that of poverty to that of inequality. Look at Egypt, Syria, and Libya and elsewhere, including the Southern European nations and we see social disquiet previously seen at Tiananmen Square, where the fabric of communities and countries play second fiddle to basic needs of families and communities. This social risk exists wherever the gap between the rich and struggling classes is large. South Africa is a classical example of this situation and this suits the Malemas of this country down to the ground. The ANC are very mindful of this risk and we can see this sensitivity in, amongst other ways, the Central Banks reversal of monetary policy, where rates might be dropping as opposed to firming. This is intended to have a dual effect, one of lightening the burden on both corporate and individual borrowers, stimulating the economy by increasing disposable income, and secondly to make the incredible foreign flows into SA cash investments, brought about by our attractive and competitive interest rates, slow down or reverse, thus weakening the rand and supporting industrials exporting goods and creating local jobs.

So, in summary, all is not bad on the local front. However, globalization is a reality and it is appropriate to note that the last two meltdowns our markets have suffered have both been the result of exogenous events, the first in 1998 as a result of the Tequila Crisis in South America and the last as a result of the Global Toxic Debt meltdown of 2008/9. Now is not the time to get greedy or too smart with capital. Having said this, it is also true that corporate earnings have been good and corporate balance sheets are pretty robust, and a healthy debate exists when discussing local vs. offshore investments. I would advocate a clear understanding of investment needs, duration and tolerance to volatility before committing money. Value is to be found, but the markets remain incredibly volatile and we would welcome discussing existing and potential new investments with you.

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RETIREMENT ANNUITIES (RA's) MUCH MALIGNED AND UNDERRATED

One could say an 'oldie, but a goodie' – Over many years the traditional retirement annuity (RA) has received a bad rap. Often for good reason as it was sold indiscriminately, was inflexible, salesmen were over incentivized to make the sale through taking commissions up front without due care and after sales service and advise, heavy penalties were incurred by investors making such policies paid up, there was a lack of transparency, fiscus support was small and contributions were age restricted. Article written by Paul Jennings, NFB Gauteng, Private Wealth Manager

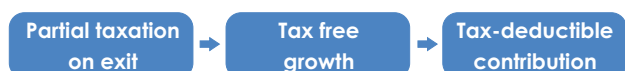
Today the game has changed to such an extent that for the right circumstances there are few investments available to the South African investing public which are more attractive, particularly on an after tax basis.

It could be said that the RA is a **'virtual tax haven'**. Having said this it is important to emphasize that the essential purpose of the RA is to provide or supplement one's retirement savings as it is not designed to provide an investment over and above this purpose. For such investments there are better vehicles available which provide greater flexibility and purpose.

The focus of this article is therefore on your retirement savings. This is particularly relevant when one considers that in South Africa today about 1,3 million taxpayers make tax deductible contributions to pension and provident funds through their employers. Only about 18,000 make any additional voluntary contribution to these funds. 1,8 million make tax deductible contributions to retirement annuity funds. Many of these are the same investors who are contributing to pension and provident funds. From which ever angle one considers this matter there are less than 3 million South Africans with a pension fund of any sort. This represents only 6% of the South African population. Coupled with this is the reality that most people, even those who do have retirement provisions, cannot afford to retire at even close to their current standard of living. This fact is exacerbated by the fact that people are living longer and

therefore need to provide for a longer period in retirement. For those who may think that they can rely on Government provision in their old age need to be reminded that the current old age pension is R1070 per month.

So let us unpack the retirement annuity to investigate whether it can be considered a 'virtual tax haven'



But please explain you may be asking!!!

“most people, even those who do have retirement provisions, cannot afford to retire at even close to their current standard of living”

- The investor is incentivized by Government in that up to 15% of non-retirement income is invested with before tax income – effectively Government pays part of your contribution calculated at your marginal tax rate.
- For those who are employed for the tax year ending 28th

February 2012 these tax deductions to retirement funds will be determined as follows:

- Employers' contributions to pension and provident funds and related benefits may be as much as 20% of employee earnings. It is noted that Finance Minister, Pravin Gordhan alluded in his 2011/12 Budget Speech, to an overhaul of contribution thresholds, suggesting that in 2013 employer contributions may increase to 22,5% of employee earnings with total tax deductible

contributions capped at R200 000 per annum per tax payer. The implication of this proposal is that very high net worth individual tax payers may have their last chance to contribute an unlimited 15% of retirement funding income to a retirement annuity.

- Employee contributions to pension funds is 7.5%.
- As already noted, individual tax payer's contributions to retirement annuity funds is 15% of non-retirement funding income subject to a minimum of the greater of R3 500 pension fund contribution or R1 750. One is able to contribute more than this amount, but any excess contributions do not enjoy the deductibility on this additional contribution. Nevertheless, any excess contributions may be deducted tax free on retirement.
- While invested in the retirement annuities fund no income or capital gain tax is paid by the fund. Effectively all gains within the fund are tax free. The only times your retirement annuity is taxed is on your allowable one third lump sum benefit, and even in this instance the first R315 000 is tax free, and on average the first R945k is taxed at an average rate of 15%. The balance of the one third lump sum benefit can be taken, but at the disincentivised rate of 36%. The balance of your retirement annuity remains to provide you with a pension or an annuity taxed at your marginal rate. In all probability this will be at a lower rate than when you were employed.
- Reference is made to the fact that the balance of your retirement annuity needs to provide you with either a pension or an annuity. By pension we refer to a traditional pension as provided by an insurance company. This is a guarantee by the insurance company to pay you and your spouse a certain pension for the duration of your lives. The advantage of such an arrangement is that you have the certainty of a pension which is not influenced by the future vagaries of the market – the insurance company takes this risk, but does so at a cost. Alternatively you have the choice of a living annuity. This allows you annually to select the amount of your annuity ranging between 2,5% and 17.5% of the balance of your investment. The advantage of this option is that you can effectively 'dial up' sufficient income to cover your annual consumption, but remembering any percentage taken at a higher level than the earning of the fund, plus taking account of inflation, will erode the value of your capital. Apart from this risk of capital erosion one also accepts the uncertainty of market risk. In making the decision between taking a certain pension or living annuity one also has the option of a combination between the two and the option at any time to convert a living annuity to a traditional pension.
- A further important distinction between a traditional pension and a living annuity is that with a pension the value of this investment ceases with the death of you and your spouse, but with a living annuity you have control of this asset in terms of investment decisions and

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nominating beneficiaries in the event of your death. What this effectively means is that the living annuity is not part of your estate which ceases on your death.

- In the past the inflexibility and lack of transparency of the retirement annuity has been a deterrent. This has radically changed with new generation investment platforms which are far more cost effective, plus offering greater flexibility with respect to contributions, choice of investment managers, transferability of investment, and importantly, absolute disclosure of all costs.
- Historically a member of a retirement annuity fund could not belong to such a fund beyond the age of 70; in other words at age 70 the member would have to take a pension. In July 2008 this upper age limit was removed which could mean that the member never retires from their retirement annuity meaning that this asset is effectively excluded from their estate thereby potentially providing a savings with respect to both estate duty and executor fees when a beneficiary has been nominated. Such a strategy can therefore be effectively utilized as an estate planning tool particularly for a very high net worth investor who will continue to enjoy the tax free status of the retirement annuity plus be in a position to continue to make annual contributions of up to 15% of their non-retirement income.
- The RA offers protection from creditors. This is particularly significant to the self employed person who may have their personal assets at risk in the event of insolvency.
- Some have argued that Regulation 28 of the Pension Funds Act is a disincentive to invest in a retirement annuity. This Regulation limits investment exposure to a maximum of 75% exposure to equities, 25% to property, 90% to growth assets which are effectively a combination of equities and property, and 25% to off shore investments. We absolutely support this principle of asset class and geographic diversification as an effective measure to control investment risk. No investor or investment manager has twenty-twenty vision when it comes to making investment decisions hence the wisdom of diversification. This supports the old adage of 'not putting all your eggs into one basket'.
- In a country that has a concerning low savings discipline and poor provision with regards to providing for retirement, the RA could be seen as a forced savings plan which cannot be readily accessed until retirement.
- One final thought is that one is only able to access ones' retirement annuity at the minimum age of 55 or in the events of death, becoming disabled and immigration. In the event of immigration then this withdrawal is considered a 'withdrawal benefit' meaning that the first R900k is, on average, taxed at 20,6% and the balance at 36%.

This article has merely highlighted the often unsung benefits of the retirement annuity. For analysis more specific to your requirements we urge you to consult with your NFB Advisor. ⊕

SOUTH AFRICANS NEED DISABILITY COVER

South Africans, unfortunately, live in a very violent society and have one of the highest disability claim statistics. It is therefore vital that our clients review the adequacy of their disability cover. Written by

Emmanuella Fernandes, NFB
Gauteng, Paraplanner



The Life Insurance Industry provides us with two solutions: a) Monthly Income Replacement Cover or b) Lumpsum Disability Cover. In determining a solution your financial planner will compare the appropriateness of these two benefits, taking into account the following:

- Premium affordability
- Waiting periods for Income replacement
- Permanent vs Temporary Disability Cover
- Industry maximums for Income replacement – limited to 75% of Income
- Consideration to existing Group Life Benefits
- Specified occupation
- Smoker status and other risk factors
- Own Occupation vs reasonable alternative occupation
- Comprehensive Disability cover vs Functional Impairment cover

A comprehensive analysis is required to determine the most appropriately tailored solution. The solution normally would include a combination of these two products.

Income Replacement Cover

Clients that are seeking a guaranteed Income solution who don't wish to manage the capital lumpsum will elect the Income Replacement option for all or part of their income needs. Income Replacement benefits are designed to replace any loss of income an individual suffers due to disability such that they are unable to perform their occupation. Income Replacement benefits can be paid for both temporary and permanent disability. It is imperative to ensure that your income is reviewed and that the benefits are regularly updated. Similarly, you need to ensure that an "in claim" escalation is selected on your policy. These payments are guaranteed up until retirement age or your selected term. Certain Life Companies have "top up" products that can increase your benefit to 100% of your salary in the event of permanent disability.

The premiums for Permanent Income Replacement Cover are tax deductible and the Income received will be taxable. Temporary Income Replacement Benefits or Sickness Benefits are usually tax free for a limited period and these premiums are not tax deductible.

Lumpsum Disability Cover

Clients that prefer a lumpsum payment in the event of a

disability have the freedom to invest the proceeds to generate an income. The impacts of inflation, the ability to achieve the required return, the capital and market risk of the investment will all have a major impact in determining the adequacy of the required lumpsum amount. Poor investment performance or loss of capital could imply that the income does not increase with inflation, or worse – it could decrease.

The premiums on lumpsum disability cover are not tax deductible and therefore the proceeds are tax free.

Example

Let's take a look at the following Income Replacement Quote

Client	Mr Smith
Age	40
Salary	R80,000 p.m. (before tax)
Insured salary	R60,000 p.m. (75% of salary)
Net Payment after an aver. tax rate of 30%	R42,000 p.m.
Claims escalation	CPI (estimated at 6%)
Term of cover	Age 65
Monthly premium	R1,300 (approximately) Tax deductible

For the same premium of R1,300 p.m. we can purchase a Lumpsum Disability Amount of R4,850,000. This amount would be further reduced if you utilised the after tax premium on the Income replacement product. Should Mr Smith be disabled after one month and the proceeds were invested at a 9% average yield, a monthly income of approximately R22,000 (escalating at 6%) will be generated for a period of 25 years. This illustration assumes a tax efficient investment and therefore a low tax base. Clearly this income would increase should Mr Smith become disabled at a later stage. The suitability of these two products would need to be reviewed by your NFB Financial Advisor in determining your optimal solution.

When the primary need for insurance is to compensate for loss of income, Income Replacement benefits are likely to be the most effective solution. Where the individual requires a cash lump sum, Lump Sum Disability benefits are better suited. ⊕

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