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Don't let retrenchment derail your retirement savings

Retrenchment is a traumatic experience. In addition to coping with the emotional stress of losing your job, you will also be expected to take financial decisions with far reaching impact.

You may be tempted into making choices that seem the least disruptive to the lifestyle that you and your family were able to maintain on your salary while you hunt for another job. But before you cash in your pension or provident fund savings to enable you to do this, it is critically important that you understand the long-term implications of your decisions.

Niel Fourie, Public Policy Actuary at the Actuarial Society of South Africa, says if at age 40 you withdrew enough money from your retirement savings to replace your salary for two years, you would nearly halve the amount available to you at retirement.

According to Fourie, the consequence would be that you would in all likelihood not be able to maintain your lifestyle in your golden years.

"It is very tempting to withdraw all your savings to make up for an unexpected loss of income, but this should always be the last resort."

Fourie adds that unless you start earning and saving double of what you did before you were retrenched, you are unlikely to make up for the loss of your retirement savings if you cash in your pension or provident fund on retrenchment.

To demonstrate, he uses the example of a 40 year-old earning a monthly salary of R19 500. After diligently saving 15% of his income since the age of 25 years, he has accumulated R757 420 in his employer's pension fund.

If his salary continues to increase by 5% a year until retirement at 65, and his pension fund benefit grows at an average of 9% a year, he is likely to retire with a princely sum of nearly R11.4 million.

However, if he was retrenched at age 40 and decided to withdraw just three months' salary or R58 500 to live on before finding work and resuming his retirement savings, he would retire with R10.8 million – nearly R600 000 less.

If he were to rely on his retirement savings for a year before finding work, this shortfall would increase to over R2 million. Two years of relying on his savings would nearly halve the amount he would have saved at retirement to R6.7 million.

If he were to withdraw all his savings and only find work three years later, he would retire with just under R4 million provided he immediately started saving again at pre-retrenchment levels. To reach the pre-retrenchment R11.4 million, he would have needed to increase his monthly savings to 42.7% - nearly half his salary.

Fourie points out that while R4 million may seem like plenty, if this individual were to purchase a living annuity at retirement and withdraw just 5% every year, his monthly income would be just R4 900 before tax in today's value of money. If you draw an income of more than 5% of your living annuity, you risk eroding your capital.

"However, a rule of thumb states that you need a monthly income of between 70% and 75% of your pre-retirement salary to maintain your lifestyle into your retirement," he says.

"This means that the individual in this example would actually need a monthly income of R49 720, or in today's terms R14 000, in his retirement."

<u>Consequences of withdrawing retirement savings at retrenchment</u>

Scenario at retrenchment	**Amount saved at age 65***	**Savings needed to make up for the withdrawal**
No interruption in savings	R11.4 million	
Withdraws enough for 3 months salary	R10.8 million	16.82%
Withdraws enough for 12 months salary	R9.1 million	22.64%
Withdraws enough for 2 years salary	R6.7 million	31.25%
Withdraws entire amount, finds work at age 44 years	R4.0 million	42.68%

*Based on an annual salary increase of 5%, and a pension fund benefit growth of 9% every year.

Tips for managing your finances following a retrenchment

Fourie emphasises that your first port of call following a loss of income should be a qualified financial adviser.

"Your financial adviser will be able to take a comprehensive view of your financial situation, and guide you on implementing a range of measures to tide you over until you find a new position," he says.

He notes that some of the decisions you should discuss with your financial adviser will include:

1. Using your severance benefit and emergency funds wisely – The size of your retrenchment benefit, together with any savings for a rainy day, will determine how long you will be able to survive financially before dipping into your retirement savings. Resist the temptation to treat yourself with this money, bearing in mind that these funds will need to tide you over until you find a new job.

2. Scaling back on your expenses – Implementing strict cost-cutting measures will help to shore up your financial resilience. You could for instance cancel your satellite television subscription and cut back on nights out at restaurants. If you still owe a large amount of debt on an expensive motor vehicle or house, you could also consider selling and downscaling in order to reduce your debt-burden.

3. Re-examining your financial protection – Key financial protection such as your life policy, medical aid and short-term insurance on your home and vehicle should remain a top priority in case the unexpected strikes. However, you could cancel additional benefits to reduce your monthly premiums, such as additional cover on your vehicle's radio.

4. Negotiating with your creditors – Defaulting on your debts could carry severe legal implications and negatively impact your credit record. Rather speak to your creditors or bank about possibly extending the term of your loan in order to reduce your monthly repayments.

5. Looking for ways to keep earning – Speak to your previous employer about contract work or consider renting out an extra room.

6. Withdrawing a portion of your retirement savings – As a last resort, withdraw just enough from your pension or provident savings to enable you and your family to survive financially until you find a way of earning again. You are entitled to withdraw up to R500 000 from your retirement savings tax-free when you are retrenched, but this allowance will include your severance benefits.

7. Preserving your retirement savings – To protect the value of your pension or provident fund savings, you may choose to preserve your savings in a Retirement Annuity (RA) or preservation fund, dependent on the rules of your fund. However, if you transfer your savings to a RA, you will not be able to access these savings until the age of 55 years. If you transfer your savings to a preservation fund, you are entitled to a single withdrawal of a portion or the entire amount saved before the age of 55.

Ends

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