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Investing for a world of change

Retirement readiness – the early bird...

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Mark Twain once said, 'The secret of getting ahead is getting started.' This sage advice is particularly relevant when applied to saving for retirement, where contributing from a young age vastly increases the probability of a successful retirement. However, many of the younger generations (millennials and generation Z) are experiencing financial headwinds that make the process of 'getting started' more easily said than done. They typically have less disposable income than the generations that preceded them due to high levels of debt and the current economic backdrop punctuated by a cost-of-living crisis due to unprecedented inflation. This has resulted in these competing financial needs being prioritised over investing.

Baby boomers, on the other hand, entered the workplace during more prosperous economic conditions, allowing many to accumulate significant wealth during their lifetimes.

So, how can baby boomers help ensure that their children and grandchildren experience a dignified retirement? It has been highly publicised that the largest ever transfer of wealth is predicted to take place in the coming decades, as the baby boomers pass away and transfer their wealth to the next generation. However, these current asset owners can start taking steps to transition a portion of their wealth, while still alive, which would result in many benefits.

The power of donations

The beauty of a donation strategy is that it can be established at any time – for adult children already in the workforce it could provide a welcome supplement to their existing savings, and for minors it may provide the gift of many years of compound growth before they even generate their own income, let alone save. Donations can be in the form of lump sums or a regular contribution via debit order.

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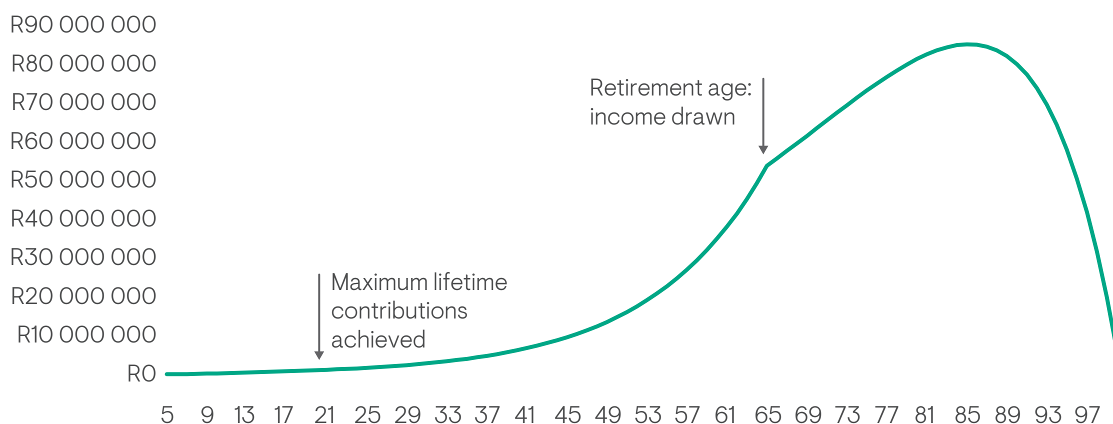
But what is the most appropriate vehicle?

Tax-free savings account (TFSA)

In our recent Masterclass series, we explored a scenario where a person contributed on behalf of a 5-year-old minor into a TFSA and contributed until the lifetime limit of R500k had been achieved. From that point the TFSA continued to grow until the child reached the age of 65. Staggeringly, the strategy provided a supplementary income that could be sustained until the age of 100. The results of the exercise can be seen in Figure 1 below.

Figure 1: Giving a loved one a headstart



Source: Ninety One. Contribution of R36 000 p.a. until lifetime limit of R500,000 achieved. Growth assumed to be 9% p.a. Income drawn at 5% p.a. with ZAR value escalating at 5% p.a.

However, it is worth taking note of the benefits and limitations of TFSAs, as we've set out below.

Figure 2: The pros and cons of TFSAs

Pros	Cons
Suitable for long-term savings with flexibility around contributions via either an annual lump sum or monthly debit order	Current limit on amount that can be contributed is set at R36 000 p.a. and lifetime limit of R500 000
Tax free growth on contributions and no tax consequences on withdrawal	The TFSA is an asset within the investor's estate, meaning estate duty applies on death
Ninety One TFSA allows for unrestricted asset allocation	As a personal account, if the child learns about their TFSA they may give in to temptation and withdraw the accumulated value. Withdrawn funds cannot be replaced.
No minimum or maximum withdrawals provides flexibility around when income can be taken, and the amount drawn	No protection from creditors
Should the child choose to emigrate the accumulated funds can be accessed without restriction	Executor's fees are applicable on death, and there are potential delays when dealing with the Master's Office

Retirement annuity

A retirement annuity provides many of the same benefits and could therefore provide the same value at retirement as the TFSA example above, assuming the same contribution amounts. It could therefore be seen as an alternative to a TFSA, with greater restrictions on access providing more comfort for the principal family member that the contributions will be used for their intended purpose. There are however some important differences, as set out below.

Figure 3: The pros and cons of retirement annuities

Pros

- Suitable for long terms savings with flexibility around contributions via either annual lump sum, ad-hoc additions, or monthly debit order
- Tax-free growth within the retirement annuity wrapper
- Protection from creditors
- Free from estate duty
- Tax-neutral transfer to annuity on retirement or death
- No annual or lifetime limit on value that can be contributed, allowing for more sizable contributions than a TFSA and for those contributions to be made for longer
- Where contributions are made from a bank account in the name of the member (child), the contributions would qualify as disallowed contributions if the child did not have an income to offset the value of the contribution against. This would allow for a tax-free income in retirement until the value of the disallowed contributions has been completely exhausted
- For working adult children (and where the contribution is made from the child's bank account), the contribution can be offset against their retirement funding income, which means they can potentially qualify for an income tax deduction (subject to certain limits)

Cons

- Asset class exposure is restricted by Regulation 28
- Currently no liquidity prior to age 55, with increased but limited pre-retirement access proposed on new contributions once two-pot system is implemented
- Requirement to convert a minimum of two thirds to an annuity on retirement
- If contributions are made from an account not in the name of the member, they do not qualify for a deduction or as a disallowed contribution
- 3-year restriction on withdrawing funds where a person ceases to be a South African tax resident
- Section 37C applies on death, which can cause delays on access to funds for those left behind
- Income drawn from a resultant living annuity will be taxed as per the PAYE tables
- Income drawn from a living annuity must be at a minimum of 2.5% p.a. and a maximum of 17.5% p.a.
- On death, where a benefit is taken as cash, it is subject to retirement tax and estate duty on any disallowed contribution that may remain

Ninety One Family Office – Making it all possible

Some clients may be reluctant to take assets currently in their own name and transfer to a family member for fear of a negative impact on the administration fee they pay. Ninety One Family Office avoids this outcome by enabling advisors to link family members for fee aggregation purposes. All family members will enjoy reduced fees as combined assets grow, new investments are made, or additional members are added to the family unit.

Benefits for client and family:

- If a donation is less than the R100 000 annual allowance, no donations tax is applicable.
- Annual donations allow for the gradual reduction of an estate over time, leading to greater preservation of wealth on death.
- Where a child account is linked to a Ninety One family, the transferring of value from parent to child has no impact on the fee paid by the principal member (if funded from other investments on Ninety One IP).
- Children benefit from the scale of their families' assets, which makes the administration fee they pay more cost effective.
- Children are now part of the family structure, allowing for a cost-efficient cascade of wealth when their parents pass away.

Benefits for the advisor

- It strengthens the relationship with the principal family member due to the value added.
- It enables the advisor to establish a relationship with the next generation at the earliest opportunity, which improves the chances of retention of assets on death of the principal family member.
- The family fee reduces the chances that the children will transfer assets to another advisor/provider.
- It creates a cost-efficient structure which maximises growth within the family, and the advisor earns a fee on a larger asset pool.

With many advisors increasingly focused on intergenerational financial planning it is clear that donations are a powerful financial planning tool. Family pricing via the Ninety One Family Office ensures there are no fee increase implications for the principal member, which removes a barrier to implementation. Importantly, it can give children or grandchildren a head start in their own savings journey, which can lead to a vast improvement in their retirement outcome. It helps to bring other family members into the advice net and assists advisors in developing a relationship with the next generation. This helps to protect current revenue for the advisor practice and can help justify a higher sale value for those advisors who are considering their own retirement plan.

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Ninety One Investment Platform (Pty) Ltd and Ninety One SA (Pty) Ltd are authorised financial services providers.

Contact information

Please visit our website at www.ninetyone.com for more information on our range of funds and portfolio products.

You'll also find application forms and other relevant documentation for offshore investing on the website.

For more information and assistance with investing, call the Advisor Service Centre Tel 0860 444 487.

Alternatively, please contact your Ninety One investment consultant.

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