Photographer : Dawn Ridler

WORKING CAPITAL

A Manager's handbook to preserving personal wealth at work – RSA edition

One of the places that people often sabotage their future wealth prospects is when they make poor judgements when they join or leave companies. This eBook will help managers, especially HR managers identify these black holes. This book will also give anyone moving jobs a good idea of what to look for.

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Introduction

Throughout my career in Financial Advisory I come across instances where a client, whether by omission or commission, has made a really poor choice that has a lasting impact on their future financial security. This has ranged from cashing in pensions (even at retirement); failing to take out 'Life Cover' options when uninsurable; changing medical aids that are integrated into life policies; poor fund choices in retirement funds and many others. I which I will use these examples to illustrate in the content below.

Changing jobs can be crucial, not just to future earnings, but to preserving the funds and benefits you have built up in the interim. Most HR managers know that they 'aren't allowed' to give financial advice in terms of the FAIS act. Does that mean they should keep their mouth shut, do an exit interview and wash their hands of the exiting employee? No. That can be just as damaging as giving unapproved advice.

Choosing a Trusted Advisor

As an employee or manager, you are going to have access to your Group Benefit Consultants, who will probably either have their own Financial Advisors or be able to recommend some. You might also have your own financial advisor/advisors that you can call on. So how do you pick one you can trust?

Beware of vested interests. If employees are being encouraged to keep their funds within the existing retirement fund and not 'preserve' it on another platform or with another provider, what are the restrictions? Can the funds be 'preserved' later if the employee changes his mind or decides to emigrate? I have come across a number of instances where funds kept in an employer fund are stuck there, even on emigration, with fund managers hiding behind 'fund rules'. Flexibility is important, within the regulations of course. What choice of funds will the employee have? Can he make the 'one withdrawal' prior to retirement as allowed by regulations? Can they preserve on another platform? What are the fees, and how do they compare to other platforms? I am not a fan of 'tied agents' that are only allowed to offer products on a single platform, but if this is your choice, do your own homework to make sure you're getting the best deal.

Remember: Funds hate losing their money to other platforms, be a devil's advocate. It might seem like the 'easiest' thing to do. Act in haste, repent in leisure.

Accredited on your Group Life platform. The Life platform is the 'Life cover/Disability/ Income protection/ Dread disease/ Funeral cover' side of the business, often looked after by a completely different provider to your retirement funds. If your Group Benefits have a 'continuation option' (see below) then you will need an Advisor accredited with that Provider to draw up a quote for your employee, if they need it (like Momentum or Discovery). Your group benefit provider may be able to get you a quote.

Check the fees. There are two fees you need to check on an Investment quote, the Total Expense Ratio of the funds and the Financial Advisor's 'upfront' and 'ongoing' commission. If you're not careful these two can put a significant hole in your employee's fund. Preservers require a fair amount of PT, so an upfront fee is often appropriate. 3.5% is the maximum allowed, 1% is more usual. On large amounts (over a million), many advisors will not charge an upfront fee. The Total Expense Ratio on the fund is more difficult to judge, but easy to compare. This can range from around 2% to close to 5%.

Be involved. Until you're sure you can trust the advisor to look after you or your employee properly, get involved with every stage. See the quotes, read the record of advice, get a second opinion. Not all advisors are created equal.

THE BASIC STUFF YOU NEED TO KNOW, OR NEED TO KNOW HOW TO FIND

If you're a manager, you aren't going to be able to give your employee financial advice, but it is important to know what 'advice' is and more importantly the potential pitfalls your employee could fall into if they don't have you pointing them out. Tip: telling your employee to tick the ' I don't need financial advice' box because it is less hassle, could be construed as advice!

TAX ON WITHDRAWALS FROM RETIREMENT FUNDS PRIOR TO RETIREMENT.

Most employees and managers are aware that there is tax on withdrawal from a retirement fund, but unsure what this is. This changes periodically, and if it does, it is usually announced in the budget. I have a summary tax guide on my website you can use http://kerenga.com/e-books-guides/. Please note that there are some substantial changes proposed to the retirement industry, and this is a summary of the current regulations. As new regulations are promulgated, this version will be amended.

IF YOUR COMPANY DOESN'T HAVE A RETIREMENT FUND YOUR EMPLOYEES MAY BE FORCED TO INVEST ON THE GOVERNMENT PLATFORM. THERE IS TIME TO ADDRESS THIS, BUT DON'T PROCRASTINATE ANY LONGER.

To put it in a nutshell, an employee has a small 'tax free' lumpsum they can withdraw from ONCE in their working life. In the 2014/15 tax year this is R25 000. Thereafter they will be taxed punitively and progressively from 18% up to 36%. This tax is lost and gone for ever, you can't offset it against income for example. It also accumulates and is deducted from the tax-free lumpsum at retirement. Financially, withdrawing the funds is a really bad idea and will take years to recover from. If the employee preserves the funds, then they can (at the moment, this may change) make one withdrawal, and one only (and it can be 100%). This will of course will be taxed. Preservation of even relatively small amounts can turn into a nice little nest egg over the years. If they don't already have one, help your employee start a life-long relationship with an advisor who will keep an eye on the investment and not just park it and let it languish through to retirement.

WHAT HAPPENS AT RETIREMENT

When an employee retires, and he or she is over the age of 55, then different rules apply. The different scenarios are complicated and have dramatically different impact on the future income and tax of the retiree. Quite frankly I don't think that financial advice should be 'optional' in this instance. Mistakes made at this point cannot be undone and will impact them for the rest of their life. Retirees need to understand the difference between 'life' and 'living annuities', the lumpsum tax rules, what a 'compulsory annuity means' and how it is going to impact on their future tax. If you're a manager, especially a HR manager, I'd recommend that you ask an employee of you can sit in on their discussions with the advisor so that you have some idea of the process. Check that your employee is given a number of different alternatives and that their needs have been taken into consideration, and the tax and financial implications discussed when making the recommendation.

There are a couple of red flags you need to be aware of. 'Life' annuities, linked to the interest rate (at that time, not increasing if the interest rate increases), will give the client certainty but are VERY conservatively invested and totally inflexible. They also die when the retiree dies. 'Living' annuities are a much better idea, but the financial process leading to the recommendation must be robust. Although the current rules in 'provident funds' (one of the changes happening sooner rather than later) allows for the entire amount to be withdrawn as a lumpsum – the tax implications on this are monstrous.

What is a continuation option

Group Life Benefits may have a 'continuation option'. This means that the departing employee has the option to carry on with the benefits in their personal capacity, without medical underwriting. This is very powerful and important, and if your Group benefits doesn't have this option, I recommend you look into it (the cost is usually minuscule) . This means that an employee who might have picked up a medical problem while in your employ (say diabetes, or an accident that hurt their back), will be able to get risk cover that they CANNOT get if they had to go for medical underwriting. If you have a senior manager, with significant liabilities, who is not going to be covered for six months while under probation at another job, discuss this with your advisor. They may put the cover in place for a short period like this, without commission, (clearly wanting to have to give back the commission after a couple of months!) This can be part of the 'give and take' of your relationship with your chosen advisor if you're regularly giving them business.

Incoming!

Most employees entering a new job will have come from another corporate environment, but it is important to know where his/her risk might lie.

Do your group benefits only start 3-6 months after starting? After the probation period maybe? If your employee has no benefits in his/her personal capacity then he/she might be uncovered for months, putting them and their family at risk. A couple of months without contributions to the retirement fund might not be a train smash. If they become disabled 2 months into your employment - that is. For you and them. Recommendation: Speak to your group benefit provider, see if this can't be changed.

Is membership of your (preferred) medical aid compulsory? If so, your new employee might lose a substantial 'pay-back' bonus with his previous medical aid and the premiums of his Life policy may increase. Recommendation : This is pretty much 'tough luck' for the new employee, and mostly limited to Discovery Health (with Momentum and Liberty in the mix to a lesser extent).

Does your new employee have his/her own Life cover, specifically disability? There is a chance that when his group benefits are added, he/she will be over-insured. Not only will they be wasting premiums, but at claim stage a claim might be repudiated when 'aggregation' is taken into account. Aggregation is the process whereby insurance companies add up all the sources of income, including that from disability claims and should it be more than 75-100% of his/her declared income, they hold back on payment. Not fair! Recommendation: Ask if they have personal policies, if they do, and you have group benefits, tell them to contact their financial advisor to discuss the structuring. If they don't have an active advisor, contact your group benefit provider, or have a couple of trusted advisors on tap that are prepared to help.

Outgoing!

If your employee has made some unwise financial choices when he left his/her previous company when they comes into your company, there isn't much you can do about it.

Most of those decisions are irreversible, and continuation options have a 30 or 60 day 'option period'. When they leave you though, then you can make a huge difference. Sure, you might not particularly inclined to, after all they might be leaving you in the lurch, and there might be some acrimony, but hopefully they will thank you one day.

RETIREMENT

If you really want to make a difference, make sure your retirees start seeing a financial advisor at least 5 years away from their retirement. They are going to have to get a good hold on their budget and expectations long before they go on a fixed income. The advisor will need to run projections on how sustainable their retirement income will be, what portfolios they should invest in, and whether they should add to their retirement pot over the last five years. Retiring an employee is NOT just a matter of filing out a form. I recently helped 'unravel a case of an employee, retiring after 27 years with one of our biggest retailers. The 'chief cook and bottle washer' at store level, who also had 'Store HR' in his title, prepopulated the retirement form for the retiree. With a single tick to a box, the retiree was advised (yes advised!) to cash in his pension. All R2m of it. The tax on that ran to HUNDREDS of thousands of rands! His wife (one of my clients) had the good sense to worry that the pension was being properly handled and gave me a call. Let's just say I made myself very unpopular with that company's head office until I had tracked down that form and got it withdrawn. If I hadn't caught it before it went to SARS, I wouldn't have been able to unravel that 'advice'. Believe me, if I hadn't stopped it, I would have dragged someone to the FSB to explain why he was giving advice in contravention of the act. This incident was one of the main reasons I decided to write this eBooklet.

Although you won't be involved in coming up with the recommendation, it is important that you understand the absolute basics of the regulations

Recommendations: Your Group Benefit consultants will probably be able to help you with this 'retirement coaching', but if not have someone you can get to help. Be aware of 'vested interests' however. Some Group Providers try and hang onto the funds.

PRESERVATION

If preservation of retirement of funds were compulsory, the retirement scenario for hundreds of thousands of former employees would be ain a far better situation than it is today. There are still cases of employees resigning from their jobs just to get their hands on their pensions. Preserving retirement funds means that the funds are moved into a 'preserver' or 'retirement annuity', without being taxed. An employee can withdraw ONCE from the preserver (this could well change). That one time withdrawal can be 100%. Withdrawals from retirement annuities are prohibited before retirement (starting age 55). Your fund may allow employees to 'preserve' their portion in the fund – just make sure what the 'small print' says, especially when it comes to moving, fund choice and withdrawals. It is interesting to note that retirement funds, while still invested, are protected from creditors (but not divorce decrees).

CONTINUATION OPTIONS

Many new Group Life cover policies have a 'continuation option' that allows the employee to pick up the policy in their personal capacity, without underwriting. This can be very powerful for employees that are going out on their own, or have picked up a medical condition that could result in an 'exclusion or loading' if they tried to get the cover in their personal capacity. For example, a car accident with mild whiplash can result in a life-long back and neck exclusion. Removal of a melanoma can result in a 500% loading on the premium (or outright decline). It is important to have personal 'life' cover, not only to 'top up' what you already have on the Group platform, but if you need it as 'surety' for a loan. Group Life cover cannot be ceded for surety.

Medical Aid Continuation

On moving jobs, employees can usually take over the membership of an open scheme in their personal capacity, with no waiting periods. The same applies to someone moving onto a new medical aid straight from an employer's medical aid. Normally is you move medical aids there will be a 3 month waiting period before any clam can be made, and a possible additional 12 month condition specific exclusion. 'Gaps' in medical aid cover after the age of 35 results in a permanent premium loading and should be avoided at all costs. This transfer is very important if your employee is joining a company with no medical aid or going out on their own.

Conclusion

When you, or an employee of yours moves into or out of a job, take a moment to focus on preserving what you have accumulated, and not just on the future prospects. Most of these decisions cannot be reversed later, and can have a significant impact on your, or your employees, financial stability.

If you'd like to contact me, or set up an appointment so I can discuss any of the above in more detail you can send me a message HERE, or on dawn.ridler@mweb.co.za, dawn@kerenga.com.