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Retrenchment!

10 Tips to Deal with this Harsh Reality

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Describing the past year as being tough is an understatement in almost all business sectors, locally and globally. South Africa's unemployment rate was at 26.7% as at the end of March 2016 (Quarterly Labour Force Survey, Stats SA) and it has no doubt increased due to the high levels of retrenchments that are taking place across various industries.

When someone is faced with retrenchment, there is an emotional rollercoaster ride that they go through as they come to the sudden realisation that there is no regular income in the immediate future to pay monthly household bills. Finding another job is also not easy to come by given the current economic environment, and the first thing that clients want to do is cancel their risk policy contracts as affordability becomes an issue. Their second focus is on making their Retirement Annuities (RA's) paid-up; the third aspect is cashing out their corporate retirement fund benefits when exiting the fund, and lastly they may want to take a partial or full withdrawal from their existing preservation funds as they need cash to supplement their immediate lifestyle costs.

To help any affected parties deal with this unforeseen situation, here are 10 tips:

1. Retrenchment would be a good reason to dip into your emergency fund (if you have one) to help you get through this rough period. Remember, it is advisable to have at least three months' worth of income saved up in an emergency fund.

2. Ask your financial planner to confirm or investigate if your risk policies have a waiver on premiums in the event of you being retrenched. If your policy does have this waiver and your circumstances qualify you to claim from this benefit, your risk premiums will be borne by the insurer on your behalf for a certain period of time which allows you to still be covered for death, disability, and/or dread disease whilst you get your affairs in order to give you peace of mind. Some life insurance-based RAs may also have this waiver.

3. One can consider taking out cover to protect one's income in the event of retrenchment – insurers will typically offer a risk benefit that pays out an income for a finite period of time based on your current income but capped at a certain level.

4. You may land a contract role soon after being retrenched which may come without group benefits. If your existing corporate retirement fund has a continuation option on risk (death, disability, dread disease, and funeral) benefits, consider taking the benefits you need in your personal capacity as the medical underwriting process is quite limited (this is usually subject to just an HIV and nicotine test). Most insurers allow you between 30 and 60 days from the date of exiting the fund to exercise this option. The premiums for the same level of cover will however be based on your individual demographic factors such as your gender, age, smoker status, highest academic qualifications, occupation, annual income, etc. The premium could end up being cheaper or more expensive than what was being paid on the corporate retirement fund.

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5. You will not incur a penalty on the capital amount of a unit trust-based RA by making contributions paid-up. The accumulated lump sum will grow according to the performance of the underlying funds. When you are ready to start contributing again, it is seamless to re-instate the contributions.

6. Transfer your corporate retirement fund capital into a preservation fund rather than cashing. The transfer is tax-neutral and should you need to access these funds at some point, you will be eligible to make one withdrawal before age 55 either partially or fully but subject to the tax that applies. If you do secure employment shortly after being retrenched and cashed out your corporate retirement fund, you would have incurred an unnecessary tax liability that has implications further down the line in terms of your tax-free exemptions allowed when you do reach normal retirement age.

7. If you are retrenched on an involuntary basis and you receive a severance pay out, your employer will apply for a tax directive on the severance pay so that you qualify for the R500 000 tax-free exemption that applies to individuals over the age of 55 even if you are below that age. Remember, if you do this, you will not be allowed any further tax-free exemptions on cash withdrawals from retirement funds when you do retire after the age of 55 (assuming that you use up the full exemption when you get retrenched).

8. If you decide to withdraw your corporate retirement fund over and above your severance pay, SARS will combine the severance pay and retirement fund together in their calculation of the tax-free exemption allowed.

9. SARS will not grant the R500 000 tax-free exemption for individuals if they opt for voluntary retrenchment. Those over age 55 who choose voluntary retrenchment but with the intention to retire early will however qualify for R500 000 exemption.

10. If you are over age 55, early retirement may seem like an attractive option whereby you can combine all retirement funds into an annuity income stream. However, bear in mind the longevity risk that you are taking as you will be reliant on this income for a longer period of time than you would have if you retired at a later date. Inflation will start to erode the buying power of your income faster than you think if you don't select a prudent draw rate (assuming that you opt for a living annuity as opposed to a guaranteed life annuity).

The days of having a job for life are over. Your financial plan should have robust features built-in to it for you to successfully manage your affairs should you face the harsh realities of retrenchment.