The Economic Impact of Retrenchment

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How would retrenchment affect your financial well-being?

It is therefore important to educate yourself about the impact of retrenchment on your financial well-being and what to do if you lose your job. While this is a scary thought, it is always better to hope for the best but plan for the worst.

If you are retrenched, you will be entitled to a severance package, of at least one week's pay for every completed year of continuous employment with your employer.

Retirement fund implications

Because retrenchment means leaving your employer, you also have to decide what to do with your retirement savings in the employer's retirement fund. You can preserve your savings by:

- leaving your retirement savings invested in that fund
- moving all your retirement savings to:
- your new employer's fund
- a preservation fund
- a retirement annuity fund

You can also take all or a part of your retirement savings in cash, but then you won't be able to earn the income you need when you retire. Any cash taken out will also be taxed.

According to the 2018 Alexander Forbes Member Watch™ analysis, on average around 9 percent of employees who leave their employers kept their retirement savings invested in their existing fund, their new employer's fund or a preservation fund. In addition, over the last three years, 89 percent of members who were retrenched from their employers cashed in their retirement savings.

The analysis revealed that retirees replaced on average around 30 percent of their pensionable income when they retired. Not keeping retirement savings invested when moving from one job to another (for whatever reason) is one of the biggest contributors to poor retirement outcomes in South Africa.

A misconception of preservation is that the money is simply kept without earning investment returns and won't grow – this is not true. A lump sum transferred to a preservation fund or left in a former employer's fund will grow with investment returns. Unfortunately, you can no longer contribute to the fund. You may make one withdrawal during the lifetime of the preservation fund, bearing in mind the tax consequences. This provides flexibility should you genuinely require the money.

South Africans in general don't save adequately for their long-term needs. This is attributed mainly to the high unemployment rate, breaks in employment, lack of education, distrust of financial institutions, money mindsets[1] and prioritising short-term, high-priority needs. In most cases, any person who has the option to take their retirement savings in cash when they leave their employer will instinctively do so. It may even be considered the “easy” option but even though saving your money now does not serve you immediately, it will definitely benefit you later to meet future needs to preserve it. Ideally emergency savings should be in place to avoid dipping into retirement funds at these exit points.

Tax implications

Everyone is given once-in-a-lifetime tax relief of R500 000 on their retirement lump sum. Note that a retrenchment severance package is considered and taxed as a retirement lump-sum benefit. Therefore, if you are retrenched and receive a severance package, the first R500 000 (of the combined severance and any retirement fund benefit paid out) will be taxed at 0 percent (so, it’s in effect tax free). Any further cash balance taken is taxed at the retirement tax table rates. However, this tax benefit will be exhausted and cannot be used again at retirement, as SARS applies an aggregate of lump-sums principle to retirement benefits.

Tips:

- **Get counselling -** Retrenchment is a financially and emotionally stressful experience. Consider counselling before making any major financial decisions. Many financial decisions will be made, and budgeting and cutting costs are unavoidable. However, it’s important to put thought and consideration into these decisions.
- **Keep paying medical aid contributions and insurance premiums-** These are essential and can prevent further financial distress should something else unexpected happen. Ensure you and your family are on a medical aid option that meets your needs. Rather reconsider any luxury goods and services or cut back on wasteful expenses.
- **Save for emergencies -** Consider contributing towards an emergency savings pot. Aim to save at least three times your monthly salary as a financial buffer. This will help take some of the pressure off if you are ever retrenched.
- **Get advice -** Because personal circumstances differ between individuals, seeking financial advice from an accredited adviser could prove beneficial in limiting expenses and managing your money so that it can stretch further and meet your specific needs. Also consider your fund’s retirement benefit counselling options, which may assist you in the financial decisions related to your retirement savings.
- **Keep learning and growing -** With global economic activity evolving, the fourth industrial revolution looming and retrenchments on the rise, it is crucial that we have a competitive edge as individuals. In an era where technology is advancing inevitably, individuals must constantly educate and upskill themselves to remain relevant in the market.