FRIDAY, 23 APRIL 2021

irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

TABLE OF CONTENT

LOCAL NEWS

Proposed changes to Reg 28 offer opportunities to revive the economy

Investing in infrastructure offers pension funds stable long-term returns.

While just about everybody contributing to a pension fund usually gets very concerned whenever changes to the so-called Reg 28 – Regulation 28 of the Pension Funds Act – are mentioned, some within the industry see the latest set of proposed amendments as a positive development that could have real long-term benefits for the country and pensioners alike.

What are the amendments to the act?

The proposed changes to Reg 28 give the pension fund industry more leeway and the opportunity to increase investment in infrastructure by increasing the proportion of funds (up to 15%) they are allowed to invest in asset classes other than the traditional top three – shares, bonds and property. The proposed changes widen the opportunities to invest in infrastructure by referring to infrastructure as a separate asset, in contrast with the current regulation that lumps it under a group of assets called alternative assets. Pension funds could choose to do so if they believe in the asset opportunities and would not be forced to invest into infrastructure.

Johan Marnewick, Head of Credit Alternatives at Stanlib, supports the proposed amendments. “The market was anxious leading up to the announcement of draft legislation,” says Marnewick, referring to concerns that government will force pension funds to invest in certain assets by setting a minimum to invest in government bonds or infrastructure. “That would have opened the door to prescribed assets. That the proposals rather set a ceiling, or a maximum, gives pension fund investors the freedom to choose the best investments from a range of different assets, including infrastructure. “In fact, the industry may be comfortable with an increase in the allowance to 20%.”

Infrastructure: physical assets that grow the economy

Marnewick refers to infrastructure investment as investing in the “real” economy, where it realises the goals of economic growth and creating employment, while investors earn good returns. “Currently, SA has an enormous capacity constraint to grow the economy. The truth is that the constrained capacity is both financial but also due to a lack of skills. The result is that our economy can only grow at around 1% to 2% per annum, at best. Investing in infrastructure can address some of these headwinds and increase capacity through financial investment and attracting and growing skills in the sector," he says. Infrastructure shouldn't only refer to public infrastructure but also private infrastructure such as schools, hospitals, housing, electricity installations, fibre networks, communications, cellphone towers and many other examples of assets that are needed to make economic activity possible. "We have had chronic underinvestment in these real assets that promote economic growth and it's stifling the potential within the economy."

Infrastructure is a suitable long-term investment proposition

Currently in South Africa often banks and private equity funds are financing infrastructure projects. "Bank funding for these projects results in a mismatch in liabilities and assets for bank balance sheets – causing them to have to hold more expensive capital and other liquidity buffers. Investing in infrastructure is a long-term endeavour. In contrast, life companies that underwrite retirement products and pension funds have longer dated liabilities which they should match to longer-term investments.

The retirement industry is much better placed to finance infrastructure," says Marnewick, adding that it comes down to bringing longer term providers of capital closer to where it is needed, resulting in more efficient outcomes for the economy as a whole. In addition, he points out that there are several other benefits in recognising infrastructure as an asset class for pension fund investors, including access to a wider range of investment opportunities and a lower-risk outcome through more diversification away from traditional assets which seem expensive at the moment.

Private investors – in partnership with the public

Marnewick points to the fact that the private sector is already the largest investor in infrastructure in SA. "Ideally we need to invest around 30% of GDP into infrastructure to grow the economy. We are nowhere near this," he says. "We dropped from 20% five years ago to 18%. Government contributed 5%, with the private sector making up the other 13%. Ideally a partnership is needed between the public and private sectors; however the public sector's contributions don't have to be in the form of capital, but can be in the form of the necessary regulations to allow the private sector access to public assets or services." Marnewick refers to the success achieved with regards to renewable energy projects, which have to date attracted over R200 billion in investment and created around 40 000 jobs during the construction of the various wind farms and solar array installations.

Transforming South Africa for the better

Marnewick believes it is in all South Africans' longer-term best interests to grow and modernise the economy. Government's contribution doesn't have to be financial, but through regulations that foster and attract real investment "The pension fund industry can be part of the solution here," he says. Cautioning against ever-present investment risks, he says pension funds can avail themselves of the expertise and experience that already exists in the fund management industry to avoid the obvious pitfalls. "Once investments start to flow, the jobs, skills development and long-term wealth creation will follow."

Moneyweb | 22 April 2021

How retirees benefit from many eggs in multiple baskets

Income stream management in retirement has been Glacier's focus for a number of years. Linda Blom, Business Development Manager at Glacier by Sanlam, unpacks what this means, some of the roadblocks to retiring with confidence, and what you need to do to get on track.

The retirement conundrum

We start saving too late; we save too little; we spend what we can access when leaving employment; we retire with debt; we don't review our retirement savings periodically and we don't get advice from a professional financial planner. In one sentence Linda sums up the reasons so many people face their retirement with anxiety and dread. She offers the following facts to consider that tell a bleak story:

- Half of South African retirees can't make ends meet.
- Half of retirees have adult dependants to support.
- More than half don't have funds saved for a rainy day.
- One in three can't cover medical expenses.
- One in three retirees has debt to cover after they retire.

Added to this conundrum, says Linda, are the risks at retirement. She lists them as follows:

• **Sequence risk –** withdrawing from your retirement account at a time when the markets are not doing well and that could damage your overall return;
• **Longevity risk –** the risk of living too long (and consequently outliving your retirement capital);
• **Investment risk –** the risk of negative performance in the markets; and
• **Inflation risk –** the risk that your income doesn't keep up with inflation.

Multiple eggs, many baskets

With this backdrop, there are many important, complex financial decisions to make when you retire. There are many options available to provide for your retirement, and there really is no one-size-fits-all solution. Combining solutions could provide the best answer to ensure sustainable retirement income.

However, choosing solutions and combining them for best effect, is tricky and has to take into account many factors that are unique to the person for whom the plan is being designed. The image below outlines the solutions available that can be combined, and their features that are taken into account to tailor a plan for your unique needs and lifestyle.

Here are some of Linda's tips for people facing retirement, to help ease some of the anxiety you may be feeling:

1. It really isn't too late to plan. You may think you've left it too late, but putting a plan into motion, at any time, can only improve your financial situation down the line.
2. Don't take the journey alone – appoint an appropriately authorised financial adviser if you don't already have one. They have the tools and know-how to help you make better decisions as they are not emotionally involved in your finances. Even skilled professionals in financial services call upon the expertise of an adviser to help navigate the tricky journey of financial planning.
3. Don't put all your eggs in one basket. Even though we're currently in a scenario of low inflation and low interest rates, this might not be the case over the long term. A combination of retirement solutions gives you the flexibility to benefit from different market circumstances.
4. Choose your solutions provider wisely. The brand behind the solution makes a big difference to your financial planning process and their track record cannot be underestimated. Your financial planner will help you choose a provider that has a platform that enables easy administration, like changes and switches.

5. Drown out the noise. It's easy to succumb to media hype or even the seemingly knowledgeable opinions of your family members or friends. However, it is best to leave expert advice to authorised experts. They are trained to take your unique lifestyle and needs into account – and their advice is based on solid research and investment industry insight.

FA News | 19 April 2021

How impact investing can help reverse losses in the battle against inequality

Benedict Mongalo, the managing director of Novare Impact Investment Partners, looks at how impact investing can make the world a better place and provide returns. For all the noise against rising poverty, hunger and unemployment, the numbers are still going the wrong way. Yet, the world is awash with cash following unprecedented stimulus that spurred stock markets to record highs, interest rates to all-time lows and a global scurry for everything from mielies to cryptocurrencies.

This paradox need not exist. Impact investing is successfully meeting the overwhelming need to address social inequality, environmental degradation, and infrastructural gaps with the requirement that invested capital make a financial return. According to data compiled by the Global Impact Investing Network, impact investing has seen assets under management jump from zero to $715 billion in just over a decade -- and most funds taking this approach by far outperformed their expectations. While often lumped together with environmental, social and governance investment strategies, impact investing takes a different approach by looking for a more direct outcome.

ESG funds, for example, buy stocks based on how well the companies manage risks such as pollution and work injuries or purchase bonds targeting green financing. Bloomberg Intelligence estimates that ESG assets will top $53 trillion by 2025. Impact investors search for projects, companies or communities seeking to solve some of the world's most pressing challenges. Once made, these investments are then objectively measured to determine how effective they are at making the world a better place, alongside a financial return.

The global push toward sustainable investment is shining light on the reality that investors can no longer bask in the glory of their rising wealth without turning that capital into something that will serve the broader needs of our people and our environment. Society's most vulnerable do not directly share in the benefits of soaring stock markets, higher commodity prices or record-low interest rates. On the contrary, the poor end up paying more for food. Let us take booming agricultural markets as an example, where investors can quickly snap up commodity futures, agricultural exchange-traded notes or index funds, or other such products that are available to buy and sell. These will always be available, however, the most vulnerable in society barely have an opportunity to participate in financial markets. To make a difference and still make money needs a fresh perspective. Where there is food insecurity due to supply shortages and surging commodity prices, there are opportunities.

These can include the funding of an agricultural project to boost output, uniting communities or operations to improve economies of scale, building a processing plant, or better connecting producers to distributors. The benefits then become tangible through stable or even lower prices, improved workers' well-being, and potentially a bigger market with a better chance of thriving. Impact investing as an asset class is only beginning to play a role where shareholder interests merge with those of a broader group of stakeholders.

Considering that governments no longer have the resources or means to meet their citizens' needs in areas from energy and transport to health and education, there is plenty of room to grow and numerous gaps to fill. With many of the gains made against poverty wiped up during the Covid-19 pandemic, the urgency to rebuild a more inclusive society is more desperate than ever. It is possible.

FA News | 21 April 2021

Will I have to pay penalties for transferring my RA?

Can the company enforce its terms and conditions without a signed contract?

I have a retirement annuity with a company that was taken out in 2007. I have recently realised I am losing money with this investment. The growth is at -1.3% currently, so I am stopping payment and want to transfer the money. The company wants to charge me penalties for this. I have requested a copy of the signed terms and conditions where I agreed to these terms. It turns out they do not have a copy of the signed contract. Can they enforce their terms and conditions without a signed contract?

I sympathise with you that the investment growth of your retirement annuity has not been favourable. However, before digging deeper into your question, I need to stipulate that it is difficult to provide specific advice on your specific retirement annuity, as I am not privy to the structure and type of retirement annuity in question and in addition whenever questions of your financial circumstances are concerned, one should realise that to respond to you in this format is not ideal as we do not know your own personal financial situation. As such I would recommend that you consult a licensed financial planner who will assist you in detail in that regard. I have however summed up generalised information that might assist in answering your question. First and foremost, you are allowed to make your retirement annuity paid-up where you no longer pay monthly contributions but remain invested until you retire i.e., from 55 years onwards.

At retirement, you are allowed by law to take a third as a cash lump sum (subject to retirement lump sum tax tables of the respective fiscal year) and the remaining two thirds must go to a compulsory annuity of your choice. Coming to the question of transferability to another retirement annuity provider; if fund rules allow, you are free to transfer your paid-up retirement annuity to another retirement annuity provider, but you cannot switch out of the tax-efficient retirement annuity and buy unit trusts. When considering a Section 14 transfer between two retirement annuities it would be recommended that any penalties or fees be taken into consideration.

Penalty fees are normally charged by the retirement annuity you are transferring from. Where there are fees that have been incurred by your retirement annuity policy, typically the fees on the retirement annuity policy were charged upfront for the term to maturity of the policy. Thus, there would still be fees payable by your policy that has already been paid by the retirement annuity provider but has not yet been deducted from your particular policy. In such cases, as an investor, you would need to consider whether the penalty fees charged would outweigh the long-term benefit of transferring to a new retirement annuity.

In addition, should you wish to continue with the Section 14 transfer to the new retirement annuity then your current provider would require you to sign off on the penalty fee charged. The penalty fee would be deducted from the current value of the retirement annuity. Should you decide that the penalty fee is not to your benefit then I would suggest that this exercise be periodically repeated every six months to a year, to determine if the penalty fees have reduced to the point where you could consider the penalty fee being acceptable (in my mind this would be when the fee falls below 8% to 9% of the capital value of the current retirement annuity).

I would further suggest that a ‘new generation’ retirement annuity is entered into where any fees are charged to the policy on an ‘as and when’ basis, which means that at any time the investor can transfer this retirement annuity to another provider without any penalty fees being charged. Additional considerations to take heed of include the contribution gap that arises when you contribute monthly via debit order between the older service provider and the new provider and whether there were linked benefits to the retirement annuity policy such as life, disability or additional insurance products. If you decided to remain with this retirement annuity offered by your current provider, I suggest rebalancing your retirement annuity's underlying funds to try and improve the investment performance (if this is an option on your particular retirement annuity policy). However, please remember that a retirement annuity has to comply with Regulation 28 of the Pension Fund Act, which is the Prudential Investment Guidelines, and this may limit how you would like to restructure the underlying funds in the retirement annuity policy you currently have.

You may incur some switching costs depending on the investment platform used, but this is relatively lower than the penalties liable should you transfer your retirement annuity. I trust this response assists you in your quest to plan for your retirement. Please be aware that this response cannot be construed as advice – we would recommend that you consult with a financial planner that is employed by a licensed financial services provider prior to making any final decisions on your retirement annuity.

Moneyweb | 22 April 2021

INTERNATIONAL NEWS

UK pension funds develop support for RI reporting challenge

A group of influential UK pension investors have developed a reporting tool to help them and other asset owners meet their responsible investment and stewardship requirements "efficiently and effectively". The pension funds worked with Chronos Sustainability, a consultancy, on the tool, which focuses on reporting obligations linked to the reporting and assessment framework for the Principles for Responsible Investment (PRI), and the Stewardship Code and implementation statements in the UK. It maps the reporting requirements against each other, allowing users to identify elements of one set of reporting requirements that could meet another, and providing a checklist of requirements.

The Universities Superannuation Scheme (USS) was one of the pension funds involved in developing the tool, alongside Brunel Pension Partnership, BT Pension Scheme, the Church of England Pensions Board and RPMI Railpen. All are members of a "Responsible Investment Roundtable," an initiative that brings together some of the UK's largest asset owners. In a post on the USS website, David Russell, head of responsible investment at the scheme's in-house investment manager, and Rory Sullivan, CEO of Chronos, highlighted the benefits of and need for good stewardship and responsible investment reporting by asset owners.

However, pension funds needed to ensure that the time and resources committed were “well spent”, they said. According to USS, its draft PRI submission alone is almost 350 pages, and it needed to hire a consultant to help it complete its Stewardship Code report. Russell and Sullivan also noted that the work on the tool and investors’ experiences showed that although there were some efficiencies to be gained, they were not many relative to the volume of material being reported.

“We found that the details of the reporting requirements – essentially a survey in the case of the PRI compared to a free-standing report for, say, the Stewardship Code – mean that while there are some commonalities on data and indicators, there is inevitably a large amount of additional writing and text editing involved in preparing submissions,” they wrote. They explained that the investors intended to use the reporting tool to explore the potential for consolidating reporting requirements and for a reduced reporting burden on asset owners, for example whereby leading organisations would only report biannually rather than annually.

On LinkedIn, Victoria Barron, head of sustainable investment of BT Pension Scheme, explained that the pension fund had supported the development of the tool “to make sense of the increasing regulation and calls for information”. “We hope [it] helps others navigate the current landscape and will lead to refining requests posed to asset owners,” she wrote.

IPE | 21 April 2021

Pension funds hear from beneficiaries on ESG – report

Pension funds and other asset owners are increasingly interested in beneficiaries' preferences when it comes to ESG issues, according to a report released by the Principles for Responsible Investment , a U.N.-affiliated investor initiative. PRI interviewed 14 asset owners worldwide that are PRI signatories on how they engage with beneficiaries. The resulting guide will help asset owners incorporate their beneficiaries' preferences, "which should be a fundamental aspect of an asset owner's investment strategy, policy and strategic asset allocation," said the PRI report, released Wednesday.

The asset owners were:

- AkademikerPension, Gentofte, Denmark.
- Alecta Pensionsforsakring, Stockholm.
- AP6, Gothenburg, Sweden.
- CareSuper, Melbourne, Australia.
- CBUS Super, Melbourne, Australia.

- Environment Agency Pension Fund, Bristol, England.
- J.P. Morgan Asset Management.
- Momentum Metropolitan Life Ltd., Centurion, South Africa.
- National Employment Savings Trust, London.
- Previ - Caixa de Previdencia dos Funcionarios do Banco do Brasil, Rio de Janeiro.
- SEB Life and Pension, Stockholm.
- Pensioenfonds ABP, Heerlen, Netherlands.
- Pensioenfonds Horeca & Catering, Zoetermeer, Netherlands.
- The Vanguard Group (Australia).
-

Interest on the part of pension funds and other asset owners is being driven by an evolving regulatory landscape, an increased acknowledgment among asset owners that investments should reflect the values of their beneficiaries, and increased realization of the benefits of doing so, the report said. In addition to exploring those factors, the guide offers a four-step process for understanding and addressing beneficiaries' core values, and a survey template to get relevant information from beneficiaries about their preferences.

Pensions&Investments | 21 April 2021

OUT OF INTEREST

Bubble territory or not - should my investments change?

It is hard to imagine that only a year ago, markets hit rock bottom and investors were worried about how the rest of 2020 would pan out. Across the globe, investors were faced with questions such as - will valuations decline even further? How and when will markets recover? Is it perhaps time to deploy cash into the market? Should we disinvest and wait for better days? Should we sit on our hands and do nothing?

Today we are facing a different dilemma. Markets are at an all-time high.

In a short space of time, everything has changed. The rollout of Covid-19 vaccines and associated hopes for imminent economic recovery, along with unprecedented fiscal and monetary support from governments and central banks around the world, has driven equity markets beyond or close to record highs of late. With stock market valuations at historically high levels speculation about a market bubble has been rekindled.

The Price-to-Earnings (P/E) ratio as a measure of valuation

Investors often look at a valuation in its most traditional form, also known as the P/E multiple. A P/E multiple (price to earnings ratio) gives investors an indication of what the market is willing to pay for every R1 of earnings generated. Setting aside the impact of short-term changes to profit, a high P/E ratio typically indicates the expectation and/or perception that a company could/would have good growth prospects, or less risk to profits, than the average company.

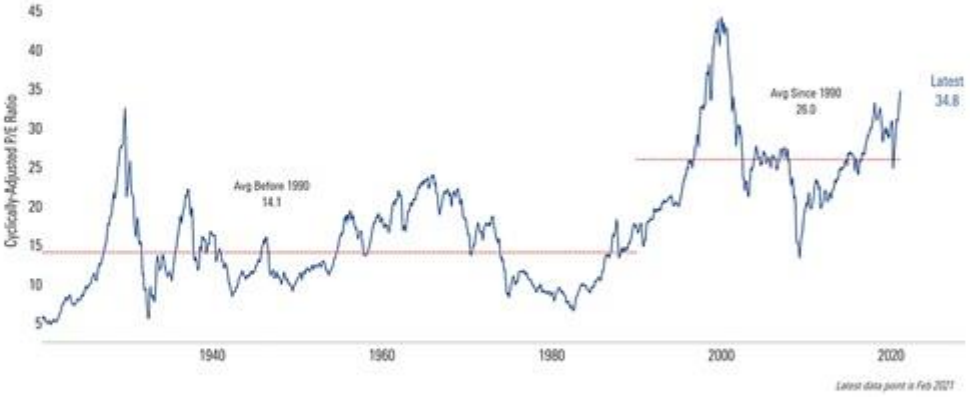
Thus, a company with a proven long-term track record of growing profits would normally trade at a high P/E ratio and a company with low growth, or a patchy profit history, would trade at a lower P/E ratio. While P/E is an incredibly good starting point to assess the valuation of a company or a market, many investors fail to look deeper.

Delving deeper into markets

The P/E ratio of the S&P 500 is trading at near-record highs. One could argue that it is, perhaps, a very blunt way to look at the world. It is important to unpack what drove the performance of the S&P 500 to these levels. When analyzing the data depicted in the below two graphs, it is clear that most of the performance of the S&P 500 came from large FAANG stocks. [FAANG is an acronym referring to the stocks of the five most popular and best-performing American technology companies: Facebook, Amazon, Apple, Netflix and Alphabet (formerly known as Google)].

Exhibit 1 depicts the cyclically adjusted P/E ratio for the US market.

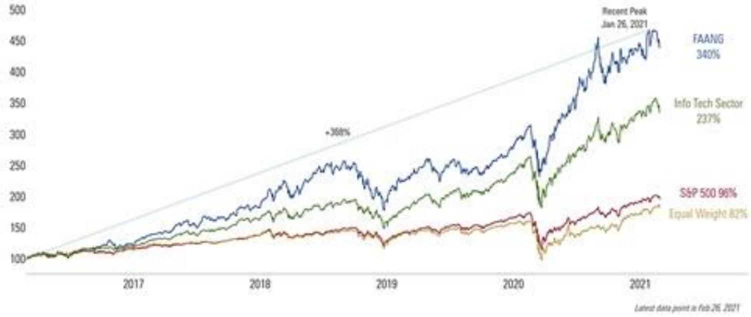
Exhibit 1 | The Shiller P/E Ratio – Valuation Using Ten Years of Inflation Adjusted Earnings



Source: Clearonomics, Robert Shiller. Data as at February 2021. Past performance is not an indication of future performance.

Exhibit 2 differentiates between the performance of FAANG stocks, other technology stocks and the S&P 500 as a whole, over the last couple of years.

Exhibit 2 | FAANG Stock Performance – Facebook, Amazon, Apple, Netflix and Alphabet (Google)



Source: Clearonomics, Standard & Poor's, Refinitiv. Data as at February 2021. Past performance is not an indication of future performance.

There is no doubt that most of the large tech giants are good companies, with robust business models and incredible management teams. However, one must keep in mind the two tailwinds that existed – the first being record low interest rates for a prolonged period of time and the second being that most of these FAANG stocks were direct beneficiaries of lockdowns worldwide. Therefore, caution should be applied when assessing if they will continue to generate such exceptional performance indefinitely. Looking at the opposite side of the coin - what about the other sectors that have not enjoyed such lucrative returns over the last number of years? Could the grass be greener on the other side but investors are not seeing it?

Is local still lekker?

On the local front, investors have enjoyed good returns from the JSE All Share index over the last few months. The question remains - will this continue or are we due for a correction? The truth is that nobody knows how long a rally can and/or will continue. What we do know is that emerging markets have been severely out of favour for the last decade or so. **Full Report:** ***https://www.fanews.co.za/article/investments/8/general/1133/bubble-territory-or-not-should-my-investments-change/31721***

FA News | 20 April 2021

Switchboard: 011 450 1670 / 081 445 8722
Fax: 011 450 1579
Email: reception@irfa.org.za
Website: www.irf.org.za

2nd Floor Leppan House
No 1 Skeen Boulevard
Bedfordview 2008