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THE RETIREMENT INDUSTRY NEWSLETTER

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New tax bills – a step closer to retirement reform in SA and immediate 3-year lockup

The draft Taxation Laws Amendment Bill ("TLAB") was published on 31 July 2020. As announced in the Budget Speech, any South African leaving in future will be subject to a much stricter process from 1 March 2021 onwards. But there was also a surprise 3-year lockup announcement for anyone with a South African pension fund, seeking to leave South Africa. This appears a sign of things to come for private pensions in South Africa. Anyone with a proper pension, ideas to move abroad or just not trusting governments plans with your pension money; needs to "read the room" and make careful decisions.

Current position under law
Under the current dispensation, the definitions of "pension preservation fund", "provident preservation fund" and "retirement annuity fund" in section 1 of the Income Tax Act No. 58 of 1962 ("the Act") contain a proviso that entitles a person to withdraw their retirement benefits before retirement age. This applies where that person "*is or was a resident who emigrated from the Republic and that emigration is recognised by the South African Reserve Bank for purposes of exchange control*". In essence, this proviso, which reads the same for each of these definitions, permits a person to withdraw their retirement benefit upon completion of a process of emigration through the South African Reserve Bank.

Proposed amendment The proposed amendment follows the February Budget Speech, where the government made its intentions clear to overhaul this process as part of the modernisation of our exchange control system, as stated in Annexure C to the Budget Review:"As a result of the exchange control announcements in Annexure E, the concept of emigration as recognised by the Reserve Bank will be phased out. It is proposed that the trigger for individuals to withdraw these funds be reviewed". The TLAB, specifically paragraphs (h), (k) and (m) of section 2(1), gives effect to this decision, by amending the proviso to the aforementioned definitions in section 1 as follows: "is a person who is [**or was**] not a resident [**who emigrated from the Republic and that emigration is recognised by the South African Reserve Bank for purposes of exchange control**] for an uninterrupted period of three years or longer" (emphasis added)

In other words, reference to the emigration process is substituted with a new test that requires a person to prove they have been non-resident for tax purposes for an unbroken period of at least three years. This new test will apply from 1 March 2021. How this must be proved other than 'financial emigration' remains unclear at this stage. Practically, after the effective date, your retirement benefits will be locked in South Africa for at least three years. The proposed amendment signals a big policy shift from a fiscal perspective, but this is one piece to a bigger puzzle that should have those who seek to emigrate on high alert.

The bigger picture

The ANC's 2019 Election Manifesto expressly states that the party will "*Investigate the introduction of prescribed assets on financial institutions' funds to unlock resources for investments in social and economic development*." The discussion on "prescribed assets" has also been mentioned by President Cyril Ramaphosa and it effectively involves compelling retirement funds to invest in government-backed assets or invest directly in government infrastructure projects. The government's intent to push this initiative was confirmed in the ANC Economic Transformation Committee's discussion document, published on 8 July 2020 and which states that "*Changes should be made to Regulation 28 under the Pension Funds Act to enable cheaper access to finance for development*."

This is critical because Regulation 28 under the Pension Funds Act No. 24 of 1956 is the main hurdle that prevents government from imposing the prescribed assets policy, as it requires funds to act in the best interest of its members. It would be very difficult to reconcile the prescribed assets policy with Regulation 28 in its current form, especially where it means investing in State-Owned Enterprises such as SAA, Eskom and the SABC. This appears to explain the move to amend it.

What does this mean for your retirement fund?

The amendment may be argued as only a draft proposal written into law or a simple by-product of a shift in exchange control policy; but do you risk your retirement life savings on assumptions of governments good intentions? This change forces the following categories into immediately making some tough decisions on their retirement. Even leaving your status quo means you have decided to subject yourself to a 3 year lock-up, retirement funding investments being subject to a "new" Regulation 28 which services "cheaper access to finance" as opposed to maximising your retirement.

Who are most impacted?

Our daily interaction with employers, executives and expatriates indicate that the following categories should give this careful consideration –

- Does it remain prudent for South African executives to keep taking a tax break and maximising their South African approved retirement savings?
- Where you have large retirement savings, the opportunity will soon be over to make best possible investment decisions – soon some will go towards cheaper access to finance.
- South Africans looking to leave in the next couple of years will benefit from at least expediting their process on retirement savings, being they are locked in for 3 years.
- South Africans who have already left, but who have not yet done financial emigration, should consider doing this within the next 6 months before the window closes.
- Those who have already financially emigrated, but left investments behind, should reconsider their position.
- South Africans with children or other foreign beneficiaries, should relook at their investments and to align with this new landscape.

FA News | 17 August 2020

ANC won't use pension funds to bail out state-owned enterprises – Godongwana

The ANC had tabled a document which puts infrastructure at the centre of the country's economic recovery post-Covid-19.

ANC economic policy guru Enoch Godongwana said he wanted to debunk the notion that the ANC intended to use pension funds to bail out collapsing state-owned enterprises. He also sought to debunk "the latest theory" that the ANC wanted to use worker pensions to fund a state bank. "All of those things a mischievous," he said. The ANC's Progressive Business Forum held a virtual discussion on Monday evening around the country's economic recovery plan. The ANC had tabled a document which puts infrastructure at the centre of the country's economic recovery post-Covid-19. To fund infrastructure spend, the party proposed amending Regulation 28 of the Pension Fund Act which would allow access to pension funds.

Amendment

This amendment would use finance institutions to fund long-term infrastructure and capital projects. The law as it stood, did not allow for it. Godongwana said they wanted to "tweak" Regulation 28. "We want to create an environment where trustees (of funds) can invest in infrastructure projects as long as those infrastructure projects are profitable," he said. Sandile Zungu of the Black Business Council said the conversation around amending Regulation 28 was massive in determining how infrastructure projects would be funded.

"The fiscus has no money," he added. Zungu said there would have to be strict measures in place to not put workers' lifetime savings at risk. Godongwana said the proposals made by the ANC for the country's economic recovery was not very different from that of business. He said the country needed a social dialogue to bring everyone together. Godongwana said construction had the ability to absorb some of the millions of unskilled unemployed in the country.

The Citizen | 17 August 2020

Employers looking to cost efficiencies and improved flexibility of umbrella funds amidst current economic pressures

Companies' search for greater cost-efficiencies is evident across most sectors in the COVID-19 battered economy, and retirement funds and group employee benefits are no exception. But it's a lot more than cost efficiencies driving the move to umbrella funds, says Nashalin Portrag, Head of FundsAtWork at Momentum Corporate, as he explores the flexibility of certain umbrella funds and the additional value offered.

Greater efficiencies, reduced costs

Traditional stand-alone retirement funds are being replaced by professionally managed, multi-employer retirement funds which offer the most cost-effective retirement and insurance benefit solutions, according to Portrag. Economies of scale and operational efficiencies synonymous with this form of funding reduce costs for employer and employee. Ultimately this makes it possible to channel more money to members' savings.

According to the 2020 Budget Review, future reforms in the retirement industry will focus on further fund consolidation. We would expect a reduction in the number of standalone funds and conversions into commercial umbrella funds, as the costs associated with smaller standalone retirement funds are much higher. Portrag says, "As the regulatory pressure on governance standards rises, employers' and trustees' time commitment and risks increase. More businesses are recognising that the costs and time required to manage their standalone retirement fund takes the focus off their core business."

Improved flexibility

According to Portrag, there is a general school of thought that umbrella funds lack the flexibility that standalone retirement funds offer. However, Portrag says that this is not true of all umbrella funds. Drawing on his experience, he says some umbrella funds consciously design flexibility into the benefits available to members. Once the employer has made certain initial choices at group level, which they believe are suitable for their employees, flexibility at member-level allows employees to shape their retirement and insurance benefits according to their specific needs and situation.

New hybrid model that suites all employees

Apart from a proactive flexible design, implementation can also offer high degrees of flexibility. A good case study is the large contingent of University of Pretoria employees who joined the FundsAtWork Umbrella Funds in 2019. "We worked closely with the university to implement a flexible model that addressed the needs of all employees - young and old, current and future. Existing employees were given the option of staying on the existing standalone fund or moving to the umbrella fund. This process is an exciting and fresh approach to handle these conversions – where members are empowered to make the ultimate decision." "A comprehensive engagement programme of roadshows, workplace media and written communication made sure that all members had a clear understanding of the different options and were empowered to make an informed decision, in line with their specific needs," says Portrag.

Employer retains control through advisory body

Portrag says that another inaccurate perception about umbrella funds is that employers lose control of the management of their employees' retirement and insurance benefits in an umbrella fund. While umbrella funds are managed by a central board of trustees who looks after the interests of members from multiple employers, some umbrella funds make provision for each participating employer to appoint an advisory body. Advisory body members are elected by the employer and its employees and help to make sure the umbrella fund addresses the needs and interests of their specific employer and employees.

Today's employees expect more immediate value

Umbrella fund members may also have access to value-added benefits that are not necessarily available through a traditional standalone retirement fund. Younger generations expect their retirement funds to add value throughout their working careers, and not just at retirement or when an unexpected event happens. Furthermore, certain umbrella fund sponsors have invested significantly in state-of-the-art digital platforms which enable a more integrated service experience and helps members make informed decisions which lead to better retirement outcomes.

Portrag concludes, "The move to umbrella funds has become well-established in recent years. We can expect the current economic situation to create further momentum for conversion of standalone umbrella funds into commercial umbrella funds."

FA News | 13 August 2020

#Women's Month: Personal finance mistakes to avoid in your 20's

August is Women's Month in South Africa, a time to both celebrate women and to confront the many issues that women face. One of these is financial freedom. To help other young women become more financially independent from an early age, Nomi Bodlani, head of strategic markets at Allan Gray, reflects on common personal finance and investment mistakes she made in her 20s. If you can avoid these, you can better position yourself for financial success in your 30s and beyond.

I remember looking at my first payslip and being completely shocked that the take-home salary had been whittled down by nearly 30% due to what a kind colleague in the human resources department later explained were "benefits". But how are they really benefits if I'm in fact paying for them? This was my first introduction to the cost of tax, medical aid and pension contributions. That first payslip became a crash course in adulthood; along with the sweet taste of my first earnings came the realisation that, like so many facets of life, decisions we make in the present have an impact on our financial future. If I could offer my 20-something-year-old self some advice, these are the money mistakes I would tell her to avoid:

Mistake 1: Believing that you're too young to concern yourself with retirement-related matters

When I was in my 20s, the idea of retirement felt abstract and it was only until I made it real for myself that I understood the actions I needed to take. One way of making it real is to truly understand exactly how much you need to be saving for retirement and how the age at which you start saving impacts this.

While your working life lasts approximately 40 years, the income you earn in those 40 years must provide for your needs, not only during the 40-year period but also, for a further 20 or so years that you could live as a pensioner. Therefore, the more you delay saving for retirement, the larger the proportion of your present-day income you need to put away for this eventuality.

Mistake 2: Not preserving your retirement savings when you change jobs

Whenever you resign from your job, or in the unfortunate case that you are retrenched, you will typically have an opportunity to access the retirement funds that you had saved through your employer's retirement or pension fund; try not to do it. If you do not preserve these funds in a retirement product, you essentially start saving for retirement all over again. I did, and I found myself in the very uncomfortable position of having to find a way to put away 20% of my income for retirement.

The older you are when you start, the more money you will have to put away. Imagine having to save 40% to 60% of your income for retirement at a time in your life when your children are attending high school or completing tertiary studies? That is how much you would need to save if you started between 40 and 45 years of age! However, if you find yourself in a position where you need to make use of some of the retirement funds available after you leave your job, withdraw only as much as you need and avoid the temptation to take as much as you can. This will also help avoid being heavily taxed if you exceed SARS's tax-free withdrawal thresholds.

Mistake 3: Relying too much on debt to meet present day needs

Debt isn't necessarily a bad thing, if used appropriately, but the cost of servicing debt can eat away at our ability to build wealth over the long term. Debt can be useful, but it is important to understand your options and plan ahead, so that you can leverage time to your advantage and earn interest rather than pay interest. When taking on debt, make sure it is for an investment and something that will actually give you benefits over time. I've used debt to go on holiday and it cost me more than if I had saved. Unlike a property investment for example, a holiday doesn't give you much benefit over time. Debt allows you to borrow, at a cost, from the future to meet a present need, while investing allows you to borrow from the present to meet future needs and build wealth over time.

Mistake 4: Not talking to your family about money

Like many South Africans who were "raised by a village", I understand the significant sacrifices that were made to educate me, so when I started working, I felt, quite naturally and without resentment, a huge sense of responsibility to join the village elders and do some raising myself.

Providing financial support to relatives can put a lot of pressure on young professionals and this is why I suggest setting realistic expectations about the level of financial support you are able to provide. In my 20s, I didn't know how to do this and often found myself overwhelmed and taking on financial responsibilities that, in retrospect, I couldn't afford. Open conversations with your loved ones about financial circumstances (yours and their own) will ensure that everyone is on the same page and that you all understand the plan. This will also minimise the financial strain of unbudgeted costs that tend to arise.

Mistake 5: Going at it alone

I completely messed up my taxes at one point while working as an independent contractor and thinking I could figure it out on my own. It was only after seeking professional advice that I could resolve them. A good independent financial adviser is not only going to help you set your financial goals, but also put a plan in place to achieve them. If I could relive my 20s, I would make sure I understood just how valuable time is to long-term financial goals and that in the context of investing, time, if you have it, is free. The earlier you start saving for your retirement, the less you need to save from your current income.

FA News | 13 August 2020

Long-term investors now hold sway over ESG

One-day issues have suddenly become the subject of short-term focus.

Long-term investors – those who have perpetually flagged the kind of systemic and workforce issues that now face companies everywhere – are having an outsized influence during this global crisis. Part of that is [seen in] the surge in interest in environmental, social and governance (ESG) investing. UBS this week said it saw flows to ESG funds and pandemic bonds of more than $71 billion in the second quarter, bringing industry ESG assets under management to $1 trillion for the first time. Citing Morningstar data, the firm found that 56% of sustainable funds outperformed their peers in the second quarter.

Sustainable investors will likely keep the wind at their backs as governments push green stimulus, the Swiss bank's analysts said. Historically, long-term investors haven't been the loudest voices at companies, but there are signs short-term shareholder activists at big companies are starting to get crowded out in such a volatile market. Shareholder activist campaigns at companies valued at more than $1 billion fell 25% in the first half of the year, according to Bloomberg Intelligence.

Speaking up

Long-term investors hold the most sway in annual meeting season, which is just wrapping up for the year. Even though much of the shareholder proposal process was set in motion before coronavirus lockdowns, the first ever virtual-only corporate annual meeting season showed long-term investors more willing than ever to speak up on ESG issues. Investors had more success on climate change and increasingly pushed companies on human rights, diversity and pay equity. They more frequently opposed individual board member elections, were slightly more willing to oppose executive pay packages, and less tolerant of dual class shares.

In a review of the 2020 proxy season this week, Morgan Stanley analysts found environmental proposals have declined 64% since 2016, as companies have been more inclined to preemptively address shareholder environmental requests rather than risk a proposal. Social proposals, however, have increased steadily over

the past four years. Both kinds of proposals saw increasing support, with the average up to 26% in 2020, compared with 19% in 2017, the firm said.

Proposal 'pass rates'

While few shareholder proposals ever garner majority support, even that was more common this year, Morgan Stanley found. The pass rate for environmental proposals rose to 18% in 2020, while no environmental proposals had passed in 2019. And the broader focus on social and inequality issues in the Covid-19 era also translated into higher votes on social proposals. Their pass rate rose to 9% this year, compared with 2% in 2017, and for diversity proposals in particular the pass rate was 20% compared with zero in 2018. In a US presidential election year, lobbying and political transparency proposals also won increasing support, seeing 36% support on average in 2020, compared with 25% in 2017.

"Corporate proxy voting records are a useful indicator of the direction of travel for ESG issues, as they highlight how investors are thinking about ESG risk and value, and indicate where corporate focus might be likely to turn in the near term," Morgan Stanley strategists led by Allison Binns, Mark Savino and Jessica Alsford wrote in the research note. If anything has become more obvious in the past few months, it's that long-term issues are suddenly a matter of short-term focus, but that raises the question of whether the process for long-term ESG shareholders to engage with companies is fast enough.

Moneyweb | 15 August 2020

The cuts in the repo rate and your retirement - what you should know

With so much news about cuts in the repo rate throughout 2020, South Africa has a 'new normal' - it's one in which we have the lowest interest rates in many years. Driven by government's concerns regarding the need to stimulate the economy, the cut in interest rates has been hugely positive for people wanting to borrow, such as those keen to get into the property market - in particular, first-time home buyers. But, the other side of the coin is the impact that these cuts are having on savers, especially on the retired community, many of whom choose to keep large sums of retirement capital in interest-earning cash investments.

The main risk of funding your retirement with cash savings is not lower interest rates. Most pensioners who live off interest from savings have had their incomes dramatically reduced by the interest rate cuts of the last few months, but this is not the only – or even the worst – risk they face. When the investment market melted down in March, those invested mainly in the money markets might have felt relieved to see their capital remain intact. That relief would have been short-lived, though. The Repo Rate, the rate at which the central bank lends money to commercial banks, has been cut by a total of 3% this year, which means that commercially available interest rates have almost halved since January.

Pensioners who are living off interest on their savings are now, like many other South Africans, feeling a lot poorer. They have seen their income shrink month on month without a likely commensurate decline in their living expenses. They aren't really poorer, though – at least not yet. These words may provide little comfort but, on the basis of the official inflation numbers, they are barely worse off than they were six months ago. This is best illustrated by an example. Let's assume a pensioner has cash savings of R1 million and that year-on-year CPI inflation is running at 4,6% (as it was at the end of February).

They earn interest at 7% p.a., paid monthly into their current account, which they use to cover their living expenses. A year later, they would still have R1 million and perhaps imagine that their capital had been preserved. However, because of inflation, the purchasing power of that R1 million has diminished. The cost of living has risen and, with inflation at 4.5%, the R1 million is worth only R956 000 in terms of what it can buy.
In the current situation they would be earning, say, only 4% interest. If they spend the same as before, they would eat into their R1 million capital, leaving just R969 000 at the end of the year. With inflation running at 2,1%, the purchasing power of that money would have diminished to R950 000. Therefore, practically, these pensioners are hardly worse off than before: a negligible 0,6% change, as the lower interest income is mostly offset by corresponding lower inflation. Still, our example underlines the fallacy of this approach. Living off interest income may create the illusion that the underlying capital is being preserved but, in truth, the purchasing power of that money is being steadily eroded...

Cash is considered a low-risk investment because it provides an almost certain return over the contract period. However, that return is also typically quite low. Savers are usually only compensated for inflation, plus a little bit extra, say 1.5-2.5%. The slight loss in wealth in our example above reflects the narrowing of that 'little bit extra', otherwise known as the real or after-inflation return. In our example, it has contracted from 2,4% to 1,9%. This presents the bigger risk in the long-term. Earning a lower real interest rate over a number of years without a cut in spending uses up savings quicker. Additionally, pensioners may find that their expenses have a higher inflation rate, accelerating that depletion.

Indeed, the real issue facing these savers is not the current decline in interest rates, but the prospect that inflation starts to increase again, while the Reserve Bank is unable to raise interest rates because our economic circumstances don't allow it. The real risk is that pensioners face the threat of outliving their savings. Although every household should have an emergency cash reserve to see them through difficult periods like this one, cash is not the 'safe' option for investors with a long-term perspective. This includes retirees, who, depending on their age, might still have an investment time horizon of a couple of decades or more.

Cash leaves them fully exposed to the negative consequences of declining real interest rates. Diversifying into other asset classes would hedge them against this risk Furthermore, cash typically delivers lower long-term returns than other asset classes. Relying on cash alone, therefore, increases the risk that retirees suffer a drop in lifestyle in the future. Although it may make their portfolio's performance more volatile over shorter

periods, diversifying across asset classes should better protect them from inflation and concentration risk, ultimately making their savings last longer.

Such diversification is easily achieved by investing in a low-cost balanced multi-asset fund, which can also facilitate automatic monthly income pay-outs. Even if they opted for a low equity fund, they would still have earned some 2% more p.a. than from the money markets over the last 10 years and would now have 24% more money. Not to mention the peace of mind, knowing that all their eggs were not in one basket.

Personal Finance News | 13 August 2020

INTERNATIONAL NEWS

Kicking pensions can down the road will cost us all

Reform of system urgently needed to protect retirement security of future pensioners

During this pandemic the Government must not ignore the urgent need for pension reform. After protracted negotiations to form a new Government, urgent attention is now required to reform the pension system and protect the retirement security of future pensioners. The underlying issues are clear: our population continues to age; the cost of providing State pension support is growing; and the participation rates and adequacy of private pension saving remain too low. Experience shows that longer-term issues such as these are difficult for politicians to address while working in five-year electoral cycles. As it stands, the programme for government is vague in its commitments to pension reform.

The last government set an ambitious target of 2022 to deliver a new private pension saving system based on automatic enrolment – a key tool in addressing coverage and adequacy issues. While the programme reaffirmed a commitment to autoenrolment, the 2022 target is now highly unlikely to materialise and a new target has yet to be set. Equally importantly, the new programme for government reaffirms the coalition's commitment to the State pension, the bedrock of the Irish pension system. This will provide reassurance and greater certainty for responsible savers planning their retirement.

Equally importantly, the new programme for government reaffirms the coalition's commitment to the State pension, the bedrock of the Irish pension system. This will provide reassurance and greater certainty for responsible savers planning their retirement. However, as the Irish Fiscal Advisory Council recently warned, some fundamental questions remain about the sustainability of the State pension, particularly in light of the new Government's decision to defer planned increases to the State pension age. As the council noted, the

share of the population aged over 65 is forecast to increase from 14 per cent in 2020 to 27 per cent by 2050. Clearly, our changing demographics are accelerating the problem.

“Covid-19-driven market volatility has already resulted in some loss of confidence among private pension savers. Without reform and cross-party support, the rising cost of the State pension, combined with our ageing population, will impose a significant financial burden on future generations and potentially cause a reduction in the living standards and financial well-being of today’s workers when they come to retire.

Shorter-term issues

The programme for government also ignores three important shorter-term issues. Firstly, a commitment to preserving the current system of tax-relief incentives is critical to encourage further private retirement saving. A report released by the Central Statistics Office last year revealed that about 40 per cent of private-sector workers in Ireland still do not have any kind of private pension savings, with many citing affordability as a specific reason.

Loss of confidence

Recent Covid-19-driven market volatility has already resulted in some loss of confidence among private pension savers; any reductions to tax-relief incentives or more draconian measures such as pension levies could cause further significant damage. Secondly, the Government must take steps to simplify and harmonise the retirement benefits products available to individual savers. Currently, there is a bewildering range of pension saving vehicles, including personal retirement savings accounts (PRSAs), personal retirement bonds and retirement annuity contracts, among others. These should all be replaced with a single, portable pension plan and made available to any individual for whom a company pension is not an option, whether in conjunction with an auto enrolment system or not. **Full Report:** ***https://www.irishtimes.com/business/personal-finance/kicking-pensions-can-down-the-road-will-cost-us-all-1.4331537***

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