WEDNESDAY, 6 NOVEMBER 2019

TABLE OF CONTENT

LOCAL NEWS

- Implications of climate change for pension funds
- The industry is hard at work
- The role of trustees in ensuring good governance within the fund
- Only 6% of South Africans will retire comfortably
- RAs: How much can you invest offshore?
- Providing employee benefits for a workforce that thinks differently

INTERNATIONAL NEWS

- How to Turn $20,000 into a $190,000 Retirement Fund

OUT OF INTEREST…

- Moody's leaves South Africa teetering on brink of 'junk'

LOCAL NEWS

Implications of climate change for pension funds

A publication by Alexander Forbes's global strategic partner, Mercer, has revealed the stark realities of the impact of climate change on the planet, with devastating consequences on virtually everything from daily lives, to agricultural production and water resources. "Investing in a time of climate change - the sequel 2019" represents three climate change scenarios: a 2°C, 3°C and 4°C average warming increase on pre-industrial levels. This showcases the expected impacts of natural catastrophes and resource availability for each temperature increase (see table).

According to the report, a 2ºC rise in temperature would result in significant losses between now and 2030 in coal, oil and gas, resulting in opportunities for higher returns on renewable energy investments. If a child with a two-degree rise in temperature is fever struck, imagine how an unabated temperature rise affects the planet, including its fauna and flora.

Extreme weather patterns affect agriculture production and water resources, ultimately affecting the sustainability of society and the environment. It's only a matter of time until these tangible effects begin to influence asset classes and therefore investment returns. South Africa is already a water-scarce country and agricultural output is a key contributor to the gross domestic product of the economy.

Three degrees of warming would cause negative returns for almost every sector, including financials, agriculture, industrials and consumer staples. The damage would be irreversible should we continue ignoring the signs up to 2030. The current trajectory could put us beyond a temperature that humans have ever experienced, some time in the next 30 years. The last time the global mean surface temperature was comparable to today was more than 100000 years ago. The last time carbon dioxide concentrations were as high as today (over 400 parts per million) was three to four million years ago, and the last time the world was 4°C warmer was more than 10 million years ago. It's possible that we could reach 4°C of warming by the end of the century. Humans have never existed in a warmer time.

According to independent scientific analysis produced by Climate Action Tracker, South Africa is falling short of its commitments made at the Paris Accord in 2016. Therefore, a paradigm shift is required in the South African asset management industry to take quality longer-term investment decisions.

"The pension funds and climate risk" report by activist organisations Just Share/Client Earth and accompanying legal opinion from law firm Fasken require South African pension fund boards to consider climate change risks in their investment decisions. A failure to consider material risks arising from climate change would likely amount to a breach of fiduciary duty by the board of a pension fund, under both regulatory frameworks and common law principles. Although not binding and ruling, the spirit of the report and opinion as well as the conversations that it has prompted in the industry.

Funds can practically begin managing these risks by considering the following:

* **Beliefs, policy, process, portfolio.** A fund should define its investment beliefs, including responsible investment. The beliefs should be articulated in a policy. The portfolio should be managed and reviewed in accordance with the policy.
* **Be an active steward (active ownership and voting practices).** Use influence as shareholders positively to affect a company's conduct through engagement and proxy voting. Do not stop there; it is more critical that you disclose the voting outcomes and reasons for supporting or going against matters.
* **Allocate to thematic investment.** Invest in assets specifically related to sustainability, such as solar, wind, geothermal energy, sustainable infrastructure, impact investing and green bonds. Also, ensure that there is a reporting framework in place that assists in monitoring and measuring the real impact these investments are having.
* **Use positive and negative screening.** Include or exclude companies from share selection according to climate change criteria, for example distinguishing between low and high carbon investments.
* **Disclose carbon exposures and carbon tax valuation.** Ensure that listed companies disclose their carbon exposures and taxes. The users of financial statements should integrate these financial measures in their assessment of the value they attribute to the companies.

The South African pension fund industry and average fund member is probably under-equipped to attend to these risks, but attempting to be proactive around climate change is helpful to long-term fund solvency and is encouraged by the regulatory environment. Being conscious of where the rands and cents of pension funds are ultimately going will encourage more sustainable allocation of assets.

Personal Finance | 5 November 2019 | Premal Ranchod

The industry is hard at work

The retirement industry is not only one of the major drivers of the economy, it plays a vital role socially as it is the only savings that many people have towards the second phase of their lives (retirement). Yet, the industry faces many challenges. We need to have open and honest discussions to find suitable solutions. These were the words of Olano Makhubela, Executive: Retirement Fund Supervision at the Financial Sector Conduct Authority (FSCA), at the opening of the recently held inaugural FSCA Retirement Funds Conference.

Like a trainer in a boxing match, Makhubela spoke honestly about the enormity of the task ahead.

Compliance… compliance… compliance

The first issue that Makhubela tackled is the much bemoaned topic of the necessity for regulatory reform. Over the past year, the retirement funds industry has had to deal with two key pieces of legislation, the Default Regulations and the new standard by the Association of Savings and Investment South Africa (ASISA) which compels funds to express costs as a percentage of the investors overall investment.

These are two radically different departure points and issues that retirement funds will need to dedicate a lot of effort to when it comes to compliance. However, past events have left a deep scar when it comes to finances. These events created the necessity for compliance.
"The move towards Twin Peaks, and the implementation of regulatory reform, was made after the 2008 Global Financial Crisis (GFC) which left many unsure about their investments and damaged trust in the financial sector. We cannot let this happen again," said Makhubela.

While the GFC was not caused by insurers. It is prudent to design and implement regulation that will ensure that such a crisis does not arise again because of the actions of companies within the financial services sector.

Consolidation and costs

The cost of saving for retirement is probably one of the most topical issues that is currently gaining momentum in South Africa. Clients need to be aware of the cost of investing and make informed decisions on the sacrifices that they are prepared to make in order to grow their investment.

A major step towards this clarity was achieved when ASISA recently released its standard on cost disclosures. This puts the ball firmly in the court of product providers to be open and honest. In addition, it is up to product providers, and the regulator, to find ways to effectively drive industry costs down. "Consolidation is an effective way to manage costs in the industry. Economies of scale means that that larger companies have more power to negotiate costs down, and there are simply to many funds in the industry for the FSCA to visit all of them. If we are going to be an effective regulator, we need to have the greatest industry oversight that is possible," said Makhubela.

The Default Regulations will also go some way in driving industry costs down. However, there is a fine line when it comes to this as some trustees may make important decisions for the wrong reasons.

"We have seen a significant move towards passive investing since the introduction of the Default Regulations. This may suit the current economic cycle that the world finds itself in because it is very hard to consistently beat the market and get alpha. In order to achieve decent long-term growth, one doesn't always have to aim upwards and shoot the lights out. However, risk profiles are important and those who can take risks need to. Appropriateness is the order of the day," said Makhubela.

And the Nobel goes to…

Behavioural economics is becoming a game changer in the financial services industry. It was so important that Richard Thaler was awarded the Nobel Prize for Economics in 2017 for his contributions to furthering its field. It's a study that provides key insights into behaviour and consumption habits that will potentially allow insurers to develop products on an individualised basis so that each product works optimally towards driving down costs and improving value.

Advice is king

There is no shortage of pressure on the regulator and the industry to effectively address the challenges that are presented. And with the assistance of behavioural economics, a solution may be in the pipelines. There is also a lot of responsibility on the part of advisers. Makhubela pointed out that there are some important mistakes that clients are making that can be resolved through expert advice.

“Members of the public are still making suboptimal contributions to their retirement savings. While we are appreciative of the tough economic climate that exists in the country, some sacrifices need to be made for the future. In addition, when members of the public change jobs, they are not reinvesting their money. There are high drawdown rates in the industry when it comes to living annuities, and the public are still opting to go for high cost products which will ultimately impair their investment. All of this can be resolved through regular consultation with advisers,” said Makhubela.

FA News | 04 November 2019

The role of trustees in ensuring good governance within the fund

Just as an organisation needs directors to run it, so does a retirement fund needs a body which is responsible for the management of the fund. Every retirement fund must appoint trustees whose duties and responsibilities are governed by legislation and fund rules. In performing their duties, the trustees must always act with due care and diligence. They should adhere to the rules of the fund and the various decision-making mechanisms outlined therein. A trustee of a retirement fund is tasked with governing the fund in the best interest of its members.

According to Emda Fourie, Head Consulting at Momentum Consultants and Actuaries, “Retirement funds with good governance policies and procedures provide a more secure savings vehicle to its members and peace of mind to all its stakeholders.” Governance refers to the process of decision-making and the process by which these decisions are implemented, similar to that of a director or board of a company. Trustees cannot absolve their accountability to members of the fund by delegating tasks to sub-committees or service providers. The board remains individually and collectively responsible for all decisions taken. It is important for trustees to ensure that they have the required training and time available to appropriately manage the affairs of the fund. “Trustees are required to continuously increase their knowledge by keeping up to date with developments and topical issues surrounding the retirement industry and also to obtain advice in areas where they are not skilled,” says Fourie.

Fourie adds that, “Ethical and effective leadership is exemplified by integrity, competence, responsibility, accountability, fairness and transparency. Members of the board of the fund should individually and

collectively cultivate these characteristics and exhibit them in their conduct by ensuring that the assets they are responsible for are not abused in any way or used for personal gain."

"Good governance is not simply a "nice to have", it is about the application of principles in order to make organisations worthy of being trusted and is essential to the effective achievement of their goals," says Fourie.

In the retirement fund context, good governance assists in managing the competing interests of members, the sponsoring employer, unions, employees of the fund and the members of the fund's board of management. Transparency and accountability are at the core of good corporate governance and is created by drafting governance policies to demonstrate the governance implemented in the management of the fund. Examples of these policies are:

• The board's code of conduct, which highlights the board's composition, the members' duties and obligations and the process to follow when they are offered gifts.

• Investment Policy Document which sets out the investment objectives of the fund as well as the process followed by the board to achieve such objectives. • Risk management policy, which highlights the risks to the fund as identified by the board. The document should also indicate the mitigation implemented to manage the risks to the fund.

• Complaints policy which records the complaints received by the fund, as well as how the complaints were resolved, the actions taken to prevent similar claims from being lodged.

"Trustees are encouraged to use governance as a navigation tool that will help them to steer the fund in the right direction and which will aid towards members of the fund achieving their retirement outcomes," concludes Fourie.

FA News | 30 October 2019

Only 6% of South Africans will retire comfortably

Given the low national savings rate and slow market growth locally and internationally, it should come as no surprise that National Treasury calculates that only about 6 percent of South Africans are on track to retire comfortably. It is crucial to start saving towards your retirement as early as possible. "While many of us

look forward to the day we are able to retire, retirement is not always as easy as we imagine it to be," says Fedgroup Life chief executive Walter van der Merwe.

"When you retire, you often suffer a loss or reduction of income but daily expenses remain and grow with yearly inflation and economic turmoil," he says. Van der Merwe says it is never too early to start making provision for retirement. To maintain your standard of living, a proper retirement plan will help to ensure sufficient income once permanent employment is no longer an option.

Van der Merwe says the general rule is that you should consistently save between 15 percent and 20 percent of your monthly salary between the ages of 20 and 60, to retire comfortably. An increasing number of funds offer their employees variable contribution rates, from 5 to 20 percent of their annual salary.

Van der Merwe says one of the most commonly asked retirement questions is: "What is the difference between a pension fund, a provident fund and a retirement annuity (RA) fund?" In the past, the differences between these three savings vehicles were substantial, but recent legislation has made them similar.

A pension fund can be joined only through a company that employs you, and your money is managed by the trustees of the fund. Your contributions and your employer's contributions are tax deductible up to a point. Upon retirement, you can take up to a third of your savings in a cash lump sum, which is taxable. The rest must be used to purchase an income/annuity, which is also taxable.

If you leave the company before retirement, you can move your retirement savings out of the company fund, to your new employer's fund, a preservation fund or an RA fund, or you can take a cash payout, which is taxed.

A provident fund was once different to a pension fund as you were able to withdraw the entire savings amount as a lump sum at retirement. With legislation passed last year, provident funds are now essentially identical to pension funds, which means you can withdraw only a third of your savings, while the rest has to be invested in an income/annuity.
However, this legislation has not been applied retroactively, which means that you could withdraw the full contribution made before March 1 last year, when the legislation came into effect, but only a third of your contributions after this date. An RA fund, to which you also make monthly contributions, is completely

independent of your employer, allowing you to choose what funds you invest in (limited by retirement fund regulations).

At retirement, you are allowed to take a maximum of a third of your savings as a cash lump sum, and the balance must be used to purchase an income/annuity. If you change jobs before retirement, this will not affect your RA, as you are not permitted to access any portion of these funds before retirement.

Personal Finance | 1 November 2019

RAs: How much can you invest offshore?

With all the uncertainty in the South African market and concerns about future investment returns, many investors are looking offshore for investment opportunities. A diversified investment portfolio is always a good strategy when saving for retirement, but before you set off looking for greener pastures in offshore markets, take note of regulation 28 and its integration in retirement annuity (RA) funds, says Jaco Prinsloo, a Certified Financial Planner at Alexander Forbes.

RA funds are governed by regulation 28 of the Pension Funds Act and prescribe limits on the various asset classes in which you can invest. Regulation 28 is enforced to protect investors against capital loss and smooth investment returns by diversifying their investments between different asset classes such as cash, bonds, property and shares, both local and offshore.

Most RA funds will have to be invested in South Africa, but you can invest up to 30 percent in offshore assets and an additional 10 percent in African assets, excluding South Africa.
However, with most South African listed companies integrated into the global economy, it is estimated that 70 percent of their earnings are generated offshore. This feature increases investors' offshore exposure from 30 percent to potentially closer to 60 percent, depending on the mandate of the fund. With the added offshore exposure comes risk in the form of currency fluctuations that have to be taken into account when making investment decisions.
The common belief is that the limits of regulation 28 reduce investment returns, which can be true when specific asset classes outperform, but there is no way to know which asset classes those will be. Having a well-diversified portfolio is one solution to this dilemma.

Having exposure to multiple asset classes, both locally and offshore, gives you the best chance of generating the returns required to meet retirement goals without taking unnecessary risk.

Personal Finance | 30 October 2019

Providing employee benefits for a workforce that thinks differently

Traditional financial advice has been based on a uniform approach for a relatively uniform workforce. Over the past five years, there has been a shift in the average workforce age, with the so-called Generation Xers (born mid-1960s to 1965 to early 1980s) and Generation Ys – the millennials – now making up the majority of employees. Statistics show that the millennial percentage of the workforce composition has jumped from 39% to 52%. Those born after 1996 – the Generation Z workers – are expected to make up 24% by 2020, next year.

The new workforce has new needs

Younger people's life events no longer happen in the same linear way as they did for previous generations. Single-parent households, particularly headed by women, far outweigh those where both parents live together. Taking care of parents and extended family, the average employee now has twice the number of dependants compared to five years ago. For various reasons, millennials change jobs every two to three years. When they do this, they frequently cash out their retirement savings, doing so more than once during their working career. They see retirement as a distant future, and believe that they will have accumulated enough money to retire comfortably when they reach retirement age.

Sadly, death statistics are now higher for younger people, our group insurance data shows that the proportion of unnatural or accident-related deaths is increasing. Critical illness statistics are also increasing. The claims statistics indicate that overall cancer claims have increased by 48% since 2012, representing 15% of all disability benefit claims in 2018. 21% of the claims were paid to employees below the age of 40.
What this should tell us is that we need to understand who these employees are, what their lives look like and what their real needs are. Corporate financial advisers must start considering the new workforce's real needs at each major life event that influences their financial journey.

The reality of who the new workforce is

They lack financial literacy. They are financially vulnerable and don't understand the retirement benefits they have or the terminology around retirement benefits.

They engage differently. They are bombarded with competing information from all sides. If communication is not specific to their needs, when, where and how they want to receive it, they don't engage at all. They want direct information that is easy to understand.

They see retirement differently. It isn't uncommon among the younger generations of employees to have at least one income-generating side hustle to sustain a desired lifestyle. They don't think about retirement because they don't think they will ever have enough funds to retire. They resolve to commit to longer-term plans, hoping that these multiple income streams will sustain them into retirement, or relying on family.

Employee benefits have remained the same

Even though the composition of the workforce has changed, employers are still offering the same major benefits they have been providing in the past. The reason is possibly a straightforward one. Employer's employee benefits decision makers are generally much older than and earn a much higher salary than the average lower-income, younger employee. They are simply out of touch with the real needs of the workforce. ***Full Report:*** ***https://www.fanews.co.za/article/employee-benefits/3***

FA News | 28 October 2019

INTERNATIONAL NEWS

How to Turn $20,000 into a $190,000 Retirement Fund

Canadians have a number of options to consider when putting together a retirement plan.

The fortunate ones have generous defined-benefit pensions at their place of work, but those situations are harder to find these days. Most company pensions are now defined-contribution plans where the

employees put part of their salary into the fund and the company matches the contribution at a specified percentage.

This can be a rewarding option, especially if the company kicks in a 100% match, but it also shifts risk to the employee as the payout in retirement depends on the value of the fund, rather than being guaranteed. Self-employed Canadians, or those who are part of the new gig economy, normally don't have any pension plan at all, and relying on CPP and OAS payments to cover their living expenses in the golden years could be a challenge. As a result, their need to create a self-directed pension is more important

What should savers do?
An RRSP is a good option to get the process started. The contribution limit is generous, at 18% of earnings, and the funds placed into an RRSP can be used to reduce taxable income for the designated year. It's always better to defer the amount of tax you have to pay the government as long as possible. Money buys more today than it will in 30 years. In addition, the tax rate when you remove the funds from the RRSP down the road will likely be lower than when you make the contribution.

A popular strategy for building retirement wealth involves buying reliable dividend stocks and using the distributions to acquire additional shares. The compounding effect can turn a small portfolio into a substantial retirement fund over time. Let's take a look at one of Canada's top bank stocks to see why it might be an interesting pick.

Bank of Nova Scotia (TSX:BNS) (NYSE:BNS) is Canada's third-largest bank with a market capitalization of $92 billion.

The company has strong Canadian operations in personal and commercial banking and wealth management. Scotiabank understands that demand is rising in the wealth management sector and made two large, aggressive acquisitions in the past year. The bank is also betting on growth opportunities in Latin America. This might appear to be a risky endeavour, given the history of economic and geopolitical volatility in the region. However, the countries of interest hold significant growth potential.

Scotiabank is focusing on Mexico, Peru, Colombia, and Chile. The four countries make up the core of the Pacific Alliance trade bloc and are home to more than 230 million people. Despite recent unrest in Chile and concerns over the policies of Mexico's new government, the long-term prospects are attractive.

In fact, the international operations are already performing very well for Scotiabank and contribute nearly a third of the company's earnings. As the middle class expands in the Pacific Alliance countries, revenue and profits should continue to rise. The bank has a strong track record of dividend growth and the board recently raised the payout. Investors who buy today can pick up a solid 4.8% yield.

A $20,000 investment in Scotiabank just 20 years ago would be worth about $190,000 today with the dividends reinvested.

The bottom line

A diversified RRSP portfolio is always recommended and owning a basket of stocks that includes top dividend payers similar to Scotiabank should perform well over the long-haul and help Canadians meet their retirement goals.

The Montley Fool | 29 October 2019

OUT OF INTEREST NEWS

Moody's leaves South Africa teetering on brink of 'junk'

JOHANNESBURG/LONDON (Reuters) - Moody's left South Africa on the brink of "junk" status on Friday after it revised the outlook on the country's last investment-grade credit rating to "negative," piling pressure on President Cyril Ramaphosa to quicken the pace of reform.

Moody's said the outlook revision on its 'Baa3' rating, the lowest rung of investment grade, was motivated by a deterioration in the economic growth outlook and rising debt. Analysts had expected the move after a bleak mid-term budget statement this week that slashed this year's growth forecast to 0.5% and showed government debt racing to more than 70% of gross domestic product by 2023.

The rand ZAR=D3 tumbled more than 2.5% over the past week against the dollar, its sharpest weekly drop since early August. Yields on local 10-year government bond issues ZA10YT=RR traded on Monday at just

over 8% but climbed as high as 8.6% following the dire budget predictions. The negative outlook means there is a window of 12-18 months in which a downgrade could be delivered, but it could come sooner if Moody's isn't impressed by the fiscal picture presented at the next budget statement in February.

"The development of a credible fiscal strategy to contain the rise in debt, including in the 2020 budget process and statement, will be crucial to sustain the rating at its current level," Moody's said in a statement after South African financial markets had closed.
It added that its new outlook reflected rising concern that the government would not find "the political capital to implement the range of measures it intends, and that its plans will be largely ineffective in lifting growth".

The finance ministry responded by saying the country had "a narrow window to demonstrate faster and concrete implementation of reforms". Ramaphosa has struggled to revive Africa's most advanced economy since taking over from scandal-plagued Jacob Zuma in February 2018. The wave of optimism among foreign and local investors that accompanied his rise to power has fizzled out as the economic challenges have grown more acute, with unemployment reaching an 11-year high above 29% ZAUNR=ECI and state power company Eskom struggling to keep the lights on.

One of the greatest worries is rising government debt, which shows no signs of stabilising soon amid repeated bailouts for state-owned companies.

'CONSISTENT UNCERTAINTY'
Fund managers said they were not expecting a steep sell-off in government bonds and the rand when financial markets re-open on Monday, because the outlook revision was expected by so many and South African assets had fallen sharply over the past week.

The spread of South African dollar debt over U.S. Treasuries is already wider than on some junk-rated sovereigns, reflecting longstanding concerns over the country's fiscal health. "Valuations are already reflecting this outcome. So on any sell-offs, we would see it as a buying opportunity," said Jean-Charles Sambor, deputy head of emerging market fixed income at BNP Paribas Asset Management.

S&P Global and Fitch already moved South Africa's debt to sub-investment level in 2017, when the country was embroiled in corruption scandals under Zuma. A move to "junk status" from all three agencies typically increases a government's cost of borrowing by raising the premium that investors demand to hold its debt.

It could also see South Africa evicted from the benchmark World Government Bond Index of local-currency debt, which could trigger billions of dollars of passive outflows.

Phoenix Kalen, director of emerging markets strategy at Societe Generale, said South Africa was now in the “last-chance saloon” and that it had to stabilise its debt.
“This will be a Herculean task,” Kalen said, citing financial pressures at state companies among causes for concern.

Ramaphosa’s government has promised Eskom 230 billion rand ($15.3 billion) of bailouts over the next decade, on top of a 59 billion rand “special appropriation” over the next two fiscal years. But analysts say it will need more state money than that. Kevin Lings, chief economist at asset manager Stanlib, said a downgrade in 2020 was now his “base case” and that some investors would be reluctant to buy South African debt until the downgrade had happened.

“Next year is going to be marked by consistent uncertainty around the currency and bond markets, it’s going to put South Africa under a lot of strain,” he said.

Reuters | 2 November 2019

Disclaimer: The IRFA aims to protect, promote and advance the interests of our members. Our mission is to scan the most important daily news and distribute them to our members for concise reading.

The information contained in this newsletter does not constitute an offer or solicitation to sell any security or fund to or by anyone in any jurisdictions, nor should it be regarded as a contractual document. The information contained herein has been gathered by the Institute of Retirement Funds Africa from sources deemed reliable as of the date of publication, but no warranty of accuracy or completeness is given. The Institute of Retirement Funds Africa is not responsible for and provides no guarantee with respect to any information provided therein or through the use of any hypertext link. All information in this newsletter is for educational and information purposes and does not constitute investment, legal, tax, accounting or any other advice.