THE RETIREMENT INDUSTRY NEWSLETTER

28 JUNE 2024

IRFA Annual Conference

International Convention Centre Cape Town
Date: 6 - 8 October 2024
Better Together

Table of Content

LOCAL NEWS

- Busting the myths: Your guide to a smooth Two-Pot transition
- Why retirees should keep their money in the market
- Fixing the retirement savings crisis requires innovative thinking
- The four stages of retirement (times two)
- 7 Ways To Preserve Today and Live Comfortably Tomorrow

INTERNATIONAL NEWS

- This Pensions Turning Point Is Good News for the UK
- Pensioners risk £11,000 hit under Labour

OUT OF INTEREST NEWS

- Managing Tax Risks Through Tax Indemnity Insurance

Busting the myths: Your guide to a smooth Two-Pot transition

As South Africa eagerly anticipates the launch of the Two-Pot Retirement System on September 1, 2024, there's a pressing need to dispel the myths surrounding the new approach to retirement planning.

Only 6% of the country's population is on track to retire comfortably, according to the sixth edition of the 10X Investments Retirement Reality Report 2023. I am on a mission to debunk common myths and empower retirement fund members with the knowledge needed to navigate this new system confidently. Dispelling any potential panic, I will clarify misconceptions and offer a clear understanding of how the Two-Pot System will function.

Here are some of the myths he's busting:

Myth: The Two-Pot Retirement System applies to everyone saving for retirement in South Africa.
This statement isn't entirely accurate. The Two-Pot System applies to most retirement funds, but there are some exceptions:

Provident fund members over 55: If you're a member of a provident fund and over the age of 55 on March 1, 2021, and still a member of that same fund, you'll have the option to choose to remain under the old system or opt into the new Two-Pot System from September 1, 2024

Pensioners, unclaimed benefits, closed funds and funds in liquidation: These categories are exempt from the Two-Pot System. Pensioners already receive their retirement benefits, closed funds are no longer accepting new members, and funds in liquidation are undergoing a wind-down process.

Legacy Retirement Annuity Funds: Certain types of older retirement fund annuity constructs have the ability to apply for exemption from the Two Pot system. It is really important to keep reading your member communications sent through to see if any of these categories apply to you.

Myth: All my retirement savings are up for grabs
Think again! The Two-Pot System keeps your retirement nest egg safe. You'll only have access to the money in the “Savings Pot”, designed for emergencies. To start you off, 10% of your existing savings (capped at R30 000) will automatically be transferred to this Savings Pot as a once-off deal! Going forward, one-third of your

future contributions will fill this emergency pot, ensuring you have some breathing room while the rest (two-thirds) of your contribution towards your retirement pot grows untouched for your golden years.

Myth: I won't pay tax on withdrawals from my savings component

Wrong, Two-Pot withdrawals are taxed as income: Under the Two-Pot system, withdrawals from the Savings Pot before retirement will be taxed at marginal rates, like other forms of income. A marginal tax rate is the amount of tax you pay on an additional unit of income. For example, if you earn more money and enter a higher income bracket, the new income will be taxed at a higher rate. Think of it as climbing a set of stairs, as you earn more, you move up to the next step and the money you earn on that step is taxed at a higher percentage but the income you earned on the lower steps remain taxed at lower rates. It is important to understand how withdrawals have a tax impact, on both the withdrawn amount and the remaining funds. Only one withdrawal per tax year is allowed (minimum R2 000).

Myth: Only employee contributions go into the Savings Pot:

The Two-Pot Retirement reforms will apply to all contributions to your fund, after payment of costs, so it will apply to both employee and employer contributions.

Myth: The Two-Pot Retirement System completely restricts access to your retirement savings.

This is a common misconception. The Two-Pot System actually addresses two key issues:

Early withdrawals: Cashing out your pension savings when you change jobs can significantly hurt your retirement security in the long run. The Two-Pot System discourages this by limiting access to most retirement funds when you change jobs, promoting long-term savings habits.

Lack of emergency funds: The National Treasury in partnership with all key stakeholders designed the Two-Pot System to allow early access to a portion of your retirement savings for emergencies. This provides financial security in unexpected situations, while still encouraging you to preserve the majority of your savings for a comfortable retirement. Navigating the complexities of the Two-Pot Retirement System may seem daunting, but fear not. Our financial education facilitators across all provinces offer free workshops to employers and trade unions for comprehensive knowledge to seamlessly guide you through this transition. You can also speak to your financial advisor for more clarity. Together, let's embrace the future of retirement planning with clarity and confidence.

Personal Finance | 25 June 2024

Why retirees should keep their money in the market

Marius Fenwick of WealthUp shares why adopting a long-term investment mindset can safeguard your financial future and maximise your retirement savings.

BOITUMELO NTSOKO: Retirement is often seen as a time to stop investing and start enjoying the fruits of one's labour. However, with life expectancy increasing, investors face a longer retirement period, which means their savings need to last longer too. This may require a change in a retiree's mindset about investing after retirement. Joining us on this episode to discuss the benefits of post-retirement investing and why retirees should view themselves as long-term rather than short-term investors is Marius Fenwick, who is a certified financial planner at WealthUp. Marius, many retirees view themselves as short-term investors, primarily focusing on drawing from their savings to cover expenses. Why is it crucial for retirees to adopt a long-term investing mindset?

MARIUS FENWICK: I think when we plan it's all [around] the age-related things. So we try and plan up to the age of 100 years, unless we are told otherwise – if, say, there are some health issues, et cetera. So, if you retire at the age of 65 you still have a 35-year investment horizon, and if you're 80 you still have a 20-year investment horizon. The problem with that is that your main objective of investment should be to beat inflation, and the only asset classes that give you the opportunity or a fair chance to beat inflation are those of growth assets and offshore; cash can't do it. If you are any form of taxpayer, cash is going to fall short.

BOITUMELO NTSOKO: So when it comes to investment options, retirees may prefer fixed deposits, or bonds which are considered safer. Could you elaborate on why they should consider maintaining a portion of their portfolio in stocks?

MARIUS FENWICK: Fixed deposits are the same as cash. You battle to beat inflation when you take tax into consideration. So even as a low taxpayer, [paying] like 20% takes away a big chunk of that return, which brings you very close to an inflation kind of return. Retirees generally have a higher inflation rate than normal individuals because of medical expenses and the cost of care. Bonds are safe, as safe as the bond issuer. But remember bonds [have] a very volatile maturity, because interest rates and inflation have an impact on bonds. So if you trade your bond, you can actually have capital loss – and severe capital losses if you're in an environment where interest rates go up or inflation spikes.

BOITUMELO NTSOKO: Inflation is a critical factor that retirees must contend with. How can they protect their purchasing power and hedge against inflation risk while maintaining a balanced portfolio?

MARIUS FENWICK: I mentioned a bit earlier the only real asset classes that can beat inflation are equities and property long term, [although] property has been very volatile of late. So one's got to get that exposure to beat inflation. But there are a few things that one has to consider. The one thing is if you look at the

purposes of the funds that the retiree has – let's say not just retirement funding – the two big crucial things there are what income they're drawing, and do they have any intention to transfer wealth? In other words, on their death must capital be transferred? That'll [determine] what the portfolio should look like. If you are drawing only 2%, for instance, of your total wealth, then you can sit in cash, especially if cash is sitting at 8.5%, because you're reaching all your objectives. But as soon as you want to transfer to the next generation, your investment term actually extends, which means you've got to take exposure to growth assets to basically beat inflation.

BOITUMELO NTSOKO: Let's talk about asset allocation more. How should retirees adjust their investment mix as they transition into retirement?

MARIUS FENWICK: I think the biggest challenge for retirees is that their inflation increases with age. As I mentioned earlier, their medical expenses [spike] and care costs are expensive. So inflation is a big enemy of retirees. So [in] what we normally talk about, I always refer to these things as 'pots', and basically create three pots. One is where you've got your cash reserve; so you've got your emergency funds in this one little sector, so to call it; plus you could add your income for a period of three years. So then for the next three years that little investment that's set aside will pay your income. It's there for emergency reserves. Then the balance of that we would split 50:50, I would say [each] about 25% of your total wealth.

Stick [the first half] into something like a low-equity fund or your stable fund kind of funds, with some offshore exposure; and put the balance into more of a medium and high equity portfolio. Then you've basically got three portfolios in one. It does make your portfolio a bit complicated. It looks like a lot of investments in one portfolio, but that does meet all the criteria that you're trying to match. It sorts out your short-term cash requirements, it gives you that medium term up to a five-year span [when] you need some decent growth. And then the other one is your higher-equity kind of component, your five-year-plus kinds of investments. That seems to work fine. The one place one's got to be very careful of is offshore exposure when you're retired and you're drawing your income. Now, I'm very pro offshore, I love offshore.

I think it's great, but as soon as you start drawing income against the portfolio, offshore works against you as far as volatility is concerned, and a bigger enemy than inflation for income is volatility. If you've got rand fluctuations and the rand strengthens like we've seen over the last couple of weeks again, that actually works very negatively against the offshore portfolio. So, one has got to be mindful; the more you draw as a percentage against your investments, the lower your offshore exposure should be. If you're drawing 2.5%, or 3%, you can have 60% or 80%; it doesn't matter. But if you start drawing around that 7.5% and 10%, as some people do, you've got to be very careful. You've got to look at much, much lower offshore exposure in those circumstances. **Full Report:** ***Why retirees should keep their money in the market - Moneyweb***

Moneyweb | 21 June 2024

Fixing the retirement savings crisis requires innovative thinking

As life expectancies increase, retirement savings need to last longer. Discovery Invest has come up with a solution that could help close the retirement funding gap.

There's been a 12% increase in life expectancy in SA since 2010 yet fewer than four out of 10 employees have a retirement fund. That means the retirement funding crisis is galloping out of control, a crisis that ultimately ends up on the doorstep of the state or, more likely, close family members. The problem is not unique to SA. The World Economic Forum estimates the global retirement industry is underfunded by $70 trillion, a gap that is racing towards an expected $400 trillion by 2050. Globally, over the past five years there has been an 82% increase in the number of people above the age of 65 – and between 2010 and 2021 there was a 188% increase in the number of people who turned 100. The retirement funding gap is defined as the difference between projected retirement savings and what is required to retire comfortably.

Just 6% of South Africans are in a position to retire comfortably. This is not surprising given that 61% of South Africans contribute less than 15% of their salaries to their retirement funds. "People are living longer, and that is making the savings problem worse," says Craig Sher, head of research and development at Discovery Invest. "Add to this the fact that one in three South African families are supporting their children and their parents. It's an inter-generational problem." Research by Discovery Invest provides some insights into savings habits and trends. Traditional levers like offering lower management fees appears to have little impact on the overall level of retirement readiness. "Our research shows that we can only improve retirement outcomes by encouraging better behaviours," says Sher.

"We developed a shared-value model that encourages healthy investment and lifestyle behaviours, and we reward savers for adopting these improved behaviours – just as Discovery Vitality rewards members for improving their health." The shared-value model encourages clients to invest longer, invest more, and withdraw wisely, with significant value in the form of boosts and discounts available when they do. And the model is performing exceptionally well. Its success is demonstrated by the more than R20 billion in shared-value rewards that clients have accrued or received to date, adds Sher. A new retirement solution that protects your capital while paying income for life, no matter how long you live. The traditional products available to retirees are living and life annuities.

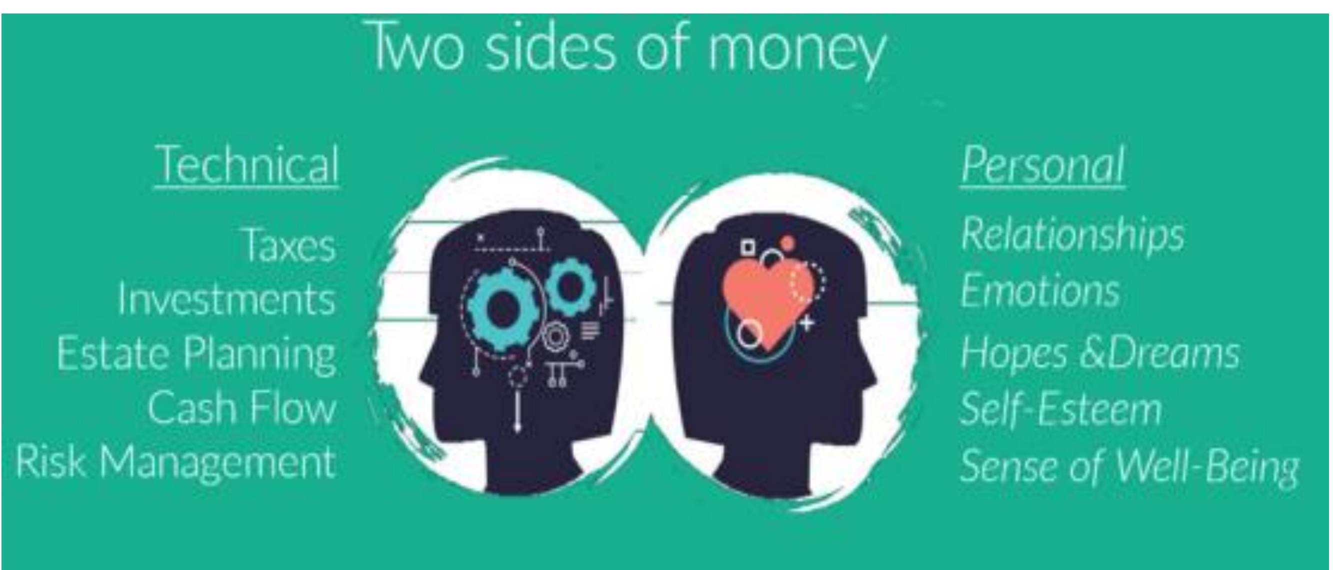
Living annuities are linked to investments such as unit trusts, cash investments or share portfolios, and rise and fall in value depending on market conditions. The risk of funds running out lies with the client, hence the need to pace the rate of drawdown each year to stretch savings as long as possible. On death, any funds left in the pot go to the beneficiaries. In the case of life annuities, the insurer (not the client) assumes the risks of the market falling, or the client living longer than expected. The product will continue to pay out as long as you live, but – unlike living annuities – there is no capital preservation, meaning the beneficiaries receive nothing after the client dies. Discovery's Secured Capital Annuity is a major advance on these two retirement

solutions, giving clients certainty, security, and additional income in retirement. It provides guaranteed retirement income, for life, with life cover payable to their nominated beneficiaries when they die. Uniquely, clients can also choose to receive thirteenth cheques (for up to 10 years of retirement) with income adjusted each future year based on expected spending patterns of retirees. Research by Discovery reveals that retirees spend more in the early years of retirement as they often pay down debt or fulfil retirement plans such as travel, leisure and supporting dependents. Spending drops in the middle years as retirees become more sedentary, then rises again in later years, usually due to increased medical spending. The Secured Capital Annuity adjusts income to be in line with these fluctuating spending needs. “Our objective is not only to encourage the right investment behaviours, but also to provide protection against the risks of outliving retirement savings as life expectancies increase. This is exactly what the Secured Capital Annuity is intended to do.” adds Sher

Moneyweb | 21 June 2024

The four stages of retirement (times two)

The complexity of the concept of money can be simplified by two aspects – technical and psychological. Two sides that can also break down retirement. When it comes to retirement, we can actually talk about the FOUR x FOUR stages of retirement. Money, a concept we’re all familiar with, has two distinct aspects: the technical side, which deals with numbers and calculations, and the psychological side, which involves our emotions and attitudes. Retirement, too, can be viewed from these two angles. I have previously shared the illustration below, but I believe it remains a relevant depiction of the core message. One could easily substitute the word “money” in the heading below with “retirement.”



While both sides of money (and retirement) are equally important, subconsciously, each side impacts the other side. The emotional side of retirement often has the longest and most profound impact on one’s life. Considering that we can easily spend a third of our lives in retirement, the psychological impact of retirement cannot be ignored. We know that emotions drive more than 80% of investment and money decisions. In many cases, we also know that psychological challenges linked to retirement outweigh financial challenges.

Let me delve into the two sides of retirement a bit more. We are all familiar with the number-crunching game when it comes to retirement planning. The talk is about setting goals and creating investment portfolios to meet objectives. This is one of the first talks you have when you start your investment strategy, and target versus actual returns are discussed at all future meetings. Don't get me wrong, these are important talks. If you don't meet these targets, you will have to face some tough decisions when retirement arrives and trust me, retirement arrives much quicker than most people anticipate.

Investopedia defines the **four technical stages** of retirement as follows:

Stage 1: Pre-retirement (Ages 50 to 62ish)

This is the decade or so leading up to retirement. You will still be working, but retirement is approaching, and you have much more retirement-related concerns on your mind. A much clearer picture of your nest egg is starting to form, and you start thinking about retirement income, expenses, and taxes. Some of the concerns, like whether you will have enough money to survive retirement, become top of mind.

Stage 2: Early period of retirement (Ages 62 to 70)

Some significant changes in your budget will occur when you first retire. Budgeting and managing your expenses will become more important, especially if you do not have a pension that provides a regular, consistent income. Buying luxury items or spending money on lavish holidays may become more of a challenge. Often, retirees realise this too late and delve into future reserves to still enjoy these pleasures while they should be more conservative with their spending. It may become necessary to downsize a home, move to a more desirable environment, and consider consolidating investments to simplify your reporting and investment structures. A re-look at estate planning is also a good idea.

Stage 3: Middle retirement (Ages 70 to 80)

Adjusting your investment portfolio may be necessary to ensure your asset allocation is suitable for sustainable income with limited volatility. Medical expenses start rising. Moving becomes a consideration if you do not yet live in a retirement home or village. Frail care and the associated costs become part of the present and future budget. Other expenses may come down. Travelling may be reduced and limited to local holidays. Hopefully, children will stop coming to you for money, and your need for life assurance may be less. If you do not have a pension plan, finding ways to save a little money every month may be a good idea. Make sure that you claim all the tax credits that you qualify for. Letting your property or sub-letting a portion may be a consideration.

Stage 4: Late retirement (beyond 80)

Healthcare costs are likely to escalate since this is the time in life when most is spent on medical bills. Moving to an assisted living or a frail care facility will attract additional costs. Your earlier savings (Stage 3) will come in handy now. Other costs should remain similar to those in Stage 3. If you cannot afford assisted living costs, discussions with family members may be necessary to consider options of living with them. Investopedia then delves into retirement budget calculators and more money-related planning advice. These are good guidelines, but they do not provide the whole picture. Let's now move to the next level. Dr Riley Moynes has

a very relevant presentation about “How to squeeze juice out of retirement”. In his presentation, he defines the four phases of retirement as follows:

Phase1: Vacation phase (also referred to as ‘the honeymoon phase’ elsewhere)

For most people, this is the phase they look forward to the most. This is the life-long holiday where one does nothing but play golf, go for beach walks, travel and visit family and friends.

But soon, boredom sets in. Then, one starts to miss the structure and discipline of working life.

Phase 2: Feel loss and lost

Once the “honeymoon” phase is over, reality sets in, and often retirees experience a feeling of loss, and they feel lost. We often refer to the “Big Five” losses:

- Loss of routine (work routine and time frames);
- Loss of identity (who am I versus what am I);
- Loss of relationships (no longer interacting with colleagues);
- Loss of purpose (what am I waking up to?); and
- Loss of power (no longer the boss).

These five losses often also lead to the three Ds:

- Divorce (since 1990, the divorce rate has more than tripled for those over 60);
- Depression (one of the biggest challenges in retirement); and
- Decline (emotional and physical health decline).

Before retirees can experience and enjoy Phases 3 and 4, they have to deal with Phase 2 and feel fear, anxiety and depression. No one said retirement was going to be easy, so buckle up! Many feel that they cannot continue with the trend in Phase 2, which leads to Phase 3.

Phase 3: Trial and error

Identify your interests and what you are good at. This often leads to some soul-searching and delving into the past when you had hobbies and extracurricular interests. Fire up these hobbies and interests again.

Keep on trying until you find something you want to get up to. Even if the first few attempts fail, don’t give up. Try and try again. You want to reach a stage where you want to wake up and look forward to the day filled with “stuff”. Not many people move to Phase 4. If they do, it is the most rewarding experience in retirement.

Phase 4: Re-invent and rewire

Some tough questions must be answered:

- What is my purpose?
- What is my mission?
- What will provide a sense of achievement?

For many, the answer lies in helping others. This can take many forms, such as community work (monetary assistance or physical help/work), teaching people a language or a subject you are good at or have an interest in, mentoring people or tutoring them in special skills, or providing them with general information that they may not have. This can be done as an individual or within a group with a common interest. Who says getting old and retiring is boring? Be creative, make a difference and feel worthy while having fun. Have you created your bumper sticker yet? There is no better time than now …

Moneyweb | 26 June 2024

7 Ways To Preserve Today and Live Comfortably Tomorrow

It's no secret that South Africa is facing a retirement crisis. According to Lynette Uys, Financial Coach and Retirement Benefit Counsellor at Momentum Corporate, only 6% of the population on track to retire comfortably, but what about the rest of the workforce? How are they supposed to navigate this perpetual maze and make it out the other side with enough to get by for the indeterminable rest of their lives? For most employed South Africans, Uys says that all begins with benefits. "Financial strain often forces employed South Africans to dip into their future savings to survive today," says Uys. "With the two-pot system on the horizon, this is going to be even easier to achieve – which is a danger to your future financial security." However, with a plan and self-discipline, Uys believes there are ways to preserve your income for the future while managing current financial demands.

Uys provide seven essential strategies to help employed South Africans strike that balance:

1. Understand your motivations – your WHY

Developing discipline starts with understanding what drives your behaviour is a critical skill for financial foresight and peace of mind. Uys advises reflecting on your financial habits and identifying the underlying motivations. "Learning to understand your 'why' is crucial," says Uys. "This self-awareness is the foundation for making better financial decisions and juggling the needs of the now versus the needs of the future."

2. Set clear financial goals

Having specific, measurable goals can help you stay focused on what truly matters on your own journey to success. "Decide what you want to achieve financially in the short and long term. Whether it's building an emergency fund, saving for a home, or planning for retirement, clear goals provide direction and motivation," says Uys.

3. Seek professional financial advice

Ensuring you have objective financial advice is essential. She suggests consulting with Retirement Benefit Counsellors who can provide guidance tailored to your needs. With intensive new regulations like the Two-Pot System, Uys says employed South Africans have an even greater need to tap into the right advice. "Financial advisors can help you navigate complex financial landscapes and make informed decisions. This

is particularly important when it comes to navigating the complex maze of employee benefits, that seldom get used to their full potential," says Uys.

4. Leverage available resources

Don't be intimidated by financial planning, without it you will never make any progress. Uys suggests utilising the resources available to you, including any resources provided by your benefits provider such us Momentum's 'Member Hub', which provides a wealth of advice and information pertaining to each member. "These platforms offer valuable information on preserving your retirement savings and making informed financial choices," says Uys.

5. Make healthy habits a priority

It may not seem like it, but Uys says the truth is that healthy bodies strengthen healthy minds. By incorporating more healthy habits into your life, you can significantly impact your financial discipline. "Try scheduling some exercise into your routine to boost mental resilience and clarity. Simple changes, like choosing a walk over watching TV, can enhance your ability to make disciplined decisions, which includes the financial variety."

6. Prepare for the unexpected

While discipline is crucial, Uys says it's also important to acknowledge life's unpredictability. The make up of our benefits are very dependent on our ability to apply agility and pivot where necessary. "Build a financial cushion to handle emergencies without derailing your long-term goals. This preparation can help you stay on track even when faced with unexpected expenses.

7. Educate yourself continuously

With new regulations and milestone moments in our economy, Uys believes it is imperative to stay informed about financial matters to make better decisions.

FA News | 26 June 2024

This Pensions Turning Point Is Good News for the UK

The pensions black hole stays stuffed

It's not often that you hear the terms "good news" and "pensions" in the same sentence together, but today I bring you some good news on pensions. Britain's corporate pension funds have just recorded their biggest surplus ever, according to actuarial consultancy Mercer. As of last month, if you look at them in aggregate (the state of individual funds will vary), the FTSE 350 defined benefit (DB) pension funds have £79 billion more than they need in order to pay the pensions of their remaining members. That's the biggest surplus on record, says Mercer. DB funds are the ones that guarantee to pay employees an annual income based in some way on their career earnings. The major benefit (from a recipients' point of view) is that all the risk is on the employer, rather than on the employee. You know what you'll get paid — it's up to them to work out how to provide it to you. For background, this is why DB pensions in the corporate world are virtually all shut to new members.

Today, most corporate pensions — including your auto-enrolment pension — are of the defined contribution (DC) variety. Under DC, both you and your employer contribute to your pension fund. You then use this fund to pay for your lifestyle once you reach retirement age. In other words, your actual income in retirement depends purely on what you save and invest during your working life, rather than being based on length of service or lifetime earnings. The risk is all on you. Just to give the full picture, DB pensions are still the norm in the public sector, but there the overall risk is (with a few exceptions) borne by the taxpayer, because unlike corporate schemes, these are not funded. How did this happen? We've discussed this before (and jokingly noted that you have Liz Truss and Kwasi Kwarteng to thank for this).

But basically it's mostly down to the rise in interest rates. Rising interest rates reduce the net present value of future liabilities. Here's a very simple example: Let's say you have to pay someone £110 in a year's time. Moreover, a government regulator comes along and tells you that it needs proof right now that you actually have the money to do that. The only savings vehicle open to you is a one-year, fixed-rate bank account. If it pays 0%, then you're going to need to show the regulator that you have £110. But if the bank account pays 10%, you'll only need to show the regulator that you have £100, because in a year's time, that'll have grown to £110. There are a few other reasons for the reversal of the pension deficit — including unfortunately, diminishing life expectancies (which means the amount of pension a company can assume it will have to pay out falls). But, overall, the sudden flip from disaster to salvation has been largely driven by the shift in interest rates.

The Rise of Auto-Enrolment

Anyway, this is largely good news. If FTSE 350 companies now have largely fully-funded pension schemes it means they don't have to worry about topping them up and so can use the money for other things. This is yet another reason to add to the pile of reasons for liking cheap UK stocks — the pension problem is not such a problem (for now, at least). But there's another pensions-related reason for doing so, which we've mentioned in passing before. Firstly, one of the major factors driving the mass exodus by UK pensions from UK equities over the last couple of decades has been this need to match future liabilities with current assets. We're already at the stage where this "rebalancing" has to be pretty much at an end. If we're also at a stage where DB pension funds start to record surpluses regularly, it's only going to increase government appetite to find a way to get its claws on said "surpluses".

Chancellor Jeremy Hunt has already fired the starting gun on that one and I'd be surprised if his likely successor, Rachel Reeves, doesn't have her thinking cap on as to where those "surpluses" could more usefully be deployed — into government pet infrastructure projects, for example. Now, I wouldn't see this as great news (you may have more faith in government than I), and I can see why so many companies are keen simply to offload the responsibility of their DB pensions onto an insurer instead (this is called a "buyout"). But it does imply that the direction of travel for DB schemes might end up being to take more, rather than less risk. However, whatever happens to DB schemes in the longer run is not as important as auto-enrolment (the DC schemes). And that's where another pensions-related story caught my eye.

In the year to the end of May, FTSE 350 companies paid more money into their DC schemes than into their DB schemes for the first time ever, according to consultancy Barnett Waddingham. In all, £8.1 billion went into DB, and £9.9 billion into DC. Now to be fair, DB overtaking DC was far more to do with the drop in the level of DB contributions, rather than a massive increase in DC. However, the fact remains that DC contributions were at their highest levels since auto-enrolment was introduced. The reason this matter is that unlike the "safety-first" DB funds, DC funds are far more likely to go into growth-orientated assets, such as equities. They won't necessarily automatically go into UK equities, but the more important point is that they aren't being sucked out either. Long story short, this is reasonably clear evidence that one of the structural headwinds that the UK market has faced for a very long time is almost certainly now exhausted. All we need now is to see some actual inflows...

Bloomberg | 25 June 2024

Pensioners risk £11,000 hit under Labour

Keir Starmer plans to force pension funds to switch to UK investments

Retirees stand to lose thousands under Labour's plans to force pension funds to switch investments to Britain, analysis shows. The party has committed to increasing investment from pension funds in UK markets, prompting experts to warn that savers could miss out on growth. An average pension fund would be £11,000 worse off over 37 years if it were invested in FTSE shares versus global equities, according to analysis by wealth management firm True Potential. The average pension pot of a 25 to 34-year-old is £9,300. If a 30-year-old's pension fund invested this sum into the FTSE All-Share Index, the pot would be worth £124,360 by the time they retire aged 67.

However, if the pot were instead invested in the MSCI ACWI, a global equities index, it would be worth £180,165 over the same period – £55,805 more than if the money had been invested domestically. If 20pc of investments were switched from the MSCI ACWI to the FTSE All-Share, a pensioner would have lost out on £11,161 of investment growth by the time they come to retire. The analysis assumes the 20-year average annual growth rate for the FTSE All-Share Index (7.26pc) and the MSCI ACWI (8.34pc). Despite Labour's manifesto pledge to increase pension fund investment in Britain, it is unclear what proportion of assets will need to be allocated domestically.

The party has also not stated whether funds will be mandated or simply encouraged to switch to UK markets. "Labour will also act to increase investment from pension funds in UK markets," the party's manifesto, released on June 13, explained. "We will also undertake a review of the pensions landscape to consider what further steps are needed to improve pension outcomes and increase investment in UK markets." Neil Rayner, of investment platform True Potential, said that while Britain was in need of more investment from private business, plans to force pension funds to invest their clients' money in domestic markets could have unintended consequences for savers. He added: "This uncertainty could come at the cost of a future generation of retirees who are currently diligently saving up for their retirement.

"Restricting investments based on geography increases the risk and volatility for these portfolios which could harm long-term results and make financial planning far more difficult for millions of people." Jeremy Hunt is already pushing pension schemes to invest in UK assets. In March, the Chancellor announced that all defined contribution (DC) pension schemes would be required to disclose their investment in UK assets from 2027, as well as their net investment returns and costs. The measure built on plans announced last year as part of the "Mansion House compact", in which some of the country's largest DC scheme providers committed to invest at least 5pc of their assets in unlisted equities by 2030. Jason Hollands, of wealth management group Evelyn Partners, said Labour would likely "go one step further" than the Chancellor. He added: "With Jeremy Hunt's 'compact', pension funds agreed voluntarily.

But there were those who thought this should be a requirement. “The question we need to wait and see is: will Labour go for a carrot or stick approach – will schemes be forced to invest in the UK or merely be encouraged to do so? “As an investor, you just want your pensions to be invested in the most attractive places, so more requirements are not necessarily a good thing. [Mandating investment domestically] would be good for the UK stock market but not necessarily the end investor.”

The Labour Party was approached for comment.

The Telegraphy | 25 June 2024

Managing Tax Risks Through Tax Indemnity Insurance

Taxpayers have multiple tax risk management options at their disposal when entering into complex transactions with each option having its own advantages and disadvantages.

The complexity of the transaction and level of assurance required are often determinative when it comes to selecting the appropriate tax risk management option. The most common tax risk management option is to obtain an opinion from an independent SARS-registered tax practitioner and, to a lesser extent, an Advance Tax Ruling ("**ATR**") from the South African Revenue Service ("**SARS**"). An opinion obtained from independent SARS-registered tax practitioner is the cheapest tax risk management option and provides the taxpayer with protection against the imposition of an understatement penalty and potentially also underestimation penalty in the event of SARS assessing the taxpayer on the particular transaction on a basis contrary to what is outlined in the opinion. Certain requirements must, however, be satisfied for the understatement penalty protection to apply.

The first set of requirements are that the taxpayer must have fully disclosed the transaction to SARS by no later than the date on which the return incorporating the transaction is due and that the opinion must have been issued to the taxpayer by no later than such date. The second set of requirements relate to the qualities of the opinion and require that it be based upon a full disclosure of the specific facts and circumstances in respect of the transaction and that it confirms that the taxpayer's position is more likely than not to be upheld in the event of the matter proceeding to court. Therefore, if a taxpayer obtains an opinion adhering to the above requirements and SARS assesses the taxpayer on the particular transaction in a manner that is contrary to what was outlined in the opinion, the taxpayer will only be required to settle the additional taxes, interest and possibly also the percentage-based penalty resulting from the additional assessment. In this case, the understatement penalty must be waived.

The opinion, therefore, effectively acts as insurance against the imposition of an understatement penalty on the particular transaction. There is, however, a school of thought holding that the understatement penalty cannot be waived where it is imposed in respect of "impermissible avoidance arrangements" which refer to cases where SARS successfully invokes the General Anti-Avoidance Rule ("**GAAR**") in section 80A to 80L of the Income Tax Act, No 58 of 1962 or its corollary for Value-Added Tax ("**VAT**") purposes in section 73 of the Value-Added Tax Act, No 89 of 1991. Proponents of this school of thought, therefore, hold that an opinion obtained from an independent SARS-registered tax practitioner adhering to the above requirements does not

provide any protection against the standard 75% understatement penalty imposed in respect of "impermissible avoidance arrangements". An ATR is issued by SARS to a particular taxpayer to provide certainty on the tax implications resulting from a transaction that the taxpayer proposes to undertake but has not yet undertaken. An ATR is, however, only binding on SARS and the applicant(s) thereto and cannot be relied upon by other taxpayers. The only material difference between an ATR and an opinion obtained from an independent SARS-registered tax practitioner is that SARS is bound by the tax implications outlined in the ATR issued to the applicant(s) whereas the opinion has no binding effect on SARS. The level of assurance provided by an ATR is, therefore, substantially better than what is provided by an opinion as the applicant(s) has absolute certainty that the tax payable on the transaction is per the principles outlined by SARS in the ATR.

The risk of SARS imposing any additional tax, understatement and percentage-based penalties and/or interest on the transaction down the line is, therefore, completely mitigated by obtaining an ATR. The ATR system does, however, have certain drawbacks including that (i) SARS and the taxpayer do not always agree on the tax implications in respect of the proposed transaction; (ii) the costs involved in obtaining an ATR is usually double the cost of an opinion as both the tax advisor and SARS charge fees for their time spent on the matter; and (iii) SARS is by law precluded from issuing an ATR on certain issues such as, *inter alia*, the application of the GAAR and the substance over form principle. Taxpayers who are entering into transactions that are potentially susceptible to attack under the GAAR (usually Merger and Acquisition ("**M&A**") transactions) are, therefore, unable to mitigate their exposure to additional tax, the standard 75% understatement penalty and interest in the event of SARS assessing them under the GAAR. This lacunae can, however, be filled by tax indemnity insurance.

Tax indemnity insurance, which is predominantly provided by non-resident insurers, provides cover to a taxpayer against the risk of SARS assessing the taxpayer on a particular transaction in a manner contrary to what is outlined in the professional tax advice obtained by the taxpayer. The taxpayer is generally able to arrange cover not only for any additional tax on the particular transaction, but also for the interest, understatement and percentage-based penalties and defence costs. Tax risks of up to R10 billion can be insured and the cover is usually grossed-up to take into account in the tax that must be paid by the taxpayer on the receipt of the policy benefits, should the risk materialise. The cover period is typically seven years and can be increased up to ten years.

The underwriting process usually entails the taxpayer obtaining an opinion from an independent SARS-registered tax practitioner which is then sent to the South African insurance broker (which acts as intermediary between the taxpayer and the non-resident insurer), together with full details of the transaction and the relevant agreements. The insurer then assesses and, if acceptable, insures the risk against the payment of an upfront lump sum premium by the taxpayer. The lump sum premium is based on the risk and total cover required by the taxpayer and can be as low as 3% of the total cover required by the taxpayer. The tax indemnity insurance option is the most expensive tax risk management option given the insurance premium and the requirement for the taxpayer to obtain independent tax advice. It is, however, the only tax risk

management option that provides the taxpayer with complete protection against the risk of SARS assessing the particular transaction under the GAAR and/or in a manner inconsistent with what is outlined in the opinion obtained by the taxpayer. In this regard, the taxpayer will still be liable for the additional tax, the standard 75% understatement penalty (in a GAAR case), possibly the percentage-based penalty and interest in the event of SARS assessing the taxpayer under the GAAR. The taxpayer will, however, receive the insurance pay out to enable it to settle its legal costs and the final tax liability.

Almost any type of tax risk can be covered by tax indemnity insurance including, inter alia, the following:
• The GAAR and substance over form principle;
• The application of any specific anti-avoidance rule;
• The disallowance of reduced South African withholding tax rates under an applicable double tax agreement as a result of the application of the principal purpose test and/or beneficial ownership test;
• Transfer pricing adjustments;
• Employees' tax and employment tax incentive adjustments; and
• Valuation disputes.

Taxpayers obtaining tax indemnity insurance must carefully consider the tax implications in respect of the insurance. The payment of the insurance premium might require the insured to reverse charge VAT at 15% where the insurance cover relates to an M&A transaction. Further, the receipt of the policy benefits will result in tax implications for the taxpayer depending on the nature of the insured transaction. Lastly, exchange control approval must be obtained for the payment of the insurance premium which, in some cases, might require the taxpayer to obtain approval from the Financial Sector Conduct Authority.

The table below provides a summary of the main features of the three tax risk management options considered in this article.

	Opinion	ATR	Tax Indemnity Insurance
Must additional tax be paid if SARS assesses taxpayer?	Yes	N/A - SARS cannot assess taxpayer contrary to positions outlined in ATR	Yes
Must understatement penalty be paid if SARS issues an additional assessment?	No, unless the understatement penalty is issued in respect of an "impermissible avoidance arrangement"	N/A - SARS cannot assess taxpayer contrary to positions outlined in ATR	Yes
Must percentage-based penalty be paid if SARS issues an additional assessment?	Possibly	N/A - SARS cannot assess taxpayer contrary to positions outlined in ATR	Yes
Must interest be paid if SARS issues an additional assessment?	Yes	N/A - SARS cannot assess taxpayer contrary to positions outlined in ATR	Yes
Cost	Lowest	Twice the amount of an opinion	Most expensive
When must the tax risk management option be obtained?	Can be after implementation of transaction but must be prior to due date of return incorporating the transaction	Before the implementation of the transaction	Can be after implementation of transaction but ideally prior to due date of return incorporating the transaction

In conclusion, each of the above tax risk management options represent an arrow in the quiver to effectively manage tax risks, based on the complexity of the transaction and level of assurance required by the taxpayer. Tax indemnity insurance provides unique benefits when it comes to insuring the tax risks associated with M&A transactions which is why its popularity as a tax risk management tool is increasing.

FA News | 25 June 2024

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

3 William Road
Bedfordview
Johannesburg 2008

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.