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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

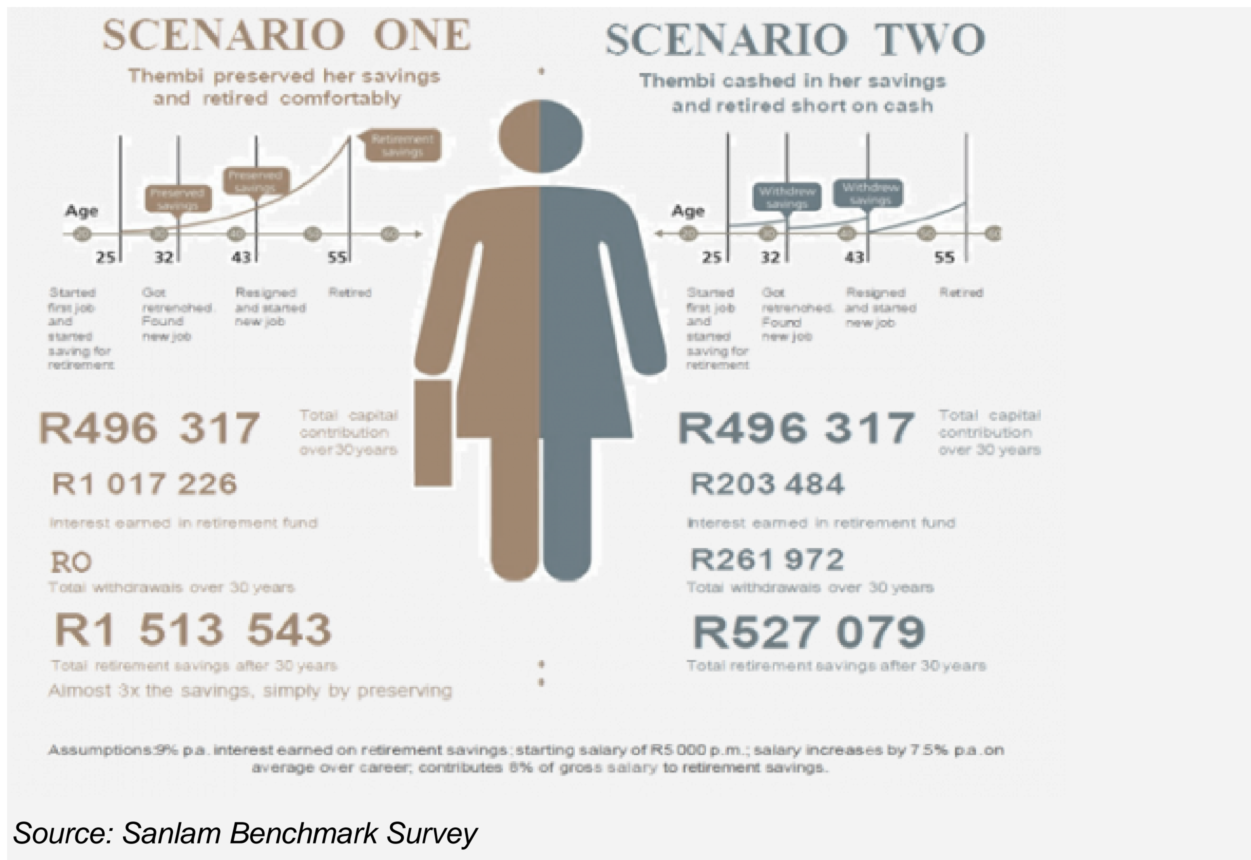
The power of preservation

And what else to remember when leaving your employer.

When it comes to investing, in many cases true success rather lies in essentially doing "nothing" rather than stressing too much about what we should be doing. The true value of inaction can be best displayed when it comes to preserving your investments. When we change employment, the temptation is always there to access our retirement funds, as the documentation is often provided as a matter of course. This is especially true when we are still younger and can easily believe the fund value is still minor, and that withdrawing our savings won't have a longer-term effect. The power of preservation proves otherwise and just benefiting from time, and compound interest can have a life-changing effect. The average person will change jobs around 12 times in their lifetime (according to a 2019 Bureau of Labor Statistics (BLS) survey of baby boomers) – even more reason to reinvest your retirement funds every time you make a life change.

A preservation fund is an investment vehicle where you can reinvest your retirement funds without any tax implication at the reinvestment stage. The preservation fund is a personal retirement savings vehicle. Preservation funds provide the flexibility of enabling you **one withdrawal prior** to retirement age of the full benefit, subject to income tax at the lump sum withdrawal tax tables**.** If a partial withdrawal is made, the balance of the benefits remains in the fund until retirement age (55). No ongoing contributions may be made to the preservation fund. Your selection of underlying investments will have to comply with the limits set by Regulation 28 of the Pension Funds Act. Regulation 28 is limitations set out by the government in order to prevent investors from taking too much risk with their retirement savings.

Various asset limitations include 75% equity exposure, 40% foreign exposure (including 10% in Africa), 30% foreign exposure (excluding 10% in Africa) and 25% maximum property exposure. The diagram below illustrates how reinvesting your funds when changing occupations, could lead to a 3x larger outcome at retirement, compared to making withdrawals on these employer changes – every time you are essentially starting over, but with a shorter investment term to retirement. For that reason, you need to start playing catchup – but from an affordability and cash flow basis, this is in many ways physically impossible.



Source: Sanlam Benchmark Survey

There are a few other essential decisions that need to be actioned when you leave an employer, depending of course on which benefits your company offered. Actioning this decision from your side is therefore imperative so that you aren't left without cover. Firstly, your medical aid contributions need to be changed over to your personal bank account, should your medical aid be structured through the employer and if you are not joining a new employer's fund. Ensure this is done immediately. Secondly, consider a continuation option should your company offer risk benefits (life cover, severe illness cover, disability cover and income protection – sometimes even an education benefit and funeral cover is included here).

In most cases, you will have the option of keeping this cover. Taking this cover into your personal capacity is called a continuation option, and you may not have to go through any medical underwriting in certain instances. You are normally covered for 30 days, depending on the rules of the policy. So, structuring this as soon as your last day contractually is important, to ensure you are not left without cover. Leaving an employer is sometimes a much bigger life event than we give it credit for – your portfolio will require holistic restructuring, and this is best done sooner rather than later.

Moneyweb | 14 October 2021

Retirement blues

Retirement can be very traumatic, but it does not have to be and fortunately for many retirees it is not.

Most of us work for around 40 years to reach our "golden years" in retirement. This is the time that many look forward to. The time that we can relax, travel the world, spend time with our loved ones and generally just chill. Unfortunately, often the reality is very different to our pre-retirement dreams… Over the years that I have been practising as a financial planner/advisor, I have walked the path with many clients who experienced "retirement blues". Often the road to retirement follows the following path:

- Pre-retirement excitement;
- Planning the long-awaited cruise or holiday;
- Look at retirement options in terms of income;
- Start getting concerned whether there will be sufficient capital to last for life;
- Attend the farewell party and officially retire. This is both exciting and traumatic;
- Enjoy the first couple of weeks or months relaxing at home or on holiday but still wake up at the same time that you did when you were working;
- Reality starts setting in. You will never go back to your old office, and you no longer have a say in the business that you were involved in for so many years;
- Start looking for things to do, boredom starts setting in;
- Start questioning self-worth, especially if you had people reporting to you during your career. A feeling of uselessness starts to enfold you;
- Waking up questioning your purpose in life. Nowhere to go and no one asking your advice. Nothing to wake up for;
- Investment angst becomes more severe because now your investment portfolio will show more volatility than prior to retirement;
- Memory starts to deteriorate. Frustration creeps in;
- Health starts to deteriorate. Moving to a retirement village becomes a point of discussion;
- Selling your family home in lieu of a smaller retirement home creates the feeling that you have lost your freedom; and
- Losing a life partner causes despair.

Often depression sets in during one or more of the above phases. Retirement can be very traumatic, but it does not have to be and fortunately for many retirees it is not. Admittedly, things will never be the same as when you worked prior to retirement but we must understand and accept that certain things will change in our lives as we get older and as we start the next phase of our lives namely retirement. The challenge is how to embrace the changes, adapt our lives and accept what life throws at us as we get older. There are many factors to consider as one ages but I want to focus on three core areas. I believe if one can get these three areas sorted out then retirement can be pleasant and something to look forward to:

- Financial independence
- Pursue of a worthwhile interest
- Quality of life

Financial independence

Preparing for financial independence during retirement starts the day you start earning a salary. Let's accept that not many people manage to do that and let's also accept that most people retire on an income that is less than what they would have liked. Not many people can retire on an income equal to their last paycheque… At the core of your retirement planning, you must have a budget. Without a budget, you cannot determine the extent of the capital required to fund the expenses. The budget must consist of monthly expenses, medium-term expected (or wants) expenses like a holiday or replacing a car, and long-term expenses like a retirement home.

Monthly expenses must be linked to future inflation per expenditure i.e. medical expenses are higher than most other expenses and medical expenses will become a larger part of your monthly expenses as you get older. The asset value we have the day we retire is what must carry us through to the day we die. This can consist of pension proceeds, investments, property, company shares, royalties, and anything else that can either generate an income or can be exchanged for cash. If the accumulated assets cannot fund your required income, you either must reduce your income expectations or reduce the term that income will be generated and start discussions with your children/family about possible future solutions and possibly their inheritance expectations. This brings two important factors into play:

- Understand your investments and be mindful of the price you pay for being too conservative. I elaborated on this in a previous article "The cost of conservatism". It is crucial to determine what return you require to meet your income needs for the rest of your life. Speculation time is now over. Forget maximum returns and aim for relevant returns. Cash and pure income funds are not the answer unless you intend to draw 2.5% maximum from your investments for the rest of your life. In the same vein, cryptocurrencies and investment schemes promising super returns should not be on

pensioners shopping lists! It is sad to see that every time some financial scheme breaks news where millions and even billions are lost, pensioners are at the core of the biggest losers. It is harsh to say this but the scammers cannot take the full blame. Investors which include pensioners, must share the blame for investing (speculating?) in schemes where severe and even total losses can occur. These schemes always offer totally unrealistic promises. Guarantees mean nothing unless they are offered by one of the large financial institutions. Where pensioners have been investing in pure share portfolios for many years prior to retirement they can remain invested in those portfolios as long as they understand the volatility and risk versus return dynamics of such a portfolio. To start investing in such a portfolio after retirement is probably not a good idea. ***Full Report: https://www.moneyweb.co.za/financial-advisor-views/retirement-blues/***

Moneyweb | 13 October 2021

Life annuities, living annuities and death

Understanding the end process of annuities better.

When you retire from your retirement annuity or retirement product, various decisions must be made, for instance:

- Do you want to take your whole provident fund in cash and pay the tax?
- Do you want to take your full one third in cash from your pension plan or retirement annuity and pay the tax on it or do you want to limit the amount in cash and purchase a life annuity or living annuity with the balance?

I would like to bring a few facts to the attention of life annuity and living annuity owners. I have encountered many clients who have totally misunderstood what happens to their annuities when they pass away, and I hope that these notes can clear some of them up. I have now encountered many clients who were under the impression that living annuities are pension products. This can be attributed to the fact that a monthly “pension” or annuity is paid. They are then under the impression that the proceeds will automatically be paid to their spouse or dependents as it would be under the Pension Funds Act. This is however not the case.

A living annuity is a life insurance product. If you have not appointed a beneficiary or your beneficiary has passed away before you and you have not updated your beneficiary nominations, it can cause a huge problem when you pass away. If there is no beneficiary

appointed, the proceeds will be taxed in your name as though you are retiring, and the balance will be paid into your estate to be distributed to your beneficiaries named in your will. The amount will attract a 3.5% executor's fee as well and will be tied down in your estate until your estate is finalised. This can create a catastrophe for your spouse or other dependents and create a liquidity shortage for your dependents. As an example: You took a lump sum of R1 050 000 from your retirement fund when you retired and invested the balance in a living annuity. At the time when you pass away, you have R3 000 000 left in your living annuity. If it is paid to your estate or even paid out in cash to your beneficiary, the tax thereon will be 36% or R 1 080 000.

This is a huge loss of capital. If your beneficiaries are named in the living annuity and they transfer the proceeds to a new living annuity in their name it will not be taxed. Please make a point of reviewing your beneficiaries on your living annuity and please discuss the implications there off with your beneficiaries. Just a few interesting facts about a life annuity, which is completely different to the above. If you take out a life annuity where the income is guaranteed for life and there is no guarantee period or joint life, the lump sum will not be repaid. For example, if you paid R3 000 000 for your life annuity and there is no guarantee and no joint life, and you pass away after one year, the R3 000 000 will not be repaid to your estate or dependants.

A life annuity can have a guarantee period of 10 years or 20 years depending on the option you take. This guarantee does not relate to your income, your income is guaranteed for life. It relates to the income that your beneficiaries will receive. So as an example: If you have a 10-year guarantee on your life annuity and you pass away after seven years, your beneficiary will receive the income for the remaining three years of the guarantee. Thereafter the income will stop and no further payments will be made. If you take out a joint life annuity on your life and your spouse's life, the income will be automatically guaranteed for life for both of you.

If you take a joint-life annuity with a 20-year guarantee and you pass away after 10 years and your spouse passes away five years later, your beneficiaries will receive the income for the remaining five years. If the last surviving spouse passes away after 21 years, the beneficiaries will get nothing. I hope that this article will help the reader to understand the end process of a life or living annuity better. The decisions made, when you invest your funds into a living annuity or buy a life annuity are extremely important and the advice of a suitably qualified advisor is of great value.

Moneyweb | 13 October 2021

Actuaries show that proposed 'two-bucket' retirement plan will improve outcomes

Actuarial modelling by the Retirement Matters Committee of the Actuarial Society of South Africa suggests that National Treasury's "two-bucket" retirement savings proposal is likely to result in significantly higher retirement income for pensioners, by allowing future retirement savings to benefit from the power of compounding. Actuary Natasha Huggett-Henchie, a member of the Retirement Matters Committee and Principal Consulting Actuary from NMG Consultants and Actuaries, says a recent analysis of fund administrator data shows that more than 80% of retirement fund members cash in their retirement benefits when changing jobs rather than preserving their savings.

While all retirement funds are compelled to encourage preservation in terms of the retirement funds default regulations introduced by National Treasury in 2016, members are still allowed to take their full benefit in cash According to Huggett-Henchie, the majority of people take their benefits when changing jobs despite the punitive tax levied on the withdrawal of retirement benefits. To make matters worse, cashing in retirement benefits also reduces the tax-free lump sum normally available at retirement. "In other words, members are making bad choices by prioritising their short-term needs and wants, sacrificing future investment growth on their benefits and risking double taxation resulting in lower pensions at retirement."

National Treasury is therefore proposing to introduce a new system, referred to as the "two-bucket system" to allow retirement fund members to access a portion of their retirement benefits for emergencies such as the Covid-19 pandemic. However, says Huggett-Henchie, the access comes with the condition that the other portion of the retirement benefit cannot be accessed before retirement (the earliest age is 55). This results in the so-called "two bucket system" where one bucket is accessible and the other is preserved for future retirement benefits.

Huggett-Henchie says a well-designed, actuarially sound two-bucket system will therefore solve two problems for retirement fund members: they will have access to emergency funding when needed and their savings will benefit from compound growth leaving them with a substantially bigger nest egg on retirement. According to Huggett-Henchie it is the compounding effect over time that accelerates the growth of your retirement savings. For this reason, she adds, Albert Einstein famously referred to compound interest as the most powerful force in the universe, while Warren Buffett attributes his wealth to "a combination of living in America, some lucky genes, and compound interest". Compounding is enabled when the returns earned on your

retirement savings together with any capital growth is left to attract further gains. The effect of earning income on income and further growth on capital gains is referred to as compounding.
To illustrate this, the members of the Retirement Matters Committee modelled the following scenarios:

Scenario 1: A retirement fund member who joined a fund at age 20 changes jobs every seven years and withdraws (and spends) the full benefit every time. However, once the member reaches age 50 they focus on saving for their retirement and start preserving their benefits until age 65

Scenario 2: The two-bucket system has been implemented and the member, who joined a retirement fund at age 20, has access to one third of their benefit in the access pot. The member withdraws the full available amount in the access pot every five years until they reach age 65.

The results:

Scenario 1: The member in the first scenario is likely to retire with a net replacement ratio (NRR) – the ratio of the member's pension expressed as a percentage of their pre-retirement salary – of around 15%, which means that they will have to learn to survive with a monthly pension of 15% of what they earned in the year before they retired. Huggett-Henchie points out that if this member further reduced their retirement benefit by taking another cash portion at retirement, their NRR drops to 10%. Therefore, someone who was earning R20 000 a month before retirement would now have to survive on R3 000 a month, reducing to R2 000 if they take a lump sum at retirement.

Scenario 2: By contrast, the member in the second scenario will retire with a NNR of 36% on their full benefit, or 32% if the cash portion is accessed. In other words, their monthly income is more than three times higher than if they had been allowed to follow the path of the person in the first scenario. Huggett-Henchie explains that despite withdrawing their full one third over their working years up to retirement, the remaining savings were able to benefit from compounding. Staying with the example of someone who was earning R20 000 a month before retirement, this person would have access to a monthly pension of R7 200, reducing to R6 400 if they take a lump sum.

Huggett-Henchie stresses that by far the best outcome at retirement is achieved by retirement fund members who never access their retirement savings, thereby enabling the power of compounding to deliver the best possible outcome. She adds that for this reason, all retirement fund members should be provided with meaningful information about the impact of accessing their emergency bucket on their long term retirement aspirations.

Rules regarding access

While National Treasury is still working out the details of how the two-bucket system will work, the Retirement Matters Committee has made a number of recommendations for consideration based on its modelling work, especially regarding the rules and restrictions regulating the accessibility of the emergency portion. Huggett-Henchie says the committee feels strongly that there should be no need-based rules, as this is open to abuse and very onerous and costly to administer. “Our modelling indicates that forcing the compulsory two-thirds preservation actually improves outcomes at retirement, and members are going to find a way to borrow against or spend their one third anyway.

Access to the one third should therefore be available to all retirement fund members regardless of need. ” She further points out that the actuarial modelling indicates that the frequency of withdrawal from the access pot does not affect the ultimate NRR at retirement. “If you withdraw more frequently you just get a smaller cash amount each time as it doesn’t have time to build-up, but the preservation part remains unchanged.” She adds that there will, however, be an administrative burden to pay the cash amount and therefore some restrictions would be needed to reduce frequency. “Here we would suggest that the regulators allow annual withdrawals, with a free once off withdrawal, and a free withdrawal every five years.

Additional withdrawals should be subject to an administration fee deducted from the benefit. Huggett-Henchie also recommends putting in place a rand limit on the withdrawal amount at any point in time to avoid abuse by high income earners. She concludes that the biggest concern for retirement funds is the potential for a proverbial “run on the bank” if all retirement fund members are allowed to withdraw their emergency funds immediately after the legislation is promulgated. To avoid this there some initial controls and safe-guards will have to be put in place, says Huggett-Henchie.

Personal Finance | 10 October 2021

New generation solutions breathe new life into SA retirement industry

While annuity solutions have been the primary source of retirement income for South Africans for decades, they tend to receive criticism for not keeping up with the evolving retirement landscape. Yet the local annuity market has undergone considerable change in recent years to address the increased risks faced by retirees and to cater for their individual needs. Fundamentally, retirement income products aim to address the major risks in retirement, namely the risk of living longer than expected, the risk of costs rising more than expected and the risk of investment market volatility. In practice, however, people want a cost-effective retirement income product that sets clear benefit expectations and offers flexibility, by not tying them in or restricting them when their circumstances change.

The private retirement investment market in SA is quite progressive compared to other countries like the UK. Our market may be significantly smaller, but it does not stand back when it comes to innovation! And while people tend to place importance on the accumulation phase, innovation in the decumulation phase should not be overlooked. Retirement regulations require you to use at least two-thirds of your retirement fund savings to buy an annuity when you retire, namely a living annuity or a guaranteed life annuity. While no annuity products score full marks on their ability to address every retirement risk and need effectively, by comparing them individually we are able to get a better sense of how well suited each product is to a retiree's individual circumstances and risk appetite.

Living Annuity

From a risk point of view, a living annuity poses both investment and longevity risk. This is because you ultimately make your own investment decisions and therefore carry your own risk, and there is no protection in place from outliving your savings and investments. While there is some inflation protection depending on your risk appetite, this is not guaranteed and generally, the negative impact of market volatility can't be mitigated. From a complexity perspective, living annuities appear to be simple products, but the difficulty arises in deciding how much is the right amount to draw in order to balance consumption needs and ensure that your money lasts

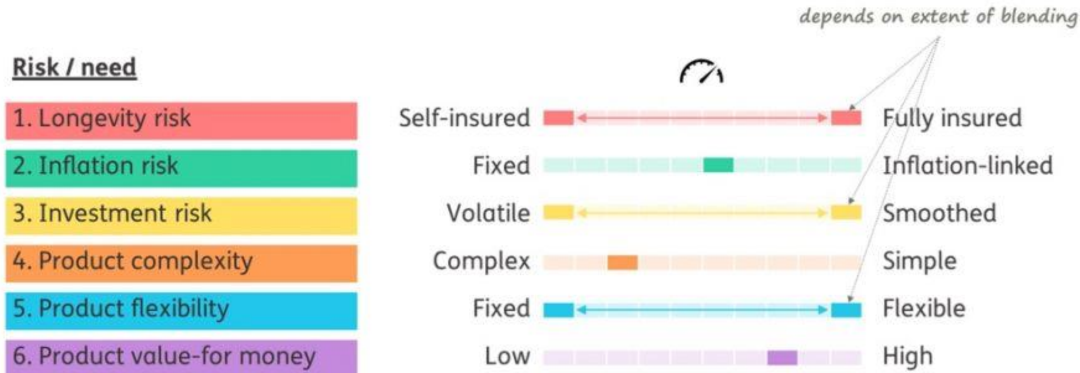
for your full retirement. Living annuities offer a high degree of flexibility in terms of investment choice and the ability to adjust your annual drawdown within certain parameters. Value for money will also vary depending on the applicable fees.

New Generation With-Profit Life Annuity

A with-profit life annuity offers a lifetime income that will never reduce, no matter how long you live or what happens to investment markets, while providing the ability to still participate in investment markets without the risk of a negative return. The term "with-profit" is derived from certain product elements where risks are shared or pooled across policyholders, which reduces the need for additional costly guarantees. With-profit annuities can also offer additional value-enhancing features like minimum payment periods or spouse's benefits.

With-profit annuities score well in protecting retirees against all three key risks – longevity, inflation, and investment risk. This annuity solution also ranks highly on perceived value for money but does not offer flexibility. In terms of complexity, with-profit annuities are relatively simple as they are clear about the level of income that is guaranteed for life and what percentage of inflation the annual increases target. However, some additional decisions are required around what level of spouse's income should continue after your death and whether any other financial dependants should be named as beneficiaries.

Blended Annuity



A blended annuity offers a good solution to the great annuity puzzle: while the vast majority of retirees are invested in living annuities, they paradoxically want income security as a primary requirement. So if it is the perceived lack of flexibility of a life annuity that makes retirees lean towards living annuities, a blended annuity can help to solve this problem by combining the flexibility of standard living annuities with the security of guaranteed life annuities in one optimal product. With a blended annuity, you get the best of both worlds. By deciding how much should be invested in the guaranteed life annuity component that forms part of the living annuity, you can choose where to position yourself on the risk spectrum between your needs and wants.

The combination of living and life annuity solutions in one product – a blended annuity – results in a product that is highly flexible and mitigates the primary risks in retirement. In overview, looking at the product gauge, blended annuities score highly on all fronts, and are no more complex than any of the other options. Over the last decade, annuities in South Africa have evolved to address the existing gaps in the traditional retirement market and meet the changing needs of retirees. However, we should not stop there. As an industry we must continue to challenge convention and drive annuity product innovation to help our customers achieve a better later life.

FA News | 12 October 2021

Financially desperate employees "resign" to get their retirement savings

Momentum Corporate's multi-employer umbrella fund, FundsAtWork, is receiving requests from participating employers to allow members to resign "artificially" to get access to their retirement savings. Employers then reinstate the employee once they've obtained access to their savings. This trend is not unique to FundsAtWork and very likely to be evident across the industry. The trend reflects the financial vulnerability of many employed South Africans. To make matters worse, many employees are unlikely to receive salary increases, let alone inflationary-related increases, as many businesses struggle to bounce back from the pandemic.

Households are becoming more desperate and those family members who are still employed are under pressure to support family members who have lost their jobs and are struggling. Nashalin Portrag, Head of FundsAtWork at Momentum Corporate, says these "artificial resignations" are not legal. "Allowing access to retirement savings withdrawal benefits through artificial resignation could have serious implications for the retirement funds involved, the participating employer and the member, as SARS views this type of transaction a serious violation of the Income Tax Act.

Recent conversations between National Treasury, business and unions to give retirement fund members limited access to a portion of their retirement savings may have made employees more aware of their retirement savings. However, even if the proposals get the greenlight at the Medium Term Budget Policy Statement in early November, the earliest any changes would become effective is during the course of 2022. In the meantime, it seems desperate, financially vulnerable employed South Africans are turning to illegal means to get access to their retirement savings.

Should SARS suspect the exit from employment was formally structured as a legitimate resignation while the real intention was deliberately disguised to allow the employee early access to their retirement savings withdrawal benefit, they will investigate further and if they find this is in the case, they could revoke the income approval of the retirement fund. This would mean, among other things, contributions to the retirement fund will no longer be tax-deductible and investments and their growth would be taxed, which would impact significantly on the financial viability of the retirement fund.

To prevent this, the employee's fund membership would need to be fully reinstated, as if the artificial resignation never occurred. This means the member will have to repay the withdrawal benefit paid to them in full, which will result in further financial hardship for the employee." Portrag concludes, "While we understand how financially vulnerable and desperate employees are, we urge all employers and employees to not succumb to the illegal act of "artificial resignations" to access retirement savings. Rather, we strongly encouraged to help employees become aware of legitimate sources of help they can turn to if financially vulnerable.

For example, our FundsAtWork umbrella fund offers all members access to financial coaching that can help members manage their finances more effectively. All our members also have access to an employee assistance programme that offers debt counselling to help them get on top of their debt and deal with the emotional impact of financial pressure, at no additional cost. Although retirement funds are not a short-term solution, they do have a critical role to play in supporting employers and their employees with the financial pressures created by the current economic situation in our nation."

FA News | 27 September 2021

INTERNATIONAL NEWS

Pension savers face risk of higher fees as Sunak seeks billions for 'levelling up'

Treasury-driven review of UK workplace pension charge cap hopes to boost investment in areas such as private equity

Ministers are looking to relax rules shielding tens of millions of UK retirement savers from high charges as they step up efforts to funnel pension fund cash into the government's "levelling up" agenda. Officials are working on proposals to dilute the 0.75 per cent ceiling on annual management fees, which was put in place in 2016 to protect workers auto-enrolled into workplace pensions from having their savings eroded by high charges. Chancellor Rishi Sunak is looking at ways to tap billions of pounds of pension fund cash to invest in long-term projects, including infrastructure schemes, renewable energy projects and innovative tech firms, to help deliver on UK prime minister Boris Johnson's pledge to spread economic growth across the UK.

Many of these assets are held in funds managed by private equity and venture capital firms, however, which commonly levy performance fees linked to certain thresholds on annual returns. Defined contribution (DC) pension managers have traditionally shied away from investing in PE and VC funds, largely because of concerns that these fees would breach the 0.75 per cent charge cap. Policy initiatives to deliver on the "levelling up" agenda will be a big theme of Sunak's Budget on October 27. The proposals to dilute the charge cap, which would be subject to consultation, represent a stepping-up of Treasury-led efforts to encourage DC pension funds to invest more widely in assets.

The review comes just six months after the Department for Work and Pensions rejected calls for performance fees to be partially or completely excluded from the cap following a consultation. At the time, it said the inclusion of those fees in the cap protected members from high fees that did not improve value for money. Sunak and Therese Coffey, work and pensions secretary, now argue the proposed reforms would allow pension savers to access funds offering better returns by investing in longer-term assets, government insiders said. However, those briefed on the plans said performance fees would not be removed from the charge cap in their entirety; the consultation would "seek a balance" that encouraged investment in illiquid assets — such as infrastructure or innovative tech firms — with the potential for greater return.

But one former regulator expressed concern that the charge cap could be loosened. "The cap was introduced on strong evidence that savers needed protection from some undoubtedly egregious charging structures," said Andrew Warwick-Thompson, a professional trustee and former executive director for regulatory policy at The Pensions Regulator. "Careful thought needs to be given to any proposal which undermines the consumer protection principle that lies behind the cap." The government has attempted to address concerns of pension fund managers about performance fees, which can be high and volatile, by allowing trustees to smooth them to reduce the risk of the charges breaching the cap in any one year, a measure that came into force at the start of October.

Last month a working group, headed by the Treasury, Bank of England and Financial Conduct Authority, recommended the government further review the charge cap to help stimulate material investment by schemes in illiquid assets. Michael Moore, director-general of the British Venture Capital Association, the industry lobby group, supported changes to the charge cap. "We recognise the important role of the charge cap and believe appropriate changes can be made so that UK pension savers can benefit from the strong long-term returns generated by UK venture capital and private equity." The BVCA said it backed a full exclusion of performance fees from the charge cap where it was supported by strong performance over the long term. Under typical performance fee structures, a fixed annual management fee is paid, regardless of return, in addition to a performance-related element. The government declined to comment.

Financial Times | 13 October 2021

OUT OF INTEREST NEWS

South Africans are projected to retire on only 40% of their final salary – Alexander Forbes

ALEXANDER Forbes Member Insights found that, on average, working South Africans were projected to retire on only 40 percent of their final salary – a long way off from what is considered ideal. Current retirees' starting pensions amounted to 31 percent in 2020, an improvement from the previous year's 28 percent.

The Member Insights report found that only six in every 100 members could retire on more than 75 percent of their pensionable salary. The 75 percent figure is the one targeted by the retirement fund industry.

The implications of Covid-19 on retirement outcomes found that about 30 percent of retirement funds implemented contribution holidays or reduced contributions. Many of the funds had since recovered and only 5 percent of funds still had these relief measures in place.
The average contribution rates reduced slightly from 14.18 percent to 14.1 percent.
Member Insights also indicated that the gender pay gap in South Africa was still high based on the analysis of the pay gap across the major nine sectors, including the public service.
It says on average, for every R1 a male member earned, a woman member earned 83 cents. The starting pensions of male retirees were 35 percent of their final salary, whereas for woman it was 26 percent.

Personal Finance | 14 October 2021

ESG: Is private equity leading the investment industry?

A South African private equity firm is using environmental, social and governance (ESG) factors as a critical deal filter, applying the ESG lens from the very start of the transaction through to ongoing management practices and eventual sale. In fact, Sanlam Investments says its private equity arm has angled its investment process so tightly towards ESG that it literally 'can't do a deal unless the company ticks all the ESG boxes'. John Seymour, head of private equity and mezzanine finance at Sanlam Investments, says private equity is nimble when compared to listed asset classes, which has allowed for a faster segway into being ESG-led and -focused.

"So, while the whole of Sanlam Investments is deeply invested in becoming Africa's premier sustainable investment house, we have been able to move extremely quickly in this regard." He says his firm's strategy isn't just about impact. "While ESG allows us to have an impact on lives and the planet, it is more than that. A well-run company that is tightly governed takes care of the environment and focuses on employees and surrounding communities is more likely to offer us a strong exit when the time is right. Simply put, these are the most future-fit businesses and the best investment opportunities.

"A few years ago, there may have been some scepticism surrounding ESG being applied in private equity, with investors feeling returns may be compromised, but this thinking is rapidly becoming obsolete." Capital Monitor reports a growth in full-time corporate social responsibility officers in private equity firms globally and says 'ESG has become a value driver rather than just a compliance or purely reporting topic'. Seymour says there are myriad ways that private equity firms can impact ESG through their investments, some include:

Direct management control: Depending on the size of its stake in the business, a private equity fund will have the ability to influence management decisions and strategy directly. This includes putting effective governance and systems in place – which can lead to significant improvements in the ways these businesses operate from an ESG perspective. In contrast, the opportunity to engage with senior management within the listed equity space tends to be less frequent.

Due diligence: Private equity funds can interrogate ESG information gathered at the due diligence stage through direct engagement with management, site visits and ESG impact assessment studies. This allows the fund to gain an in-depth understanding of the company's historical ESG performance and provides an opportunity to co-design solutions with the investee companies on how to address these after the transaction.

ESG clauses: Private equity funds can negotiate and incorporate specific ESG clauses into shareholder agreements and management performance incentive plans, including adopting specific action items to address opportunities identified as part of the ESG due diligence process.

Business stage: Private equity funds often invest in an earlier stage or less mature businesses, which allows them to help shape business practices and strategies, including ESG strategies and systems. The Sanlam Investments private equity division looks to invest in companies with a high propensity to absorb and grow jobs, empower disadvantaged groups, particularly women and offer employment opportunities to the youth. Having an impact on communities is also a consideration as many of these companies may anchor large parts of the economies within the local communities.

The majority of the South African private equity activity now sits in the lower mid-market space, with investments targeting smaller companies. Seymour describes the Sanlam private equity business as 'one of the few true mid-market private equity players' in South Africa, with a targeted fund size of R2-billion. It looks to invest in companies with earnings before interest, tax, depreciation, and amortisation (EBITDA) of between R50-million and R250-million. Much of the private equity activity in the upper end of the market previously came from international players, but these have largely withdrawn from South Africa.

The Sanlam private equity fund is open for investment. However, a generalist in nature, however, sectors on the fund's radar have remained resilient through Covid-19. As a result, Sanlam Investments will soon announce its next two investments. Like its investment into food processor Cavalier Group, it will be funded from the Investors' Legacy Range launched by Sanlam Investments early in the Covid-19 crisis. Both have strong ESG and impact strategies, and the investment capital and management expertise will help sustain and create jobs and further improve job quality and inclusivity.

FA News | 11 October 2021

SA women ‘earn’ less than men even in retirement

Influenced by decades of inequality, breaks in careers, wage differences – and a higher cost of converting accumulated savings to an income.

South African women can’t seem to catch a break as the effects of the gender wage gap threaten to follow them into retirement. An Alexander Forbes study based on member analysis and released on Tuesday has shown that women are likely to get about 10% less income from their retirement funds than men. The reasons for the gender gap include the consequences of decades of inequality and breaks in careers to raise a family, according to the report. “It is also a result of lower contributions being made to retirement funds by females, in general, as well as the fact that after retirement females live longer than males on average.” Having a longer lifespan, on average, means women’s retirement income diminishes because it needs to stretch over a longer period.

Replacement ratio

The survey analysed almost one million of the insurer’s retirement fund members and found that in 2020 the replacement ratio for working females was 26.56%, while that of their male counterparts was 35.3%. The ratio for women even came in about 5% lower than the overall average of 31.47%, the company stated in a presentation. The country’s largest (private) pension fund administrator projected that the average replacement ratio will increase to 40%, which is still significantly lower than the ideal ratio of 75%. “According to Member Insights, only about 6% of retirement fund members can expect an income in retirement above 75% of their pensionable salaries,” the company found.

While the gender pay gap for the bottom 10% has “equalised” over the years, it remains relatively high across major sectors. On average women earn 83 cents for every rand earned by their male counterparts. This gap widens in some sectors like agriculture and business services, where women earn 81 cents and 77 cents respectively. “If we look at the top 10% of the highest salaries, the gender wage gap is 7%, meaning for every R1 a male member earns, the female member earns 93 cents,” says Ntsheki Molefe, regional executive for retirements at Alexander Forbes.

Reform to improve preservation

The Covid-19 pandemic saw growing appetite among South Africans to cash out retirement savings to make ends meet. However, the company advises against people cashing out their savings before maturity. Instead, Alexander Forbes supported the “two-bucket pension reforms”

proposed by National Treasury as an alternative that will protect long-term preservation and satisfy immediate financial needs. Projections by the group show that future generations – who stand to benefit from the proposed policy reform – could see their retirement outcomes double, at the least. “People’s savings [could] be anywhere between two and two-and-a-half times better over a 35-40-year period because of this – even if they were to take their short-term bucket,” says John Anderson, Alexander Forbes’s executive for investments, products and enablement. Anderson added that their modelling of the two-bucket system revealed that if people were to preserve both their long and short-term investments over the 40-year period, they would receive the desired 75% replacement ratio at retirement.

Impact on millennials

The group’s research also revealed that early millennials below the age of 24 suffered greater financial stress due to the pandemic, which resulted in significant job losses and left young people at a higher risk of defaulting on their loans. “The analysis found that at least 14.11% of loans taken by Early Millennials were in default, followed by Late Millennials at 4.79%, Generation X at 2.27% and Baby Boomers at just 0.94%,” the company said. “This [unemployment] is going to continue being a huge challenge in the industry because it’s these years when people contribute towards their retirement that makes a huge difference,” Anderson said.

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South Africa's private security sector leaves guards feeling unsafe and unprotected

South African security guards, who already earn a pittance, are being ripped off by their employers – and possibly by their pension fund when it comes to their retirement savings. The office of the Pension Fund Adjudicator revealed last week that it had reported the Private Security Sector Provident Fund (PSSPF) to the Financial Sector Conduct Authority (FSCA) for what appears to be systemic problems with fund governance and administration. The fund was the biggest contributor to complaints in the past year, with employers accused of failing to pay over contributions while making deductions from employees' salaries.

Pension Fund Adjudicator Muvhango Lukhaimane says she is concerned about the quality of responses that required follow-ups and the fact that the fund had failed to take advantage of her office's revised complaints management process. "There was no attempt at all on [the PSSPF's] part to resolve complaints directly with members," she said. In a statement last month, the FSCA confirmed that it had previously conducted a supervisory on-site inspection of the PSSPF in November 2017. Since then, it made an application for the fund to be placed under curatorship. But in September 2018, with the agreement of the trustees, it appointed statutory managers to the board of the fund.

The statutory managers then commissioned an independent forensic investigation of the fund. After these investigations, the FSCA "commenced with regulatory action against various parties". It would not divulge anything further as this action is an ongoing and confidential process, it says. Olano Makhubela, the FSCA's divisional executive for retirement funds, explains that a curatorship, which can be by consent between the regulator and the fund's trustees or by court order, takes away the management of the fund and vests it with the curator. "Given the history with some of the curatorship in terms of costs and duration, the unions were worried about losing their participation in the management of the fund over a protracted period, which would also have significant cost implications on the fund."

A statutory manager, on the other hand, is appointed by agreement between the fund's trustees and regulator. Makhubela says, in this case, management is still vested in the trustees, but they are overseen by the statutory manager, and work jointly with him. "It is important to note that one of the conditions stipulated by the FSCA before agreeing to a statutory manager was that certain trustees could not continue on the fund, given the various allegations," he says. Lukhaimane says her office has been referring matters relating to the management of the fund to the FSCA for at least the past seven years. "There is also a huge problem with the administration of the fund. In some instances, employers are paying contributions, but these

are not being allocated timeously to the members' records. This has resulted in instances where some employees have asked their employers to stop contributing to the fund [which is against the law] because they have seen their colleagues leave without receiving their benefits or die and have dependants not receive the death benefit." She notes that the private-security sector is "very peculiar" in several ways. Employers do not need to have a track record to participate in the sector. The Private Security Industry Regulatory Authority (PSiRA) licenses security companies and regulates how they operate. "Even though participation in the fund is mandatory as prescribed by the Department of Labour, compliance is very low and none of the players, except the fund itself, deals with the payment of contributions to the fund.

You have small employers, big employers and employers that include security as a side business to their bigger businesses. "Compounding this is the proliferation of small players in the industry, who are affected by cash flows. When you have clients not paying timeously, this has a ripple effect on all the other employer obligations. The Pension Funds Act has gone as far as to criminalise the nonpayment of contributions; however, the fund has to take action and set the ball rolling," Lukhaimane says. "So far, some employers that have tried to institute matters for prosecution have yet to see a single case taken on by the NPA [National Prosecuting Authority]. At a policy level, though, there is sufficient information for the industry and the Department of Labour to take a decision on whether this fund is fit for purpose.

In other words, given all the peculiarities of the sector, is there no better way to provide for security guards than through a mandatory fund?" she asks. The most recent published financial statements on the PSSPF website are for the 2019 financial year, although the FSCA has verified that it has received the financials for the year to February 2021. The 2019 financial statements reflect that member funds for the year amounted to R5.53-billion, with R36-million in the unallocated contribution account. This account holds the funds that have been received but cannot be traced to contributors within 90 days. A total of 22,049 members had been transferred to the unclaimed benefit fund, with a total benefit value of R122-million.

The PSSPF was formed in 2001 and provides retirement, disability, death and funeral benefits to employees in the sector. The problems with noncompliant employers go back as far as nine years and probably further. In 2012, there were about 350 complaints to the adjudicator related to the PSSPF, but, by 2016, these had slowed to just over 100. In 2016, the fund engaged with more than 1,000 noncompliant employers, resulting in 390 acknowledgements of debt amounting to R275-million. Of this amount, the fund had received R145-million, which was then allocated to member accounts. At that time, the fund entered into litigation with noncompliant employers.

Growth of private security

PSiRA has almost 2.6 million individual security officers and more than 11,000 security businesses on its register. Manabela Chauke, PSiRA's chief executive officer, says there has been a 14% increase in registered active security officers and a 33% increase in the number of registered active security businesses over the past eight years. One of PSiRA's objectives is to ensure that businesses comply with the PSSPF to ensure that security officers are not exploited.The PSiRA annual report for 2020/21 shows that the authority conducted 6,055 security business compliance inspections and, of those, 466 employers (8%) were found to be noncompliant in relation to the PSSPF.

If that sample is extrapolated, does this mean that as many as 880 employers are potentially noncompliant when it comes to their employees' retirement funds? As at end-March this year, there were 900 improper conduct dockets pending against security service providers for allegations of failing to pay the statutory minimum wage to employee security officers. There were 917 improper conduct cases pending against security service providers for allegations of failure to comply with the PSSPF.

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10 general rules for a secure retirement for women (Part 2)

To what extent should you make decisions on your retirement with your spouse? Read some of our thoughts on the best practices for financial planning for couples.

When confronted with the hard realities of available retirement money, death, divorce, or disability, it always makes sense to talk openly to your spouse timeously and discuss the exact point of reference and standing for both of you. Continuing from part 1 of the general rules for a secure retirement, here are five more: Honesty is a key element in any retirement discussion; therefore **rule six** should make relationship histories clear and transparent. In the event of you or your partner having been married before, establish the financial consequences of the divorce(s). Be specific in establishing whether your or your partner's former spouse has a right to any part of your spouse's retirement savings, or even received a portion of that retirement already. It is crucial to know if a previous spouse is still a dependant or has dependant children who will be entitled to a share of any group life and disability benefits.

Rule seven is to clarify "what is mine is mine". What is yours must remain so and if you are helping a partner, for example in funding a business, make it a repayable loan rather than a gift, particularly when retirement savings are involved. Do not see your accumulated retirement

funds as a standby source of family financing, unless in dire need. It is extremely dangerous and irresponsible to cash in your retirement funds, where it is possible, to fund some venture, and it will have damaging tax consequences. Keeping your assets in your name is **rule eight** and is especially valid if your spouse runs their own business. Securing major assets – like your home and car – in your name or in the name of a trust of which you are also a trustee, ensures that creditors cannot attach the assets if the business venture falls apart. By exposing your assets to creditors, you may find you will have to use your retirement savings as a financial lifeline, something you do not want to do as you will possibly never recoup those losses.

Rule nine is to get independent advice, preferably a different financial planner from your partner's to avoid a conflict of interest. Finally, **rule ten** is to be in control. A sure-fire way towards a calamity is an attitude of "I am bad with figures, so I let my partner do all those things for me". Stay fully involved in all your family finances, as there are numerous ways that assets can be hidden from spouses using instruments such as trusts and nominee companies. Always heed these words, even if you have stars in your eyes and love in your heart: If someone has malicious intent and you have shown no interest in managing your affairs, you will pay a financial penalty and will possibly endure a penniless retirement.

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