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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

TABLE OF CONTENT

LOCAL NEWS

- Pension fund reform: The race to be ready is on
- Surviving retirement
- Majority of cash-strapped South Africans unable to retire comfortably

INTERNATIONAL NEWS

- U.K. looks to reprioritize investment flexibility in pension fund legislation
- Australia regulator scrutinises pension funds over unlisted asset pricing

OUT OF INTEREST NEWS

- What is sector investing?

LOCAL NEWS

Pension fund reform: The race to be ready is on

But the lack of final legislation, together with the early implementation date, is complicating things.

Pension funds and their administrators are racing against time to implement highly complex changes to their rules before South Africa's pension fund reforms come into effect on 1 September this year, instead of 1 March 2025 as originally planned.A major concern is the lack of final legislation which means some 3 000 retirement funds will have to amend their rules without knowing whether there will again be changes once the final bill is passed. "There is still a lot of uncertainty and there is only about six months within which all the processes must be set in place," says Joon Chong, tax partner at Webber Wentzel. "We need the legislation to be tabled to parliament, voted on and passed so that it can be published and made into law. We need that really soon."

It can be done, and hopefully it will be done smoothly, she adds.

Nicci van Vuuren, senior associate at Webber Wentzel, says pension funds still need to communicate all the changes to members, who have to understand what the changes mean for their retirement. "The problem is you cannot educate someone if you do not know what the final legislation says," says Van Vuuren. "Even if there is an overall understanding … there [are] still a lot of little nuances that need to be finalised. We still do not have a date when the final legislation will be promulgated and parliament only starts on 2 February." Jenny Klein, principal associate at ENSafrica, says there are two competing objectives. Some people have a desperate need to access their retirement savings, in particular, because of the Covid-19 pandemic. On the other hand, the industry wanted to have sufficient time to implement these extensive changes. It is important to get it done correctly to avoid chaos when millions of members want to withdraw, and the systems are not in place, she says.

The new system

There are three components to the new system. At implementation, the value of a member's retirement savings will be fixed. That is the vested component. The current rules remain applicable to that portion, which means on retirement the one-third lump sum amount will be tax-free up to R550 000 and the two-thirds portion will be annuitised. The savings component (savings pot) will have "seeding capital" that will be automatically transferred to the savings pot.

This is 10% of the vested pot up to R30 000. Going forward, one-third of the contribution will be allocated to the savings pot and two-thirds to the retirement component (retirement pot). Contributions and the growth in the retirement pot will be preserved until retirement from the fund. “People will no longer be able to leave their employment in order to access their retirement savings,” says Klein. They will be able to withdraw from the savings pot once a tax year, and whatever is not withdrawn rolls over into the next year. “This is the liquid portion of your retirement funds. However, normal income tax rates will apply to withdrawals prior to retirement,” warns Chong.

2024 tax year (1 March 2023 – 29 February 2024)

22 February 2023 – See changes from last year:

Taxable income (R)	Rates of tax (R)
1 – 237 100	18% of taxable income
237 101 – 370 500	42 678 + 26% of taxable income above 237 100
370 501 – 512 800	77 362 + 31% of taxable income above 370 500
512 801 – 673 000	121 475 + 36% of taxable income above 512 800
673 001 – 857 900	179 147 + 39% of taxable income above 673 000
857 901 – 1 817 000	251 258 + 41% of taxable income above 857 900
1 817 001 and above	644 489 + 45% of taxable income above 1 817 000

Source: Sars

Klein says the question was raised whether it is appropriate to tax the individual on the savings pot withdrawal at the marginal tax rate, which can be up to 45%. In responses to the draft bill, a flat tax rate or some form of exemption was suggested. “National Treasury did not accept any responses to amend that aspect. I do not expect any change to the tax treatment of savings withdrawals before retirement.” ***Full Article:*** ***Pension fund reform: The race to be ready is on - Moneyweb***

Moneyweb | 29 January 2024

Surviving retirement

Financially, emotionally, psychologically and physically.

Retirees have to be resilient. One often hears that getting old is not for sissies, and the more I deal with retirees (and the older I get …), I realise there is a lot of truth in this statement. The changes that take place when entering retirement and into retirement are often underestimated. The challenges that retirees must face often do not diminish; as one ages, challenges tend to escalate not only in intensity but also in numbers. Without a decent support system and proper planning that was done in the past, retirement for many is not a pleasant experience. This is sad because retirement should be the time that you enjoy the fruits of your past hard labour … Realistically, one must accept that with age comes diminishing health, memory, strength, and increasing emotional challenges.

There is not much that one can do about this, but one can reduce stress and emotional worries by making sure that financial challenges are minimal and, at the very least, that you understand what your future financial position will be and adapt your lifestyle accordingly. The good news is that it is not always doom and gloom. We often find that the first concern when discussing financial affairs is one of running out of money. In many cases, the concerns are not justified. It is more a matter of understanding your financial affairs. It is also a matter of placing your financial needs first. Far too often, retirees are burdened with the financial affairs of their children or family members. It may be necessary to have a hard talk with children prior to entering retirement. If you don't and keep on funding children, then the discussion around who is going to fund you and pay your medical expenses in retirement when your funds run out becomes crucial.

We see far too many retirees funding their children's failed business ventures, assisting with property purchases, paying private school fees, and the list goes on. If you have substantial wealth, this is fine. For the majority of retirees, unfortunately, this spells doom. I know, as parents, we want to help our children as much as possible, but please take your own needs into consideration first because your children will probably not be able to help you financially if you do run out of funds. I have diverted a bit, but this is a very serious problem that occurs far too often. Let's get into the actual theme of the article and discuss the four challenges that I mentioned at the beginning of this article. For different retirees, the challenges will rank in a different order of importance.

Financially

Financial challenges are the easiest to deal with since they purely involve figure bashing. How much capital do I need to provide a pre-determined income and planned expenses? To determine the capital amount required, the following factors need to be considered:

1. What monthly income will I require at the start of retirement?
   - Create a detailed budget and stick to it as best you can.
   - Make allowance for holidays and investing. It is important to keep investing in retirement to provide for unforeseen expenses.
2. What inflation number am I going to use?
   - Remember that medical expenses are going to increase the older you get. Medical inflation is much higher than core inflation. Use an inflation number of at least 2% above the published CPI.
3. What capital expenses do I anticipate during my retirement?
   - Replacing a car, visiting children overseas, etc.
4. Do I plan to leave capital for my loved ones?
   - This is crucial. The more you want to leave your children, the larger the initial capital requirement will be.
   - When you retire and didn't manage to accumulate sufficient funds to ensure a fair legacy discuss this with your beneficiaries. Don't let them live with the illusion of a potential "fat inheritance".
   - This will ultimately also determine your drawdown rate and the quality of your retired life. If you do not intend to leave a legacy, then your drawdown rate can probably be increased to 7% compared to 4% if you want to leave a legacy.
5. Longevity
   - We generally plan to age 100 as far as an income requirement is concerned. You can adapt longevity according to genetics, health issues, etc., but I would suggest not planning for shorter than age 90.
6. Emergency reserves
   - It is always advisable to have a decent amount saved in a cash-type investment for emergency expenses. How much is up to you, but as a guide, I suggest six times your monthly retirement income. ***Full Article:*** ***Surviving retirement - Moneyweb***

Moneyweb | 31 January 2024

Majority of cash-strapped South Africans unable to retire comfortably

South Africa is sitting on a retirement time bomb, with only 6% of the country's population on track to retire comfortably. This is according to the sixth edition of the recently released 10X Investments Retirement Reality Report 2023. The report is based on the findings of the 2023 Brand Atlas Survey. Brand Atlas tracks and measures the lifestyles of the universe of 15.4 million economically active South Africans – defined as those living in households with a monthly income of more than R6,000, aged 16+, with internet access through online completion surveys. This year's survey shows that there has been little fundamental change in South Africans' inclination or ability to plan for retirement in comparison to findings from last year's report.

The 10X Investments Retirement Reality Report 2023 found that the majority of South Africans have not formally planned for retirement, and of those who have planned are not confident that they are on track to be able to support themselves for the long-term considering inflationary pressures and the economic climate. This comes at a time when half of the South African adult population (49.2%) is living below the poverty line, according to Stats SA. Consumer confidence, as measured by the FNB/BER Consumer Confidence Index, has been negative since the last quarter of 2019. When Covid-19 hit, it dropped to a record -33 points, recovered to about -10 points in 2021, but dropped again, hovering around -20 points in 2022 and the first half of 2023.

Tobie van Heerden, Chief Executive Officer for 10X Investments, said that in comparison to 2022's survey, the 2023/24 report found an increase in the number of people recognising the importance of having a retirement plan in place. "The difference between what South Africans expect their retirement to look like and the realities faced by those in retirement and approaching it, cannot be underestimated. Knowledge and information are key to closing the expectation-reality gap – in their long-term interests South Africans need to be better informed on the importance of saving, the power of compound interest, the consequences of not saving, the additional disadvantages that women need to overcome, and the impact of costs," said van Heerden.

Planning for retirement

About half of respondents who had a retirement plan indicated that their plans were "probably" or "definitely" on track, with some variation across age groups. Significantly, 29% of people over 50 indicated that their plans were "definitely not" or "probably not" on track. According to 10X, it is extremely difficult to correct any deficit in savings after reaching 50, and requires at least 30%-40% of a monthly salary to be invested into retirement savings in order to

comfortably retire. Almost three quarters of respondents (72%) whose plans were not on track gave “I am not able to save enough” as a reason. This ties in with reasons given for not having a retirement plan in the first place: 70% of respondents without a plan agreed with the sentence: “I cannot afford to save, I have nothing left over at the end of the month”. According to van Heerden, the survey responses underline the harsh economic realities for the majority of South African consumers. “Year after year, we are seeing a large proportion of respondents that have been partially or strongly of the view that they will need to continue earning a living after their formal retirement date.” Of the respondents who do have a retirement plan, only 37% could give a definitive answer on the costs, as an annual percentage of assets, of their retirement investments. Another 37% had no idea what the costs on their investments were; 13% believed that the fee depended on performance; while 13% believed they were not being charged at all.

Women’s Financial Health

Over the years, women have consistently been rated lower than men in most metrics concerning financial wellbeing and retirement planning. Half (49%) of all female respondents to the survey indicated that they do not have a retirement plan, compared with 43% of men. More than double (11% versus 5%) the number of men than women said they were diligently following a well-conceived retirement plan. Women tend to save more than men (30% of women versus 26% of men), while men tend to invest more (24% of men versus 14% of women). According to the report, although a prudent, cautious approach to investing is admirable, it may ultimately be to women’s detriment, as only higher-risk investments, such as listed equities, can deliver inflation-beating growth over the long-term. Stagnant GDP, large-scale retrenchments and the impact of COVID-19, have resulted in people increasingly changing their jobs. According to the Retirement Reality Report 2023, 56% of working people changing jobs admitted to cashing in their retirement savings.

Retiring on own terms

Fewer people are able to retire on their own terms. In the 2021 report this figure was 70%; this year it had dropped to 60%, one of the most significant statistics to come out of the survey. van Heerden said: “This trend reflects the challenging economic times we are living in, indicating a rise in employers compelling their older workers to take early-retirement packages.”Only just over a third (35%) of the retirees who had saved for retirement indicated that they were “fairly” or “very confident” that their savings would last. Notably, two percent of retirees indicated that they had already run out of savings, meaning they were relying either on family or state support.

FA News | 01 February 2024

INTERNATIONAL NEWS

U.K. looks to reprioritize investment flexibility in pension fund legislation

The U.K. government is amending proposed legislation to ensure defined benefit plans do not become overly risk averse, following a consultation review that was published online. DB plans in the U.K. will be able to take more investment risk when supported by sponsoring employers, according to the government's final position on the long-running development of new legislation for pension plans. "It was never (the U.K. government's) intention to bear down on risk-taking across the board. Rather, it was to make funding standards clearer and to promote planning for the long term," said Paul Maynard, U.K. minister for pensions, in a news release. "By listening to stakeholders, we've learned that it is easy to inadvertently drive reckless prudence and inappropriate risk aversion."

The U.K. government received 92 responses to the consultation, including from representatives and sponsors of occupational pension plans. The U.K. government said respondents to the consultation were concerned that the draft regulations "did not fully reflect" the circumstances of open pension plans. Some respondents claimed the draft regulations would prevent trustees of open plans from taking account of new entrants and future accruals when managing their plan funding, which could lead to these pension funds planning to derisk sooner than necessary. "The (U.K.) government says it has revised the regulations to better support the productive finance agenda," said Graham McLean, head of pension scheme funding at Willis Towers Watson, in an emailed comment. "While some of the tweaks may help this, the suggestion that schemes will have freedom over investment is more implicit than it needed to be, and it is hard to see anything in the final regulations which fulfills the promise to 'make it explicit that there is headroom for more productive investment.'"

The government consultation also noted that the majority of U.K. defined benefit plans are closed, and that more than one-third of pension plans have retiree liabilities accounting for over 50% of their total liabilities. As a result, longer-term strategic planning has become increasingly important to manage the funding and investment risks attached to a mature pension plan. "An initial reading of the new regulations suggest that the Department for Work and Pensions has listened to industry feedback and made some positive revisions to the DB funding code regulations which enhance flexibility, especially for open DB schemes," said Nigel Peaple, director of policy and advocacy at the Pensions and Lifetime Savings Association in an email. "Importantly, it also clarifies that DB schemes can take appropriate levels of investment risk

where supportable by the employer covenant. Notably, the final set of regulations specifically provide greater flexibility by empowering mature schemes to diversify investments in a wide range of assets without constraints," Peaple added. There were also concerns that the new regime would result in a disproportionate governance burden for small pension plans, and some respondents were concerned that the proposed legislation was not appropriate for cash balance plans that sit alongside defined contribution plans. In response to the consultation, the U.K. government provided assurance that investment in sustainable growth "is a matter to consider" alongside the affordability principle. It was also made clear that open pension plans can take account of new participants and future accruals when determining when the plan will reach significant maturity.

In certain cases, The Pensions Regulator will also be given the flexibility to ask for less detailed information from smaller pension plans so as to reduce regulatory burden.Maynard said the U.K. government will look for the regulations be effective in April and apply to pension plan valuations beginning in September. "The increased focus on scheme-specific flexibility is to be welcomed given the risk of inflicting unnecessary cost and burden onto smaller schemes," said Simon Kew, head of market engagement at consult Broadstone, in an emailed comment to *Pensions & Investments*. "Trustees and employers now have the clarity to set in place long-term plans for schemes that will benefit members while delivering a regime that will encourage potential benefits for the U.K. economy." The Society of Pension Professionals also welcomed the changes to the upcoming legislation following the consultation, though the group warned that detail contained in TPR's upcoming funding code will be crucial to understanding how these regulations will work in practice.

Pensions & Investments | 30 January 2024

Australia regulator scrutinises pension funds over unlisted asset pricing

SYDNEY, Jan 31 (Reuters) - Australia's prudential regulator said on Wednesday it will review how sections of the A$2.5 trillion ($1.7 trillion) pension fund sector value unlisted assets and that it is already working with several funds whose practices need to improve. As part of its supervision priorities for the next six months, the Australian Prudential Regulation Authority said it will conduct a "deep dive review" into valuation practices at a number of large and mid-sized pension funds. The unnamed funds have material holdings of unlisted assets, a broad category which can range from office towers to private loans. The review will also look at how those funds manage liquidity. Reuters reported last week the regulator had already asked

funds to provide information for the review. Two of Australia's largest pension funds, Australian Super and Aware Super, said they had received requests. Chair John Lonsdale said the regulator was already working with funds which needed to improve, separate from the review. "We want to push into it," he said on a call with reporters. "What we're saying to regulated entities ... we want you to value appropriately, we want you to monitor, we want you to report it and we want it to be accurate."

While APRA on Wednesday gave few details about the review, a private letter sent to the industry in November and seen by Reuters showed it included liquidity risks associated with exposure to unlisted assets like commercial property, private equity and credit. Unlisted assets, whether wind farms and warehouses or private company shares, are popular in the pension sector and holdings can reach as high as 40% of all assets in some funds. APRA has long been concerned about how the sector prices these assets which rarely trade. A 2021 review found revaluation frameworks were "typically inadequate". New standards were introduced last July, including quarterly asset valuations.

Reuters | 31 January 2024

OUT OF INTEREST NEWS

What is sector investing?

This strategy offers a tailored and strategic approach to portfolio management, suitable for investors seeking targeted exposure and risk diversification.

Introduction: The evolving landscape of investment

In the dynamic world of finance, sector investing stands out as a well-adopted strategy for investors. This article delves into some important aspects of sector investing. This approach acknowledges that while companies within the same sector can vary widely in their specific attributes, they often share commonalities in basic economic behaviours and performance. The fundamental principles of sector investing were notably articulated in 1986 by Brinson, Hood, and Beebower. They explored the concept into two primary elements: sector allocation and stock selection, particularly from the viewpoint of generating ‘excess returns’. Following this conceptual framework, major investment firms like BlackRock, Vanguard, and Fidelity have incorporated sector rotation strategies into their investment methodologies. These companies provide a variety of sector-focused exchange-traded funds (ETFs) and mutual funds, enabling investors to integrate sector rotation into their investment portfolios effectively.

Decoding the Global Industry Classification Standard (GICS®):

The Global Industry Classification Standard (GICS®) is a critical framework in sector investing. Developed jointly by MSCI and Standard & Poor's, it dissects the equity universe into 11 major sectors, providing a standardised approach for investors globally. This categorisation aids in-depth stock analysis, strategic sector allocation, and portfolio diversification, tailoring investments to specific economic segments with unique characteristics and growth trajectories.

Sector breakdown:

- Energy: Comprising companies in oil, gas, and renewable energy.
- Materials: Including chemicals, construction materials, and metals.
- Industrials: Covering machinery, aerospace, and defence.
- Consumer discretionary: Encompassing automotive, retail, and luxury goods.
- Consumer staples: Focused on food, beverage, and personal products.
- Healthcare: Spanning pharmaceuticals, biotechnology, and healthcare equipment.
- Financials: Comprising banks, investment funds, and insurance companies.
- Information technology: Dominated by software, hardware, and semiconductor firms.
- Communication services: Involving telecommunication and media companies.
- Utilities: Encompassing electric, gas, and water utilities.
- Real estate: Including real estate management and development firms.

In a global context, sector investing involves navigating domestic markets and understanding international economic trends and regulatory environments. This adds an extra layer of complexity and presents opportunities for diversification and exposure to emerging markets.

Benefits of sector investing:

- Targeted growth: Investing in sectors with high growth potential allows investors to align their portfolios with emerging economic trends.
- Risk management: Diversification across sectors can help mitigate the impact of market volatility.
- Adaptability: Sector investing allows flexibility in response to economic cycles and market changes.

Drawbacks of sector investing

- Market sensitivity: Sectors can react highly to economic news and market shifts.
- Concentration risk: Overinvestment in a single sector can increase volatility.
- Timing challenges: Misjudging the timing of sector shifts can result in underperformance.

Rotation strategy:

A key component of sector investing is the sector rotation strategy, which entails reallocating investments among various sectors in response to the phases of economic cycles. This

strategy leverages the cyclical nature of markets, aiming to enhance returns by focusing on sectors that are poised for growth. A common approach for investors to effectively leverage sector opportunities is to align their investments with the business or economic cycle stages. Typically, economies undergo four predictable stages: expansion, slowdown, contraction, and recovery. Different sectors often exhibit varied responses during each of these phases. By discerning the current stage of the economic cycle, investors can strategically target sectors that have historically demonstrated outperformance in that stage.

See below as highlighted by Fidelity Investments:

Source: Fidelity Investments

Sector theme in 2023: Information technology

At first glance, 2023 seemed to be a remarkable year for US stock markets, evidenced by significant gains such as the 24.23% increase in the S&P 500 and the Nasdaq Composite's robust 43.42% rise. However, a closer look reveals that the positive performance of 2023 was predominantly driven by seven major companies in the tech sector, known as the "Magnificent Seven." This elite group comprises Nvidia (NVDA), Tesla (TSLA), Meta Platforms (META), Apple (AAPL), Amazon.com (AMZN), Microsoft (MSFT), and Alphabet (GOOGL). Remarkably, these seven entities have collectively reached a market capitalisation of $12 trillion, accounting for over a quarter of the S&P 500 and more than half of the Nasdaq 100. In 2023, these companies contributed nearly 62% of the total return of the S&P 500. To put this in perspective, if the remaining 493 companies in the index were excluded, the overall return of the S&P 500 would plummet by 14.29% from 24.23% to just 9.94%, highlighting their substantial impact. On average, the other companies in the index only gained about +8.3% in 2023. The chart below

provides a clearer picture of the impressive share price performance of these seven companies in 2023:

Source: Morningstar

Outlook and conclusion:

Looking ahead, we anticipate a period marked by a slowdown in economic activity, possibly leading to a mild recession, followed by a recovery phase characterised by decreasing interest rates. Traditionally, certain sectors tend to outperform during these economic cycles. During recessions, sectors like consumer staples, utilities, and healthcare often excel, as they typically provide essential services that remain in demand regardless of economic conditions. Conversely, in the recovery phase, the real estate and consumer discretionary sectors usually see an upturn, benefiting from renewed consumer confidence and spending. This pattern of sector performance offers a strategic perspective for investors navigating through varying economic landscapes. In sum, sector investing offers a tailored and strategic approach to portfolio management, suitable for well-informed investors seeking targeted exposure and risk diversification. By understanding the distinct characteristics of different market sectors and their interplay with economic cycles, investors can make informed decisions aligned with their investment goals. For further insights, please visit us here.

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

3 Williams Road
Bedfordview
Johannesburg 2008

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