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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

TABLE OF CONTENT

LOCAL NEWS

Africans dream of a comfortable retirement, but studies underline harsh reality of inadequate savings

While almost half (47%) of South Africans list a comfortable retirement as their primary savings goal, according to the 2023 Old Mutual Savings and Investment Survey (OMSIM), South African families who participated in a financial lifestyle social experiment cannot save adequately for retirement. Lizl Budhram, Head of Advice at Old Mutual Personal Finance, says this difficulty to save enough for retirement is contextualised by the OMSIM findings indicating that almost half of South Africans remain financially stressed and that seven out of 10 have not seen their income increase since 2020. Therefore, it is unsurprising that saving for retirement appears outside the top financial priorities for the South Africans surveyed.

In 2023 income security (63%), cutting expenses (58%) and paying debt (52%) are the most prioritised, while only 33% of respondents ranked securing their investments and 34% creating an emergency savings fund as a priority. While OMSIM data reveals that 64% of respondents had a pension or provident fund in place and 51% had a retirement annuity, the Old Mutual social experiment, featuring eight South African families and a grocery store, provides a harsh reality check. In a grocery store recreated by Old Mutual, each family's breadwinner was asked to fill up a trolley with their usual supply of monthly goods, scanning each item as they went along. They didn't know that the prices were adjusted for inflation based on their predicted year of retirement, and the provided budget was based on how much they would receive as a pensioner once they retired.

Findings revealed a significant retirement savings shortfall, with some families discovering that they were over budget by amounts ranging from 100% to 800%. "Our follow-up with four families highlights their persistent challenges and financial constraints. People need to pay much closer attention to their retirement savings: what will they need in retirement? Will the savings be enough to cover these needs? Most people will likely find that they need to increase their savings, which is not easy in the current economic environment. Postponing retirement is an alternative option which can also be considered." says Budhram. One family deeply affected by the experiment is the Tifflins. Their biggest realisation was that they needed to be more open about their finances and recognise how close they were to retirement.

"While we have made sacrifices to reduce our debt every month since the experiment, we are still unable to initiate a proper savings plan due to our lack of available funds. We are determined, however, to start saving towards retirement," says Mr Tifflin. Budhram says the Tifflin's ongoing struggle to save highlights many South African families' financial obstacles. Similarly, the Greek family had a rude awakening when they realised their tendency to overspend on luxury items would have dire consequences for their retirement years. While they have made efforts to cut down on specific areas of spending and pay off their bond, they still need help allocating sufficient funds toward retirement savings. "We have not consulted a financial adviser, and our focus remains on immediate financial priorities. Although we are more aware of our need to save for retirement, it is difficult to save regularly today," says Mrs Greek.

The Matewane family's biggest realisation from the experiment extended beyond the struggles of financial management and making ends meet. Mrs Matewane, a single mother, says that while she cannot increase her retirement savings contributions, she has decided to enrol her children in a more affordable school, allowing her to allocate additional savings toward their tertiary education. "It was not an easy decision, but I now recognise the importance of financial planning. I intend to consult with a financial adviser early next year to develop a comprehensive education plan so my children can attend university," she says. In contrast, the Khumalo family seized the opportunity presented by the experiment and promptly took action.

"We started a retirement annuity and have been actively contributing to it, and it's been such a relief, giving us certainty about our financial future. To optimise our savings, we have engaged with our financial adviser, whom we underutilised in the past. We have since had two meetings to assess and update our current policies," says Mrs Khumalo. Budhram says financial constraints, changing life circumstances, and struggling to juggle competing priorities are real challenges, but solutions exist. "The experiences of these families underscore the larger issue of a retirement savings shortfall affecting South African society. Despite the wake-up call provided by the experiment, the reality remains that many families are still unable to save sufficiently for retirement.

This ongoing challenge necessitates a deeper examination of the issues that impede families from securing their financial future."Budhram says families and individuals must seek professional guidance to address pressing issues, such as options and alternatives when creating a workable retirement plan, limited access to affordable financial products and services, or a debt burden that has become unmanageable. "The stories of these families should serve as a call to action for policymakers, financial institutions, and society at large to prioritise retirement planning support and financial education," says Budhram. "By addressing the underlying barriers to saving, South African families can be empowered to take meaningful steps toward building a more secure retirement."

FA News | 8 August 2023

Harnessing tax simulations for informed lump sum withdrawal strategies

Managing lump sum tax payments can be challenging, especially when it comes to retirement fund withdrawals and severance packages.

In this article, we explore the significance of lump sum tax simulations, and provide advice on how South Africans can optimise their tax strategies, says Porcha Schelhase of Gravitas Tax.

Lump sum tax 101

A specific retirement event, such as withdrawing or retiring from a retirement fund or being retrenched, may trigger a one-time, lump-sum tax payment on the amount received (death is also a trigger). The complexity of calculating lump sum taxes generally necessitates the need for a tax simulation, so financial professionals can offer their clients the best possible advice, enabling them to make informed decisions.

Advantages of lump-sum tax simulations

1. **Clarity and accuracy**: Tax simulations provide clear, accurate estimates of lump sum tax liabilities based on individual financial circumstances. By inputting specific data, taxpayers can anticipate their lump sum tax obligations, enabling better financial planning;
2. **Informed financial planning**: Lump sum tax simulations help individuals prepare in advance for significant financial events. By understanding their estimated tax liabilities, taxpayers can make informed decisions on how to use lump sum proceeds wisely and/or explore possible tax-saving opportunities; and
3. **Identifying tax optimisation strategies**: Tax simulations enable individuals to explore different scenarios, thereby enabling them to identify potential tax optimisation strategies.

Tips for effective lump-sum tax simulations

1. **Accurate data input**: The accuracy of any simulation depends on the data provided. Ensure that all financial information provided to your financial professional, such as income, deductions and lump sum amounts, has been correctly entered;
2. **Explore multiple scenarios**: Consider various different outcomes based on potential changes to tax regulations or a future financial situation. Taking the approach of a comprehensive analysis will help individuals to make well-informed financial decisions; and

3. **Stay informed**: Remain abreast of tax regulations as changes occur so that you can produce more accurate simulations for your clients. Tax laws can evolve significantly over time, thereby impacting the outcome of a simulation.

Lump sum tax simulations play a crucial role in empowering individuals to make informed financial decisions. By providing clarity, aiding financial planning, and identifying tax optimisation opportunities, these simulations ensure that taxpayers remain well-prepared for any significant financial events they may face. What is vital in such a simulation is that accurate data is entered into the system and that a range of scenarios are explored to optimise any lump sum tax strategies effectively. By embracing lump sum tax simulations, each individual is able to take charge of their financial future and also navigate any future tax obligations with confidence.

Moneyweb | 8 August 2023

What happens to my retirement annuity when I emigrate?

South Africans who choose to emigrate will have to wait for a period of three years before they can access and prematurely withdraw their retirement funds.

Emigrating can be a nice way to open yourself up to new horizons. It is an exciting, life-changing experience that offers endless opportunities. However, such a significant step requires thorough planning, especially when it comes to financial matters such as retirement savings. For those who are invested in a retirement annuity (RA), understanding the implications of emigration is crucial. A RA is a popular long-term savings vehicle in South Africa, designed to provide financial security during retirement. It allows the investor to make regular contributions that are invested in various asset classes, accumulating growth over time. One of the key benefits of RAs is the tax advantages it offers, such as tax-deductible contributions, tax-free growth and tax-free withdrawals of up to R550 000 upon retirement.

As of 1 March 2021, the South African Revenue Services (Sars) introduced new laws and regulations regarding the treatment of RAs for individuals who choose to emigrate. The Tax Bill indicates that individuals who are part of a retirement fund would be eligible to receive lump sum benefits only upon meeting the requirements of ceasing to be a South African tax resident and maintaining such non-residency status for a minimum of three consecutive years. This three-year stipulation signifies that individuals who decide to emigrate will need to wait for at least three years before they become eligible to withdraw their retirement savings.

South Africans who choose to emigrate will have to wait for a period of three years before they can access and prematurely withdraw their retirement funds. However, expatriates will bear the responsibility of proving their tax residency status in another country for the required duration. Furthermore, they will need to provide evidence of their physical absence from South Africa during this specified period. Once Sarrs is satisfied with the evidence establishing your non-tax residency due to your formal tax exit from the country, you will then be granted permission to tap into your retirement savings.

It is crucial to thoroughly assess all aspects of the situation, as significant tax consequences exist regardless of the course of action chosen. Opting for early withdrawal of your retirement funds will result in considerably higher tax deductions compared to withdrawing the funds after retirement. On the other hand, ceasing tax residency entails a potential capital tax liability as well. When you cease to be a tax resident, a deemed disposal occurs for capital gains tax (CGT) purposes. This deemed disposal is considered to have taken place on the day just before the date when you stopped being a tax resident. As a result, you are treated as if you have sold all your worldwide assets at their market value, excluding immovable property owned in South Africa and personal-use assets.

As we are aware that RAs offer attractive tax benefits to South African taxpayers. Contributions made to RAs are tax deductible, reducing your taxable income and potentially lowering your tax liability. Even after you become a non-resident for tax purposes, you still enjoy these tax benefits when contributing to your RA, provided you have sufficient taxable income in South Africa. To make well-informed decisions about your RAs when emigrating, seek assistance from financial advisors and tax professionals who are familiar with both your home country's tax laws and the requirements in the destination country. You can ensure that your retirement assets are managed successfully and in line with your financial goals by carefully assessing your alternatives and receiving professional advice, no matter where your life path takes you.

Moneyweb | 4 August 2023

INTERNATIONAL NEWS

Pension fund returns increase to 6.4 percent

Pension fund returns improved to an average of 6.4 percent in the year to June 2023 compared to less than one percent a year earlier following the improved performance of equities and offshore assets. Industry surveys carried out by Actuarial Services East Africa (Actserv) and pension fund administrator Zamara shows that while the weighted average return for equities remained in the red over the period, there was an improvement from the double-digit decline seen in the 12 months to June 2022. Actserv's survey put the equities returns at -6.0 percent, compared to -17.5 percent in June 2022, while Zamara's survey gave equities a return of -5.8 percent, compared to -18.7 percent a year ago. On the overall returns, Actserv reported an improvement from 0.4 percent in June 2022 to 6.1 percent this year, while Zamara's survey shows an improvement from 0.5 percent to 6.7 percent.

Pension funds normally invest in large, stable blue chip stocks at NSE, which offer better security against loss of savers funds while generating steady returns from dividends and potential long-term capital gains. They, therefore, carry a large exposure in the largest firms which include Safaricom, Equity Group, KCB Group and EABL. "The improvement in local equities was attributable to the divergence between corporate earnings growth and stock prices, which has enhanced attractiveness," said Actserv in its Quarter Two 2023 pension schemes investment survey. Offshore investments meanwhile turned around a decline of 16.6 percent in the previous year to offer a return of 37.3 percent this year. The asset allocation to offshore investments, which are deemed risky, is small at 2.36 percent, reducing the impact of their performance on the overall returns for schemes. Fixed income returns remained relatively stable at 8.5 percent in the period, compared to 7.3 percent in 2022.

Government bonds

This asset class holds the bulk of pension fund investments, accounting for 80.6 percent of total assets, ahead of equities at 16.6 percent. The low-risk government bonds market offers pension funds stable, long-term income, which fits in with the lengthy maturity profile of the savings they handle for workers. The improved performance of schemes in general cuts the value of pension savers' wealth that has been bled to inflation, which averaged 8.7 percent in the 12 months to June 2023. The returns from investments determine the interest that pension funds pay savers on their contributions each year, after factoring in administrative and other fund management expenses.

Business Daily | 8 August 2023

Why insurers, pension funds should co-opt ESG in investment strategies

Question: What is the significance of considering environmental, social, and governance (ESG) factors for insurers and pension funds in their investment strategies?

The importance of ESG in the decision-making process for insurers and pension funds has become more important, as the world gained consciousness of the impact of climate change and the importance of sustainability. So, what exactly are ESG factors? They refer to a set of non-financial metrics that measure an organisation's performance in areas such as environmental sustainability, social responsibility, and corporate governance. Traditionally, financial analysis has focused on purely financial metrics, such as profits and losses.

However, there is growing recognition that ESG factors can have a significant impact on long-term financial performance, risk management, and brand reputation. This is especially true for insurers and pension funds — important drivers of economic growth and development in Africa. However, they face a range of challenges that could impact their long-term sustainability. One of the key challenges is the growing recognition of the importance of ESG factors in financial decision-making. Adopting ESG principles can help financial institutions identify risks and opportunities that traditional financial analysis may overlook, leading to better long-term performance and more sustainable outcomes for stakeholders.

This trend is not limited to developed economies and is a global trend with consumers becoming increasingly concerned about the impact of their financial decisions on the environment and society. Pension funds and insurers tend to have investments that are long-term in nature and therefore are exposed to significant ESG risks. Along with this, they are also fiduciaries of their beneficiaries and therefore have a moral obligation to consider ESG factors in their investment decisions. By integrating ESG considerations into their underwriting and investment decisions, they can identify and manage ESG risks, improve their risk management practice, enhance their long-term financial performance, and contribute to sustainable development.

For example, they can utilise ESG metrics to assess the risks associated with climate change, natural disasters, and human rights violations. This is especially true given the growing demand from consumers for products and services that align with their environmental and social responsibility. Good governance practices will also help ensure that insurers and pension funds are managed in an effective, transparent and accountable manner, which can reduce the risk of fraud and misconduct. Consumers are seeing good governance as important because it provides a level of assurance that their benefits are being managed responsibly. In Kenya, the adoption of ESG principles in the insurance and pensions industry is still in its early stages. However, there are positive signs that this is changing. The Nairobi Declaration on Sustainable Insurance is an indication of the growing recognition of the importance of ESG in the financial sector in Kenya. Similarly, the United Nations Principles for Responsible Investment has seen an increase in signatories from Africa, with more than 50 institutional investors from the continent currently signed up. Insurers and pension funds should continue to prioritise ESG integration in their decision-making process, products, and services.

This will not only lead to better long-term performance but also create positive impacts on our society and environment. It may seem difficult to commence the integration of ESG, but here are some ways the industry can advance ESG integration: Set the tone at the top and allow it to facilitate the integration process of the company and this includes strengthening the boards' responsibility for overseeing ESG issues. Develop and implement ESG policies and guidelines that align with international best practices, standards, and regulations.

Collaborate with stakeholders, such as regulators, investors, customers, and communities, to identify and address ESG issues and opportunities. Incorporate ESG factors in underwriting, risk management, investment decision-making, and product development. Engage in ESG reporting and disclosure to provide transparency and accountability to stakeholders. Continuously monitor and evaluate ESG performance and impact as well as adjust strategies and practices accordingly. There will be no one-size fits all approach.

The adoption of ESG principles can have significant benefits for financial institutions, investors, and our society. The Nairobi Declaration on Sustainable Insurance and the United Nations Principles for Responsible Investment provide frameworks for the integration of ESG factors into financial decision-making. As a society, we all have a role to play in promoting environmentally and socially responsible financial practices, and the adoption of ESG principles is an important step in this direction.

Business Daily | 8 August 2023

OUT OF INTEREST NEWS

The resilient mindset, let us not fail to save

As we consider the importance of saving, whether for the short, medium or long term, and take into account the current economic impacts that have reduced our disposable income through the cycle of interest rate hikes, I have to ask myself are we failing to save due to the economic situation or are we really just not good savers, and if so, why. As South Africans, apart from our sense of humour we are a resilient Nation of individuals.

When it comes to saving and saving in a tough economic cycle, we must remain committed, flexible, in control and purposeful. The resilient mindset speaks to our ability to navigate emotions, biases, and tradeoffs in our pursuit of creating future wealth.

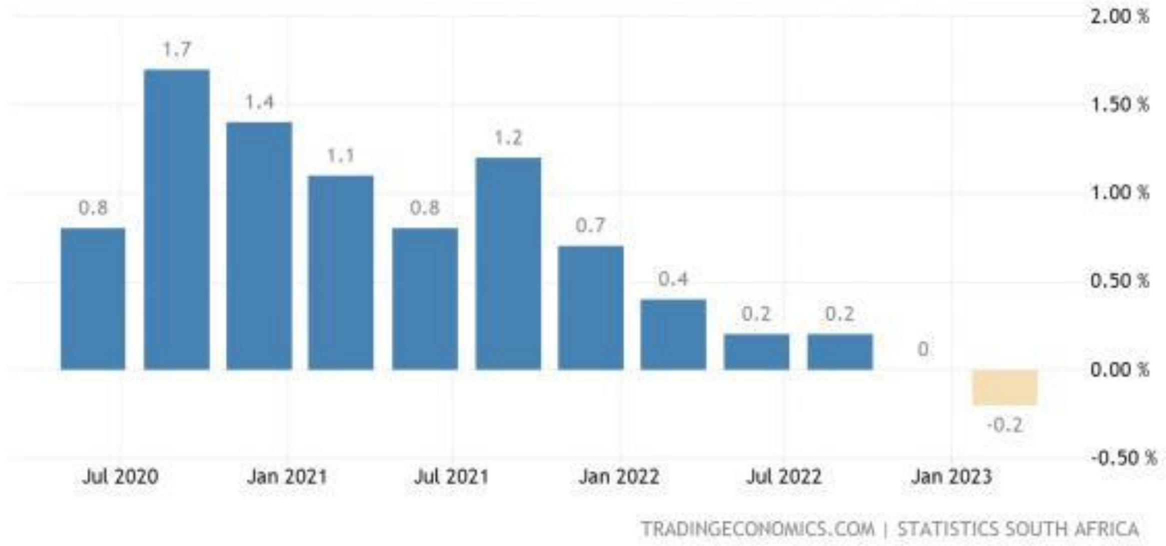
Failing to save during tough economic cycles

How do we save during the current economic cycle? Firstly, we are all experiencing pressure on our ability to save, and my continued approach to this conundrum is not to fail to save as the impacts of not saving for that unexpected and unplanned event or the longer-term consequences for our retirement planning cannot be underestimated.

The tradeoff in the current high interest rate cycle should not be on our savings plan, but rather on making changes to our buying and spending habits during this time – how many streaming options do we need to subscribe to, what can we cut back on and where can we stop spending in order to meet our saving commitments?

The savings rates over the quarter periods July 2020 to end January 2023, demonstrate the impact of our inflationary and interest environment on our actual savings percentage as the South African population.

(Table: **https://tradingeconomics.com/south-africa/personal-savings**)



Source: Morningstar, 30 June 2023

Looking at it from another perspective, without planned savings for an unexpected event we are likely to rely on loans, family, or extended credit facilities.

Behavioural biases

If we consider the concept of failing to save through a behavioural lens, we can identify our very own characteristics and biases towards savings, which may lead to a low saving rate.

Self-control or Present bias

We inherently have a self-control or present bias, where we prioritise our current needs, spending and purchases over our long-term goals. Considering the fast-paced world that we live in, instant gratification is made ever easier through the ease of online shopping, where we catch ourselves solving for the moment rather than the medium and long-term savings goals we wish to achieve.

Overconfidence bias

The overconfidence bias sees us making decisions based on our own judgement of a situation, therefore in the context of saving, we are confident that if we start later, we will make up returns that will help us meet our savings goals.

Status quo bias

Status quo bias refers to our inability to change our behaviour and decision-making unless there is a clear incentive to make a change. When considering this in conjunction with self-control or present bias, we respond by keeping our decisions as they are.

Herd bias

Social conforming can lead to herd bias, this refers to our listening and following groups of people on decision making. Consider for a moment: a group of people driving the right car, living at the right address, and leading the lifestyle, we may be drawn into this at the detriment of our own savings culture. Alternatively, the action of the group lends itself to a specific number – you only need to replace 75% of your final monthly income in retirement. You plan your savings accordingly. Is this 75% the right number?

How do you become a better saver?

When considering your needs, and your short-term to long-term goals, understanding just some of the biases that are well documented in behavioural economics and finance can lead to a changed decision-making process with improved outcomes for your personal plan. Start now, stick to your plan, make the right tradeoffs that keep your plan on track and in place and save for the goals and lifestyle you want to achieve.

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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