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THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

Two-pot system effective date - 1 September 2024?

Discussions with the National Treasury, SARS, FSCA, GEPF and the Government Pensions Administration Agency have indicated that the date proposed by the Minister of 1 September 2024 would be achievable.

The Minister of Finance, Enoch Godongwana, has proposed that Parliament extend the date of implementation of the two-pot system contained in the Revenue Laws Amendment Bill (the RLAB) from 1 March 2024 to 1 September 2024. This matter is due to be tabled before the National Assembly on Wednesday, 6 December 2023, for debate.

In his letter to the Chairperson of the Standing Committee on Finance, Minister Godongwana raised the following concerns with the 1 March 2024 implementation date:

• Retirement funds cannot amend their fund rules to cater for the "two-pot" system until the Pension Funds Amendment (PFA) Bill is tabled in Parliament, explaining that the effective date of the RLAB cannot predate the implementation of the PFA Bill.

• Once these bills have been tabled, funds will have to submit their amended fund rules to the Financial Sector Conduct Authority (FSCA) for registration. Funds are also required to communicate the proposed amendments to the fund rules and its impact to members.

• There are 1 324 active retirement funds which will all be required to submit amended rules to the FSCA for registration and approval. Godongwana cautioned it will take at least three months for the FSCA to do so.

• Not all funds are regulated under the Pension Funds Act, such as the Government Employees Pension Fund (GEPF) where fund rule amendments require consultations through the Public Sector Coordinating Bargaining Council. In this case, the employer (represented by the Department of Public Services and Administration) must submit the amended rules for consideration by parties in the Bargaining Council. Godongwana warns that these processes are likely to extend beyond 1 March 2024 before they are completed.

• The South African Revenue Service (SARS) has indicated that they need at least six months after the promulgation of the legislation to put a system in place to deal with applications from funds for the correct tax rate to be applied to withdrawals from the new "savings component". SARS warned that if the 1 March 2024 implementation date is retained the incorrect amount of tax may be withheld, resulting in either hardship or liability for members on assessment at the end of the tax year.

• The implementation date of 1 March 2024 “would require fund managers of retirement funds to urgently reallocate their portfolios to meet the potential liquidity demands from the expected withdrawal requests”. This can have a negative knock-on impact on markets, “as assets will need to be disposed of over a shorter period to prepare for those increased withdrawals”.
• Godongwana emphasised that “retirement fund members and financial advisors will need sufficient time to assimilate the implications of the new system, otherwise, members may make hastened decisions that could undermine their financial future”.

The two-pot system arose from a simple concept which has huge political appeal, to allow financially distressed fund members to withdraw a limited amount of money from their pension savings. Up to now, financially distressed members of funds have had to leave their employment to access their pension and provident fund savings. Actuarial studies have also indicated that the retirement component which must be annuitised only on retirement will overall result in members having greater amounts of retirement savings, even if they decide to withdraw the savings component in full every tax year. Godongwana also confirmed that much work was still needed on several aspects of the RLAB which are complicated.

One of the complexities of the two-pot system is how it will be implemented for defined benefit funds (DB funds) the largest of which is the Government Employees Pension Fund (GEPF) which has more than 1,2 million members. A major difference between defined contribution funds (DC funds) and DB funds is that in DC funds, it is possible to calculate the value of the contributions that have already been made by the member, but in DB funds, the final pension fund benefit will be based on the final salary of the member plus the number of years’ service. The RLAB has provided for the savings and retirement components of DB funds to be determined with reference to a member's pensionable service on or after 1 March 2025, or a reasonable method of allocation as approved by the FSCA.

The implementation of the two-pot system for DB funds must be carefully undertaken to ensure fairness to all members of each DB fund. Any necessary engagements with the FSCA by DB fund administrators will also require additional lead time from the promulgation date to implementation date. The Association for Savings and Investment South Africa (ASISA's) position is that the industry needs at a minimum, a 12-to-18-month lead time from promulgation date to implementation date. The Minister's proposal of 1 September 2024 recognises members' urgent need for funds, and the practical challenges of implementing the system after promulgation.

FA News | 6 December 2023

Rethinking retirement solutions in South Africa

Living annuities are never far from controversy in the South African advisory industry, as advisors and product providers debate the most appropriate application of these products to SA pensioners' retirement plans.

Between 2000 and 2015, bond, property and equity markets delivered attractive real returns (even with the short-lived financial crises in 2003 and 2008). Over this period, the living annuity established itself as the preferred retirement income product in South Africa, with several large pension fund administrators indicating around 2015 that over 90% of pension fund assets found their way into living annuities when fund members retired. At the time, very few people expected that the era of strong investment markets supporting high-income living annuities would come to an end. This change is best illustrated in Figure 1, which shows the performance of three living annuities between July 2000 and June 2023:

- All three started with a notional R1 000 000 of capital and a 5% initial income draw.
- All three received identical CPI-linked annual income increases.
- Two of the annuities were invested in ASISA multi-asset sector averages, and one was invested in the Ninety One Opportunity Fund.

Figure 1: Real AUM in 5% p.a. income living annuities

Source: Ninety One and Morningstar, dates to 30.06.23. Performance figures are calculated NAV-NAV, net of fees, in ZAR. Performance of Opportunity A class shown. For illustrative purposes only. An individual investor's performance may vary depending on actual investment dates. Highest and lowest annualised returns (rolling 12-month figures): Jul-05: 43.8% and Feb-09: -15.7%. Please also refer to the ***Ninety One Opportunity Fund page*** *on our website.*

Figure 1 shows the inflation-adjusted assets under management (AUM) for the three living annuities over time. Broadly speaking, if the AUM in the living annuity remains around or above the initial capital amount in real terms (i.e. R1 million), the annuity is a success. If the market value of the annuity dips far below the inflation-adjusted AUM, the annuity is at significant risk of failure, or is already failing. There are two takeaways from this graph. The first is that investment alpha/outperformance can make a significant difference to pensioners. The annualised performance of the Ninety One Opportunity Fund over the period (1 July 2000 to 30 June 2023) illustrated was 12.6% p.a., and the ASISA Multi-Asset High Equity sector average performance was 11.06% p.a. over the same period.

Whilst the Opportunity Fund outperformed the sector average by only 1.5% p.a., the fact that it did so over 23 years means that this living annuity has a fund value that is two-and-a-half times that of the fund value associated with the sector average living annuity. That is a remarkable gap, which can be attributed to both the Opportunity Fund's capture of market upside and its proven downside risk management. The second takeaway from Figure 1 is that after the first 15 years in which the average balanced fund easily delivered a 5% real income (above inflation), there is a deterioration in the real fund values, starting from around 2015. This deterioration coincides with the slump in investment markets as the SA economy stuttered through a series of crises, including load-shedding, Covid-19, and general government and municipality infrastructure collapse.

Reassessing the retirement road map

These challenging market conditions sparked a retirement debate in which the entire industry started to rethink the following issues:

i. What constitutes safe versus dangerous living annuities?

ii. How should you manage pensioners who are faced with poorly structured living annuities?

iii. What is the role of a guaranteed life annuity?

At Ninety One, we have **published** widely on all three of these points since 2017. In summary, our research sets out the following conditions for a successful living annuity:

i. It draws an income below the critical threshold level given the age of the pensioner.

ii. It has at least 60% exposure to growth assets (equities).

iii. It has between 25% and 55% of the portfolio invested offshore.

iv. It has a portfolio structured to minimise volatility, given the level of real return targeted. **Full Article*****: Rethinking retirement solutions in South Africa (fanews.co.za)***

FA News | 7 December 2023

How to maximise offshore savings

Strategies for South Africans to minimise forex charges.

In the current global financial landscape, marked by economic uncertainty and market fluctuations, South Africans are increasingly seeking avenues to safeguard their wealth and explore opportunities beyond the country's borders. Unique challenges, including strict exchange control regulations and the ongoing unpredictability of the rand, complicate the financial landscape. Political and economic uncertainties further amplify these challenges, as shifts in government policies or economic conditions can directly impact the rand, and subsequently affect returns on offshore investments.

Here are key strategies for maximising offshore savings and minimising forex charges in this intricate economic scenario.

Foreign currency accounts – a gateway to diversification and cost-efficient transactions

A crucial initial step is opening a rand CCM account and foreign currency account (if required), typically offered by major banks and forex intermediaries such as Kuda FX. These accounts empower South Africans to hold and transact in various foreign currencies, such as US dollars, euros, or British Pounds, providing a means to diversify savings. Diversification serves as a risk management strategy. If you have international financial commitments or expect to make purchases in foreign currencies, Kuda FX can assist with hedging strategies against currency risk. Holding multiple currencies, shields your savings from adverse exchange rate fluctuations and economic conditions. Foreign currency accounts also enable South African clients to earn interest on their rands by capitalising on higher interest rates, thereby maximising potential savings.

Minimise forex charges through an intermediary

In today's era, forex intermediaries have proven invaluable for minimising foreign exchange charges, offering cost-effective ways to manage and transfer funds internationally.

Lower transaction costs: streamlines forex transaction costs, by ensuring a more direct and efficient process.

Real-time exchange rates: access to real-time rates means clients can make informed decisions at the most advantageous times. This again helps individuals and businesses optimise their forex transactions and cut costs.

Transparent pricing: transparency and consistency in margins and spreads are important when it comes to foreign exchange transactions. Typically, intermediaries bring greater fee transparency compared with traditional banking institutions.

A common oversight, however, is that individuals are often unaware of the two revenue streams for a bank or foreign exchange intermediary in a trade. Beyond the obvious stream of commissions and fees per transaction, which is typically clearly stated on the trade advice, the second fee lies within the exchange rate — the spread or margin that is added to the interbank exchange rate. Clients need to be aware of the percentage margin or cents that are added to the exchange rate, which could vary and is typically very opaque in the industry.

A healthy spread or margin ensures the client receives competitive pricing on the exchange of their currency. Whilst offshore savings offer numerous benefits, its important to understand all associated risks and strive for a balanced approach. On the positive side, offshore savings can provide opportunities for higher returns, asset diversification, and greater financial security. However, they also come with currency exchange rate risks, geopolitical factors, and regulatory challenges. By adopting these strategies, South Africans can safeguard their wealth and capitalise on international investment opportunities.

Moneyweb | 10 December 2023

Slew of dubious legislation being rushed through Parliament is 'electioneering at its worst' – legal expert

The results of three separate, independent opinion polls released in October could point to the rationale behind the legislation being rushed through with little thought given to practical implementation or funding.

The government is fast-tracking new legislation and legislative changes in what seems to be a blatant ploy to win over voters ahead of next year's elections. The slew of legislation being rushed through includes retirement reform (the two-pot system) under the Revenue Laws Amendment Bill, the Pension Funds Amendment Bill, the Road Accident Fund Amendment Bill and the Expropriation Bill. The biggest one is the National Health Insurance Bill, which was approved by the National Council of Provinces on Wednesday, 6 December.

The Bill now awaits sign-off from President Cyril Ramaphosa, but the healthcare industry is aghast that it has gone this far with few to no amendments, and has not taken much, if any, feedback into account. Martin Versfeld, a partner at Webber Wentzel, says it is nothing more than "electioneering at its worst". "It's extraordinary that the Bill has gone through unamended when even the Department of Health has accepted that there should be amendments pursuant to submissions made by the industry," he says.

“The only plausible explanation for the way it has been rushed through in such an unseemly fashion is that this is part of the electioneering process. “It’s got nothing to do with whether the Bill is in good order or not, and everything to do with the ANC wanting to make the statement that they are changing the healthcare landscape, [when] what they’re in fact doing is reckless.” Versfeld says consequences could include massive disincentives for those wanting to study medicine, massive push factors for healthcare providers to exit the market and huge uncertainty for the medical schemes industry, whose future hangs in the balance.

The Board of Healthcare Funders says the Bill in its current form restricts medical schemes to the provision of complementary cover, potentially rendering them unsustainable, and the enormous economic value that medical schemes currently add to the health sector would be lost to South Africa if the Bill goes ahead unchanged. Even the Minister of Health, Dr Joe Phaahla, in a carefully worded statement issued on Wednesday, said: “Continued collaboration with all stakeholders, transparent communication and a phased approach to implementation are crucial components of our strategy.” Versfeld points out that, since the idea of the NHI was first floated, the question of how it will be funded has remained unanswered.

Retirement reform

Then we have the two-pot retirement reform system, where the implementation date allowing members to make an initial seed withdrawal from their retirement funds has been ping-ponging back and forth. The implementation date was initially set at 1 March 2023, then postponed to 1 March 2024. The retirement funds industry made much of the fact that this did not give it sufficient time to change its processes accordingly. At the Medium-Term Budget Policy Statement (MTBPS) on 1 November, National Treasury indicated that the implementation date would move to 1 March 2025. And then, in an astonishing about-turn, Parliament’s finance committee voted to move the implementation date back to 1 March 2024 (on the back of very loud motivations from labour unions), before the implementation was moved to 1 September 2024, where it now stands.

Joon Chong, a partner at Webber Wentzel, says retirement funds have indicated they need 12 to 18 months from the date of final legislation to implement the required changes. However, the September implementation date, though better than 1 March 2024, will only give them six months’ lead time. “Effectively, around 1,324 active retirement funds will have to have rule amendments signed off by the Financial Sector Conduct Authority before 1 September,” she says. Finance Minister Enoch Godongwana has cautioned that this process alone will take at least three months.

SRD grant extension

The Social Relief of Distress (SRD) grant has been extended by another year to March 2025, although National Treasury has made it clear that additional taxes may be needed to fund the grant. The SRD grant was introduced to support low-income individuals affected by the lockdowns during the Covid-19 pandemic and was intended to be in place for one year only. However, as elections loom in 2024, the grant has been extended each year, despite the glaring lack of a funding mechanism. The MTBPS last month cautioned that, if the SRD grant or a similar type of new grant were made permanent, beneficiaries were expected to increase from 27.3 million in 2023/24 to 40.4 million in 2040/41. This was expected to shift social grant expenditure to 3.8% of GDP in 2040/41.

ANC's dwindling popularity

The results of three separate, independent opinion polls released in October could point to the rationale behind the legislation being rushed through with little thought given to practical implementation or funding. An Ipsos poll in June and July found 43% support for the ANC, 20% for the DA and a much-improved 18% support for the EFF, with the remaining 19% split among a host of smaller parties. Two separate telephonic polls, by The Brenthurst Foundation and the Social Research Foundation, presented similar results. Notably, the Ipsos and Brenthurst Foundation polls also showed the ANC losing its majority in two key provinces: Gauteng and KwaZulu-Natal. Together with the Western Cape, which has long been governed by the DA, the three provinces account for more than half of South Africa's population and nearly two-thirds of its GDP.

Daily Maverick | 10 December 2023

INTERNATIONAL NEWS

Exclusive: South Korea's pension fund, central bank to extend FX swap line

SEOUL, Dec 8 (Reuters) - South Korea's National Pension Service (NPS) and central bank are in talks to extend their foreign exchange swap programme that was due to expire in December, according to two government sources with direct knowledge of the matter. "The two institutions seem to be in agreement with each other to extend. They are considering it positively," a welfare ministry official told Reuters. Another official at the welfare ministry, which oversees the NPS's fund management and policies, also said extension is currently under discussion. The NPS, the world's third-largest public pension fund, and the Bank of Korea (BOK) established in April a foreign exchange swap line of $35 billion to ease pressure on the local currency from the pension fund's growing investments abroad.

The swap allows the NPS to use the BOK's foreign exchange reserves in times of currency market volatility, removing one of the heaviest sources of pressure on the won in the spot market. The new amount and period are not yet determined but will likely be in line with the existing contract, one of the welfare ministry officials said. The move comes amid concerns among foreign exchange traders that the local currency would face additional pressure if the pension fund, a major market player with huge demand for dollars, had to return. The won has weakened 3% against the dollar so far this month, sharply reversing the course from November, when it posted its biggest monthly gain in a year. For 2023, the won has so far fallen 5%, on track for its third straight yearly loss.

"It is a news if it does get extended, and it is still a news even if it doesn't," one currency dealer said. The won, one of the most volatile emerging market currencies, still faces external headwinds from uncertainty over the U.S. monetary policy and a sluggish Chinese economy, traders say, with the country's exports expected to make only a modest recovery. In Reuters' request for comment, an official at the BOK said it was discussing with the NPS about extending the swap line. The NPS also confirmed they were in discussion. The NPS has been increasing its overseas investments for higher returns, adding to demands for dollars. As a result, the NPS has come under criticism for aggravating declines in the won with skewed dollar demand in the market. During the dollar's rally in the three months to October, the BOK's foreign exchange reserves dropped by $9 billion to the lowest level since mid-2020.

The NPS bought $8 billion worth of foreign stocks and bonds during that period, central bank data showed on Friday. The monthly average buying of foreign stocks and bonds for the January-October period stood at $2.6 billion, bigger than any other year on record. Soon after Reuters reported on the swap extension, the won gained as much as 1.21% against the dollar in the onshore spot market, sharply rebounding from a more than three-week low. The NPS held a total of 983.4 trillion won ($746.11 billion) in financial assets as of end-September, 51.6% of which was in foreign assets. It plans to raise the ratio to 60% by 2028.

Reuters | 8 December 2023

Trade associations sue SEC over short selling, securities lending disclosure rules

The Managed Funds Association, National Association of Private Fund Managers and Alternative Investment Management Association sued the SEC on Dec. 12 over its rules requiring increased disclosure of short-sale-related data and securities lending data. According to the lawsuit, the SEC disregarded the interconnected nature of the rules and took a contradictory approach to regulating interrelated markets. "The resulting rules are arbitrary and capricious," MFA President and CEO Bryan Corbett said in a Dec. 12 news release. "The SEC needs to go back to the drawing board and develop a consistent, coherent approach that will protect investors and avoid undermining the resilience of our capital markets."

The SEC **finalized the rules on the same day** at an October meeting, with the agency's two Republican commissioners voting against both rules. One rule would require certain institutional investment managers to report short-sale-related data to the SEC within 14 calendar days after the end of each month. The agency would then publish such data, on a slightly delayed basis, aggregating by security and keeping manager information confidential. The other rule mandates that parties to securities lending transactions disclose specific information on those transactions to the Financial Industry Regulatory Authority by the end of the day that the loan is effected or modified. FINRA is then required to make certain information it receives public by the morning of the next business day, according to an **SEC fact sheet.**

But according to the lawsuit, the rules are contradictory.
The rule on short-sale reporting purposely publishes data on an aggregated and delayed basis in order to reduce harm, the SEC said. However, "the commission then contradicted and undermined those very same considerations in the securities loans reporting rule by requiring daily public disclosure of individual transaction information pertaining to loans of securities in a manner that effectively serves as a proxy for short-sale activity," the lawsuit states. The rules are

also invalid for other reasons, according to the lawsuit, including that their costs outweigh their benefits, they overstep the SEC's statutory authority and they are in violation of the Administrative Procedures Act. The organizations filed the lawsuit in the 5th U.S. Circuit Court of Appeals, based in New Orleans, and are represented by Jeffrey B. Wall and Judson O. Littleton of the law firm Sullivan & Cromwell. They are asking the court to invalidate the rules. "These two rules underscore how the SEC has ignored calls from industry, market participants, and Congress to consider the interconnectedness and aggregate impact of its rulemakings," Alternative Investment Management Association CEO Jack Inglis said in the news release.

In a **hearing last month,** Rep. Ann Wagner, R-Mo., who leads the House Financial Services Subcommittee on Capital Markets, said the pace of the SEC's rule-making "raises questions about the agency's ability to comprehensively evaluate the cumulative effects, indirect costs, and cross-market implications of these rules," and leaders of two industry groups agreed. The three trade associations that filed the Dec. 12 lawsuit were also a part of the **six organizations that sued the SEC in September** for its private fund adviser rule. The organizations said the SEC failed to show a need for that rule, exceeded its authority, and significantly changed the final version of the rule without allowing for public comment.

Pensions & Investments | 12 December 2023

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