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THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

DA's retirement fund proposal rejected ahead of pension reform paper

Parliament's finance committee has rejected the Democratic Alliance's proposed A bill that would allow pension fund members to use 30% of their pension savings as a loan guarantee, to help alleviate the financial pressure they may be experiencing due to Covid-19. The rejection was expected, not only because the government has its own solution, but because it was an ill-considered proposal, well-meaning perhaps but lacking insight into the likely financial and tax consequences. It was an idea a politician might put forward to win votes, but not a serious policymaker. ANC MP Gijimani Skosana was more diplomatic, saying that "any pension fund amendment bill requires a feasibility study with options …

Parliament cannot be expected to consider draft legislation that lack the comprehensiveness that is required for such a serious matter." No such feasibility study accompanied the amendment bill, nor had the DA issued a discussion paper to get the retirement industry's thoughts on the matter. From that point alone, the proposal was always likely to fail. But it also made no sense conceptually. Fund rules permitting, the Pension Funds Act already allows members to obtain a direct loan from the fund or use their savings as a guarantee. This, however, is strictly limited to loans related to immovable property, and even then most funds' rules don't allow it, due to the cost and complexity it adds to the administration.

Underlying both the direct loan and the fund guarantee is the requirement that members can service the loan. In both cases, they are still liable for monthly interest (at the prescribed rate in the case of a direct loan from the fund) and capital repayments, and are evaluated accordingly. This means that a member who cannot afford a housing loan under normal considerations would also not qualify for a pension-backed loan. If a loan was nevertheless granted to a person who cannot afford the repayments, as the DA envisages, it is likely that the guarantee would soon be called by the lender. This then becomes a roundabout way to access pension benefits by way of an early withdrawal, leaving a retirement funding gap that would be further enlarged by the lump-sum tax on the early withdrawal.

Beyond these preservation issues, the idea also undermines a core safeguard of the Pension Funds Act to protect members' retirement savings from creditor claims, even in insolvency proceedings. Although the DA's proposal flies in the face of public policy, there's no denying that fund members who are in serious financial difficulties don't care about public policy. Many

people are in that situation, even more so after the pandemic containment measures, and have no other recourse than their fund assets. Our regulators and politicians have long struggled with this dilemma of competing needs. The ideal would be a system that facilitates both: immediate relief in emergencies plus also better retirement outcomes down the line. Fortuitously (or perhaps not), the finance committee's rejection of the DA bill comes just as National Treasury is about to publish its own paper on a more flexible pension system, to address this very issue. Treasury's proposed "two-pot" system will let savers access a portion of their fund (perhaps up to one-third) provided they then save the remainder until they retire. It's a pragmatic solution that balances short and long-term needs and brings in the compulsory preservation that National Treasury has long strived for, albeit through the back door.

The current system allows pension and provident fund members to withdraw their savings every time they leave their employer. According to the *10X Investments South African Retirement Reality Report 2021*, the percentage of fund members who do so remains stubbornly high at 60%. Other studies suggest the number is closer to 80%. Even before the pandemic hit, exiting fund members frequently took all the money whether they had an urgent need for it or not, indicating that they don't appreciate the importance of compound returns in a long-term savings plan. In the 10X report, almost half the respondents believe they can secure their retirement in under 30 years (rather than the recommended 40), unaware that the 10-year delay will halve their pension.

Practically, the partial withdrawal merely accelerates access to that portion of the fund that is inevitably taken as a lump sum at retirement anyway. But by having to preserve the balance, which then becomes subject to mandatory annuitisation at retirement (other than for vested balances), it will also guarantee those fund members receive an ongoing retirement income, which in turn reduces reliance on the state's old age grant. It is a win-win proposal that promises to lessen the state's burden at both points of access. While we await to see more details in the discussion paper, from what we know so far, this plan has, unlike the DA's folly, broad industry approval.

Personal Finance | 6 December 2021

Top hacks to make investing for retirement feel less like a sacrifice

If you struggle to stay motivated to invest for retirement, there are a number of psychological tools that you could consider tapping into. So says Thandi Skade, investment writer at Allan Gray, who shares her top hacks for fostering habits that promote improved investment outcomes.

Hack 1: Temptation bundling

"Temptation-bundling is a powerful tool to generate willpower, which could ultimately be harnessed to alleviate the psychological pain that we associate with things we perceive to be a sacrifice, like saving for retirement," says Skade. Temptation-bundling is the idea of combining two particular types of activities: one that is beneficial, but that you often put off actioning because it's not much fun, and one you enjoy doing, but that is not the most productive use of your time or resources. "You are more likely to change your behaviour and form good and long-lasting habits when you are immediately rewarded for completing an action perceived to be a sacrifice," says Skade.

"By linking a reward to a difficult task through temptation bundling, what you are really doing is reframing your perception of a task into something you can look forward to, instead of something you'd rather avoid." She uses the example of an annual meeting with a financial adviser, which you may experience as an anxiety-inducing exercise. Instead of delaying it, consider making the engagement less formal by meeting at your favourite leisure spot (the reward) to plan for your financial future (the task that "ought to" be done). "The key to effectively applying temptation-bundling to achieving long-term financial goals is finding a way to include rewards in the process so that it becomes an instantly gratifying experience and a foundation from which good habits can be formed."

Hack 2: Psychologically reframing an overwhelming event, making it more manageable

It is naturally overwhelming to think of the large amount we will ultimately need to see us through retirement. However, if we rather focus on a monthly amount we can afford, and commit to a regular debit order that escalates annually, it suddenly feels more manageable. "Being confronted with a smaller, more palatable figure makes it psychologically easier to commit to making the sacrifices required to benefit our future selves." Remember, she says, it is typically less painful to tackle a new goal by starting small. "This could mean supplementing your pension fund benefit provided by your employer with monthly contributions to a retirement annuity or tax-free investment, or setting up a monthly debit order to a unit trust – suitable for most of your investment goals. Starting with a small contribution and gradually increasing it over time can make it easier to commit to automatic, annual debit order increases."

Hack 3: Use the power of visualisation to bridge the gap between your present and future self

Skade says psychologically reframing how you identify with your future self can give you extra motivation to save for retirement. "The act of visualising your future self enables you to build an emotional connection and identify with this person, making them feel less like a stranger. The more you can connect your present self with your future self, the more likely it is that you will align your present-day behaviours and decision-making processes with those goals," explains Skade. She says one should start by creating a vivid image of what your future self looks like: Consider things like the physical appearance, needs, goals, desires and the kind of life you want to live in the future.

"To make it more real, you could even write a letter from your future to your current self," she suggests, noting that in changing our natural pattern of time travel by going to the future and working backwards, we are forced to step into the shoes of the individual we may become and view things from 'their' perspective. "Beyond these powerful behavioural interventions, consider seeing an independent financial adviser who can help you overcome biases and encourage you to remain committed to your financial goals," concludes Skade.

BUSINESS REPORT | 2 December 2021

Looking forward to your last day at work … ever?

While some of us are hanging up the Christmas lights, a number of people will be getting ready to hang up their work attire for the last time. Approaching retirement is both exciting and unnerving, and soon-to-be retirees have much to think about. ***Andre Tuck, senior investment consultant at 10X Investments****, answers a few common questions.*

What are my investment income options?

Before retirement, it was up to you to build a savings pot to finance your retirement. When you retire, you are obliged by law to use at least two-thirds of your retirement savings to buy an annuity, which will pay you an income in retirement. There are two types of annuities you can choose from: a guaranteed annuity (also known as life annuity) and a living annuity.

What's the difference between a living annuity and a guaranteed annuity?

A guaranteed (or life) annuity is an insurance-type product, where the insurer pays you a specified amount every month for the rest of your life. While this insures you against longevity risk (the risk of outliving your savings), it comes with a few limitations. These include not having

any control over how your money is invested and not having the flexibility to draw a lower or higher income. This can be inconvenient should your expenses change, or if you wanted to spoil yourself with, say, an overseas trip. Another downside is that your policy dies with you and, even though you may be able to make provision for your spouse, no money passes to your heirs. A living annuity, on the other hand, is an investment-type product that transfers the risk and responsibility for securing a sustainable income to you. This gives you more control (and responsibility), with greater investment and income flexibility. Your heirs will inherit whatever is left of your capital after your death.

How do I choose which annuity is best for me?

These products address different needs. Therefore, this decision requires careful evaluation of your personal circumstances and plans for your retirement. There are a host of factors to consider – for example, your health, age, desired income, how much you have saved and the needs of a financially dependent spouse. You will also need to think about whether you prefer a secure or flexible income and whether you want to leave something for your heirs. It's important to do your research and consult a financial adviser to help you make the decision that's best for you.

Can I switch at a later stage?

Legislation allows you to switch from a living annuity to a guaranteed annuity, but not the other way around. Once you have signed up for a guaranteed annuity, there is no going back.

How much income will I need to retire comfortably?

During your working life, you will probably have saved toward a specific number. Now that you are retiring you will have a better sense of what your lifestyle costs are and can, therefore, be more precise about what you will need. A carefully thought-through budget is always the best place to start. And what better time to refine your budget than as you reflect on the past year and look toward a new one.

Here are a few things to think about:

- Your primary goal will be to cover essential living expenses, such as accommodation, groceries, utilities and healthcare.
- You should set something aside for emergencies and other unexpected costs.
- You may decide to make lifestyle changes, such as trading in an expensive vehicle for a more affordable one or moving to a smaller home.
- Make sure you also budget for enjoyment, such as travel and hobbies.

How will my income be taxed?

The income you receive from your annuity (living or guaranteed) will be taxed according to the prevailing personal income tax table.

How much income would I be able to draw from a living annuity?

To help you work out a sustainable income to ensure that your savings last your retirement years, you should consult a planning tool such as the 10X living annuity calculator, or speak to a financial adviser.

What will my annuity cost?

Few retirees realise that the fees on their living annuity are likely to be their single biggest expense in retirement. Switching to a low-cost provider could boost your financial position significantly without compromising your lifestyle. Assuming an annual drawdown of 5% from R4.8 million in a living annuity, you would receive a pre-tax income of R240 000, or R20 000 a month. At the industry's average annual fee of almost 3% (typically made up of advice, administration and investment management fees), your costs would be around R144 000 a year (R12 000 a month).

Moving to a low-cost provider that charges less than 1% a year in fees, you could draw R28 000 a month, and pay fees of R4 000. But drawing 8% a year will deplete your savings quite quickly. It would be more prudent to keep your income unchanged and let the 2% annual saving compound in your living annuity. Depending on your choice of portfolio and future market returns, this could add between five and 15 years to your income stream. Whether you have been retired for many years or are about to embark on this next chapter of your life, have a look at your numbers and make sure that it's you who's enjoying the lion's share of the fruits of your life's work. It might just be the best Christmas present you could hope for.

Personal Finance | 6 December 2021

The wonders of a windfall

It's hard to believe that the end of another year is already upon us. Under "normal" circumstances, December would be a time when many of us would be looking forward to receiving an annual bonus. However, the reality is that some companies have struggled over the past 12 months and may not be in a position to pay their staff something extra at the end of the year. But that shouldn't stop you from having a financial plan in place for receiving additional income. Whether you receive a financial windfall in the form of a bonus, tax refund, or any extra money for work you've done outside of your normal job, it's important to think about how to use your cash injection wisely.

It can be very tempting to spend a windfall on a large-ticket item or something you hadn't intended to buy because it feels like "free" money, especially when it's a surprise. But squandering this boost to your financial wellbeing can be wasteful, especially when there are many investment opportunities that can yield so much more value than simply splurging could. The enjoyment of spending money is often short-lived; but investing your money can be very rewarding, particularly over the longer term. Here are some suggestions on how to use your windfall wisely:

1. Boost your retirement savings.

There's been a number of studies published that suggest South Africans may be in a retirement crisis, with very few having sufficient funds to retain their standard of living once they enter retirement. Ad-hoc lump sums are a wonderful way to boost your capital. If you are behind in your retirement savings, a windfall can help you to catch up.

2. Increase your discretionary savings.

You could add a lump sum into your discretionary unit trust account or tax-free investment (for the latter, make sure not to exceed your annual limit). Ultimately, your future self will find this far more satisfying than spending everything right away, in one go, with nothing really to show for it. You can also use your unit trust account to save for something that you really want in a year or two. Point being, you will have more options and a greater sum available if you invest a windfall and wait a while for it to grow.

3. Settle your debt.

If you do have some debt to pay down -- particularly short-term, expensive debt such as a maxed-out credit card -- paying it off is another great step to take to improve your financial wellbeing. While it's mentally difficult to use "current" money to pay back the past, it's important to get out of debt. The less you owe, the less interest you will pay. It's worth discussing with a

financial adviser how best to use your windfall. You may even be able to eliminate a sizeable chunk from your debt burden and increase your savings.

4. Consider an alternative.

It's definitely a good idea to diversify your investments, and you could even consider greater offshore exposure in your unit trusts. You might have some preconceptions about offshore investing, so **this article** on debunking three common myths could be useful. Chatting to a financial adviser is best to assess what sort of exposure you could consider.

Create your own windfall

Keep in mind that by making additional contributions to an approved retirement fund could mean that a tax refund is due to you, creating a windfall that can be reinvested. You could also decide to put aside R500 a month from December this year to November next year. This way you guarantee you'll have a bonus in December 2022, no matter what. There are a number of lower-risk options available for short-term investments. Whichever option you choose, having a financial plan in place will help reduce the chances of spending your cash injection wastefully, and increase the probability of getting the most out of it.

FA News | 7 December 2021

INTERNATIONAL NEWS

Push to get UK pensions money into private equity is flawed

It seems that the British government wants to rebuild better at all costs. And the costs involved are the fees paid by the country's savers through their pension schemes. So the urgency on this subject is that the latest reform aimed at getting more savers' cash in less liquid asset classes such as infrastructure and private equity have been given two months to show results. From October, pension schemes can smooth out the performance fees typical for these types of investments over several years to prevent the 75 basis point levy limit protected by savers in default funds for defined contribution schemes being exceeded.

This in itself was controversial. The cap is an important board of consumer protection, especially for these schemes that handle auto-entry fees. Workplace schemes tend to compete on cost, and therefore the average levies are actually only about 48 basis points. The change was, as some feared, merely a first step. The government last week proposed to scrap its smoothing mechanism and instead remove performance fees completely from the limit. It has suggested that it could give trustees flexibility to improve outcomes for savers, while accommodating the type 2 and 20 fee structures commonly used in private markets, maintaining member protection against high or unfair levies, and also benefiting long-term projects of the British economy.

If the benefits of removing the cap sound too good to be true, it's probably because it's so. It's an idea that – while recently by the Productive Finance Working Group, which includes the Bank of England, the Treasury and regulators – has long been advocated by the private equity and venture capital industry. The sector's fee structure was fairly bulletproof. Now some of the biggest workplace schemes, like Nest invest more in private markets but with a policy of not paying performance fees. There is indeed a challenge around auto-enrollment and a generation of workers who are unlikely to save enough to ensure a comfortable retirement: LCP and Interactive Investor reckon a worker to pay the statutory minimum into a scheme would again have to save half as much to achieve the same pension pot as a worker who started a decade ago, due to lower investment returns.

Cutting off potential sources of growth is unhelpful. But the limit exists for a reason, namely that the impact of higher fees on pension pots is significant. The Pensions Policy Institute found that typical charges within a default scheme erode retirement savings by about 14 percent. The payment of levies at the level of the limit eroded savings by 20 percent. The latest government

reform will leave the high management fees charged by private asset funds within the limit, while exempting "well-designed" performance fees. No one has yet decided what that means. But potential design requirements may come against the industry's classic objection that it raises money on a global basis on global terms. The government hopes that this reform will encourage investment managers to change their fee structures, although it is unclear how and why this would be the outcome.

The Pension and Lifelong Savings Association argues that there are other factors that limit investment, including liquidity issues and the requirement to "consider risk and reward carefully". The latter can easily keep schemes on the side lines at a time when increasing questions are over whether private equity really generates better returns as public markets over the long term, whether the returns justify the additional leverage involved, and whether the flow of money to private markets is likely to further moderate returns. The fact that returns are in private capital strongly skewed towards top performers contributes to the risk of overpaying for average performance.

In any case, Esther Hawley, a senior investment consultant at Barnett Waddingham, notes, the government's rapid time scale to make money flow is contrary to the reality of most pension funds, in a market that is still cost-driven and in larger pools. Try to consolidate that you may have more bargaining power. This makes you wonder what reform, leverage or beef stimulus the government might take next to move money in the direction it apparently thinks it should be.

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