IRFA DISPATCH

Institute of Retirement Funds Africa

THE RETIREMENT INDUSTRY NEWSLETTER

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Red tape or reform?

As the Conduct of Financial Institutions (COFI) licensing framework reshapes the financial industry, financial service providers face a range of challenges and opportunities. Understanding the potential impacts, regulatory burdens, and benefits of these changes is crucial for navigating this evolving landscape. FAnews spoke with Lisa Teixeira, Masthead Compliance Specialist, and Anri Dippenaar, Masthead Head of Compliance, about the implications of the new framework.

COFI brings additional compliance responsibilities

Teixeira noted that the licensing requirements will significantly impact operations, “Under the new system, there will be a bigger focus on what activities they do. So, regardless of what the financial institution identifies as, for example, a bank, an FSP, or a product provider, if they carry out more than one identified activity - which many financial institutions do - they only need one licence, but they will have to obtain authorisation for each activity and add it to their licence.” Dippenaar elaborated on whether additional compliance responsibilities will be introduced by the expanded licensing scope. “While the new framework may initially bring with it additional compliance responsibilities, such as providing the Financial Sector Conduct Authority (FSCA) with the assurance of the financial institution’s governance, expertise and capacity in terms of these specific activities, it aims to streamline requirements for FSPs, product providers, and some other financial services participants. It seeks to simplify the regulatory landscape, ensuring that businesses are clear about the regulations they need to follow to be compliant with conduct standards, avoiding confusion and multiple sets of rules.”

Increased red tape

Concerns have been raised about the potential for increased red tape with the licensing framework. Teixeira stated, “Concerns were raised that without careful assessment and deliberation among all stakeholders of the impact of the proposed framework, the new approach to market conduct would only be a ‘FAIS plus’ approach, combining the principles-based application of the FAIS Act with the more prescriptive application in other legislation. There is a fear that these principles will serve simply as a ‘catchall’ for the regulators.” This concern is echoed in the Explanatory Policy Paper accompanying the COFI Bill. COFI amplifies and extends the principles of market conduct regulation introduced by FAIS. However, it is much more than that - it is a comprehensive overhaul of South Africa’s financial sector regulation, designed to streamline oversight, promote fairness, and foster trust in financial institutions. Its broader scope and systemic impact make it a transformative piece of legislation, not just an enhanced version of FAIS. For financial institutions, the benefits anticipated are reduced regulatory duplication, enhanced customer trust, and better market conduct which can outweigh the perceived increase in red tape.

The impact and implications

The impact of the licensing framework will vary between smaller and larger financial institutions. Dippenaar explained, “COFI requires licensed financial institutions to have governance arrangements proportionate to the nature, size, scale, and complexity of its conduct risks or business model and activities. The Bill also emphasises proportionality in consequential changes to the Financial Sector Regulation Act. From an intention perspective, the principle-based model should allow smaller entities to do what is required to maintain good client outcomes, as opposed to having to comply with the same ‘rules’ at the same level that applies to larger corporations.” On another note, Teixeira discussed the implications of COFI’s licensing changes for financial innovation and technology adoption. “The focus on consumer outcomes allows financial institutions to quickly identify consumer needs and market gaps and will likely increase competitiveness because innovation can happen faster. However, the ability to better identify issues, needs, and market gaps is largely dependent on the ability to gather and inspect relevant data. Technology and tools (even at a lower and simple level) will help FSPs and other participants to have a view of the data, but if the same data is very manual and needs to be produced by primarily manual interventions, this will take more time away from other activities in the business - like production.”

Preparing and adapting

To prepare for and adapt to the licensing requirements under COFI, Dippenaar advised financial institutions to begin early analysis. “The final licensing application form is not yet available, but the second draft of the COFI Bill includes a list and definitions of licensing activities. These activities may still change, but financial institutions can still use them to prepare. We have already started helping our members by providing an early view of these activities, allowing them to analyse their business operations and identify potential concerns or uncertainties.” The potential benefits of the licensing framework, however, extend to consumers and the financial industry as a whole. Teixeira explained, “The new licensing framework under COFI offers several potential benefits. Unlike the current system, which licenses financial institutions based on their type, the new framework focuses on the activities they perform.

This means that institutions carrying out multiple activities will need only one licence but must obtain authorisation for each activity. This change addresses flaws in the existing system, ensuring that all relevant services are regulated, enhancing consumer protection. “In her concluding remarks, Dippenaar added that the COFI Bill is a critical development that will shape the future conduct framework. She noted that while the exact timeframe for the Bill is yet to be confirmed, the FSCA has moved forward, establishing an industry reference group - the COFI Bill Transition Working Group under the Market Conduct Committee - in the second half of 2024. This group aims to assist the FSCA in refining the draft-themed frameworks and providing guidance and support for the transition process.

FA News | 28 January 2025

How to use retirement savings to pay less tax

With tax season here, you might be wondering how to make your money work harder for your future while reducing your tax burden today. If you're a working professional juggling multiple financial priorities, understanding the tax benefits of retirement savings could be your secret weapon for building long-term wealth – and all without significantly impacting your current lifestyle. And while we're talking about your retirement savings, how have yours been doing lately, and do you know if you're paying too much for whatever you're getting? Retirement annuity investments, in particular, have a reputation for being overpriced and poorly managed. Did you know you can get a free, no-strings-attached comparison report from 10X to see if your investments could be doing better?

Smart tax planning for your retirement savings

Let's start with a practical example. If you're in the fourth tax bracket below, earning R540 000 per year (R45 000 per month) and contributing 15% of that (R6 750) to a retirement annuity, you stand to save around R26 000 on tax. If you split that up over 12 months, it equates to a tax saving of just over R2 000 per month. So, your retirement savings cost you around a third less than you are actually paying – Sars is effectively helping fund your retirement.

Here's what makes retirement fund contributions particularly powerful:

1. You can deduct up to 27.5% or R350 000 (whichever is lower) of your taxable income or gross remuneration (whichever is higher);
2. This applies across all your retirement funds combined (pension, provident, and retirement annuities); and
3. If you contribute more than the annual limit, these excess contributions roll over to future years.

But the benefits don't stop there. When you eventually draw from these savings in retirement, you could pay a lower tax rate than you do now. Want to see exactly how much you could save? Our Tax Savings Calculator can show you the immediate impact on your take-home pay and tax bill.

Tax-free growth: The hidden advantage of retirement annuity savings

While the immediate tax deduction is appealing, there's an even bigger benefit that many people overlook: your investment grows completely tax-free within a retirement fund.

Unlike discretionary investments such as a unit trust, you pay:

- No tax on interest earned;
- No tax on dividends; and
- No capital gains tax.

Currently, Morningstar estimates the 'tax drag' on a local high equity portfolio at around 1.2% annually. Retirement fund members don't pay this tax. When taking the effect of compounding into account, this annual cost saving could translate into as much as 30% more money after 40 years.

Smart strategies to boost your tax benefits

If you receive an annual bonus or 13th cheque, here's a tax-smart approach to consider:

• **Additional voluntary contributions (AVCs):** Talk to your HR department about directing some of your bonus to your company retirement fund through an AVC. You'll get the tax benefit immediately, and your future self will thank you.

• **Top up your retirement annuity:** Don't have an AVC option? Consider using your bonus to boost your retirement annuity instead. The tax benefit works the same way.

• **Preserve your benefits when changing jobs:** One of the biggest mistakes people make is cashing out their retirement savings when they move jobs. The tax implications are significant.

By preserving your savings in a preservation fund or retirement annuity, you keep your money and its tax advantages working for you. Furthermore, you give yourself more time for compound interest to work for you. It's incredibly difficult to 'get back' the years you contributed to your company retirement fund. Withdrawing early means it's much less likely that the real effects of compounding (from about year 20 onwards) do their best work for you.

Okay, you want to be tax-savvy – so what to do next?

• **Verify your details annually:** Double-check your personal information on the South African Revenue Service (Sars) eFiling system, including bank details, contact numbers, and addresses. Incorrect information can cause delays in processing refunds

• **List all sources of income:** Ensure that you account for all your income, including salary, rental income, side hustles, or any other form of earnings. Forgetting even small amounts can lead to penalties later.

• **Determine your tax-paying status with Sars:** Understand whether you are a provisional taxpayer. This applies if you have income sources beyond your salary that exceed certain thresholds, requiring you to make tax payments throughout the year.

• **Don't just rely on an auto assessment:** While Sars provides auto assessments, you don't need to accept them blindly. Errors in data collection are common, so always double-check the calculations and ensure the information is accurate.

• **Compare your previous returns:** Use your previous year's tax return as a reference point. If your financial situation hasn't changed drastically, the line items should be broadly similar. Significant deviations might indicate a missing income source or expense.

• **Request a statement of account**: After filing your return, request a statement of account from Sars. This document reflects your current tax position, including any outstanding payments, penalties, or refunds due. Ideally, this statement should show a zero balance, indicating that your tax affairs are in order.

• **The right reference number is crucial:** When making payments to Sars, ensure you use the correct payment references. Incorrect references can lead to misallocations, potentially resulting in penalties even if your total payment is correct. Remember to verify your bank details with Sars, especially if you recently changed accounts. Even seemingly minor changes can create significant issues with refunds.

Know where you stand with your retirement annuity

• Use 10X's Retirement Annuity Calculator to check if you're on track for a comfortable retirement.
• Compare your investment costs. High fees can eat into your returns just like taxes do. Use our EAC (effective annual cost) calculator to get a handle on how much you're actually paying to invest for retirement, or get a free comparison report to see if you could be saving on fees.

Smart tax planning through retirement savings isn't just about paying less tax today – it's about making your money work harder for your future. By understanding and maximising these benefits, you're not just saving on tax but building a more secure retirement.

FA News | 23 January 2025

Retirement planning through different life stages

Retirement planning is essential at every stage of life, but the focus will evolve as circumstances change. It needs attention throughout your lifetime – as your life changes, your retirement planning needs will also change. Also, bear in mind that several factors have positively impacted human longevity over time, which has contributed to the increase in average life expectancy worldwide. Increased longevity requires a thoughtful, flexible retirement plan that anticipates not only a longer life but also the changing needs and challenges that come with it.

Here are a few aspects to consider at different stages of your lifetime.

At the beginning of your career

• Start saving early. Compound interest benefits those who start saving sooner, and even small, consistent contributions can grow significantly over time.
• Employer contributions. Take full advantage of employer retirement plans.
• Develop budgeting habits. This skill set will stand you in good stead. Good spending habits allow you to save more and will help you to achieve your goals throughout your life.
• Invest in growth assets. With many years until retirement, focus on growth-orientated investments that offer higher potential returns.
• Make use of the most appropriate products. There are many product options available to investors, so ensure that you get financial advice to assist you in making the right decisions from the start.

If you get married and start a family

• Reassess your investments. With additional family obligations (which may also include homeownership), consider a diversified portfolio that balances growth and stability.
• Plan for education costs. Make sure that you balance your retirement savings with other financial obligations like saving for children's education, rather than sacrificing saving for retirement entirely.
• Review your insurance needs. Ensure that you protect your family's financial future with adequate life and disability insurance.

When you are seasoned in your career

• Reassess your risk tolerance. Adjust your portfolio so that it is aligned with your goals and objectives.
• Estimate retirement expenses. Assess the lifestyle you envision and anticipate any large costs you may encounter, such as medical or travel expenses.
• Plan for healthcare. Consider what healthcare insurance needs you have, and bear in mind that healthcare needs generally increase in retirement.

As you approach retirement

• Consider your retirement budget. Estimate the income you will need to cover your retirement expenses.
• Plan withdrawal strategies that are aligned to your goals and objectives.

At retirement

• Monitor your spending. Stick to your budget and be mindful of withdrawals to avoid outliving your savings.
• Adjust your investments based on longevity needs. Be aware that some growth assets may still be necessary to account for inflation and longevity.
• Consider healthcare and estate planning.

Revisit your plans over time

Allan Saunders famously said that “Life is what happens while we are busy making other plans.” Remember to give the necessary attention to what is truly important to you, rather than spending too much time focusing on ‘other plans’. Throughout all life stages, it is essential to review your financial plan on a regular basis and ensure that the necessary adjustments are made to align with your goals and objectives. Getting expert advice can certainly be beneficial here, so consider partnering with a financial adviser on your journey.

FA News | 23 January 2025

Retirement: How much is enough?

Reaching the retirement phase of life and navigating related financial planning can be daunting. Unfortunately, this well-deserved season of life can cause both financial and emotional stress without strategic planning. In addition, many people, irrespective of their life stage, do not know how much will be enough.

A few principles must be included when constructing any resilient, all-weather portfolio that must provide income. One element is diversification between asset classes. This includes a combination of cash, bonds and, most importantly, growth assets (referring to local and global equity exposure).
With any investment requiring an income, there are two main objectives:

- Keeping up with inflation (actual inflation) – referring to medical aid increases, food inflation and actual cost of living (this is not 6% for the average individual); and
- Not withdrawing more than your investment returns.

This entails planning for inflation and your income drawdowns to ensure the capital remains in place for as long as possible. It is also essential to ensure a well-diversified portfolio to manage risk and ensure consistency in return. We typically don't draw income from equities but from cash, ensuring we can manage market movements and tax implications.

1. The main unknown in retirement is what "actual" inflation will do. If your lifestyle expenses rise by 10% or more annually, you will start feeling out of pocket quite quickly.
2. The second is life expectancy – the possibility of living up to or even more than 100 years of age is not impossible today.

Drawdown rate

In a well-diversified portfolio with a long-term investment goal, we aim for a return of 10-12% consistently (CPI +6-7). If we plan for a higher inflation rate (let's assume the rate of your annual medical aid increase is 8% for this example), you need to aim to draw closer to 4-5% of the fund value if you want to ensure the capital will remain untouched for as many years as possible. The drawdown percentage, return on the portfolio, and managing inflation become extremely important, which is why proper wealth management is key. Adding a 1% return to the strategy increases the timeline by two to three years. For example, if we are looking at providing a net income of R50 000 per month, you will roughly require a fund value of R15-R20 million if we want to achieve the 5% drawdown rate. Taxation and inflation need to be taken into account. The return you achieve on your portfolio is not the only role-player, as 7% versus a 10% average return over the longer run can have a vastly different outcome. Taxation and product optimisation will also play an important role.

Portfolio construction

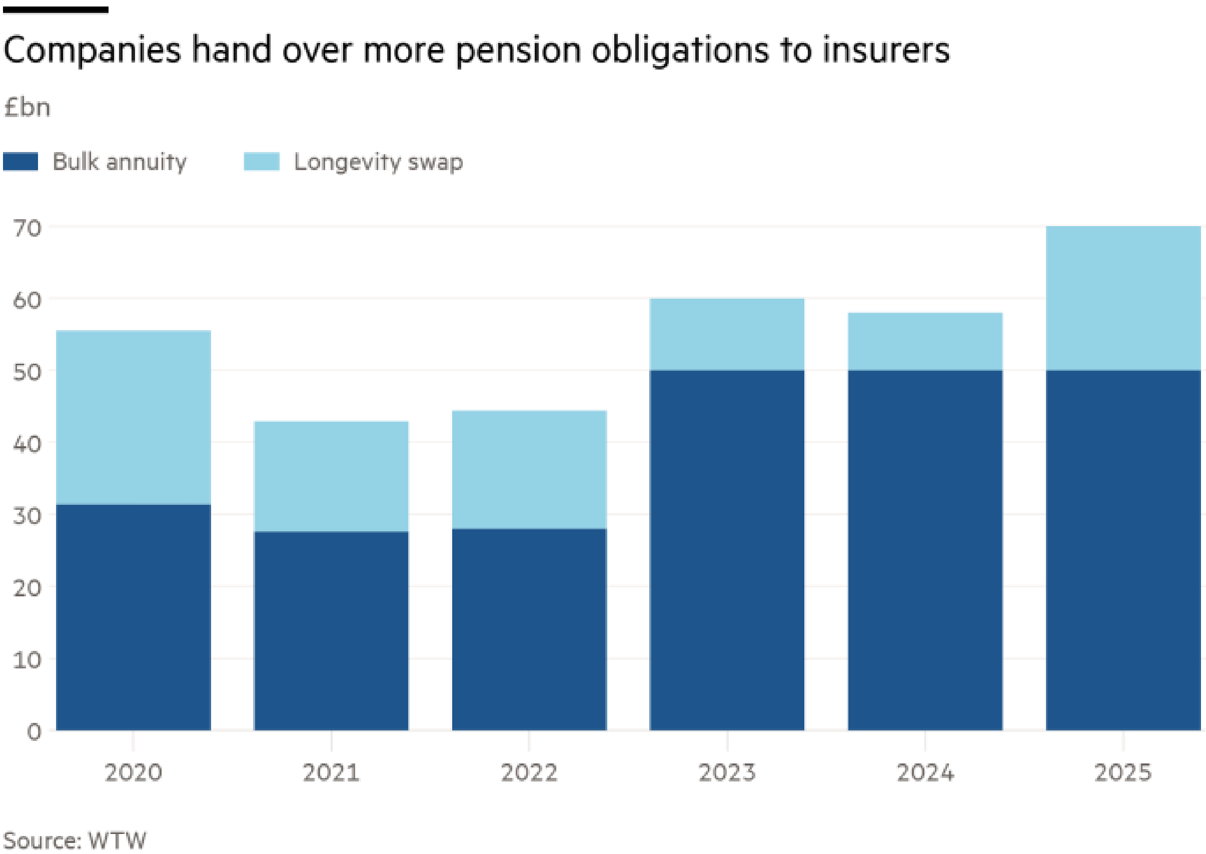
Typically, using more than one product at retirement is suggested. The idea is to optimise expected returns, asset allocation, and taxation. If retirement is not well planned for, the tax will eventually significantly erode your net outcome. If your entire portfolio consists of retirement vehicles, this lump sum will transfer to a living annuity, and your income will be taxed on PAYE scales. This can significantly increase your tax effect on income expectations. When planning for an ideal retirement, remember to consider your "savings rate". This means that you should be saving in proportion to what you earn, increasing your savings as your income increases over the years. Remember to also factor in regular bonuses, as this forms part of your total income. Ultimately, retirement should be planned for in great detail. A trusted advisor can provide the necessary insights to prepare for your future and give you peace of mind

Moneyweb | 27 January 2025

UK insurers set for record £70bn of pension transactions

Pension consultants WTW says improved funding positions have made bulk annuity deals more attractive

UK businesses are set to offload a record £70bn of pension risk to insurers this year as healthy scheme funding levels support a flurry of dealmaking, according to a new forecast. Funding levels of defined benefit pension schemes have improved after higher government bond yields reduced the value of future liabilities. That has made bulk annuity deals, where companies sell their pension schemes to insurers who then take responsibility for meeting pension obligations, more attractive. Companies have sought to hand over their pension liabilities to insurers because it means they no longer have to report the pension surpluses or deficits in their own accounts — or assist with any shortfall — while such deals have become an important source of revenue for insurers. Pension consultants WTW has forecast a combined £70bn in sales this year, made up of £50bn of bulk annuity transactions and £20bn in longevity swaps, where pension schemes insure against members living longer than expected, from just under £60bn in 2024.



Forecasts for a buoyant 2025 follow volumes that were slightly lower than predicted last year as some employers decided to keep their schemes or delay buyouts, in anticipation of higher surpluses. The Conservative government last spring explored options to allow companies to access scheme surpluses, estimated to be worth more than £100bn on a low-risk measure, causing some well-funded schemes to run for longer in order to take advantage of the expected improved access. Chancellor Rachel Reeves is expected to soon lay out plans to allow companies and scheme members to benefit more from surpluses in defined benefit schemes. Shelly Beard, managing director in WTW's pension transactions team, said funding levels had "generally continued to improve" over the past year, enabling companies with smaller schemes to transfer their pension obligations to an insurer.

Royal London and Utmost both completed their first bulk annuity transactions last year, bringing the total number of insurers operating in this market to 10. Last summer private capital giant Brookfield applied for a licence to operate as a UK insurer to enable it to make bulk annuity deals. "The defined benefit de-risking market is the envy of the global insurance world. [It is] bigger than any other, including the US," said David Richardson, chief executive officer at Just Group, which completed 129 bulk purchase annuity transactions last year. More than 35 per cent of the UK's 4,900 DB pension schemes, which manage a combined £1.2tn of assets, are fully funded on a buyout basis, meaning they could afford to hand over their schemes to an insurer, according to the Pension Protection Fund, which was set up by the government to compensate pensioners if their employers' scheme fails.

Bumper bulk annuity transactions have also attracted scrutiny from regulators, with the Prudential Regulation Authority earlier this month warning of the risk of funded reinsurance deals where UK life insurers pass some of their pension liabilities to overseas reinsurers. Concerns include whether, in the case of a reinsurer's default, assets brought back to the books of UK insurers would be sufficient to cover their risks. Charlie Finch, partner at consultancy LCP, said his firm had been lobbying the PRA to give better disclosure on funded reinsurance as "a vacuum of information has made people worry more than they might need to".

Financial Times | 27 January 2025

Pension reforms to go further to unlock billions to drive growth and boost working peoples' pension pots

Working people and businesses are set to benefit from new rules that will give more flexibility over how occupational defined benefit pension schemes are managed, as the government continues to remove blockages that are inhibiting its growth agenda that will improve lives of working people across the UK.

- Prime Minister and Chancellor to tell leading CEOs that Britain is back and open for business.
- Changes to pension rules will allow trapped surplus funds to be invested in the wider economy, fuelling economic growth.
- Move is part of government action to remove blockages that are stopping growth - from regulation to planning processes.

Working people and businesses are set to benefit from new rules that will give more flexibility over how occupational defined benefit pension schemes are managed, as the government continues to remove blockages that are inhibiting its growth agenda that will improve lives of working people across the UK. Hosting a meeting with leaders of Britain's biggest businesses in the City of London today (Tuesday 28 January), the Prime Minister and the Chancellor will set out the details of changes and tell some of the country's leading CEOs that Britain is back and open for business. At the roundtable, the PM and Chancellor will outline how restrictions will be lifted on how well-funded, occupational defined benefit pension funds that are performing well will be able to invest their surplus funds. This follows action taken by the government last week to bring a renewed focus on growth from some of the UK's biggest regulators, a shake-up to legal challenges on planning applications, and new "brownfield passports" to speed up housing in commuter hotspots.

Prime Minister, Keir Starmer said:
The number one mission of my government is to secure growth, drive higher living standards for everyone, and get more money into people's pockets. To achieve the change our country needs requires nothing short of rewiring the economy. It needs creative reform, the removal of hurdles, and unrelenting focus. Whether it's how public services are run, regulation or pension rules, my government will not accept the status quo. Today's changes will unlock billions of investment, pushing forward in delivering my Plan for Change.

Chancellor of the Exchequer, Rachel Reeves said:
I know this government and businesses are united on growth being the top priority for our economy, which is why I am fighting every day to tear down the biggest barriers to growth, taking on regulators, planning processes and opposition to this urgent mission. The Prime Minister and Chancellor will tell CEOs from some of the UK's most successful companies that that the government is seeking to create the best possible conditions for the private sector to thrive. They will promise to work in partnership with businesses, to deliver high-quality jobs across the country, and the economic growth that will fund the schools, hospitals and roads

that we all rely on. Pension trustees and the sponsoring employers could then use this money to increase the productivity of their businesses – to boost wages and drive growth or unlock more money for pension scheme members. High growth and more productive businesses boost the size of the economy which in turn will fund our vital public services. This more efficient approach demonstrates that the government has been listening to business, and will give businesses more flexibility, allowing trapped surplus funds to be invested into the wider UK economy, or given to scheme members as additional benefits. Where trustees agree to share a portion of scheme surplus with a sponsoring employer, the employer may choose to invest these funds in their core business, for example to purchase equipment or supplies, and/or provide additional benefits to members of the pension scheme.

Approximately 75% of schemes are currently in surplus, worth £160 billion, but restrictions have meant that businesses have struggled to invest them. These reforms build on the Chancellor's Mansion House reforms which will create pension megafunds as part of the biggest set of pension reforms in decades, unlocking billions of pounds of investment in exciting new businesses and infrastructure and local projects. Over £1.1 trillion is held by pension funds in the UK and defined contribution pension schemes are set to manage £800 billion worth of assets by the end of the decade. This Government is determined to encourage these pension funds to deliver investment and drive economic growth – which is the only way to make people better off. Jonathan Lipkin, Director of Policy, Strategy & Innovation at the Investment Association said:

Unlocking surplus capital from defined benefit schemes has the potential to both boost UK growth by opening up investment opportunities for companies and their stakeholders, as well as the possibility of higher pensions for scheme members. With around £1.1 trillion in assets, defined benefit schemes already make a significant contribution to the funding of the UK economy and public services. With the right guardrails in place, the government's proposals could help channel more funding into the economy, by enabling schemes to invest more widely and take on greater risk, while allowing for members to receive an uplift to pension benefits. Zoe Alexander, Director of Policy and Advocacy at the Pensions and Lifetime Saving Association, said: The PLSA backs surplus release, with the right protections in place to ensure member benefits are secure.

Surpluses could be used to increase DB scheme benefits or could be redirected to fund contributions to sponsoring employers' defined contribution workplace schemes. Lowering the legislative threshold for allowing returns of surplus could potentially encourage trustees, in conjunction with their employers, to adopt a more ambitious mindset and take on slightly riskier investment strategies for their DB assets, including greater investment in UK assets. Patrick Heath-Lay, Chief Executive Officer for The People's Pension, said: It is positive news to see the government is looking at the pension industry as a whole. This will help unlock more of the £2.9trillion that is held in UK pension savings, to benefit savers and the economy alike. We look forward to other pension schemes following our plans and outlining how they will invest in private markets. The roundtable discussion will focus on the government's partnership approach to growth with business, including how regulation can better support the Growth Mission, and the role of business in achieving the UK's ambitions in AI which the Prime Minister unveiled earlier this month. Every regulator has a role to play in the Growth Mission and the Chancellor is hosting a series of roundtables with the 17 regulators that the Prime Minister wrote to in December, to discuss their proposals to support growth in the coming year. The meeting with CEOs comes days after the Chancellor's return from the World Economic Forum, where she pitched Britain's investment credentials and let global business leaders know that the UK is open for business again. She championed early reforms to planning, pensions, and regulation that make it easier to do business in Britain and remove barriers investors from overseas face. On Wednesday, the Chancellor will make a speech where she will set out plans to push through further planning reforms to get Britian building again, rip up regulatory barriers so we can encourage more investment into the UK and announcements to boost trade and investment. The government will set out the details of the surplus policy in its response to the Options for Defined Benefits consultation, due this Spring.

Further information:

- Currently DB scheme surplus can only be accessed where schemes passed a resolution by 2016, so not all schemes can access surplus even if trustees and sponsors both want to do so.
- Legislative changes could enable all DB schemes to change their rules to permit surplus extraction where there is trustee-employer agreement. This allows trustees to assess the suite of options available in striking a deal with employers on how best scheme members can also benefit – linked to improving member outcomes.
- Trustees have an overarching fiduciary duty to act in the best interests of their members. When considering surplus extraction, trustees must fund the scheme and invest its assets in a way that leads to members receiving their full benefits.

GOV.UK | 28 January 2025

Will tax confusion drive SA's hedge funds offshore?

Discussion document wants them out from under the collective investment scheme umbrella.

The hedge fund industry is still small but is described as the most innovative financial vehicle in the South African market in the last decade. However, a recent proposal by National Treasury would create tax uncertainty for investors in these funds and may potentially lead to investments flowing to international hedge funds where there is tax certainty. Treasury published a discussion document on the tax treatment of collective investment schemes (CIS) at the end of last year. One of the proposals in the document is to take hedge funds out of the CIS tax regime.

This option would automatically remove the current tax treatment and take out many of the funds where the revenue-versus-capital distinction is most at question, Treasury argued. The South African Revenue Service (Sars) has been auditing hedge funds, reclassifying capital as revenue within the funds and taxing it. Capital is tax exempt in the fund, but revenue is not. Joon Chong, tax partner at Webber Wentzel, said during a National Treasury workshop that instances where Sars declared capital amounts as revenue during an audit does not mean it was because of trading activities. She noted that companies would rather settle with Sars than engage in costly and protracted litigation. South African case law is quite outdated and the chance of being successful in court is slim.

The history

In 2015, the South African government took steps to incorporate hedge funds into the broader regulatory framework for CISs. In the discussion document, the hedge fund business model is characterized as "the active trading of underlying assets or positions held for relatively short periods and may well include gearing and the use of derivatives" to ensure the highest possible returns. "This business model would be indicative, in terms of case law, of a profit-making scheme, the gains of which should be of a revenue nature." Treasury also described them as "complex and exotic investment vehicles" that are only available to high-net-worth individuals and institutional investors.

Too simplistic

In their comments, industry specialists said assumptions in the document about hedge funds and how they are managed are oversimplified. There is no distinction between long-only and other hedge funds, or between closely held and widely held hedge funds. It was almost like there was a one-size-fits-all approach Cy Jacobs, co-founder of 36One Asset Management, said the discussion document paints hedge funds in "pretty poor light" and describes them to be risky. In reality the amount of trading, particularly in large hedge funds, is less than the amount that occurs in long-only funds. This was echoed by Clint du Sautoy, consultant at Dinc Management, who said about 40% of the hedge fund industry, in terms of rands invested, has exposure to very static capital assets. "In terms of the capital nature of these portfolios, they are as capital as capital can be. They do not churn." He also noted that in the UK the revenue authority's approach is that the active management of an investment portfolio is not considered as trade.

Good fit

Du Sautoy raised concerns that taking hedge funds out of the CIS tax and regulatory regime will set the industry back 10 years. "The industry is properly regulated and definitely fits under the CIS umbrella. It has given investors a lot of confidence and in some respects, SA is far ahead of the world." Other commentators also warned that removing it from the CIS regime may undermine the role of hedge funds in mitigating market inefficiencies. Investors may prefer international hedge funds, which will shrink the domestic hedge fund market. Uncertainty about the taxation and regulation of hedge funds will be negative for market sentiment.

Matt Whitelaw, equity analyst at 36One, said the hedge fund industry in SA is around 3% of the market, while it is around 20% in the US and also around 20% in emerging markets such as Brazil. There are a number of jurisdictions looking to attract hedge funds, notably Abu Dhabi. Several hedge funds are redomiciling there because they have tax certainty. Abu Dhabi is prepared to pay 40% of upfront costs for hedge funds to redomicile there. "You basically create a death wish for the hedge fund industry [in SA] by not giving it tax certainty," he added.

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