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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

Understand the true nature of a foreign retirement product

Binding class ruling highlights the importance of contributing to reputable funds.

A recent ruling by the South African Revenue Service (Sars) has highlighted the importance of aligning with a reputable offshore pension fund provider and understanding the tax and cost implications. In the binding class ruling Sars found that the foreign pension trust in question was not a pension fund, provident fund or a retirement annuity fund, and therefore the benefits associated with a pension product would not apply. Timothy Mertens, chair of Sovereign Trust SA, says it is important to note that this ruling (BCR 080) only applies to the applicant and the class members of the applicant, who are all undisclosed. “If you are invested in a reputable international retirement plan there should be absolutely no issue whatsoever,” he adds. Sars also notes that the ruling is only binding between Sars and the applicant and the class members. “It does not constitute a practice generally prevailing.”

The ruling

A binding class ruling is issued in response to an application, in this case by a South African company, and clarifies how the Sars commissioner would interpret and apply the provisions of the tax laws relating to a specific proposed transaction. The application for the ruling was made by the South African company, the founder of a foreign pension trust. The trust is a non-resident pension scheme constituted by way of a trust deed. The class is South African resident investors who will make contributions to the trust and become beneficiaries of the trust. The ruling determined the income tax, capital gains tax and estate duty implications for resident beneficiaries of such a foreign pension trust. Mertens says it will be an error to tarnish all non-resident pension or retirement products with the same brush (in terms of this specific ruling).

Facts pertaining to the trust

According to the applicant the trust was established in a foreign jurisdiction where its beneficiaries are potentially exempt from income tax on any annuities or lump sums paid to them, provided that the individual is not resident for income tax purposes in the foreign jurisdiction. The specific pension scheme did not require the investor to purchase any annuity and there was no drawdown limit. Investors could also take a loan of up to 50% of the fund value before normal retirement date. Sars ruled that the trust was not a pension, provident or retirement annuity fund as defined in the Income Tax Act. It ruled, among others, that an investor would acquire a personal right against the trustees of the foreign pension trust when becoming a beneficiary of the trust. The investor would acquire a vested personal right to the income and capital of the trust. According to the ruling the vested personal right will constitute "property" in terms of the Estate Duty Act and will then form part of investor's dutiable estate upon death. The ruling in this instance is binding for five years from July 2022.

The real benefits

"The primary and sole purpose of a retirement product should be for the provision of future benefits in retirement and not tax planning," says Mertens. If there happen to be tax benefits for such products based on specific scheme rules or provisions in the Income Tax Act these are "ancillary" and subject to change. Mertens adds that the benefits of contributing to a foreign pension fund are numerous, but mostly include diversification of investment in the "literally thousands" of investment funds offshore that have the dollar, euro or UK pound sterling as their underlying reporting currency.

"These are generally much less volatile than the rand."

"It also means that one can achieve some degree of stability for future retirement provision given that a foreign pension can also be managed in a stable, highly regulated and tax efficient jurisdiction such as Guernsey, Jersey or the Isle Of Man to name but a few." However, he advises potential investors to seek a proper tax opinion should they have any doubts about foreign retirement products.

Moneyweb | 2 September 2022

When should a pension fund death benefit be paid into a beneficiary fund?

Boards of pension funds must often decide between whether to pay a benefit that is due to a minor beneficiary directly to their guardian or whether the benefit should be paid into a beneficiary fund. The payment to the guardian is often made as a lump sum whereas a payment into a beneficiary fund will result in the guardian receiving monthly payments deducted from the lump sum that is invested by the beneficiary fund. The discretion afforded the board of management of a fund to make payment of a death benefit to a beneficiary fund is provided for in terms of section 37C of the Pension Funds Act.

As with all discretion, the board of a fund must have a rational basis for its decision. In other words, the decision that it makes must stem from the information that has been placed before it. In terms of the Children's Act, a parent who acts as guardian of a child must administer and safeguard the child's property and property interests. The payment of the minor child's benefit to her or his legal guardian should be done in the ordinary course of events unless there are cogent reasons for depriving the parent of the duty to take charge of her minor children's financial affairs and the right to decide how the funds due to the minor should be utilised in the best interests of the minor child.

The following four factors need to be considered when determining whether to pay to the guardian, namely:

- the amount of the benefit;
- the qualifications (or lack thereof) of the guardian to administer the monies
- the ability of the guardian to administer the monies; and finally
- the benefit should, as far as it may be practical, be utilised in such a manner that it can provide for the minor until he attains the age of majority.

The Childrens Act requires that in all matters concerning the care, protection, and wellbeing of a child, the standard that the child's best interest is of paramount importance and must be applied. Section 7 of the Children's Act provides for factors that must be taken into consideration when determining the best interests of the child which includes the capacity of the parents, or any specific parent, or of any other caregiver or person, to provide for the needs of the child. In instances, where the board has decided to depart from the ordinary route of effecting payment of the benefit directly to the minor's legal guardian, it will have to show the existence of good grounds giving rise to an apprehension that the guardian will fail to fulfil her or his duty (Ramanyelo v Mineworkers Provident Fund, [2003] 7 BPLR 4894 (PFA) at paragraph 14 and 15).

There have been very few reported cases dealing with the circumstances under which a guardian should be deprived of the right to administer monies on behalf of her or his minor children. In Van Rij NO v Employers' Liability Assurance Corporation Ltd 1964 (4) SA 737 (W), the mother of the minor child had been appointed as his curator ad litem as the whereabouts of the father were unknown. The then Supreme Court made a damages award in favour of the minor child but the Court was not satisfied that the guardian was competent to handle monies on behalf of the minor child. Accordingly, it appointed a trust company to handle the proceeds on behalf of the minor child, until he attained the age of majority.

The approach of the Court was that since the guardian was not competent or qualified to administer the proceeds of the award, the benefit was placed with a trust company. This approach of determining when to deprive a guardian of the right to administer monies on behalf of a minor child was approved by the Appellate Division in Woji v Santam Insurance Co Ltd 1981 (1) SA 1020 (A). Therefore, there is a duty on the board of management of a fund to investigate the guardian's capacity to administer the money on behalf of the minor child before it decides to pay the benefit into a beneficiary fund. It is only in cases where there is reason to believe that it would not be in the best interest of the minor child to pay the benefit to his/her guardian, that the fund may decide to pay the benefit into a beneficiary fund.

FA News | 31 August 2022

Women, take note: your partner shouldn't be your retirement plan

Financial independence is important during any person's lifetime, at all stages. By starting to plan for your retirement early in your working life, you can maintain your standard of living in your retirement years. While having a life partner can be wonderful, he or she should not be considered as a part of your retirement plan as they may not even have saved sufficiently to meet their own requirements. Women tend to live longer than men, and since research shows they generally earn less, this means that they need to save more, for longer, than their male counterparts.

It is important to familiarise yourself with how you were married and what the terms are should the marriage end either in divorce or death. If you are married in community of property, both you and your spouse's assets will form part of your deceased estate and your spouse will automatically, by law, be entitled to 50% of the combined assets. You can be married out of community of property with or without the accrual system. Being married without accrual is the easiest system to work with in your will and estate; your assets remain your own and you may deal with your assets as you wish with no claim from your surviving spouse.

Often, a home will be registered in one partner's name while the other contributes to the bond repayments. If you are not married or are married out of community of property, ensure that you have a written cohabitation agreement. These financial contributions can be difficult to prove if the relationship ends, leaving the one partner with no claim to the property. Having sufficient planning in place for both parties is always advisable, and each party should have their own savings and investments. A tax-free savings account is a great place to start, allowing you to save up to R36 000 a year without paying tax on the growth.

Increasing your contributions to your work retirement fund will help you accumulate larger savings for your retirement. To take advantage of the benefits of compound interest and avoid a hefty tax liability, it is also advised to keep your retirement savings invested when changing jobs. When leaving your employer, a number of tax-free options are available to you and one should seek financial advice in order to understand which of these is the best choice for you:

- Transferring your savings to your new employer fund;
- Transferring your savings into a retirement annuity fund;
- Transferring your savings into a preservation fund; or
- Keeping your funds invested within your previous employer's retirement fund through a paid-up status (not contributing further to the fund).

Each of the options noted have varying implications such as when you would be able to access the retirement funds either through resignation, dismissal or retirement and whether you are able to continue contributing towards the fund, therefore each individual person would need to seek financial advice from an accredited financial advisor so as to determine which option would best suit their individual needs. Regular consultations with a financial planner will ensure that you are on track for a secure retirement.

IOL | 29 August 2022

Your options at retirement

Exploring the most common decisions retirees are faced with together with some factors to consider in the decision-making process. Saving for retirement generally takes decades to achieve and invariably culminates in a point at which you are required to make a number of critical decisions in a relatively short space of time. These decisions can be multi-faceted and far-reaching – and getting them right the first time is essential. Here we explore the most common decisions retirees are faced with together with some factors to consider in the decision-making process.

Retiring from work

While there is no legislated retirement age in South Africa, keep in mind that many employers have a pre-determined retirement age at which point employees are required to retire from the company. Where the employer sponsors a retirement fund, such as a pension fund, the formal retirement age of the fund is usually synchronised with the company's retirement age for the sake of expedience. However, formal retirement from the company does not necessarily mean that you need to retire from your pension fund, and it is important that you understand the options available to you (see below). Further, your employer may wish to retain your services in the form of part-time employment or contract work which means that, while you may need to formally retire from the company, you could be in a position to continue generating an income.

If you are self-employed or your employer has no formal retirement age, you will naturally have the option to continue working and generating an income for as long as you like or are able to. Whether you choose to stop working will depend on a number of factors such as whether you are sufficiently invested for retirement, your health, and your objectives for retirement, amongst other things.

Retiring from your fund

Another important decision you need to make is when to retire from your fund. As mentioned above, formal retirement from your employment does not mean that you have to retire from the fund. Here we unpack your options should you (i) choose to delay retirement or (ii) elect to retire from your fund.

(i) Delaying retirement

If you are invested in a retirement annuity (RA), the earliest age of retirement is age 55, following which you are free to retire at any stage depending on your circumstances. If you are a member of your employer's retirement fund, you are no longer compelled to retire from the fund when you retire from employment. Generally speaking, you have the following options available to you:

- *Deferred benefit:* You can leave your money in your employer's fund as a deferred benefit until you are ready to start drawing from your investment, although there are a number of factors to be cognizant of. Firstly, if you elect to defer your benefits, keep in mind that you will not be able to make any additional contributions towards the fund and your group risk cover will fall away. Further, your funds may need to remain in their current investment strategy or alternative funds which the pension fund provider makes available. Note you will continue to be charged investment management fees and administration costs – although as part of a group retirement fund, it is likely that you will benefit from favourable institutional fees.
- *Preservation fund:* Another option is to transfer your retirement fund benefits into a preservation fund which is effectively a holding bay for your money until you are ready to start drawing down from your investment but, again, there are a few factors that should be noted before proceeding. Firstly, the once-off withdrawal option that is available pre-retirement, remains available to you where you are effectively delaying your retirement, however, be aware of the taxation of such a withdrawal. Further, the rules of provident preservation funds, specifically in respect of investment contributions made before 1 March 2021, are different from those of pension preservation funds, so be sure to understand how you will be affected when you make withdrawal decisions on retirement. A transfer to a preservation fund is tax-free and preservation funds are transferrable to another active pension and or provident fund providing they comply with the rules of the new fund.

- *Retirement annuity*: Transferring your funds into a RA is another option available to you, remember that this option will allow you to continue contributing to your investment. That said, keep in mind that if you transfer funds from a provident fund to an RA, your vested rights – being those contributions made specifically towards a provident fund before 1 March 2021 – will be lost and this, in turn, will limit your lump sum withdrawal options at retirement to one-third of the fund value. In addition, a RA currently does not allow any access to the funds before the minimum retirement age of 55 except in specific circumstances.

(ii) ***Retiring from your fund***

When choosing to retire from a fund, the options available to you will depend largely on the type of fund you are invested in and when those investments were made, particularly in the case of provident funds. As a general rule, where your fund has a value of less than R247 500, you can withdraw the full amount on retirement keeping in mind that the first R500 000 lump sum retired from a retirement fund is free from tax. This means that if you have never previously withdrawn from a retirement fund or taken a retrenchment benefit, you will be able to access R500 000 tax-free at retirement. If you have previously withdrawn or taken a retrenchment benefit this will reduce your tax-free amount accordingly. That said, it is important to understand the withdrawal rules pertaining to the various retirement funds. In summary:

- *Retirement annuities:* When you retire from a RA, which is permitted any time from age 55 onwards, you have the option of commuting one-third of the fund value while you are required to use the remaining two-thirds to purchase an annuity income. You may choose to use up to the full amount to purchase an annuity income.
- *Pension funds:* The date at which you can retire from your pension fund will be stipulated in the fund rules. At retirement, you once again have the option of taking one-third in cash while using the balance to purchase an annuity income or to use the full amount to purchase an annuity.
- *Provident funds:* The recent retirement fund harmonisation process, which aimed to streamline the treatment of retirement funds, came into effect on 1 March 2021 and it is important to understand how this affects your options at retirement. If you were age 55 or older on 1 March 2021, you have the option to withdraw 100% of your investment at retirement regardless of when your contributions to the fund were made provided you remained with the same provident fund up to your retirement. If you were under the age of 55 on 1 March 2021, any contributions made before this date will be vested and, at retirement, you can withdraw up to the full amount. which case you can withdraw the full amount. ***Full Report:*** ***https://www.moneyweb.co.za/financial-advisor-views/your-options-at-retirement/***

Moneyweb | 29 August 2022

INTERNATIONAL NEWS

Workers cut pension contributions amid cost of living crisis

Unions warn that inflation is pushing people to reduce or end payments to make ends meet

Workers are leaving pension schemes or cutting their contributions, trade unions say, as the cost of living crisis prompts desperate measures that will reduce their retirement funds. The warning comes as UK inflation is predicted to hit 18.6 per cent, the highest rate among larger western economies, and as real wages fall at the fastest rate for at least two decades. The Trades Union Congress, the UK's main movement for organised labour, said a growing number of its members in the private and public sectors were leaving their pension schemes. “In the face of falling pay and rising bills, it's understandable workers feel under pressure,” said TUC deputy general secretary Paul Nowak, who called on employers to do more to support staff, including increasing pay.

The BTU, an independent union that represents employees of Lloyds Banking Group, told the FT it had seen similar actions by bank staff. “We've been contacted by Lloyds members who are reducing their pension contributions because of the cost of living crisis,” said Mark Brown, general secretary of the BTU. One employee, a customer services assistant earning close to £23,000, said she had decided to reduce her contributions from 3 per cent to 2 per cent. However, lower paid staff has to contribute 6 per cent to their pension pot to receive the maximum 15 per cent company contribution compared with the 3 per cent required for senior bankers, including chief executive Charlie Nunn.

While the discrepancy between pay bands has narrowed after a change in policy in 2020, it remains higher than high street rivals such as HSBC, Barclays and NatWest. “It's very unfair and divisive to employ higher earners on different pension terms to their wider workforce and unlikely to create a positive and supportive working environment or corporate culture,” said Luke Hildyard, director of the High Pay Centre think-tank. Lloyds did not immediately respond to a request for comment. Peter Tutton, head of policy at debt advice charity Step Change, warned that such action by employees could severely impact their financial stability in future.

“It's important that people are aware that cutting their pension contributions can affect long-term financial health, may mean they fall out of workplace auto-enrolment schemes and could lose their employer's pension contributions,” he said. Meanwhile, employers are being encouraged to look at what more they can do to assist employees under financial pressure who are looking to quit their pension plan. Mark Futcher, a partner at actuarial consultancy Barnett Waddingham, said he had held discussions with companies about the "potential" for more supportive policies on pension opt-outs. "We have not seen many [opt-outs] at the moment but we do expect to see more," he said. "Where employers offer generous contribution structures above the automatic enrolment minimum, 3 per cent of pensionable pay, the employer could allow employees to temporarily pause their employee contribution for a period of three to six months to ease the cost of living."

Financial Times | 30 August 2022

More people leaving workplace pension schemes, TUC warns

Growing numbers cannot afford to save for retirement, prompting calls to increase employer contributions

Is it ever a good idea to stop paying into your UK pension scheme? Growing numbers of workers are cutting their workplace pension contributions or opting out of schemes entirely because they cannot afford payments – prompting calls for employers to increase the amounts they pay in. With real wages falling and bills rising sharply, people across the country are looking for ways to reduce spending and supplement their incomes, and the TUC said it was hearing about staff in both the public and private sectors who had concluded they could not afford to save for retirement at the moment. "Based on what our unions are telling us, anecdotally they are saying quite a lot of people are having to leave schemes," a spokesperson for the trade union said.

"That is public sector and private sector … It's something we're hearing quite a lot from the public sector unions." Its warnings follow data released in August indicating that the number of people choosing to opt out of their company pension scheme increased by almost a third between March and July this year. The figures were issued by Penfold, a digital pensions platform used by private savers, the self-employed, company directors and businesses. About 10% of people quit their workplace scheme, and the TUC said Penfold's findings – which would translate into a two to three percentage-point increase in opt-out rates, lifting them to about 12%-13% – appeared broadly consistent with what it was hearing.

The reports have already led to calls for the government and the pensions industry to work together to come up with a solution to avoid people being left short at retirement. Investment advisers say workers thinking of quitting their scheme need to think very carefully before jumping ship. Someone who opts out is essentially giving up the pension contributions from their employer, which effectively amounts to “a voluntary pay cut”, said Tom Selby, head of retirement policy at investment firm AJ Bell. “Furthermore, you will miss out on the upfront boost provided by pension tax relief,” he added. Tisa (the Investing and Saving Alliance), a membership organisation for UK financial firms, said: “In times like these, reducing or opting out of pension contributions is unsurprising, and it is easy and understandable to forget about the long term.” Renny Biggins, head of retirement at Tisa, said possible solutions it was proposing included increasing the amount that employers had to pay in under the UK’s auto-enrolment workplace pension regime from 3% of earnings to 6%, in order to allow staff to cut their contributions and release some money to supplement their disposable income.

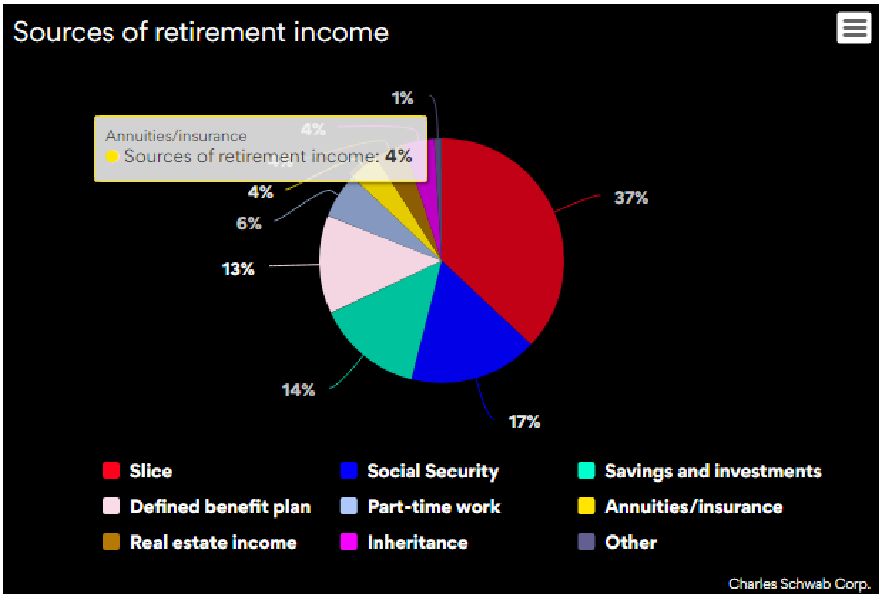
Alternatively, employers could opt to continue paying pension contributions while allowing their workers to take a temporary contribution holiday. “We recognise there are immediate needs for people to provide for their families, but we are nonetheless concerned that if people decide to reduce or opt out of their pension now, there will be consequences in the future,” said Biggins. Jack Jones, pensions policy officer at the TUC, said: “Our longer-term policy target is for increased employer contributions.”

National Employment Savings Trust (Nest), a publicly owned pension scheme set up by the government which now has 11.2 million members, said the opt-out rate for newly enrolled workers had largely remained stable throughout the pandemic and was currently at 10.2%. Nest said it had seen a very small increase in the number of members becoming inactive, which included people who had chosen to stop paying in, but that it could not say if this was due to increases in the cost of living.

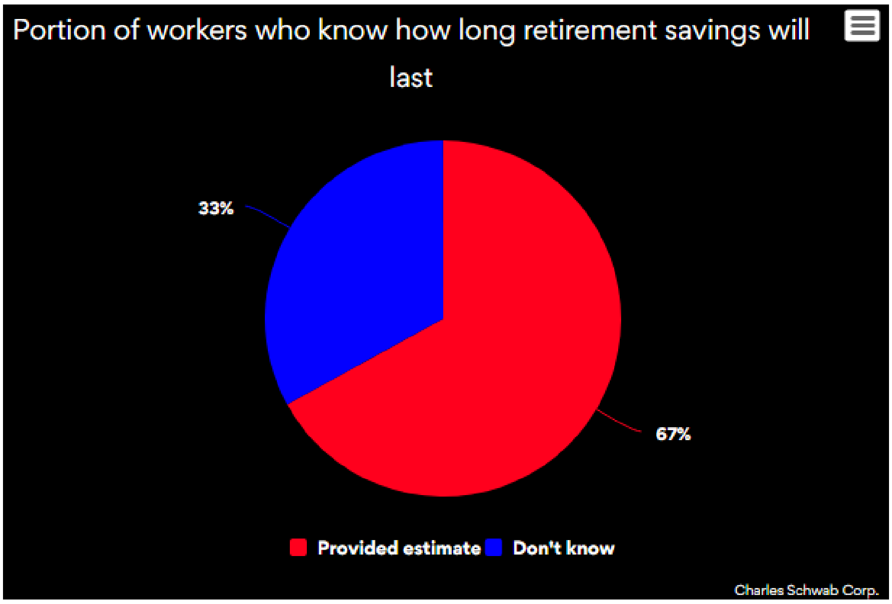
The Guardian | 31 August 2022

401(k) expected to fund largest portion of retirement

Workers expected their largest source of retirement income, 37%, to come from their own and partner's 401(k) accounts, according to Charles Schwab's 2022 401(k) Participant Study that was conducted from April 4 through April 19 and released last month. This was followed by 17% derived from Social Security and 14% from other savings and investments.



One-third of employees didn't know how long their retirement savings would last. Out of the two-thirds that provided an estimate, the average length was 23 years. Nearly a quarter of the respondents, 24%, stated that the pandemic delayed their retirement.



Pensions & Investments | 30 August 2022

OUT OF INTEREST NEWS

Your investment strategy matters

There is no shame in making a shift or two in your portfolio and adjusting your strategy for the right reasons.

Opening your investment statement over the last couple of months, especially at the end of June, would most probably have caused you to feel a bit anxious. It often leaves an investor wondering if they are still on the right track, whether they are still invested in the right type of funds or assets, and what should they do. Even the very best investment advisors sometimes ponder over this, even if it is only for a second or two. This is typical human behaviour, so do not think you are alone. Without a doubt, and most of the time, it makes sense to not make big moves when there is market volatility, especially when there is a retraction in the market. This is not just a gut feeling or an opinion that is given, but history and most importantly, data over different periods in time, shows this.

Phasing in ZAR to USD

However, there is no shame in making a shift or two in your portfolio and adjusting your strategy for the right reasons. A while back we advised clients to start phasing in ZAR to USD and this was at a time when the rand was trading between R14.50 – R15.50. This is not to say all clients must do this, but you need to think about the strategy, especially when looking at offshore investing. It is almost impossible to time the right entry point. But to provide clarity, you must ask yourself is the rand weak at this point or is it a fair price and what will my strategy be? It can be wise to convert euros to dollars at this stage as well, as in the past we have usually seen a stronger euro against the dollar, but this might just change where we see a stronger dollar for longer against the euro. In any case, the dollar is the more widely used currency in the world.

Uncorrelated funds

If you had been in tech stocks in the last year or 18 months you might not agree with this, but these types of funds are uncorrelated with the rest of the market. That is what you want in a portfolio to a certain extent. The real question you must ask is, will these companies still be around 10-plus years from now? Will they be making a substantial difference in our lives over the next couple of years? It is no secret that the world is moving towards technology and AI in a big manner. I'm not saying this is where you should bet all your money, but if your answer is yes to the above questions, there must be a portion allocated at least.

Hedge funds and other

There was a time not so long ago when hedge funds came under immense scrutiny over their high fees and rightly so, especially if they did not deliver a return. These funds typically are not correlated with the rest of your typical unit trust funds in SA, especially with balanced funds and they can add real value to your portfolio. We have used a well-known hedge fund that has delivered really good returns after fees over time and has given clients more diversification in their portfolios. The arrow in their quiver is that they are allowed to long and short shares and this often provides for a wider mandate and more opportunities. Again, I'm not implying this is the alpha and omega, but it can be wise to get exposure in your portfolio to these types of funds.

Fees

This is probably one of the few things you can have actual control over in your investment portfolio. In most instances, it's the platform and fund manager that get the bulk of the fees. Sometimes it makes sense to pay higher fees, especially when blending your portfolio with a hedge fund which is a higher fee structure but will still most probably give an after-fee return that will be to your benefit. All in all, it must be a combination between local/offshore and active and passive. That will probably be the portfolio that will stand the test of time.

Where to from here?

Rumour has it that Europe will most probably go into a recession. They have raised interest rates for the first time in 12 years and the cost of energy has increased almost nine-fold. The US is 50/50 for a real recession. GDP-wise it is in a technical recession, but good payroll numbers are keeping it afloat. At this stage, it looks like a "soft" type of recession which should not have a huge impact on our market. A lot is uncertain given the ongoing war between Russia and Ukraine. I would recommend an investor take a phased approach at this stage and be wary of going all in into a specific asset class.

Moneyweb | 29 August 2022