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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

The two realities that destroy wealth during retirement

Manage these well and you will be assured of a secure retirement.

There are two occurrences that have the potential to ruin your retirement. Manage these well and you will be assured of a secure retirement. During the wealth accumulation phase (en route to retirement) and the wealth distribution phase (in retirement), investors are subjected to the same investment challenges. However, there is a particular devious investment occurrence that causes devastation to retirees when one gets it wrong and unfortunately, there is not much you can do about it because it is unpredictable… The one thing that applies across the board is that we have no idea what returns are going to look like over an investment period. We may be able to reach some conclusions of what returns could (should?) look like over a 20-year period considering various investment portfolios.

In this scenario past returns do have some resemblance to future returns. What the returns are going to look like every year, however, is all but impossible to predict especially where growth assets are part of an investment strategy. If the objective is to grow your investment to a certain value over say 20 years, it is irrelevant in what order the returns on your investments are achieved. Whether the first five years provide negative or positive returns followed by multiple years of positive or negative years or a mixed bag of returns is totally irrelevant to the final outcome as long as the annualised returns are the same over the period. The average return per year you receive is what matters irrespective of in what order returns were achieved.

See the table below as an example: Scenario 2 returns are in reverse order of scenario 1 resulting in the same annualised return of 3.9% per year in both cases.

Scenario 1			Scenario 2		
Year	Return	R 1 000 000	Year	Return	R 1 000 000
1	- 9.0 %	R 910 000	1	17.0%	R 1 170 000
2	- 11.0 %	R 809 900	2	16.0%	R 1 357 200
3	- 22. 0%	R 631 722	3	13.0%	R 1 533 636
4	28.0 %	R 808 604	4	9.0%	R 1 671 663
5	11.0 %	R 897 550	5	11.0%	R 1 855 546
6	5.0 %	R 942 428	6	8.0%	R 2 003 989
7	15.0 %	R 1 083 792	7	16.0%	R 2 324 628
8	5.0 %	R 1 137 982	8	- 12.0%	R 2 045 672
9	- 37.0 %	R 716 928	9	2.0%	R 2 086 586
10	26.0 %	R 903 330	10	15.0%	R 2 399 574
11	15.0 %	R 1 038 829	11	26.0%	R 3 023 463
12	2.0 %	R 1 059 606	12	- 37.0%	R 1 904 782
13	- 12.0 %	R 932 245	13	5.0%	R 2 000 021
14	16.0 %	R 1 081 645	14	15.0%	R 2 300 024
15	8.0 %	R 1 168 177	15	5.0%	R 2 415 025
16	11.0 %	R 1 196 677	16	11.0%	R 2 680 678
17	9.0 %	R 1 413 378	17	28.0%	R 3 431 268
18	13.0 %	R 1 597 117	18	- 22.0%	R 2 676 389
19	16.0 %	R 1 852 655	19	- 11.0%	R 2 381 986
20	17.0 %	R 2 167 607	20	- 9.0%	R 2 167 607

From the above, we can conclude that it is irrelevant in what order returns are achieved if the objective is pure capital growth. Now let's use the same assumptions as above but assume an annual drawing of R40 000 as income. Suddenly the order of returns becomes a crucial component in capital preservation.

Scenario 1				Scenario 2			
Year	Return	Income	R 1 000 000	Year	Return	Income	R 1 000 000
1	- 9.0 %	40 000	R 870 000	1	17.0%	40 000	R 1 130 000
2	- 11.0 %	40 000	R 734 300	2	16.0%	40 000	R 1 270 800
3	- 22. 0%	40 000	R 532 754	3	13.0%	40 000	R 1 396 004
4	28.0 %	40 000	R 641 925	4	9.0%	40 000	R 1 481 644
5	11.0 %	40 000	R 672 536	5	11.0%	40 000	R 1 604 625
6	5.0 %	40 000	R 666 163	6	8.0%	40 000	R 1 692 995
7	15.0 %	40 000	R 726 088	7	16.0%	40 000	R 1 923 874
8	5.0 %	40 000	R 722 392	8	- 12.0%	40 000	R 1 653 009
9	- 37.0 %	40 000	R 415 107	9	2.0%	40 000	R 1 646 069
10	26.0 %	40 000	R 483 035	10	15.0%	40 000	R 1 852 980
11	15.0 %	40 000	R 515 490	11	26.0%	40 000	R 2 294 755
12	2.0 %	40 000	R 413 631	12	- 37.0%	40 000	R 1 405 695
13	- 12.0 %	40 000	R 323 995	13	5.0%	40 000	R 1 435 980
14	16.0 %	40 000	R 335 835	14	15.0%	40 000	R 1 611 377
15	8.0 %	40 000	R 322 702	15	5.0%	40 000	R 1 651 946
16	11.0 %	40 000	R 318 199	16	11.0%	40 000	R 1 793 660
17	9.0 %	40 000	R 306 837	17	28.0%	40 000	R 2 255 885
18	13.0 %	40 000	R 315 931	18	- 22.0%	40 000	R 1 719 590
19	16.0 %	40 000	R 326 480	19	- 11.0%	40 000	R 1 490 435
20	17.0 %	40 000	R 341 981	20	- 9.0%	40 000	R 1 316 296

The above results show that the biggest challenge to capital preservation when drawing income against an investment portfolio is the sequence of returns, especially in the first five years of an income-paying investment like a living annuity. Even though the underlying annualised returns are the same in scenario 1 and scenario 2 over the 20-year period, the way they were achieved determines the sustainability of the investment. I have purposefully used a low annualised return in my explanation. The above calculation has one major flaw namely that a static income figure is used.

Inflation was ignored. Inflation – the second demon. Don't let the above table in any way instil a false sense of security within you leading you to believe that a low annual return will suffice. By increasing annual income by inflation, capital preservation becomes a major challenge. Unless a return can be achieved that is equal or greater than income + future escalations capital will be depleted. The return requirement is not a static figure. Consider the following table with different income and escalation requirements:

Income as % of capital	Annual escalation	Annual return required to preserve capital for a period of 25 years after which the original capital amount will start to deplete.
4%	5%	8% per year return required
4%	7%	9.5% per year return required
5%	5%	9.5% per year return required
5%	7%	11% per year return required
7.5%	5%	12.5% per year return required
7.5%	7%	14.5% per year return required

The above figures show what returns will be required every year to preserve capital for 25 years given the different objectives. We all know that investments do not provide returns in a consistent positive pattern unless they are guaranteed. If you are lucky and achieve returns in sequence as indicated in scenario 2 in the previous table where they are substantially higher than what is required in the first five years, then you may be off to a good start. If, however, returns are achieved as in scenario 1 you have a very serious problem in retirement. So how do we protect an income-paying investment portfolio against capital destruction considering that returns are by no means guaranteed and even less so projectable?

Some strategies to consider:

- Draw the minimum income of 2.5% until the portfolio has grown by at least five years' worth of annual income then keep income below 4% per year. It may be a good idea to take your one-third commutation value and invest in a five-year retail bond depending on the prevailing yield. This will enable you to reduce your living annuity drawdown.
- Supplement retirement income via voluntary investments and rental income. Try and plan your investments so that you have 50% investments in voluntary funds (a rental property can be considered as a voluntary investment in this case) and 50% in compulsory funds at retirement. Flexible income options can be a saviour.
- Change your income to a drawdown base (draw less than what the previous year's returns were) as opposed to maintaining a real income (inflation tracking). The starting income remains crucial, keep it as low as possible for as long as possible.
- Consider guaranteed life annuities for at least a portion of your investments in you require an income of 6% or more from your investments.

Here are some "dos" and some "don'ts" that you can consider that may improve your chances of a more sustainable retirement investment portfolio:

Moneyweb | 7 March 2023

Creating a tax-friendly retirement

A three-step plan to optimise a tax-friendly retirement environment.

As Jimmy Kimmel said: "When it comes to taxes, there are two kinds of people. There are those that get it done early, also known as psychopaths, and then there is the rest of us." With the new financial year starting off, why not place focus on ensuring you are optimising your annual tax benefits?

Herewith is a three-step plan to optimise a tax-friendly retirement environment.

Step 1:

Let's start with retirement planning and probably the most under-utilised benefit. Contributions to a retirement fund are tax deductible. This can consist of a combination of a retirement annuity, as well as a pension/provident fund with your company. These contributions can be deducted from your taxable income up to a maximum of 27.5% of your remuneration or taxable income, capped at R350 000 p.a. If you exceed these contributions, you start building up a "pool" of contributions referred to as your disallowed contributions. At retirement, you will be allowed to withdraw R550 000 tax-free, provided you have not previously made withdrawals.

Because you can add these previously disallowed deductions to the tax-free portion of the cash lump sum you withdraw at retirement, the tax-free amount can potentially be increased infinitely. If you can build up a substantial disallowed contribution "pool", you can increase this to a few million over your working life. Once retired, the portion of your retirement portfolio that you didn't take as a cash lump sum, gets converted to a life or living annuity. The income you earn from this investment is taxed on the income tax scale. But here the benefit of section 10C of the Income Tax Act becomes applicable. Whatever portion of your disallowed contribution "pool" is still available can be offset against this income. Essentially, for years you can earn a tax-free income by utilising your disallowed contributions.

Step 2:

Optimise your tax-free investment. You are allowed to invest R36 000 p.a, and R500 000 in your lifetime. It will take you 14 years to reach the allowed limit on this investment- if you contribute at the annual maximum rate. You can still leave this portfolio to benefit from compound interest after the limit is reached. If you only remained invested for 14 years, and contributed the maximum over this time, assuming an average return of CPI + 6% p.a., at today's inflation rate, you'd already have a fund value of 1 228 958.93. Let's assume these funds are left another 15 years to benefit from time in the market, growing at the same rate. Now your fund value has grown to

R6 726 787.54. This can be accessed 100% tax-free, thereby supplementing your tax-free income earned from your living annuity with income from your tax-free investment.

Step 3:

Structuring a voluntary investment for short-term needs/emergency funds (capped fund value – you want to keep the fund value low enough to ensure you will stay within your annual exclusions on all tax benefits). With a voluntary/flexible investment there are two main tax implications that need to be considered. An annual exemption/exclusion applies to each.

For any interest-bearing asset class (cash and bond exposure) – (this also applies to cash in the bank), an annual interest exemption applies. This is currently R23 800 p.a. and if you are over the age of 65 this becomes R34 800 p.a. Any interest earned over and above your exemptions will be taxed at your marginal rate.

Funds allocated to growth assets (equity exposure) can trigger capital gains tax. This is where you are essentially taxed on your growth earned. CGT is triggered on the disposal of an asset, e.g. the sale of a house. In the investment vehicle, it will be triggered by withdrawing or switching equities – perhaps because of a change in strategy. This is something that can be calculated and therefore known and which can be planned for. Each individual gets an annual capital gain exclusion of R40 000. (To determine the GCT there is a formula that applies using the net capital gain, the inclusion rate of 40% and your marginal rate).

Lastly, I would recommend ensuring your estate planning is also addressed. Ensuring continuity within the family and using investment vehicles where beneficiaries can be nominated, or a trust/company to ensure that funds don't need to move to your estate at death. Estate duty is levied at 20% and 25% depending on the value of your estate. Not only is this a large amount of tax payable, but the timeline of winding up an estate can take months. I would recommend working with a wealth advisor to ensure the structuring of these vehicles is optimised. The earlier this is done the better – as changing vehicles in time becomes quite challenging. These benefits are also about time in the market. The earlier you can start– the better the outcome!

Moneyweb | 6 March 2023

Start saving at an early age to make sure you retire with enough money

Retirement planning is one of the most important parts of your financial journey, but it is often neglected or postponed until close to retirement age.

Starting to plan for retirement is easier when you are still young, and you have few financial responsibilities. This is the right time to save as much as possible to accumulate higher interest allowing you to meet your financial needs during your retirement. Under-saving for retirement remains an issue in South Africa; a new study found that only 12% of the 3.6 million people of retirement age received a form of income in 2020. It also showed that more than 90% of retirees are unable to maintain their standard of living prior to retirement, and two-thirds of members have less than R50 000 in their retirement funds, according to the new survey by Genesis Analytics and the Financial Sector Conduct Authority. Additionally, only 7 to 10 million South Africans out of an employed labour force of about 15 million have retirement savings. Saving for retirement is a challenge in South Africa, but there is good news: it is never too late to start saving.

The first step in planning for your retirement

Managing your finances and finding a way to acquire wealth starts with tracking your spending and aiming to save three to six months' worth of expenses in your savings bank account; this will start making your money work for you. Once you understand that money is a tool for achieving your financial aspirations in life, you will start thinking differently about it.

There are several factors to consider when planning for retirement, including:
– your current income
– current expenses
– retirement savings
– investment strategies
– estimated cost of living in retirement.

Financial wellness begins with the recognition of any bad spending habits you have and replacing them with good spending or savings habits. This includes saving for your future and starting with a retirement plan in your twenties or thirties. Starting young will help you stay on track to achieving financial wellness and feel more confident about preparing for your future. Remember that the older one gets, the higher the cost of medical care and as the years go by, the cost-of-living increases. When preparing for retirement and the medical needs associated with the natural progression of life are neglected. This could lead to situations where, at an older age, you need to rely on family or the government for your basic needs.

The role of a financial adviser in your retirement

A financial adviser's role is to help you to achieve your financial goals in life regardless of your current financial situation. They will conduct a financial needs analysis to assess your needs, your current lifestyle, and future financial and personal goals. This will give the adviser a comprehensive view of the tailored solution needed to help you to reach your goal, as well as whether you need additional financial products that will help you secure your lifestyle such as medical aid, life cover, short-term insurance, or investments. A financial needs analysis will also allow your financial adviser to consider critical factors around retirement saving, including your current income, current expenses, retirement savings, investment strategies, and estimated cost of living in retirement.

You will then receive quotations to review and compare with your financial adviser, to decide on the type of product you need that is suitable for your needs. Don't feel rushed or pressured into choosing a financial product - it is important that you fully understand what you are signing up for, as it is your future after all. Kick-starting your future with a proper financial plan can be a great way to ensure your success. A financial plan is a summary of all your short and long-term financial goals as well as the strategies developed to achieve them. It will also detail the action steps you need to take, such as retirement planning, investment advice and management, budgeting, and education savings.

A financial plan also helps to identify risks, keep track of finances, and safeguard you against disruption. Working on your plan with a financial adviser can help to make the right financial decisions and reach your ultimate financial goal: robust retirement savings that will sustain your living expenses until death The perfect time to begin your retirement planning is when you are between 20 and 30 years old, as the younger you are, the fewer financial responsibilities you have, allowing you to save more. An important consequence of starting to save when you are younger is compound interest has more time to significantly increase your savings. Legislation has allowed retirement savings to benefit from the factor of time, as access to your retirement savings is very limited, with only special circumstances giving you access. By using your wits and a disciplined approach, you will be able to save and invest more money, enabling you to live comfortably post-retirement.

IOL Business | 7 March 2023

Overcontributing to an RA could be a good thing

Overcontribution can be used to reduce or even neutralise the amount of tax paid on living annuity income payments.

Not many investors are aware that any retirement contributions which did not previously qualify for a deduction can be used to reduce tax payable on retirement lump sums or post-retirement income. The total contributions an individual makes to any pension, provident or retirement annuity fund during the year of assessment are tax deductible. However, the retirement funds contribution deduction is limited to, the lesser of: R350 000; 27.5% of the greater of your: remuneration or taxable income. Taxable income before including capital gain. If you contribute more than that it is seen as a disallowed contribution. But the perks to overcontributing to a retirement product are as follows:

You reduce your income tax liability at retirement:
Overcontribution can be used to reduce or even neutralise the amount of tax paid on living annuity income payments. The income you draw from your living annuity can be drawn tax-free until your disallowed contribution is exhausted. You receive your living annuity income without paying tax on it. More disposable income to use during retirement.
If you structure it correctly you reduce estate duty:
Retirement annuities and living annuities are not estate dutiable. Disallowed contributions might be estate dutiable if you do not include your beneficiaries in the planning process while you are alive. Overcontributions are seen as a deemed asset in your estate unless your beneficiaries transfer the funds directly to a living annuity.

If your beneficiaries elect to withdraw the annuity as a lump sum	If your beneficiaries elect a living annuity
The disallowed contribution will be available for the beneficiaries should they elect a lump sum from the retirement funds. Where a beneficiary elects a lump sum, it is taxed in the hands of the deceased as if it was received the day before death. The disallowed contribution will be deducted from any lump sum amount to determine the taxable amount (par 5 of the Second Schedule). Based on the amended section 3(2)(bA)/e) disallowed contributions will	The disallowed contribution will not be relevant in this instance. No tax will be payable upon the transfer from the retirement funds to the living annuity. The disallowed contributions will be lost as a potential tax benefit as it is only the person that made the contributions that can benefit from it from a tax point of view. No estate duty inclusion.

be included in the deceased estate for estate duty purposes.	

Your executor cannot take a fee on retirement annuities:
Correctly structuring your beneficiaries means succession falls outside of the control of the executor.

You create liquidity for your beneficiaries:
Because your beneficiaries won't have to wait for your estate to be wound up, they get access to the funds sooner. Meaning they would just need to submit your death certificate to start the process of accessing funds instead of waiting for the master's office, which can take up to a year to finalise estates.

You create tax efficiency for your beneficiaries:
Retirement annuities are exempt from tax on dividends and interest, and no capital gains tax is payable on the growth earned in the investment, so if your beneficiaries preserve the retirement annuity the growth inside of it is tax efficient. By using this disallowed contribution as an estate planning tool, you get to limit estate duty, but it is important to make sure your finances are a family matter to ensure that these estate duty benefits are in fact enjoyed. Brenthurst believes that financial planning is a family matter and that your children should also be involved with financial planning. Consulting with a qualified, accredited advisor can give you access to platforms that offer family pricing, so your beneficiaries can start saving and pay lower fees over the long run.

Moneyweb | 3 March 2023

INTERNATIONAL NEWS

U.S. multiemployer pension funding drops in 2022 – Milliman study

The estimated aggregate funding ratio of multiemployer defined benefit plans in the U.S. dropped to 79% as of Dec. 31, down from 91% at the end of 2021, according to a study from Milliman.

The drop in funding ratio was largely the result of significant investment losses during 2022, according to the study. Both the Russell 3000 index and Bloomberg U.S. Aggregate Bond index posted double-digit negative returns during the period at -19.2% and -13%, respectively. Investment returns were poor enough that the funding ratio dropped despite the first wave of special financial assistance funding approved by the Pension Benefit Guaranty Corp. under the American Rescue Plan Act of 2021.

In 2022, a total of 35 multiemployer plans received $9 billion in special financial assistance. The study notes also that an additional $37 billion of SFA assistance was paid in January. If those amounts had been paid before the end of 2022, the aggregate funding ratio would have reached 84% as of Dec. 31. "The SFA has been vital for multiemployer plans in dire financial condition; however the underlying conditions for these plans have not changed," said Timothy L. Connor, a principal at Milliman and co-author of the study, in a news release Monday. "They continue to be very mature, have high negative cash flow, and depend highly upon asset performance. Investment returns will continue to be a driving factor to sustain these plans for the long term."

The complete study is available on Milliman's **website**. It is based on publicly available IRS Form 5500 data filed by more than 1,200 plans.

Pensions & Investments | 7 March 2023

Exclusive: S.Korea pension fund ready to revive FX swap with cenbank

SEOUL, March 6 (Reuters) - South Korea's National Pension Service (NPS), manager of the world's third-largest public pension fund, will collaborate with foreign exchange authorities when needed to help stabilise the market, its chairman told Reuters.

Chairman Kim Tae-hyun also said during an interview on Friday with Reuters that re-establishing a currency swap arrangement with South Korea's central bank which expired at the end of last year could be part of such collaboration.

Reuters | 3 March 2023

Kansas anti-ESG bill could cut pension returns $3.6 bln -analysis

March 8 (Reuters) - Legislation pending in the U.S. state of Kansas to stop the use of environmental, social or governance (ESG) considerations by public contractors would reduce state pension system returns by $3.6 billion over 10 years, a new fiscal analysis shows.

The note issued by the state's Division of the Budget on March 7 is the latest to show the challenges facing Republican politicians looking to block or slow the growing use of ESG considerations by businesses and investors.

Reuters | 9 March 2023

OUT OF INTEREST NEWS

4 ways women can win at managing their finances

For women to have true financial independence, they need to take more control of their finances and grow their money, according to African Bank.

Ester Ochse, product head at FNB Integrated Advice, said that there are certain factors that women need to consider in regards to their finances, such as living longer than men and taking care of their extended family.

Ochse shares 4 ways that women can take care of their finances:

1. Budget

Drawing up a budget will help to monitor spending as well as the allocation of money to the needs of a household.
If women are unsure about starting their own budget, here are three methods they can use:

- The 50/30/20 budgeting rule

With this method, women need to allocate 50% of their net income to needs like rent, groceries, and utilities; 30% to wants such as hobbies, vacations and dining out; and 20% to financial goals like savings and debt payments.

- The 80/20 rule

This budgeting method allows women to allocate 80% of their income to needs, wants and debts and 20% of their income to savings.

- The 70/20/10 rule

This method separates income into three groups: 70% for living expenses, 20% for debt payments, and 10% for savings.

2. Credit

"While there is not a major difference between men and women, over the past year, we have seen more men taking up more unsecured credit than women." "The idea is to reduce unsecured credit to a manageable level with the freed up cash flow from the budgeting exercise and then applying the principle to reducing secured debt."

3. Saving money

When it comes to savings, she says women are slightly better at saving than men, with this group consistently having more savings on hand than their male counterparts. Approximately 2% more women have one month's worth of saving compared to men. "The ideal aim is to have three months' worth of income available in a fund that can be easily accessed, specifically for unforeseen expenses. It may seem like a lot but start small and set small goals to build up an emergency saving," Ochse says.

4. Protecting family

To take care of your loved ones, having life or funeral cover - and having a will in place is important. She says more women tend to take up life and funeral cover compared to men.

What is the difference between life and funeral cover?

Life cover is aimed at ensuring that a person's financial dependants can maintain their lifestyle if something should happen to the breadwinner, while funeral cover is aimed at taking care of expenses after the death of a loved one. The latter will, however, not be sufficient to help a family maintain their expenses. It is important to get advice to guide you in getting the right amount of cover required for your specific circumstances. Having a will in place will allow women to protect their family and ensure that both their financial interests are looked after, and that the people they want to inherit their estate will inherit it.

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