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THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

Where are we with the two-pot system?

The legislative process by which the government's well-publicised new system of saving for retirement, the two-component or "two-pot" system, becomes law, is happening slowly and not without hiccups, as the system requires amendments to a several acts governing taxation and financial services.

The National Treasury appears in a hurry to get at least the most crucial legislation passed by the end of March, with the implementation date now set for September 1. The implementation date is a matter of consternation for the retirement fund industry, because the new system demands considerable administrative changes. The industry first agreed on March 1, 2025, but Parliament's finance committee pushed it forward to March 1 this year. The earlier date – now just a few weeks away – has proved unrealistic in the light of Parliament's schedule, so Spring Day is the compromise. (For a reminder of what new system will entail, read Brett Ladouce's article, "Two-pot system: do not eat from the savings pot")

In a recent blog, "The Two-Pot System: A New Era for South African Retirement Funds", Rael Bloom, the product development actuary at Coronation, says that although the September implementation date provides additional time for the industry to prepare, it remains challenging because of key issues to be resolved, including:

- A raft of regulatory changes are required to give legal effect to this new system and provide clarity about the changes required. These include changes to the Income Tax Act and Pension Fund Act, which must be finalised and promulgated.
- The South African Revenue Service must adjust its systems and processes to accommodate the tax requirements.
- The Financial Services Conduct Authority must approve enabling rule amendments for all retirement funds affected.
- Administrators must make necessary system upgrades and adjustments to meet the requirements of the new system.
- Funds must make necessary preparations, such as ensuring that they have the correct bank details for all members.
- Member education about the new system must be conducted to help members understand how the new two-pot system works, dispel any myths about it and clarify what will happen to the accumulated savings pots.

Parliamentary process

Finance minister Enoch Godongwana published the Pension Funds Amendment Bill (PFA Bill) on January 30. This amends the Pension Funds Act to insert certain definitions to provide for the two-pot system and follows from the Revenue Laws Amendment Bill, which establishes the system and which is expected to be voted on in Parliament on February 20. Bowmans financial services expert Deidre Phillips says that although it is expected that the two-pot system will take effect on September 1, "we are still awaiting the amendment to the Income Tax Act by the Revenue Laws Amendment Act". Phillips notes: "According to Parliament's National Assembly and National Council of Provinces 'Meeting of Committees' schedule (also published on January 30), the Standing Committee on Finance (SCoF) was scheduled to meet on February 6 to receive a briefing by the National Treasury on the PFA Bill."

She says further SCoF meetings are scheduled on:

• March 12 for public hearings to take place on the PFA Bill.

• March 19, for responses by the National Treasury to submissions received on the bill.

• March 26, for the consideration and adoption of the SCoF's report by the National Assembly on the clause-by-clause deliberations on the bill. ***Full Article**: Where are we with the two-pot system? (iol.co.za)*

IOL | 10 February 2024

Retirement annuities as an alternative to a trust

Retirement annuities offer numerous tax advantages and are powerful tools for estate planning. For many navigating the financial planning landscape, the thought of managing a trust might seem daunting, especially when considering the costs and complexities involved. That's where the idea of leveraging a retirement annuity as a strategic alternative comes into play. Not only do retirement annuities offer numerous tax advantages, but they're also powerful tools for estate planning, aiming to foster asset growth outside of one's estate. When structured with care, a retirement annuity can serve as an efficient and effective substitute for a trust.

The shift towards retirement annuities

In the realm of financial planning, deciding between a trust and a retirement annuity is more than just a choice – it's a pivotal decision that can significantly impact one's estate planning and tax strategy. Retirement annuities have gained traction as a favoured option for those seeking a simpler, tax-advantaged route to estate planning. The increase in tax deduction limits from 15% to 27.5%, with a cap of R350 000 annually, has only sweetened the deal, enhancing the appeal

of retirement annuities within a well-rounded financial strategy. This tax incentive, combined with the allure of tax-free growth on investments, positions retirement annuities as a prime choice for those looking to maximise their estate's value while minimising tax liabilities.

Shared advantages with trusts

Despite their differences, retirement annuities and trusts share some fundamental benefits:

- **Protection against creditors:** Similar to trusts, retirement annuities offer a layer of protection for your assets against creditors, thanks to specific safeguards outlined in the Pension Funds Act.
- **Asset growth outside the estate:** Both retirement annuities and trusts enable assets to appreciate outside of your estate, effectively reducing potential estate duty implications.
- **Estate duty exemptions:** Like the assets held within a trust, approved contributions to a retirement annuity are excluded from your estate, offering a clear estate duty advantage.
- **Fiduciary duties:** The fiduciary responsibilities of managing both trusts and retirement annuities align closely, with an emphasis on asset protection and equitable distribution in accordance with legal mandates.

Considerations on liquidity

However, it's important to be mindful of the liquidity restrictions associated with retirement annuities. Access to your funds is generally restricted until you reach the age of 55, at which point you can only withdraw up to one-third of the total value. This limitation highlights the need for strategic financial planning to ensure that your short-term liquidity needs are balanced with your long-term financial security.

Making the right choice

The decision to opt for a retirement annuity over a trust is deeply personal, hinging on your individual financial goals, estate planning requirements, and tax considerations. Retirement annuities distinguish themselves through their tax efficiency, protection from creditors, and streamlined wealth transfer capabilities, making them an appealing alternative to traditional trusts for many. Nevertheless, engaging with a financial planning or estate planning professional is crucial to tailor this decision to your specific circumstances, ensuring that your financial strategy is comprehensive, cohesive, and aligned with your overarching financial objectives.

In conclusion, a secure retirement requires careful planning, professional advice, and an active role in managing your retirement funds. Before making any decisions, it's critical to consult with a certified financial planner. The financial landscape is complex and constantly evolving, making it essential to seek advice from those with the requisite knowledge and experience. Be wary of relying on commentary from individuals who may not possess the professional background necessary to provide sound financial advice. "The greatest risk in investing is your own behaviour," said Warren Buffett.

Moneyweb | 12 February 2024

Getting SARS To Sponsor Your Retirement

Pieter Albertyn, Head of Product Solutions at Momentum Investo, says it is a lost opportunity not to invest in a retirement product. Times are tough. We hear it from our clients, and just a glance over the economic pages of any publication shows how many South Africans are battling to make ends meet. Neesa Moodley from Daily Maverick reported on 7 October 2023 that 4,3 million risk policies lapsed in the first six months of last year. People couldn't keep up their life insurance and funeral policies. But however hard life is, as a young actuary it was drilled into me how important it is to save for future financial burdens. Of course, we also learnt the sums to prove this – the earlier you start saving, the less hard your money must work later.

The later you leave saving for something, the more money you must throw at the same dream. It's the interest you earn on your interest that makes the difference – the pebble in the water causes the ripple effect of growth. Many people hope that some miracle will happen to ensure a comfortable retirement. In the financial services industry, we often share in the joy of people who started making provision early enough. But we also lament with those who waited too long. They then often want to take wild risks with the limited money they have to make it grow faster. In my experience, you need time on your side, not some lucky windfall. But with retirement savings, there is a big brother who will help you save and kick-start your investment.

He is called the South African Revenue Service. Yes, the same guy who we always blame for taking our hard-earned money, gives us back something when we look after ourselves. Because the government is so keen for people to save for their own retirement, you get huge tax breaks for investing in retirement products. These tax breaks equal the tax rate you usually pay. If you earn R30 000 per month, you pay income tax of 26%, and this is the tax break you'll get, too. It means you get R260 back for every R1 000 you invest. Now that is an unbeatable deal – Black Friday will battle to offer you a discount of more than 25%. People will get this break for monthly contributions to a retirement annuity. They can also top up their retirement

money any time during the tax year to get the same percentage discount. That is why financial advisers are so eager to help their clients to invest more before 29 February 2024, the last day of the current tax year. And the next tax year, the same breaks wait. The new two-pot retirement system the government will implement will also make several retirement products much more flexible. Investors who have an emergency will have access to some money every year, once a year, at any time during the tax year before they turn 55. You may have buyer's remorse if you have spent too much money on shoes or a bottle of perfume, but will you ever regret investing too much money for your retirement? I doubt it. It's time we start bragging about our retirement products just as we hope the neighbours will notice our new car. And why wouldn't you invest if SARS is picking up part of the bill? It's time to get something back.

FA News | 12 February 2024

INTERNATIONAL NEWS

UK pension funds lost £425bn in year of bond market crisis

Schemes registered a new quarter drop in asset value in 2022 driven by mini-Budget turmoil, finds Pensions Regulator

UK pension fund values plunged by around £425bn in 2022 as bond market turmoil sparked by Liz Truss's "mini" Budget led to forced asset selling by retirement schemes, according to a new regulatory analysis. The extent of losses to pension funds in 2022, which equated to a near quarter drop in asset value over the year, was disclosed in a long-awaited report by the Pensions Regulator this week. The House of Commons' work and pensions select committee had asked the regulator to examine the impact of the September 2022 bond market crisis on thousands of corporate schemes using popular liability-driven investment (LDI) strategies. "The fall in the value of gilts had significant impacts for pension schemes with 'Liability Driven Investment (LDI)' strategies, in particular, for those which had used leverage to increase their exposure to long term gilts," said the regulator.

LDI strategies are used by "defined benefit" schemes to manage the volatility of their liabilities. They involve heavy purchases of government bonds but also the deployment of leverage, or borrowing, in the use of instruments such as gilt repurchase agreements. When long-term gilt yields shot up to record levels in response to the then prime minister's economic programme, pension schemes' LDI hedges came unmoored, forcing them to dump hundreds of billions in assets to meet collateral calls. The sell-off only abated when the Bank of England intervened in

the bond market. The regulator estimated that the combined value of assets for 5,100 company defined benefit plans fell by around £425bn over 2022, from £1.79tn to £1.36tn — equivalent to a 24 per cent drop. “This fall in assets is primarily due to the loss in value of gilts, corporate bonds and property,” said the regulator in its report released on Wednesday. The report found that asset values hit their lowest point for 2022 in September of that year, indicating the effect of the “mini” Budget which was published that month. However, the analysis also found that pension schemes ended 2022 in overall better financial health owing to their liabilities falling more steeply than the drop in asset values, as higher gilt yields reduced the cost of pension promises.

Liabilities fell in aggregate by 33 per cent, or around £575bn, in contrast to the 24 per cent drop in asset values. However, the regulator said the “true impact” of the gilt market crisis “will not be known in full for several years” after each scheme had done a formal valuation of their finances. Iain Clacher, a professor at Leeds University Business School who gave evidence to the work and pensions committee, said the report “shows just how significant the impacts of the LDI crisis were”. “As TPR have acknowledged that they won’t know the full extent of this until scheme returns come in, this suggests that this number is likely to be higher once everything is known.”

Financial Times | 8 February 2024

OUT OF INTEREST NEWS

The growing tax gap, and what to do about it

Sars needs to be able to improve its performance when it comes to taxes due versus taxes collected – and public money needs to be spent more efficiently. Finance Minister Enoch Godongwana has the uncomfortable task of telling South Africans this month that he is going to squeeze them a little harder to get at least R15 billion in additional taxes from them – but increased efforts to fill the current tax gap and prevent wastage and downright theft from the public purse would go a long way to easing the squeeze on taxpayers. Kyle Mandy, tax technical partner and tax policy leader at PwC, says the firm estimates the tax gap to be around R300 billion.

This is not out of line with estimates from the South African Revenue Service (Sars) itself, but it is up significantly from 2020 when it was estimated to be around R50 billion. The tax gap is basically the amount of tax that should be collected but is not because of avoidance and policy

provisions such as rebates, deductions or exemptions. Mandy says if Sars is able to close the gap by even 25%, it would make a substantial difference; this would give the fiscus an additional R75 billion. One way of closing the gap is to improve Sars's collection performance. "Throwing" money and resources at the tax agency will allow it to improve its performance. "The best investment that National Treasury can make, in many respects, is to provide Sars with all the resources it needs to be able to do it," says Mandy. He believes closing the tax gap will create a virtuous cycle.

The additional revenue will enable the government to offer some relief to taxpayers or reduce some of the tax rates.A second crucial element, says Mandy, is to ignite economic growth. That will require all the structural reforms that have been highlighted and spoken about over many years. "In some respects, the reforms are starting to happen, but it has been very slow. Structural reform is crucial to get the economy on a better growth path, which in turn will improve revenue as well."

State spending

Mandy believes it is critical for government to address the ineffective use of public money. "The biggest problem is not a shortage of revenue, but it's the way in which it is being spent." There is a metaphor that says "Eat what you cook". Why do civil servants, including parliamentarians, benefit from private healthcare, private security and private education and not the services the public sector is cooking up, he asks. This allows them to become insulated from the rest of the population.

"There is this disconnect between what affects them and what affects the broader population." According to the 2023 Tax Statistics publication, the three largest contributors to total tax revenue collected by Sars remain personal income tax, company income tax and value-added tax. These three combined were responsible for 81.3% of total tax collections. Companies contributed almost 21% of total tax revenue in the 2022-23 tax year.

The small guys

An important part of the economy that gets a lot of airtime but very little support is the plight of small and medium-sized enterprises (SMEs). The Income Tax Act provides two important opportunities for small businesses to pay less tax, says Colin Timmis, country manager for Xero South Africa, a cloud-based accounting software platform for small businesses. The small business corporation (SBC) tax and turnover tax regimes have been around for many years, yet the uptake has been quite low. In fact, says Timmis, it has been "abysmal" in terms of the turnover tax. Around 1.2 million companies submit tax returns; however, only about 160 000 are registered for SBC. This figure has remained stagnant for the last five or six years.

Rethink needed

There have been few changes to the rates and design of the two regimes. The qualifying threshold of R1 million for turnover tax has remained unchanged since it was introduced. "The reinvention and better education around the two tax regimes are probably long overdue. There hasn't really been a rethink of how to make it more appealing for business owners to make use of them," says Timmis. In the 2023 Xero State of South African Small Businesses report, most small businesses said they want greater backing from the government. Nearly two thirds (64%) of the participants want government investment in digital skills and innovation, 35% want more government support with tax incentives, 28% want funding, and 26% would like government-backed skills development.

Moneyweb | 13 February 2024

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