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THE RETIREMENT INDUSTRY NEWSLETTER

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National Treasury shoots down bill that aims to grant loans from pension funds

JOHANNESBURG - THE NATIONAL Treasury did not support the Pension Funds Amendment Bill that aims to allow workers who were in financial distress to access their pension savings through loans, Treasury's tax and financial sector policy head, Ismail Momoniat, said yesterday.

This was even though workers were going through a period of severe financial distress caused by the effects of the Covid-19 pandemic because of salary cuts, retrenchments, and illness and death in families, trade union Cosatu told Parliament's standing committee on finance yesterday.

Momoniat told the committee that the aim of retirement reform was to encourage savings and reduce poverty, because South Africa had a very low savings rate, and the household savings that did take place were mostly contractual through the deduction of pension fund contributions from salaries.

He said pension fund reform was necessary, because the many loopholes in the retirement regulations allowed people to cash in their entire pension, the governance of many funds was poor, there were too many pension funds, and the aim was to encourage more annuitisation, so that people could receive a regular monthly income in their old age.

He said it was critical that any access to retirement savings did not undermine the long-term objectives of the fund, and the Treasury was concerned that members would wipe out their funds by being allowed to take out loans.

Momoniat said the bill was also likely to increase the indebtedness of employees, and it did not specify how this indebtedness would be dealt with or repaid.

The bill would also mean that retirement funds, which typically invest for the long term, and also in critical infrastructure, would have less money to invest because of having to pay out for these loans, said Momoniat. The bill also needed to be accompanied by a suite of tax and other measures, he said.

A spokesperson for the Association for Savings and Investment South Africa (ASISA) – the organisation's members are investment service providers to the pension fund industry – said the bill would have very limited success, because the National Credit Act regulations specify that a person who takes out a loan must have the capacity to repay it. ASISA said the bill "will not have a good outcome". ***Full report:*** ***https://www.iol.co.za/business-report/companies/national-treasury-shoots-down-bill-that-aims-to-grant-loans-from-pension-funds-96461afa-ca9d-482f-b3e6-9ad4117d790b***

IOL | 20 May 2021

Best of both retirement annuities

In Is the annuity debate shifting back from life, to living? we looked at the pension options available to South African retirees upon exit from their retirement annuities or retirement funds. We discussed the benefits and drawbacks of various solutions in the life / guaranteed annuity product universe before turning our attention to the living annuity space. We have since spoken with Deane Moore, CEO: South Africa at Just Group, about a pension funding solution that allows your clients to incorporate aspects of both life and living annuities into a blended or hybrid solution. The discussion started with a quick refresher of the annuity environment circa 2021.

High level pension purchase decisions

"At the highest level, the pension purchase decision is to choose between a life annuity and a living annuity," says Moore. "In the case of a life annuity the retiree converts their accumulated retirement capital into a pension for life; in the case of a living annuity the retiree invests his or her accumulated retirement capital in various portfolios and is limited by regulation to drawing down an income of between 2.5% and 17.5% of these portfolios, annually". A living annuity appears to be a simple product; but what you are effectively doing is asking a bus driver, computer programmer, engineer or marketer to instantaneously source the skills needed to invest and manage a pot of cash to last their remaining lifespan.

A retiree who opts for a life annuity can add a spouse's benefit, minimum payment period or guaranteed period to the product at inception. They can also choose from various broad product types that determine how their future pension will be calculated. Options include a level, fixed escalation, inflation-linked or with-profit annuity. "A 5% fixed escalation is popular; but inflation-linked products are not used that frequently in the retail space because retirees can get better value from a with-profit annuity, which aims to generate increases in line with inflation," says Moore. He adds that actuaries have introduced unnecessary complexity to the with-profit debate through inaccessible concepts such as post-retirement interest (PRI) and investment participation rate (IPR).

Lower levels of absolute guarantee

Just has simplified the with-profit annuity advice process by introducing three broad increase categories which are determined by the underlying portfolio's performance against a CPI benchmark. The retiree will therefore know up-front what pension increase is being targeted. Just has no discretion in awarding the with-profit annuity increase and the retiree has access to a transparent formula with which to calculate the increase. Retirees who choose the with-profit annuity are purchasing a level of absolute guarantee, and each increase is locked in for life.

"On a like for like basis, retirees who purchase life annuities receive on average 2.5% per annum more in pension than those in living annuities who follow the FSCA's guidance on a sustainable drawdown rate," says Moore. This is because insurers price guaranteed annuities across a pool of people based on average life expectancies. A male who retires age 60 will, on average, live to 83 years versus a female, who would live to 87. "Those in a living annuity cannot plan for the average because they must allow for the possibility of living longer and provide an income into their mid-90s or even 100," he says.

The preceding discussion suggests that individual retirees could be better served by a life annuity at certain stages in retirement and by a living annuity at others. South Africa's regulatory environment allows retirees to divide their retirement funding capital into both a life and living annuity upon retirement; but there is limited flexibility thereafter. The only option available to your client would be to flip the entire balance on a living annuity into a life annuity, which can be done at any time. It has, however, become fairly common for advisers to recommend either a life or living annuity at retirement, in the former case focusing on an optimal mix of guarantee and income and in the latter, on the close management of the client's investment and withdrawal decisions.

The best of both worlds?

What if there was a way for retirees to improve their outcomes by combining life and living annuity features in a single product through retirement? "During modelling for our blended solution, we considered what retirees needed a guaranteed income for," says Moore. This first step requires a consideration of post-retirement lifestyle and drawing up a budget of essential living expenses to include accommodation, food, insurance, medical costs and transport at each stage in retirement. This is the amount, together with an allowance for inflation-type increases that retirees should guarantee or lock in at the earliest possible opportunity. "If you can secure that amount when you retire then you know that whatever happens, you have covered your essential expenses for life," he says. "You can do this with a life annuity". ***Full report:*** ***https://www.fanews.co.za/article/retirement/1357/annuties/1360/best-of-both-retirement-annuities/31923***

FA News | 19 May 2021

Is borrowing from our retirement savings a good idea?

South Africans are drowning in debt and it is hard to imagine that more debt is the solution to the structural economic issues we face.

The Pension Funds Amendment Bill aims to provide members of retirement funds the ability to use their retirement savings as security for a loan. The bill proposes that members be allowed to borrow up to 75% of their fund values, using their retirement savings as a guarantee of repayment. Current pension fund legislation only allows for retirement fund benefits to be applied for home loans.

The bill is being considered by Parliament and claims that:

"By enabling a member to access a pension-backed loan, that member will be able to leverage their pension fund investment prior to their retirement date, without eroding their provision for eventual retirement. Lending institutions will be enabled to offer loans to pension fund members at competitive interest rates and over extended or deferred payment periods given that the loan is fully guaranteed." – Pension Funds Amendment Bill, B30-2020

If the goal is to alleviate hardship in what must be some of the worst economic conditions many South Africans have ever experienced, it is worth looking into. The problem is, there is not much to look into. The full proposed amendment is simply:

1. Section 19 of the Pension Funds Act, 1956, is hereby amended by the insertion after subsection (5B) of the following subsection: ''(5BB) A registered fund may, if its rules so permit and subject to prudential standards, furnish a guarantee in favour of a person other than the fund in respect of a loan granted or to be granted by such other person to a member, which guarantees may not exceed 75% of that member's share in the value of the fund''.

That is it. No guidelines as to what loans may be applied for, no attempt at minimising the abuse from lenders that this could lead to when desperate individuals start to give up their rights to their retirement funds when applying for loans from the “wrong” lenders at the “wrong” terms.

With so few parameters, we have to wonder how this bill could even be up for consideration at all in light of the compulsory annuitisation of provident fund benefits that has just been implemented in March this year. It seems completely contradictory in an environment where the government is supposedly trying to encourage saving for retirement. Will it be taking with the one hand and giving with the other?

This matter is obviously very complex. On the one hand, you have a country on its knees, and this may bring relief to many people if they choose to use the loans responsibly. On the other, it has the potential to exacerbate the situation exponentially. Lenders now have no risk. They can grant loans to anyone with a fund value with a full guarantee that they will get repaid.

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The bill quite cheekily states that it will have no financial implications for the state. I can almost guarantee that it will in no way help the state to reduce the number of people dependant on government grants after they leave the workplace at retirement age.

I am not convinced that the long-term impact on the fund member was considered either. Yes, in an ideal world having access to funds when you feel you most need them should improve your financial position but unfortunately, more debt is not the solution for most people. There will always be the minority of individuals that will only ever use this guarantee when there is truly no other option and there may even be many people out there who are extremely responsible with debt and settle it quite diligently. The problem is “many” is not the same as “most”.

There is a lot of pressure from the public to expedite the passing of the bill due to the financial impact of Covid-19. The truth is we were in trouble well before the pandemic hit! ***Full report:*** ***https://www.moneyweb.co.za/financial-advisor-views/is-lending-from-our-retirement-savings-a-good-idea/***

Moneyweb | 14 May 2021

Getting a jump start on a successful retirement

Financial advisers and planners have a crucial role to play in ensuring that their clients remain on track with their life financial plans. The disruption caused by the pandemic and subsequent national lockdown has resulted in many individuals deferring important financial decisions or ‘waiting out the storm’ in risk- and outcome-inappropriate assets. As the world enters the next stage of its post-pandemic economic recovery you should be encouraging your clients to revisit their financial plans and make sure that they are still on track to achieve the financial goals and objectives it contains, especially that of a sustainable retirement.

Consistent and timely retirement planning

There are plenty of ‘hooks’ you can use to refocus your clients on the need for consistent and timely retirement planning. An Alexander Forbes media release titled How to prepare for and take control of your retirement encourages consumers to begin saving for their retirement as early as possible. “Too often, people only start to think about their retirement when they are five or 10 years away from it,” says Rita Cool, a Certified Financial Planner ® at the financial services firm. This is way too late. It makes more sense for individuals “to get the ball rolling as soon as they start working”.

Many of our readers are probably sick to death of the oft-repeated formula for a successful retirement; but we will repeat it anyway. To ensure a sustainable income in retirement requires that you save 15% or more of your gross annual income for 40 or more years, and always preserve. This recipe for success comes courtesy the retirement funding industry and has been repeated ad nauseum at retirement funding events and seminars for decades. Yes, it is simplistic. And yes, it fails to acknowledge that there are many paths that can lead to a successful retirement. But it hits the mark in putting the spotlight on time as one of the biggest value generators in the savings environment. Time is also recognised as a critical factor in building wealth.

Small, incremental steps to accumulate wealth

An Actuarial Society of South Africa (ASSA) article titled How to grow a meaningful nest egg with little money but a lot of time perfectly illustrates this point. Darius van der Walt, actuary and member of the Investments Committee of ASSA, warns against the misconception that building wealth requires a sizeable amount of money. “While you need some spare cash in order to invest, having a lot of time ahead of you is far more important than the amount of money you can spare every month,” he says. “The earlier in life you start investing, even if it is a small amount, the bigger your nest egg will be when you need it most”.

Thus starts the discussion of the magic of compounding, a familiar story to regular FAnews readers and financial advisers worldwide. Investopedia.com offers a succinct definition of compounding as “the ability of a sum of money to grow exponentially over time by the repeated addition of earnings to the principal invested; each round of earnings adds to the principal that yields the next round of earnings”. In this context ‘earnings’ refer to the dividends, interest or rental income earned on an initial capital investment. “It is the compounding effect, over time, that significantly accelerates the growth of your clients’ investments,” explains Van der Walt, who offers the following example to illustrate.

Two of your clients invest monthly amounts into a portfolio of unit trusts in the South African Multi Asset High Equity category; but the timing and amount of their instalments differ. Unit trusts in this category are designed to earn both dividends and interest in addition to capital growth and are suitable for investors with longer term investment horizons. For the purposes of this example, we assume that each client starts their journey at the same time, age 25, and earn the average return, net of fees, on the aforementioned unity trust category.

Helping R60k to punch above its weight class

Client A starts saving in February 2001, at age 25, by investing R500 a month in a SA Multi Asset High Equity portfolio. Over the next 10 years client A invests a total of R60 000, reinvesting all earnings. Monthly contributions stop at this point; but client A chooses not to withdraw any of the investment, leaving it to grow until the end of February 2021. Client B chooses to party from age 25 to 35 and only starts contributing to a SA Multi Asset High Equity portfolio from February 2011. In an attempt to make up lost ground, Client B decides to invest R1 000 per month into the fund, contributing R120 000 over the following decade. Once again, all earnings are reinvested.

At the end of February 2021, client A’s investment would have been worth R265 782. And Client B would be sitting on a disappointing R174 290 despite having invested twice as much capital. And that, dear readers, is the power of compounding, sweetened by time. Client A’s investment benefits from an additional decade of compound growth. The example was reworked to illustrate how compounding benefits an investor in a less volatile SA Interest Bearing Money Market portfolio. In this case Client A’s R60 000 investment would have been worth R174 021 and Client B’s R120 000 investment would have been worth R168 078.

Time in the market is an obvious winner for retirement savings outcomes and explains why retirement fund managers encourage your clients to begin saving for retirement as soon as they start working. As a financial adviser you will be painfully aware of how difficult it is for late starters to make up this lost ground, a reality that makes managing client expectations through the retirement savings process all the more important. Van der Walt also concedes that it can be tough for your clients to think about long-term investing when their current focus is on keeping a roof over their heads and food on the table.

The ABCs of sound household finances

Cool observes that something as simple as a household budget could get your clients thinking more urgently about their financial goals. It is not adequate to simply match income and expenses; each expense should be carefully considered to eliminate waste and free up money for different savings objectives. Your clients should then review progress against their budgets on a monthly basis. “By starting this good habit, your clients will be using the opportunity to put themselves in a better position to achieve [positive financial outcomes],” she says.

Van der Walt offers two anecdotes that should resonate with late starters. The first is that the best time to start investing / saving is today, and the second is that starting small beats not starting at all. “The reality is that there will likely never be a comfortable time to start investing,” says Van der Walt. “But the discipline of committing a fixed amount every month to a long-term investment will secure a better financial situation for your clients and their families in the future”. South Africa’s collective investment schemes (CIS) industry is the perfect playground to practice investing and savings discipline with many funds taking minimum monthly investments of just R500. Those who can afford to should increase their monthly investment by inflation each year. Most importantly, they should remain invested for as long as possible.

Sit tight to prosper through market collapses

One of the interesting observations from Van der Walt’s compounding example is that investors who bought unit trusts and left them untouched earned significant annual returns between 2001 and 2021 despite three big market collapses. The power of compounding and time meant that the 2001 Dotcom Crash, 2009 Global Financial Crisis and 2020 COVID-19 pandemic hardly made a dent. “Investors who panicked at the time and sold their investments would have locked in those losses, while those who stayed benefitted not only from the recovery, but also the resulting compounding effect," he concludes. Both Cool and Van der Walt encouraged readers to attack the investing and savings dilemma with assistance from the financial advice community.

FA News | 17 May 2021

INTERNATIONAL NEWS

Ageing China boosts private sector role as pensions time bomb ticks

China is tweaking its $1.2 trillion pension system to increase private sector involvement as its population ages rapidly and underfunding looms, but experts say fundamental changes are needed to provide adequate safety nets.

The China Banking and Insurance Regulatory Commission (CBIRC), the country's top banking and insurance regulator, said at the weekend that it is expanding a pilot program of private pensions into two more regions - Chongqing and Zhejiang province.

And sources with direct knowledge of the matter told Reuters CBIRC is also considering endorsing a list of private pension funds and appointing a group of professional managers to run them under a new scheme.

The change comes days after China showed the extent of its demographic challenges, reporting that citizens aged 65 or older accounted for 13.5% of its 1.4 billion population in 2020, jumping from 8.87% a decade ago. Read more

China's pensions problem is grave. The Chinese Academy of Social Sciences (CASS), a state think-tank, said in 2019 that state-led coverage will peak at 6.99 trillion yuan ($1.09 trillion) in 2027, and may be exhausted by 2035.

That scenario, coupled with the 100 trillion yuan of banking and wealth management savings of its people, is enticing to the private sector. Foreign pension providers are also waiting in the wings to jump in as and when rules allow.

But after a tame start, the private pension sector would need higher investment returns and incentives like bigger waivers on capital gains tax to woo the average investor who typically relies on bank deposits and property investment returns to fund their retirement needs, say experts.

Another hurdle is China's huge informal sector where millions work without contracts and neither they nor their employers make pension contributions.

"The state-led coverage is facing challenges, and the expansion of corporate contributions to the pension system is limited by informal employment," said Dong Keyong, a professor at Tsinghua University, at a forum in Beijing this week.

"A third source, and only the third source (of private pensions), is the way out, and there's an urgency for us to further expand this pilot."

While the government and corporations are the main contributors to pension systems in developed countries, China's corporate contributions and private pensions were equal to 7.3% of its gross domestic product as of end-2018, versus 136% in the United States, according to data provided by Dong.

Most Chinese rely on state-led urban pension funds, which require employers to contribute the equivalent of 16% of their staff's basic salaries to the state pension fund each month, a ratio higher than many countries.

Former finance minister Lou Jiwei said last year that the state pension on average was only sustaining the retired with less than 50% of the income they earned before retirement, and that ratio was expected to go down further.

According to Tsinghua University professor Dong, the portion of citizens aged 65 and above will increase sharply, before stabilising at the ratio of about one-third of the total population.

The CBIRC did not immediately reply to a Reuters request on Thursday seeking comment.

'WRONG FOOT'

Some local insurance giants, including People's Insurance Company of China (601319.SS) and China Pacific Insurance Group (601601.SS), and some mutual fund houses have been selling commercial pension products, but they are short-term, lasting no more than a few years.

China Pacific Insurance Group also sold longer-term products packaged with property investments, which was better received.

Appointed insurers in the first private pension investment trial - in Shanghai, neighbouring Suzhou city and Fujian province - only lured some 400 million yuan in purchases over the past three years. That was just a fraction of China's current 8 trillion yuan pension system.

It "started off on the wrong foot," said Zheng Bingwen, an expert with CASS, in 2019, citing reasons such as insufficient policy incentives for individuals and sales agents.

In the longer term, the CBIRC is looking to boost private pension investments backed by China's 80 trillion yuan of banking deposits and 20 trillion of wealth management products.

"We should study and turn massive individual savings that do not have pension characteristics into long-term, secured, profitable pension products. I believe that's what we need to do, and that we already have the foundation of," CBIRC Vice Chairman Xiao Yuanqi told the Boao Forum in April.

($1 = 6.4382 Chinese yuan renminbi)

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Gig economy couriers should be eligible for a pension, says UK regulator

Companies including Deliveroo and Uber urged to recognise food couriers' employment rights

The head of the UK's pension regulator has called on gig economy companies to recognise the employment rights of those who work for them and set up workplace pensions.

Charles Counsell, the chief executive of the Pensions Regulator, said the government-backed body was already working closely with Uber on a workplace scheme after a supreme court ruling found the ride-hailing group's private-hire drivers should be classed as workers, with rights to minimum hourly pay, holiday pay and a pension.

At present, most couriers for companies operating in the gig economy, including Deliveroo and Uber's food courier business, UberEats, as well as most of Just Eat's couriers in the UK, are classed as self-employed contractors without key workplace benefits including a pension.

After the supreme court ruling, Uber agreed that its 70,000 UK private-hire drivers would be recognised as workers with minimum hourly pay and a pension.

"I am going to call on other organisations in the gig economy to start to recognise that the people who work for them are workers and should be eligible for a pension," Counsell told the regulator's TPR Talks podcast.

"It is all about helping people working in the economy to have a decent standard of living in retirement and I really encourage those in the gig economy to take a stance and start putting their workers into pensions. Let's not deal with this on a case-by-case basis," he said.

Counsell's stance was supported by Stephen Timms, the MP who chairs parliament's work and pensions select committee. Timms told the podcast that the influential committee would be launching an inquiry this autumn into how to help those in the gig economy save for retirement.

"I'm pleased that Uber is constructively implementing that decision [of the Supreme Court]," Timms said. "Others like Deliveroo ought to be doing the same."

He said that gig workers would see "significant benefits" from a change to worker status.

The GMB trade union said the comments by Counsell and Timms reflected an environment in which it was getting harder for the likes of Deliveroo to deny their couriers worker status.

Mick Rix, a national officer for the GMB, said: “Pensions are important to all working people. The more people in a pension scheme, the more comfortable and better off people will be in retirement.”

Alex Marshall, the president of the gig economy union, the Independent Workers Union of Great Britain, said workers should not have to battle to ensure that employment law was enforced. “The Uber ruling was resoundingly clear that these workers are owed their rights. This is a sector that thrives on exploiting loopholes. The ruling must be enforced immediately and be applied across the gig economy,” he said.

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