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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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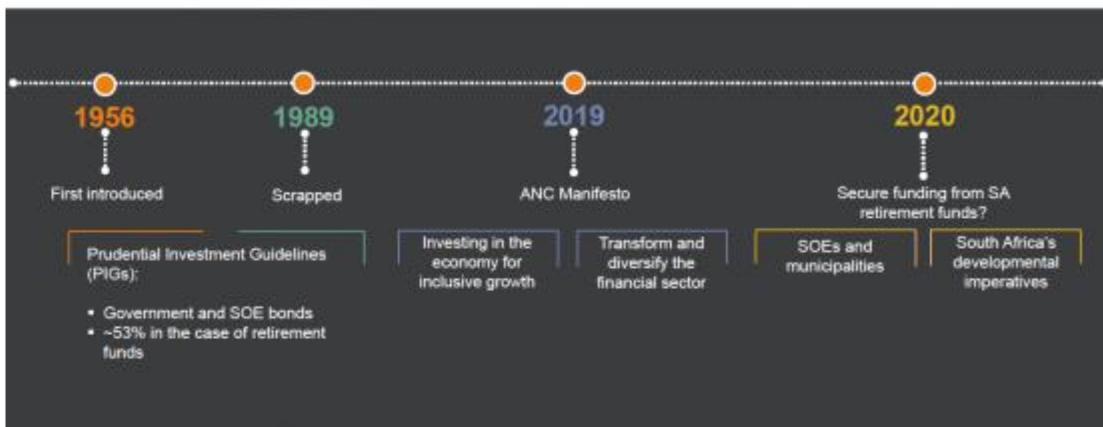
LOCAL NEWS

Prescribed assets is not the answer – Alexander Forbes

Government should rather consider impact investing.

The South African government should consider impact investing, rather than prescribed assets as a way to fund state-backed projects. This was the view backed by Alexander Forbes, in its 'A prescription to change investment focus: the role of alternative developmental investments in our economy' webinar, on Wednesday. Using prescribed assets – a regulatory mechanism where a government stipulates where pension funds must invest – as a means to drive its spending priorities is controversial.

It essentially amounts to the government mandating where and how pension money should be spent, with the returns on these investments coming second to the needs of the state. In recent years the ruling ANC has mooted adopting prescribed assets to fund its development agenda. If it did so, it would be adopting an Apartheid-era policy that has been criticized for depressing earnings for pension funds.



Alexander Forbes believes the government should instead back a policy like impact investing, where incentives and structures are put in place to improve social and economic well-being, and funders are free to pick and choose what they want to invest in. Head of investments consulting Janina Slawski said that there are several problems with the government pushing prescribed assets onto pension funds, such as limiting the number of investment propositions they can get involved in, as well as the increased risk of not meeting the need for higher returns. She said this could be seen effectively in the reduction in returns from the 1960s to the end of the 1980s, when the return on equities and inflation is taken into account for this period. (The Apartheid government instituted prescribed assets from 1956 to 1989.)

Prescribed assets | The opportunity costs

	Nominal returns			Opportunity costs	
	Equities	Prescribed assets	Inflation	Equities returns – Prescribed Assets returns = "Opportunity Cost"	Prescribed Assets returns - inflation = "Real Opportunity Cost"
1960s	11.3%	4.9%	3.0%	-6.4%	
1970s	24.5%	7.3%	11.3%	-17.2%	-4.0%
1980s	20.2%	13.5%	14.5%	-6.7%	-1%

Our history with prescribed assets has not been a good one

Source: Association for Savings & Investment SA (ASISA)

***Full Report:* https://www.moneyweb.co.za/investing/prescribed-assets-is-not-the-answer-alexander-forbes/**

Moneyweb | 6 August 2020

New tax bills impose stricter rules to take retirement funds abroad

The draft Taxation Laws Amendment Bill ("TLAB") was published on 31 July 2020 and with it comes an overhaul of the regime for taking your retirement funds abroad. In terms of the proposed amendments, expatriation of these benefits will be subject to a much stricter process from 1 March 2021 onwards.

Current position

Under the current dispensation, taxpayers may withdraw their retirement funds prior to their retirement date, upon emigration for exchange control purposes, where such emigration is recognised by the South African Reserve Bank ("financial emigration"). This concession is provided for in the respective definitions of "pension preservation fund", "provident preservation fund" and "retirement annuity fund" (collectively referred to as "retirement funds") in section 1 of the Income Tax Act No. 58 of 1962 ("the Act").

Each definition makes provision for withdrawal where a person *"is or was a resident who emigrated from the Republic and that emigration is recognised by the South African Reserve Bank for purposes of exchange control"*. The law in its current form has undergone several amendments, but in principle the concession was first introduced with the Taxation Laws Amendment Act No. 3 of 2008.

Taxpayers were warned

The amendment comes as no surprise, as government made its intentions clear in the February Budget Speech, per Annexure C to the Budget Review: *"As a result of the exchange control announcements in*

Annexure E, the concept of emigration as recognised by the Reserve Bank will be phased out. It is proposed that the trigger for individuals to withdraw these funds be reviewed". Now that day has come.

Proposed amendment

The Explanatory Memorandum to the TLAB echoes what was said in the February Budget, that the regime change arises as a result of the modernisation of the exchange control system. The Explanatory Memorandum further notes that *"a new test should be inserted which will make provision for payment of lump sum benefits when a member ceases to be a South African tax resident"*. The change is brought about by the amendment of the relevant definitions in section 1 of the Act, by the substitution of the reference to the emigration process with a new test which only allows withdrawal in respect of *"a person who is not a resident for an uninterrupted period of three years or longer"*.

This may seem like a complete deviation from the previous position, but where one studies the development of the current law in detail, it is evident that tax residency and the financial emigration process (if done under the correct circumstances) are inextricably linked. Arguably, this is revealed by the amendment, as the administrative process has now been stripped away, leaving only the fundamental element of tax residency.
Full Report: https://www.fanews.co.za/article/retirement/1357

FA News | 11 August 2020

When I'm Sixty-Four

Negotiating your retirement journey during Covid-19

When you hit retirement age, no one expects you to be your own doctor, mechanic or accountant. So why do so many of us assume that becoming a retiree automatically qualifies us to make the best decisions about the management of our retirement income? So asked Just CEO Deane Moore during a recent COVID-19 webinar hosted by 50plus Skills. "Managing an optimal investment portfolio that delivers a sustainable income and protects against inflation, for life, is no mean feat," says Moore, "especially when subject to the constraints faced by today's retirees."

While some pensioners may not be in formal employment, many are unable to reduce consumption due to basic needs. In common with most South Africans, resources in retirement may be limited, while tolerance for market risk is low. In support of these constraints, Lynda Smith, CEO of 50plus Skills, identified three macro trends that are impacting retirees in different ways; namely longevity, technology and COVID-19. "Studies show we are living 10 years longer than our parents' generation and double that of our grandparents.

The arrival of COVID-19 and rapid advancement of technology has forced many people of retiring age to shift into a much higher gear at a much faster pace than expected," she said. All things considered, how can

retirees ensure they have sufficient retirement funds to see them through their golden years? While the COVID-19 crisis initially provoked anxiety, Moore reaffirmed that a retiree's approach to retirement should remain the same, regardless of market conditions. When planning for retirement, he urged participants to think about their retirement savings in two parts – needs and wants. He then identified three sensible steps to follow in order to best manage and protect retirement income.

Step 1: Draw up a budget
Spend time detailing your needs (things like groceries, housing, rent, utilities, medical insurance, future frail care and transport) and your wants (travel, shopping, dining out, hobbies etc). If you can afford it, allocate a percentage of your 'wants' savings to leave a capital legacy for your spouse and/or dependents.

Step 2: Choose an appropriate retirement product for each pot
To cover your needs, a life annuity offers peace of mind by providing a guaranteed monthly income for life that will never decrease. You are also able to set a legacy benefit that pays a chosen income percentage to a nominated spouse and/or dependent in the event of you passing away. Different life annuity options offer varying levels of protection against inflation, including with-profit annuities, inflation-linked annuities and fixed-escalation annuities. To cover your wants, you may consider choosing your investments and annual drawdown in a living annuity. Carefully managed, living annuities allow flexibility and choice.

If you can draw less than 4% per annum from this type of vehicle, you should be able to sustain your income for life and perhaps leave further capital for beneficiaries. However, if you have to draw more than this, you must ensure that your needs are met by the life annuity, or else you may run out of money and become financially dependent of your loved ones in your final years. A blended annuity is a new product that combines a life annuity and living annuity in one place. Not only does it provide the certainty of a life annuity, it also gives you the flexibility of a living annuity and allows you to 'top up' the life annuity within the living annuity down the line, should your needs increase.

Step 3: Seek professional advice
Research states that roughly 95% of South Africans reach retirement without sufficient income to sustain their lifestyles. So, just as you would not expect to treat your own medical ailments at 60, it makes sense to seek the advice of a qualified financial adviser to help you understand your options within your individual context. They will consider how your retirement savings can best be used to meet your financial needs and offer advice in setting an investment strategy that makes sense in the context of your aspirations.

FA News | 6 August 2020

What to do when your client faces a bad versus 'less bad' financial outcome

There are still thousands of South African investors and savers who are trapped in legacy retirement annuities (RAs), unable to switch to something more appropriate for the 21st Century due to the punitive exit penalties built into the product by life insurers. To make matters worse, most of these products have produced dismal net returns, spanning decades. Savers are damned if they take the exit penalty on the chin to set off on a product replacement journey, and equally damned if they stay in the RA to its term. We thought to muse on the topic of RA replacements after commenting on a LinkedIn post that drew dozens of insights from irate annuitants, financial advisers, and CFP®s.

Committing financial suicide

Comments in the chain typically took the following form: My client, Mr X, has been invested in an RA offered by Insurer A. He has been contributing to the product for more than a decade and the fund value is approximately equal to the total contributions made over that time. Fees and charges on the RA run to as much as 6% per annum. To stay the course until retirement is akin to financial suicide; but if Mr X, through me as his adviser, initiates a product replacement via a section 14 transfer, Insurer A will demand an early termination fee of approximately 15% of the fund value. Does this sound familiar?

Many legacy RAs concluded in the late 1990s and early 2000s allow an insurer to take up to 30% of the accumulated capital upon the annuitants early exit, which they invariably do. Another solution, often touted by the life insurer, is to move the long-suffering annuitant into another product in its product stable. This amounts to a 'next best' outcome for the insurer who can trumpet a 'fair treatment of customers' and public relations victory by waiving the termination fee. In reality it retains the client in a new product, continues to generate servicing fees for the intended terms, and anyway keeps the early termination penalty 'on file' in the event the client wishes to exit pre-term.

A united stand against abuse

Many financial advisers have weighed in on the thread, with the common response being that advice professionals should take a united stand against this type of insurer-led abuse. "In an industry where clients should be at the centre of everything we do, how can insurers still get away with this?" asked one adviser. It is fair to single out life insurers for the fee-based products that they foisted on investors and savers all those years ago. It is also fair to criticise how they structured their distribution centres and incentives to contribute to yesterday's culture of churning and mis-selling; but there is another side to the coin.

The incentives offered by large life insurers to financial advisers in the form of commissions coupled with the book-building exercises that were commonplace in the early 2000s and beyond have caused significant harm to consumers, whether conducted legally or not. One or two advisers admit as much on the thread, saying that the advice process and incentive structures in place in the industry at the time were part of the problem. What outcome would you expect, for example, if a financial adviser is taking 3% up front and 1% ongoing

commission on a retirement saving product? A counter argument from incensed advisers is that most insurers will clawback adviser commissions upon early termination, the suggestion being that the insurer is double-dipping by punishing both annuitant and financial adviser.

Taking the hit, today

There are numerous other considerations that occur around the product replacement theme. For example, countless individuals who are stuck in poorly performing RAs are dissuaded from making additional retirement-funding contributions: Why pour good money after bad? “You would be foolish to increase your investment in a fund that fails, over decades, to beat inflation,” laments one commentator. From an advice perspective the consensus seems to opt for the ‘least bad’ outcome, with most of the comments on the LinkedIn thread suggesting that the client takes the hit on the early termination and set out on a new journey in a more suitable financial product. Of course, the decision will hinge entirely on an individual’s financial circumstances.

The Financial Sector Conduct Authority (FSCA) has been heavily involved in stamping out poor advice practices. It initiated the Retail Distribution Review (RDR) in 2014 and has, since then, been implementing its 50-plus proposals via frequent changes to the regulation. It addressed the highly charged issue of churning and replacement early on; but countless other improvements have since been made. Many remain concerned that the authority has not done enough to tackle issues that crop up at the coalface of product design, by making sure that insurers truly integrate the concept of treating customers fairly into their insurance and investment product offerings.

Time for a radical rethink

The preceding paragraphs merely reflect on the suitability of financial advice and legacy RAs at a point midway through 2020. There are other considerations too; such as whether the current regulatory environment still makes sense for South African retirement savers in the prevailing socioeconomic context. “We are starting to heavily debate the value of investing in retirement annuities in South Africa, even with the tax benefit,” mused one LinkedIn contributor. Regulation 28, introduced to prevent local savers from being overexposed to riskier assets, has become a drag on portfolio performance due to the shrinking South African equity market; the looming threat of prescribed assets; and the inability of investors to take appropriate offshore positions in their portfolios, among other challenges.

FA News | 4 Aug 2020

Eskom pact won't include pledge to use state worker pensions

As had been initially proposed.

A pact between South Africa's government, labor unions and business to cut the debt of the stricken national power utility won't include a pledge to use the pensions of state workers as had been initially proposed. An agreement due to be signed at the next meeting of the President's Working Council has no firm undertaking to use the funds of the R2.1 trillion Public Investment Corp, which manages state workers' retirement money, or private pensions, said Cas Coovadia, the chief executive officer of lobby group Business Unity South Africa. Coovadia spoke in an online briefing with Bloomberg.

The Congress of South African Trade Unions proposed in December that funds from the PIC and the Development Bank of Southern Africa, a state lender, be used to cut Eskom Holdings's debt to about R200 billion. The utility currently has a debt burden of about R480 billion and is struggling to meet its costs. "We just said all possible public and private financial support for Eskom and to reduce its debt must be mobilised," said Matthew Parks, parliamentary coordinator of Cosatu, which is a member of the country's ruling coalition. "We kept it high level."

A date for the meeting where the accord will be signed hasn't been set. It was due to take place on August 3 but was delayed. Cosatu's initial proposal raised concerns that pension funds could be forced to invest in Eskom through the use of so-called prescribed assets. Business leaders, including Coovadia, have said while private investors are willing to invest in state companies and infrastructure, they don't want to be compelled or directed to, and must earn an acceptable return on investment.

Moneyweb | 7 August 2020

Sygnia launches health innovation fund

SA investors will have exposure to the global healthcare industry and Oxford Sciences Innovation.

Sygnia Asset Management has had notable success over the past few years with its thematic offerings. The first was the Sygnia 4th Industrial Revolution Global Equity fund, launched in 2016, followed by the Sygnia FAANG Plus Equity fund in 2018. Last year, it added the Sygnia Oxford Sciences Innovation fund, which provides access to shares of Oxford Sciences Innovation Plc, to its range. 'These funds have done exceedingly well, and are the fastest growing Sygnia funds,' said CEO of the Sygnia Group Magda Wierzycka.

Its latest product, she added, is 'a natural follow on'.

Launch
On Wednesday the firm launched the Sygnia Health Innovation Global Equity fund, which provides South African investors with exposure to the global healthcare industry. This is a sector that has enjoyed particular prominence due to the Covid-19 pandemic. 'The idea for the fund came about some time ago and it's a fund we would have launched anyway, but Covid-19 has accelerated trends in the market,' said Wierzycka. 'Investors in South Africa don't have a lot of opportunity to invest in this sector, and the pandemic has accelerated the need for this kind of investing.'

She emphasised that healthcare has established itself as of the most innovative global sectors. This includes advances in areas such as 3D printing of human tissue, genetic sequencing and virtual reality tools that allow surgeons to practice and perfect intricate surgeries. This fund therefore builds on Sygnia's focus on disruption and new technologies.

Portfolio
The fund does not track an index, but it is a rules-based portfolio. 'It only considers developed market equities, and those that are categorised as healthcare companies according to the Global Industry Classification Standard,' said portfolio manager Monique Davidson. 'We identify the top 150 companies based on free float-adjusted market capitalisation, and then run all those eligible companies through an ESG (environmental, social and governance) screen.' This process filters out companies that do not meet a required ESG threshold. The remainder are added to the portfolio, and weighted according to their free float-adjusted market capitalisation. 'So it's a similar process to how an index would be constructed,' said Davidson. ***Full Report: https://www.moneyweb.co.za/news/companies-and-deals/sygnia-launches-health-innovation-fund/***

Moneyweb | 6 August 2020

Preservation funds: Your questions answered

It is important to understand exactly how preservation funds work.

If you've recently been retrenched or lost your job, you may be contemplating moving your retirement fund benefits into a preservation fund. However, before doing so, it is important to understand exactly how preservation funds work.

What is a preservation fund?
A preservation fund is a retirement fund and, as such, falls within the auspices of the Pension Funds Act and the Income Tax Act. The primary purpose of a preservation fund is to house and preserve the proceeds of a pension or provident fund where a person has been retrenched or dismissed, or where he has resigned from his employ. Proceeds transferred from a pension fund must be transferred to a pension preservation fund, while proceeds from a provident fund must be transferred to a provident preservation fund. It is not possible

to withdraw a portion of your retirement fund and invest the balance into a preservation fund. In other words, if you choose to preserve your capital you are required to transfer the full amount into a preservation fund.

What are the tax implications of transferring to a preservation fund?

If you move your retirement benefit from a pension or provident fund directly into a preservation fund, there will be no tax consequences, making preservation funds tax-effective investment vehicles. Further, you will not be taxed on the investment returns achieved in the preservation fund. Also, funds invested in a preservation fund fall outside of your estate and are therefore exempt from estate duty. You will only be taxed if you withdraw from your preservation fund, with the first R500 000 being tax-free.

Can I make additional contributions to my preservation fund?

No, you cannot make any additional contributions to your preservation fund once you have set it up which means that your investment will only grow in line with its net investment return. Your preservation fund can only receive direct payments from another approved retirement fund. Choosing the most appropriate investment strategy for your investment horizon is therefore of the utmost importance.

Can I withdraw from my preservation fund?

Yes, you are permitted to make one full or partial withdrawal from your preservation fund before the age of 55, which is generally the retirement age for most preservation funds.

Can I split my retirement benefits between multiple preservation funds?

You are not able to split the proceeds from a single pension or provident fund across multiple preservation funds. However, you are permitted to invest the proceeds of different pension or provident funds across different preservation funds, although bear in mind that the tax-free portion on withdrawal will be calculated as a cumulative total across all your preservation funds.

Do I have to transfer my retirement benefits to a preservation fund?

No, you also have the option of transferring your retirement benefits tax-free to a retirement annuity. However, bear in mind that you cannot access funds housed in a retirement annuity (RA) before age 55. As in the case of a preservation fund, no tax is paid on the investment returns achieved in your RA and the proceeds of your RA do not fall into your deceased estate and therefore do not attract estate duty.

Can I transfer my preservation fund to another preservation fund?

Yes, you are permitted to transfer your preservation fund to another preservation without incurring tax. You are also permitted to transfer it to a retirement annuity or to your employer's retirement fund without paying tax. ***Full Report:*** ***https://www.moneyweb.co.za/financial-advisor-views/preservation-funds-your-questions-answered/***

Moneyweb | 6 August 2020

INTERNATIONAL NEWS

How UK state pension age compares to retirement ages in other countries around the world

STATE PENSION age must be reached in the UK in order to get the state pension age, although that's not to say there's a set retirement age anymore. A new analysis has compared the current UK state pension age to other countries around the world.

Men and women in the Netherlands and in South Korea work longer than adults in any other country, according to new research. The analysis by personal finance experts TheMoneyPig.com compared 41 countries around the globe to find the age for retirement. In the Netherlands, people work until they 68, the comparison found, while men and women work until they're 68 and 67 for men and women respectively in South Korea. Meanwhile, Norway, Italy, Israel, Iceland and Greece all have the age of retirement set at 67 years old.

In Europe in particular, it seems many countries retire at around 65 to 66 years old. Currently, that includes the UK, although changes to the state pension age mean it's set to rise over the coming years. Elsewhere in the world, other places with a retirement age of 65 include New Zealand, Mexico, Jamaica, Hong Kong, Canada and Brazil. And, in China, Japan and Thailand, the age is 60 years old. So, which country ranked as having the lowest retirement age in the analysis?

The answer is the United Arab Emirates with Emiratis able to retire at just 49-years-old. However, that's not the case for expats, who would face retiring at 65 years, the personal finance website said. In the UK, state pension age is now the same for both men and women - something which has been the case since November 2018, following changes to the state pension age for women. However, across the world, there is still some discrepancy between the ages men and women can retire. Women are able to retire at a younger age, for instance, in China, Qatar, Turkey, Russia, the Czech republic, Austria, Brazil, Gibraltar, Jamaica, Poland, Switzerland, Israel and South Korea.

A spokesperson for TheMoneyPig.com said: “Retirement ages differ slightly around the world but not massively. "Looking at the data it would be fair to say that mid 60s is around the average age for retirement. “What is important wherever you live, is to plan for your retirement so you can enjoy it without the financial concerns it can bring. “It’s important to think about this early and to be realistic on just how much money you need, how much you can afford to pay in now and if there are ways you can boost your pension pot."

Full Report: ***https://www.express.co.uk/finance/personalfinance/1321157/state-pension-uk-age-changes-world-comparison***

Express | 12 August 2020

California pension funds weighing impact of ruling

Pension plans around the state are evaluating the impact of the recent California Supreme Court decision that relaxed the so-called California rule. Industry sources said the ruling gives employers and states a little more wiggle room to close loopholes. In its July 30 opinion, the court ruled against plaintiffs' argument that the state's pension reform legislation, a law designed to eliminate so-called pension spiking, violated the contract clause of the constitution.

"We believe the court's decision provides clarity and guidance for LACERA and other public pension plans," said Steven P. Rice, chief counsel at the $58 billion Los Angeles County Employees Retirement Association, Pasadena. However, LACERA officials do not foresee the California Supreme Court's decision in the case having an impact on LACERA's retirement plans. The pay items that were addressed by the decision were never considered pensionable by the LACERA board of retirement, Mr. Rice said.

The $16.2 billion Orange County Employees' Retirement System, Santa Ana, did have some pay items that were banned as pension spiking by the pension reform at issue in the case, according to a written statement. "The OCERS board has not taken any action to exclude the pay items in controversy, but rather continue with the conditional inclusion of such pay items," OCERS said. Pension fund officials will provide updates regarding the impact of the latest case to its participating employers and members as soon as possible, it said. Robert Kinsler, OCERS spokesman, declined comment beyond the written statement.

Pensions & Investments| 10 August 2020

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