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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

Hands off my pension

The debate has shifted to whether pension fund assets can be used more effectively to support economic growth

In recent commentary the ANC's head of Economic Transformation, Enoch Godongwana has made it clear that the party is moving away from the term 'prescribed assets' as economic policy and to rather focus the conversation (and potential policy changes) on finding ways to unlock South Africa's pensions to assist with the country's infrastructure goals. The issue of prescribed assets started gaining traction after the ANC's 2019 election manifesto, which tabled the introduction of prescribed assets on financial institution funds for social productive investments including: housing, infrastructure for social and economic development and the development of townships and the village economy.

The current debate has now shifted to whether pension fund assets can be used more effectively to support economic growth and provide much needed funding for economic development, without prescription i.e. "should Regulation 28 of the Pension Funds Act have a minimum allocation to infrastructure" to "does Regulation 28 allow sufficient flexibility to invest in infrastructure?"

Regulation 28

As Regulation 28 remains central to the debate it is important to gain a better understanding of its influence, objectives, and current parameters. Regulation 28 applies to pension funds, provident funds, retirement annuities and preservation funds. Thus, the impact and reach are significantly broader than the "pension fund" industry and in some way impacts most savers and investors. Regulation 28 provides guidance of where pension fund managers, investors, and asset managers should invest their retirement savings. Most retirement savings are invested in balanced funds where the pension fund and asset manager has to ensure adherence to Regulation 28.

The primary objective of Regulation 28 is to manage investment risk and ensure investors do not take undue risk with their retirement savings. This is achieved through providing investment maximums to manage investment risk. Some of these broad parameters include a maximum of 75% invested in shares; a maximum of 25% in property and a maximum 30% invested in international assets (excluding Africa). Each one of these broader categories are then broken down further limiting the exposure to i.e. any share or exposure per debt instrument.

Unlisted infrastructure trends

Regulation 28 currently allows investment into infrastructure; these investments are most often structured as private equity funds and as such between 10% and 2.5% can be invested in infrastructure-related

investments (this does depend on the underlying legal structure). Currently South African pension funds invest +/- 1% into unlisted infrastructure. At face value South African pension funds and asset managers are significantly under invested in infrastructure. However, a 2019 survey by the OECD provides some more insight into the allocation of large global pension funds to infrastructure. Even though the allocation to alternatives has continued to grow globally (now at 14.4%) there has only been a marginal increase to unlisted infrastructure during recent years, from 1.8% to 2% in the most recent survey.

The reason for this lower allocation can certainly not be attributed to performance. A number of South African- and global Asset managers have established infrastructure funds, investing into a range of opportunities including renewable energy, housing, village “developments”, education, roads rail and ports and also venture into areas such as agriculture. Some of these have now established exceptional track records over the last 10 years. In order to invest more in the “real” economy and directly into infrastructure projects, the challenge is not the current limits of Regulation 28 or the availability of opportunities but rather the structure of the pension funds and also the structure of the underlying alternative (infrastructure) investment opportunities.

The following are some of the structural challenges in allocating more pension fund assets to infrastructure:

- Pension funds require liquidity.
- Pension funds require liquidity to provide regular member pay-outs and claims. Private equity and infrastructure related investments traditionally have a very long-term time frame 7 to 10 years with limited liquidity during the period.
- The SA market is still relatively concentrated.
- Even though some asset managers have ventured into this market, the investable universe is still relatively small limiting the available opportunities. This increases risk and makes it difficult to implement a diversified strategy.
- The retail market can’t access infrastructure opportunities The retail market can only access debt (or bonds) associated with infrastructure projects as they require daily liquidity.

In order to allocate more pension fund capital to infrastructure, the real issue is not the regulation, but rather finding innovative structural solutions and investment opportunities to allow pension money to flow into infrastructure investments. Pension fund managers, principle officers and trustees of pension funds (including pension funds, provident funds, retirement annuities and preservation funds) have a fiduciary responsibility to manage pension assets on behalf of members and to appropriately manage the risk within the fund. In a constitutional democracy it seems inconceivable that these fiduciary obligations will be infringed upon. I suspect we will see more public–private partnership collaboration and the development and deepening of the industry to broaden the infrastructure opportunity set available to pension investors.

Moneyweb | 24 September 2020

About to retire? Your first few years of retirement are critical

Your salaried years may be over, and your retirement contributions may have stopped, but that doesn't mean you should forego your savings mindset. After all, it could be critical to successful retirement planning.

Start retirement sustainably

As you approach retirement, speak to your financial adviser about the amount you've saved compared to the amount you'll need to live on in retirement. Then, make decisions around your retirement budgeting accordingly – you may need to cut back on your pre-retirement expenses, or consider a part-time job in your early retirement years. It's critical to have sight of this early into your retirement, so that you can put a sustainable plan in place. "If you've applied yourself diligently towards your savings, and you want longevity out of your retirement capital, then 25% of your retirement capital should give you an income at least in the short to medium term," says Kiru Padayachee, Business Development Manager at Glacier by Sanlam.

He also highlights longevity risk – the risk that an investor, who is drawing down an income from their savings, outlives their capital; and sequence risk – the risk that the timing of withdrawals from retirement savings will have a negative impact on the overall effective rate of return – as factors worth considering. Speak to your financial planner about how to ensure your withdrawals are appropriate to manage these risks. How you save and spend in your first few years of retirement will set you up for financial habits that will help ensure longevity into your retirement.

Apply the 4% rule

You've spent years planning for retirement carefully – now it's important to manage your retirement income withdrawals so that your hard work pays off for the duration of your retirement. The 4% withdrawal rule is the guiding benchmark that's used globally by pension funds, says Kiru. By withdrawing 4% of your capital per year in the first few years of retirement, you should leave enough of it to continue to grow, ensuring its longevity.

For example:

Retirement capital	R1 000 000
4% of capital	R40 000/year withdrawal for the first 10 years

With this formula, you'd be able to set yourself up for the next 25 years. "The 4% rule is within the inflation target. If you can live with what you earn, adjusted for inflation on an ongoing basis, then you shouldn't run out of capital," says Padayachee. Lower capital means higher percentage withdrawals to maintain your standard of living, which won't sustain you for long, especially since it isn't geared to keep up with inflation. "With the 4% rule, the general premise is that with a 50% equity portfolio and 50% bond/cash portfolio, you, as a retiree, should have at least 25 years of income," continues Padayachee.

Be intentional about eliminating debt (and avoiding new debt)

Do this so your retirement income isn't encumbered by outstanding debt, like student loans, cars and houses, in your golden years. A guide, suggests Padayachee, is to reduce your total debt by paying it off in set increments for each year leading up to your retirement. For example, if you have R20 000 in debt, aim to reduce your debt by R5 000 each year in the four years leading up to your retirement, so that by the time you retire, your debt balance is zero.

Once you're in or nearing retirement, reducing debt becomes increasingly critical – and taking on new debt is to be cautioned against. Ideally, your retirement income should go towards living expenses rather than servicing debt costs. Speak to your financial adviser about how to speed up any debt repayments owed, and the impact this may have on your retirement income.

Draw up a retirement budget

This is an essential tool for helping you plan for the next chapter of your financial life. It links back to your desired lifestyle in retirement. It won't miraculously snap into place; it'll involve a budget adjusted for the income you'll receive after you've stopped earning a salary, and hopefully no need to service debt that you would've settled by the time you retire. Critically – and perhaps most uncomfortably – your budget will likely need to decrease into your retirement, since not many of us are able to increase our income from when we were earning into our retirements. The sooner you can plan what this looks like and make the adjustments, the better – and the more likely you'll be able to enter retirement comfortable that your income will be sustainable.

Discuss your retirement planning with a financial adviser

Put retirement planning on the agenda for your next meeting with your financial adviser to get a clear understanding of what you'd be able to afford in your retirement. Your pre-retirement savings efforts are only part of the puzzle; ask your financial planner about post-retirement solutions that are best suited to your needs.

Explore your post-retirement options

Depending on your wealth bracket, there are various options available to you for sustaining your retirement income.

If you're a middle- to high-net-worth retiree

A living annuity gives you market exposure, which means, depending on its composition, it'll be invested in funds, whether it's unit trust funds, shares, exchange-traded funds or index funds. "If you have too little retirement capital, then this is not the vehicle to be in because of the uncertainty of the way that it will earn its returns," says Kiru. Needless to say, the financial management of this solution is critical.

Withdrawals: 2.5-17.5% per annum

Frequency of payout: monthly, quarterly, six-monthly or annually

Upon death: money is available to beneficiaries, either as capital or as an annuity, so whatever is left in the living annuity.

If you're a middle- to lower-net-worth retiree

Life annuities offer the certainty of a fixed monthly income, with no exposure to markets. This eliminates the pressure on you, the annuitant – but because the rate applies for as long as you are alive, you can't benefit from market movements, or any increase in the interest rate.

Withdrawals: set rate per month for the rest of life

Frequency of payout: monthly

Upon death: the capital is not available to beneficiaries other than a spouse who may have been selected as an income beneficiary for the annuity to continue.

If you're somewhere in the middle

Some life insurers offer hybrid options, which combine features of living and life annuities in a single product.

Personal Finance | 22 September 2020

'De bloedige hand' principle and its application in section 37c pension fund distributions

The Pretoria High Court has refused to extend the 'bloedige hand' principle in instances where the beneficiary of a death benefit was the child of the deceased's killer. The 'bloedige hand' principle holds that no person who unlawfully causes the death of another may inherit from the deceased. The deceased and his wife were killed by the deceased's stepdaughter (Bonolo). The stepdaughter had a minor child who was living with and dependent on the deceased and his wife. The deceased had nominated his mother and his wife as beneficiaries to his pension benefit upon his death and in the event that his mother died before him, he nominated his wife as the only beneficiary.

Notwithstanding that Bonolo was instrumental in the murder of the deceased and his wife, the pension fund awarded the entire pension benefit to Bonolo's child in terms of section 37C of the Pension Funds Act 1956. The deceased's siblings contested this by filing a complaint with the pension funds adjudicator. The adjudicator set aside the pension fund's award and ordered a re-investigation of the allocation. The pension fund conducted the investigation and declared that the siblings were not dependants of the deceased and this decision was confirmed by the adjudicator.

The deceased's siblings launched an application to review the decision of the pension fund adjudicator relying on the principle that '*de bloedige hand neem geen erfenis*'. The reasoning of the applicants was that, since the child's mother was precluded from receiving a benefit based on the 'bloedige hand' principle, her child was equally not entitled to benefit and the common law ought to be extended. The court disagreed for the following reasons:

- The '*bloedige hand*' principle does not extend down the bloodline to exclude anyone other than the '*bloedige hand*' from receiving the benefit;
- The trustees of the pension fund correctly distributed the deceased's pension benefit in accordance with section 37C of the Pension Funds Act by establishing factual dependence on the deceased notwithstanding that there was no biological link between the deceased and the child; and
- The trustees correctly compared the child's position with that of the deceased's siblings and established that the siblings are not indigent and their need was premised on what could be categorised as speculative future contingencies.

The judgment aligns with the position that only a wrongdoer should be prejudiced by his or her actions. The order sought by the siblings in this instance would have been to the detriment of the child despite him being innocent.

FA News | 23 September 2020

INTERNATIONAL NEWS

Coronavirus threatens Europe's pension industry

Call for savers to be protected as rising unemployment and low interest rates inflict damage

The coronavirus pandemic has dealt a blow to pension systems across Europe, heaping pressure on policymakers to introduce reforms to avoid a decades-long retirement crisis, according to an influential consumer group .Big increases in unemployment will shrink the tax revenues used to fund state pensions and reduce contributions to retirement saving schemes run by employers and individuals. At the same time, cuts to interest rates and new government-backed bond-buying programmes have reduced the income pension funds earn from their fixed-income investments. Guillaume Prache, managing director of Better Finance, which represents European savers, said that economic headwinds and the emergency measures taken by governments in response to the pandemic represented "the perfect mix" to destroy the long-term value of pension savings.

"Governments have explicitly chosen to sacrifice the protection of pension savers in favour of the artificial reduction of EU member states' debt costs by granting unprecedented subsidies in the form of negative interest rates and massive public debt purchases," said Mr Prache. Even before Covid-19, savers faced challenges generating enough income for their retirement. Better Finance examined private pensions data from 18 European countries for up to 20 years and found that a 50:50 equity/bond tracker fund has outperformed the vast majority of pension products, with high fees reducing returns for savers. While Dutch Pillar II pension plans, occupational pension schemes that employers and employees both pay into, delivered annualised returns of 5.5 per cent after fees and inflation over the decade ending in 2019,

equivalent plans in other countries failed to match this. Voluntary privately funded pension plans, known as Pillar III schemes, delivered net annual real returns of just 1.3 per cent in France, 1.6 per cent in Germany and 2 per cent in Italy over the latest 10-year period available. Returns generally improved strongly in 2019 due to buoyant equity and bond markets but some of those gains have been eroded this year. Wide variations in the performance of pension savings schemes across countries are a concern to EU policymakers. Better Finance urged regulators to impose standardised disclosures of pension funds' past performance data to make it easier for savers to compare products. It also called for the EU to protect retirement savers if insurance companies, which are key providers of pension products, go bust.

Mr Prache added that it was "disappointing" that the European Commission had not acted to curb the payment of financial inducements to advisers, which Better Finance said created conflicts of interest and encouraged the sale of unsuitable and expensive pension products. The call from Better Finance comes as concerns mount that rising unemployment will prompt older workers to raid their pension savings early. "Spending pension savings now means that money will not be available for later life and there could be consequences during retirement," said Alistair Byrne, head of retirement strategy for Europe at State Street Global Advisors.

"People need to be conscious about the contribution gap in their pension savings and the impact that will have on their retirement. "Mr Byrne cautioned that low interest rates would also increase funding strains on companies that offered defined benefit schemes where pension benefits were linked to salaries while in employment. "Liabilities for DB schemes are increasing. The problems caused by coronavirus could result in more companies finding themselves less able or less willing to support their DB scheme," he said.

Financial Times | 28 September 2020

Canada's pension fund plans to invest a third of funds in emerging markets by 2025. India is a major component

SINGAPORE — Canada's massive pension fund plans to invest up to a third of its funds in emerging markets over the next five years and India is an important destination, according to a senior executive. The Canada Pension Plan Investment Board (CPPIB) manages about 434.4 billion Canadian dollars ($329.75 billion) as of June 30. A bulk of its investments are in North America — around 34% of total assets are allocated in the United States — followed by Asia. "We expect to invest up to one third of the Fund in emerging markets by 2025 and India is a key component of that," Suyi Kim, CPPIB's Asia Pacific head, told CNBC by email.

"Our investments in India span different asset classes including infrastructure, real estate, public and private equities, funds and co-investments and credit," Kim said, adding, "We see domestic consumption, technology and increasing demand for infrastructure to support the growth underpinning many of the

themes and opportunities we look at in India. ”CEO Mark Machin recently told CNBC that the pension fund was reviewing its bond holdings in light of near zero interest rates. CPPIB has an office in India. Some of its investments there include a stake in Kotak Mahindra Bank as well as $225 million to the India Resurgence Fund, which invests in distressed assets in the country. In December, CPPIB said it agreed to invest up to $600 million in India’s National Investment and Infrastructure Fund that included a $150 million commitment in NIIF’s Master Fund and co-investment rights of up to $450 million in future opportunities.

India’s growth issues

The growth rate of South Asia’s largest economy took a hit over the last few years following important currency and tax reforms that were said to have disproportionately affected small businesses and people in the informal sector. The coronavirus pandemic this year dashed early signs of recovery as India went into a nationwide lockdown between late-March and May as part of its efforts to slow the infection’s spread. Still, India is now the second most-affected country in the world behind the United States, with more than 5.9 million reported cases and over 94,000 deaths.

Growth for the three months from April to June fell 23.9%.

The financial sector — already in crisis for several years — faces an erosion of loan growth and higher credit costs as it prepares for a rise in bad debt from retail and corporate borrowers. Experts previously told CNBC that if the sector decides to stop lending to borrowers with low credit scores, or charge them a much higher interest on loans, it could delay India’s economic recovery. “The ongoing credit issues in the financial services industry, which have been exacerbated by the pandemic’s impact on the economy, also present interesting investment opportunities to provide long-term, stable capital to select financial institutions and companies to finance India’s next growth cycle,” CPPIB’s Kim said.

Last week, ratings agency S&P Global said India’s banking sector, which entered the pandemic with an overhang of nonperforming assets, will see a slow recovery to pre-Covid levels that could stretch beyond 2023. “We have taken negative rating actions on Indian banks and (non-banking financial institutions) as operating conditions have deteriorated through the crisis,” S&P Global said in a report, “Global Banking: Recovery Will Stretch To 2023 And Beyond.”

“The Indian banking sector is considered a late-exiter. Its recovery will be longer, but some ratios may return more quickly to pre-COVID-19 levels as they were weak prior to the onset of COVID-19 (in contrast with many other jurisdictions),” the ratings agency said. CPPIB’s Kim said that beyond India, the Canadian pension fund sees investment opportunities in Greater China, South Korea, Japan and Australia.

CNBC News | 27 September 2020

OUT OF INTEREST

72% of South African women are living in 'survival mode'

An online survey of South African women conducted by Sanlam has found that 72% consider themselves to be living in ‘survival mode’. This means that the surveyed women find it challenging to focus on the long-term, particularly planning their finances, given the focus on daily needs. Could there be a way for women to rebound from survival mode and navigate the challenges they are facing?

The study also found that:

- Six in 10 women’s income has reduced due to the pandemic
- Four in 10 women have already adopted money conscious behaviours in response to the reduction in their income
- Five in 10 women were spending significantly more on food and other expenses than before lockdown

The survey was conducted by Sanlam and had a sample size of over 2 000 women across South Africa. Findings echo a recent United Nations Development Programme (UNDP) socio-economic study, which talks to household financial vulnerability and found that 34% of middle class South African households were likely to drop below the poverty line as a result of Covid-19. Kenosi Magosha, Head: Client Solutions Savings says individuals rebounding from the pandemic, particularly how women’s personal economies rebound, is a key part of helping the economy and individuals get back on their feet as research has shown.

“One of the important tools in coming out of survival mode is access to financial advice and savings. Our study showed that only two in every 10 women have a financial adviser. This means women are not tapping into financial expertise when it comes to their financial planning in the short-, medium- and long-term which impacts on financial health and resilience.” Survey results also showed that women were 3 times more likely to consider themselves to be in survival mode when they didn’t have access to financial advice.

Magosha notes, “This is compared with only 1.3 times for women who do have access to financial advice. We believe this shows that advice can help women rebound and close the gap on financial resilience.” Magosha offers some tips for women trying to practically rebound and plan their way out of survival mode when it comes to their finances:

1. Adopt zero based budgeting

For anyone who has reduced income, taking a bottom up approach to budgeting that looks at spending priorities is critical. Magosha explains, “Zero-based budgeting is a way of budgeting where you start from zero, rather than tweaking an existing budget when reviewing spending priorities. One needs to ask, “what

should I spend on that can enable me to make progress and enable financial resilience?" "When doing this exercise, do not neglect how to invest in self-development to access opportunities or start side hustles to diversify your income. The UNDP report and other research also highlighted how this can help reduce the chances of falling into poverty."

2. Engage a professional financial adviser to set up a rebound plan

A rebound plan will allow you to start building up emergency savings which are a vital part of financial resilience. This is particularly important for the four in 10 women surveyed who are currently not able to save at all. The rebound plan will ensure that they can become financially resilient and avoid the debt trap. Magosha explains that with the help of a financial adviser, we can shift focus from the short to long term and give attention to savings for enabling our future.

This will include saving for retirement and education, which ensures our future and opportunities for the next generation are secured, a very important aspect of long-term financial resilience. "Working with an adviser can also help ensure that protection is in place in the form of insurance to ensure that gains made when rebounding are not lost should unexpected events happen." A financial adviser will also help with managing debt carefully by working out a debt repayment plan and critically evaluating whether additional debt being considered aligns with the rebound plan.

3. Don't neglect your holistic health

When working on recovering from a set-back, it is important that women don't neglect their holistic health - mental, emotional and spiritual. "If someone is not in a strong state of mind, it can quickly derail any progress in the sphere of financial health", explains Magosha. ***https://www.iol.co.za/personal-finance/debt/72-of-south-african-women-are-living-in-survival-mode-0b0edfee-ca46-427c-9427-dea46ca4180f***

Personal Finance | 21 September 2020

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