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Institute of Retirement Funds Africa

THE RETIREMENT INDUSTRY NEWSLETTER

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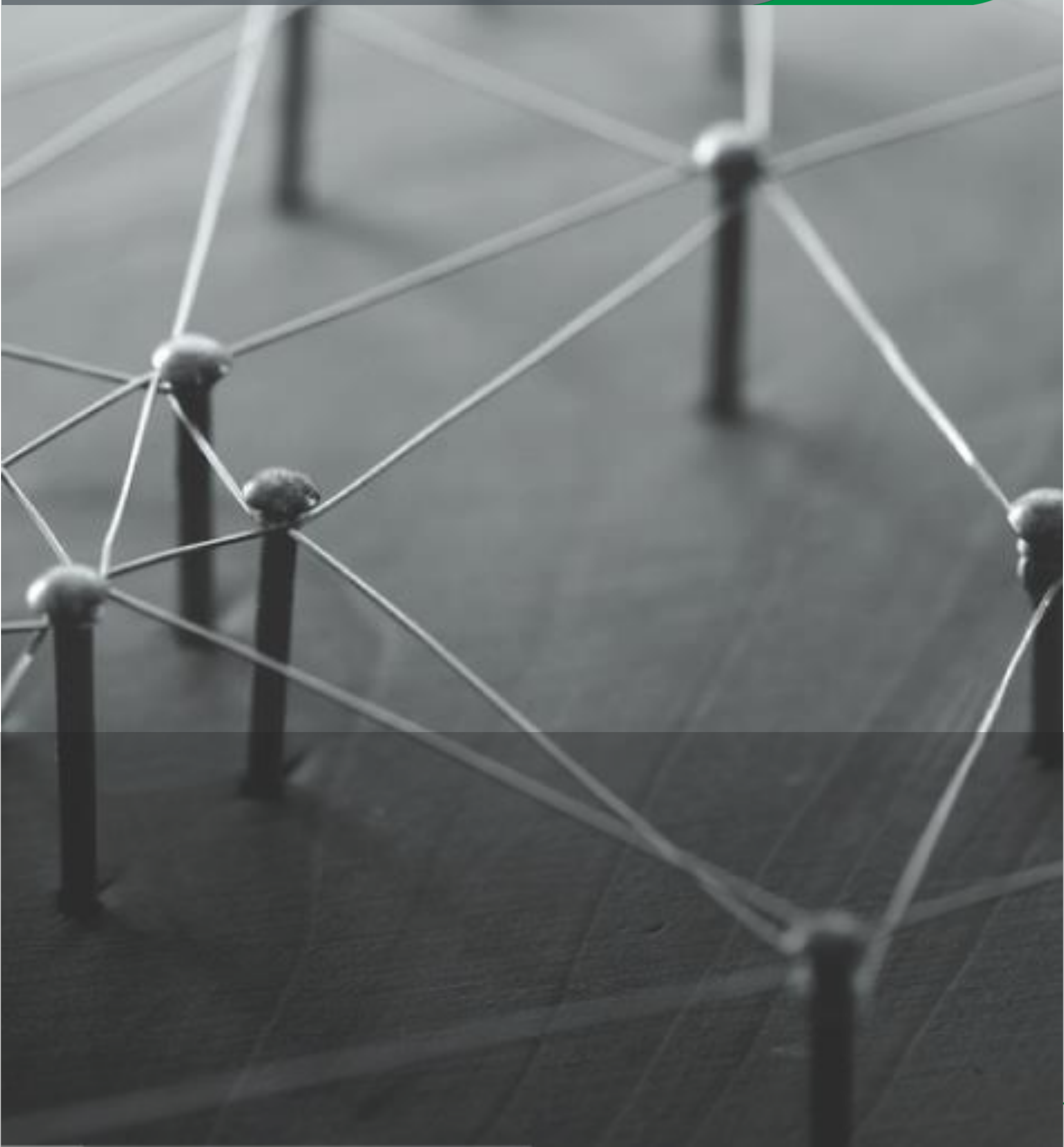

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Pension fund or endowment: Which is the better tax option?

Two advisors answer this reader's question

I have approximately R4 million in after-tax savings. I'm considering either adding this amount to my existing pension fund, which currently holds R12 million, or starting a new endowment policy. I am already contributing to my pension fund above the annual R350 000 threshold. At 50 years old, still employed, and earning in the 45% tax bracket, which option would be better from a tax perspective?

Dear reader,

Thank you for your question.

Let's consider your current situation: You have R12 million in an existing pension fund and still contribute more than R350 000 per year, R4 million in free reserves, pay tax at the highest rate (45%), and are only 50 years old. You are in a very enviable position. Well done!

Your decision on how to apply the R4 million will hinge on three questions:

1. At what age do you intend to retire?
2. What do you anticipate your tax rate will be when you retire?
3. How much in free reserves (unconstrained funds) will you have at retirement age?

When considering my response to your question, I must make some assumptions about the above questions. Since you did not mention any current outstanding debt, I will assume that I can ignore it and that you are debt-free. If you have debt, it makes sense to settle outstanding "bad" debt, such as credit cards, before investing. Leases or any other debt where you cannot claim the interest from tax, such as rental property, should also be settled before investing.

Looking at the pros and cons

Let's turn back the clock and consider the pros and cons of the products you are considering. I include a table for unconstrained funds like unit trusts, exchange-traded funds (ETFs) and so on.

Feature	Retirement fund (Corporate fund or RA) to living annuity	Endowment	Unconstrained funds (Unit trusts, ETF, shares, etc.)
Tax deductibility of contribution	Up to 27.5%, max R350 000 p.a.	Nil	Nil

Tax payable on taxable returns	Nil	30% on interest and CGT within product	At marginal rate. CGT in own name
Tax payable on income	Yes, per Sars income tax tables	Interest and rental income, taxed within product	Interest and rental income taxed at marginal rate
Liquidity	One-third cash at retirement. Balance to purchase an annuity	Restrictions apply in first five years	No restriction. Can be traded freely
Protection	Protected from creditors	Protected from creditors after three years	No protection
Estate impact	Excluded from estate	Included in estate. No executor fee if beneficiary nominated	Included in estate
Transferability	Trustees decide on distribution at death	Beneficiary nomination possible	Distributed according to your will

From the above, it becomes clear that you have to consider quite a few scenarios. It may not be an all-or-nothing approach; perhaps a “bit of everything” approach will suit you better.

Pay attention to tax

One of the most critical factors that you must consider is tax. Be careful not to be seduced by the tax deductibility of contributing towards a retirement fund just to grow it to the point where you will pay 45% tax in retirement. That is not desirable. The fact that you already have a substantial amount invested in your retirement fund and contribute more than the allowed R350 000 per year towards retirement funding indicates that you are heading in that direction. The short-term tax-free income benefit that you will enjoy when you retire due to the disallowed contributions may not be enough justification to invest in the retirement fund. More calculations and assumptions must be made to better understand your future tax liability.

If your marginal tax rate is estimated to be north of 30%, leaning more towards an endowment makes sense since your indirect tax will be 30% in the endowment. Remember, although endowments are not taxed in an individual’s name, they pay 30% tax within the product under the five funds rule of insurance companies. It is also essential to consider the investment’s portfolio construction. Not all underlying assets are taxed equally. Only the components that generate interest, like cash, bonds, and rental income, are taxed. The growth of equities is not taxed unless, of course, a qualifying transaction triggers capital gains tax (CGT). If you really want to optimise your investment portfolio, then these factors must be taken into consideration and allocated to the "wrapper" that is most tax-efficient for that particular asset. It may mean that if you have an equity-biased investment, a plain old unit trust or ETF may just be the most dynamic and uncomplicated product of choice. On the other hand, all your interest-bearing assets can be held in a tax-free investment where no taxes are paid, similar to retirement funds. As I mentioned earlier, more information and analyses will be necessary to determine your "sweet spot" as far as wrappers and portfolio construction are concerned.

Splitting investments

In a previous article, I discussed the importance of aiming to split your investments 50/50 between retirement funds and voluntary (discretionary) funds. Splitting income drawn from the two different "pots" profoundly impacts taxes payable. Drawing more from voluntary funds drastically reduces your marginal tax rate since CGT rather than income tax becomes payable. Another factor to consider is the amount you intend to spend annually on holidays and capex, such as replacing motor vehicles. These funds should be kept in cash, and if this amount is substantial and pushes your interest earned beyond the annual interest abatement, more tax-efficient funds should be used for that component.

I diverted beyond endowments and retirement funds. My apologies if I complicated a simple question. The point I am trying to make is that more thought and planning should be applied before you decide. You have the opportunity and ability to accumulate substantial investments by the time you retire. Minor tweaks and strategic planning can make a massive difference in the outcome of your wealth accumulation. Remember that the outcome does not end the day you retire. It goes way beyond retirement and must include the most efficient way for your wealth to transfer to loved ones sometime in the future. Good luck with your decision. If you would like to discuss some strategies in more detail, please feel free to contact me or one of my team members.

Choose well and invest wisely.

Dear reader,

It's important to remember that financial planning is nuanced. Restricting yourself to either a pension fund or an endowment with discretionary money, which has endless investment options apart from the two choices offered, would not be prudent. That being said, let me get on to answering the exact question: When deciding whether to contribute an additional R4 million to your existing pension fund or initiate a new endowment policy, it's crucial to consider the tax implications, investment restrictions, and financial objectives.

1. Contributions to pension funds

In South Africa, pension fund contributions are tax-deductible up to the lesser of 27.5% of the greater of your remuneration or taxable income or an annual limit of R350 000. Since you already contribute above the R350 000 annual threshold, additional contributions will not provide immediate tax deductions. However, these excess contributions are carried forward under Section 10c. They can reduce the taxable portion of your retirement benefits upon withdrawal or offset future income tax.

Regulation 28 considerations

Pension funds are subject to Regulation 28 of the Pension Funds Act, which limits asset allocation to ensure diversification and protect members' interests. Key restrictions include:

- Equities: Maximum of 75%;
- Property: Maximum of 25%;
- Offshore assets: Maximum of 45%;
- Hedge funds: Maximum of 10%; and
- Private equity: Maximum of 15%.

These limits may constrain your investment choices and potential returns within the pension fund. The more you restrict your wealth manager, the less they can perform.

2. Endowment policies

Endowment policies offer tax benefits, especially for individuals in higher tax brackets. Taxation within an endowment policy is as follows:

- Interest income: Taxed at a flat rate of 30%; and
- Capital gains: Effective tax rate of 12%.
- Given your marginal tax rate of 45%, investing in an endowment policy can provide significant tax savings. The income and capital gains within the policy are taxed at lower rates than your marginal tax rate.
- **Liquidity and access**
  Endowment policies typically have a minimum investment term of five years, during which access to funds is restricted. In contrast, while pension fund contributions are intended for retirement, accessing these funds before retirement age can result in penalties and tax implications. However, should a crisis arise, endowment policies offer one loan and one surrender during the initial five years.

- **Recommendation**
  Considering your current contributions already exceed the tax-deductible limit for pension funds, and given your high marginal tax rate, allocating the additional R4 million to an endowment policy appears to be a more tax-efficient strategy. This approach allows you to benefit from the lower tax rates within the endowment structure, potentially enhancing your after-tax returns.

However, it is crucial to align this decision with your financial goals, investment horizon, and liquidity needs. Consulting with a Certified Financial Planner (CFP) can provide personalised advice tailored to your situation.

Moneyweb | 5 December 2024

Say no to (savings) pot

Withdrawals from your savings pot will have significant negative consequences for your long-term financial security.

South Africa's two-pot retirement system came into effect on 1 September 2024. The system divides retirement contributions into two pots: a retirement pot and a savings pot. While this system offers greater flexibility, it also presents significant downsides for investors who are not careful about accessing their savings. The retirement pot is designed to be a long-term savings vehicle for purchasing an income in retirement. From 1 September 2024, two-thirds of your monthly retirement contributions will go towards this pot. The savings pot, on the other hand, can be accessed from 1 September 2024. An initial seeding amount (the lower of 10% or R30 000) plus one-third of monthly contributions will make up the value of your savings pot. Withdrawing from your savings pot before retirement, however, will have significant consequences for long-term financial security.

The dangers of the savings pot

One of the primary dangers of accessing the savings pot before retirement is the erosion of your savings. Early withdrawals reduce the overall value of your retirement savings, which will significantly impact future retirement income. Let's use an example to illustrate this. Sam and Sam's bestie both have R1 million in their retirement annuities. On 1 September 2024, Sam's bestie decides to withdraw the full balance of her savings pot (a value of R30 000). Sam avoids the temptation to withdraw from her savings pot and leaves her retirement annuity to grow until her retirement. Fast-forward 35 years later, when Sam and her bestie reach retirement age. Sam's retirement annuity will be worth R28 102 437. Sam's bestie's retirement annuity will be worth R27 259 364 – R843 000 less (or approximately R153 000 in today's terms, assuming an inflation rate of 5%).

Now, let's assume that Sam and her bestie both start working at the age of 22. Sam and her bestie both contribute R6 000 per month towards their pension funds; however, Sam's bestie withdraws one-third of her contributions (the savings pot component) every year. When they reach the retirement age of 65, Sam's pension fund will be worth R44 574 135, while Sam's bestie will have a pension fund of R29 716 090 – a staggering difference of almost R14.9 million (or R1 828 000 in today's terms)! Moreover, withdrawals from your savings pot also have severe tax implications. Let's assume that Sam's bestie earns R50 000 per month and needs access to her savings pot of R30 000. While she may have access to the full amount, she will only receive approximately R19 200 – with the balance of R10 800 going towards the taxman.

How to avoid accessing the savings pot:

To avoid the pitfalls of accessing your savings pot before retirement, investors should consider the following strategies:

- Create a robust emergency fund: Ensure that you have an emergency fund equal to three to six months' worth of living expenses in an easily accessible high-interest account. Do not treat your savings pot as an emergency fund!
- Maximise contributions to retirement funds: Contribute as much as possible to your retirement funds. This will provide you with a substantial tax benefit and help you put money away for your old age.
- Seek professional advice: A certified financial planner can help individuals navigate the complexities of the two-pot retirement system and develop a personalised strategy.

While the two-pot retirement system offers increased flexibility, it is essential to approach it with caution. Withdrawals from your savings pot will have significant negative consequences for your long-term financial security. By understanding the risks and adopting a sound financial plan, individuals can maximise the benefits of the two-pot system and ensure a comfortable retirement.

Moneyweb | 4 December 2024

Run on numbers: the impact of municipal debt on retirement funds in South Africa

Retirement fund arrears are spiralling out of control in local government, putting municipal workers' retirement savings in jeopardy. With billions in unpaid contributions, this could result in a situation that could devastate the financial futures of those relying on these funds. The FSCA released its latest list of employers allegedly non-compliant with section 13A of the Pension Funds Act (PFA) as of 31 December 2023. They reported receiving the details of 7,770 employers who violated section 13A of the PFA by 31 December 2023. The list consists of 109 pages, named no less than 2 330 entities. Of the list, it is evident that there is a major non-compliance issue in the Private Security industry.

1. Another disturbing fact is that 149 municipalities out of a total of 257 are in arrears as well, which is equivalent to 58% of the municipalities in the country being in arrears. Resulted from a combination of challenges over time, including a consumer culture to not pay for services, inefficiencies in municipalities and Eskom, unintended consequences/gaps in legislation, Eskom's inability to assist municipal revenue collection of property rates and service charges in Eskom supplied areas within municipal demarcations, etc. Some municipalities are in a position of financial gridlock that requires a radical change towards their insolvent trajectory while being mindful that a persistent culture of financial mismanagement behaviour coupled with a consumer culture of not paying, primarily led to their position.

Municipal Eskom debt is a material risk to the Eskom debt relief

2. Not only is the debt position of municipalities a problem facing the government so too is the financial health of municipal pension funds a great concern for employees and retirees. There are several different public pension funds: National Fund for Municipal Workers, there is also a separate fund called The Municipal

Councillors Pension Fund (MCPF) which was established on 01 May 1988 in terms of the Pension Benefits for Councillors of Local Authorities Act No. 105 of 1987, there is also a Fund named Joint Municipal Pension Fund and the largest public Pension Fund is The Government Employees Pension Fund (GEMPF). In addition, there is Die Vrystaat Munispale Pensioenfonds (the Fund) which is registered with the Financial Sector Control Authority as a registered pension fund in terms of the Pension Funds Act (No 24 of 1956) with a Registration Number of 12/8/412. The unpaid contributions from municipalities alone are estimated at R1.4 billion across ten retirement funds. The consequence management is in operation.

One example of action against wrongdoing is that of Johnny Mackay, the former municipal manager of Kai Garib Municipality, who was arrested for violating the PFA during his tenure. As has become the norm that a person is seen as not guilty until final proof, Mackay has since become the head of the Department of Public Works in the Northern Cape. The court will pronounce his action in due course. Unathi Kamlana, the Commissioner of the FSCA, has pointed out that various other cases are being investigated and that people in contravention of the Municipal Finance Management Act and the PFA will be prosecuted by the SIU. Kamlana stated that there were R5.2 billion in arrear contributions – representing 0.2% of the total R3.15 trillion in assets within South Africa's retirement funding system. It may appear insignificant but the individual who may be affected by his or her Fund's shortage could not rely on the industry as a whole to make good for a specific Fund that has a shortage.

3. The Registrar of Pension Funds provides a central database on the FSCA website to assist members of the public to ascertain through the search engine if there are any unclaimed benefits due to them. An enquirer will be required to input basic information onto the Unclaimed Benefits Search Engine, i.e. name, surname, identification number, fund name, name of employer, etc. for the search engine to check if there is a possible match. On a successful match, the enquirer will be provided with the contact details of the fund and/or administrator. The pension fund industry can now allocate up to 45% of its assets offshore. Additionally, about 40% of the revenue from the Top 40 companies on the JSE is generated outside South Africa, effectively externalizing capital. Theoretically, South African Funds can have a maximum exposure of 45% plus 40% of the remainder 55% being 22% bringing the total foreign exposure to 67%. We, (me included) are always quick to criticise the ANC government, but one must give credit where credit is due. This statistic is phenomenal and ought to be highly regarded, much in the same light as the high level of freedom of speech that we have in this country.

4. There has been much speculation as to whether local investments can match offshore investment returns. Now three years later into the shootout between local and offshore investing, Piet Viljoen is well ahead of his rival Magnus Heystek of Brenhurst. The consideration of prescribed assets can be seen as an acknowledgment of the government's shortcomings in infrastructure development and economic management. In a low-trust environment where corruption and inefficiency are rampant, the pension fund industry faces the challenge of whether it can confidently allocate funds to government projects. The idea of prescribed assets suggests that the government is now looking to the pension fund industry to compensate for its failures.

5. Conduct of Financial Institutions Bill (COFI Bill) which commences on 31 March 2025

The CoFI Act amends the Financial Markets Conduct Act 2013 to ensure financial institutions treat consumers fairly. The CoFI regime, , is designed to protect consumers by putting the consumer at the forefront of institutions' decisions and actions1. The COFI Bill aims to move away from a 'rules and regulations' approach to a 'principles and outcomes-based approach. If only all government institutions could take cognisance from this principle the lives of our citizens would be so much better. A good example of a rules-based approach that is in place in the CIPC office. They have a tick list and only act based on their tick list. No effort is made to look at underlying principles. For them in adjudicating if a company application for reregistration is warranted, they simply reject, and the result is the applicant must spend thousands of Rands to obtain a court to intervene.

6. Tax and the Two Pot retirement system

Citizens finding themselves under financial pressure may look at the prospect of withdrawing funds from their savings port. However, the tax man lurks and is only too happy to collect his slice of the withdrawal. Contributions to retirement funds are not taxed. Therefore, the tax will be deducted from any amount withdrawn. Tax will be calculated at the tax rate applicable to the individual. Taxpayers must also ensure that they have no outstanding returns and do not owe Sars. Debt owed to Sars will be deducted from the withdrawal amount. Zwelinzima Vavi (born 20 December 1962[1][2]) is the General Secretary of the South African Federation of Trade Unions (SAFTU). Zwelinzima Vavi has come out fighting against the paying of tax on retirement payouts. His arguments that we are already overburdened have fallen on deaf ears. A well-known advice often given is "pay and the pain goes away" which may come in handy to deal with the two everlasting realities, death and taxes. Extensions are possible but avoidance is never possible.

Personal Finance | 1 December 2024

Why investing a portion of your retirement savings offshore is still a good idea

This limited share of the world economy underscores the importance of diversifying your investments across international markets.

There has been a lot of positive sentiment in the markets recently, especially following the formation of the government of national unity in South Africa, which has contributed to a significant strengthening of the rand. However, it's crucial to keep in mind that South Africa currently accounts for less than 1%of the global GDP. This limited share of the world economy underscores the importance of diversifying your investments across international markets. By doing so, you can reduce your exposure to the risks and volatility associated with focusing solely on South African assets.

The case for diversifying offshore

While offering opportunities, the South African stock market is dominated by major commodity producers. As a result, it is heavily reliant on sectors that are sensitive to global economic conditions, particularly those that affect commodity prices. This makes our local market vulnerable to fluctuations that could negatively impact your retirement savings if you're solely invested in South Africa. By investing offshore, you can reduce the concentration risk that comes with a domestic-only portfolio and gain exposure to industries and economies that are not as prevalent in South Africa. For instance, sectors like technology, healthcare, and pharmaceuticals – which drive much of the global growth – are underrepresented in the local market.

Why offshore investing makes sense

Here are some key reasons why investing offshore remains a prudent strategy for South African investors:

1. Geographic diversification

Investing offshore enables you to spread your investments across different countries and regions, mitigating the risk of being too dependent on the South African economy. This geographic diversification provides a buffer against domestic downturns and opens up opportunities in other economies that may be performing better.

2. Reduced dependence on the rand

The rand is known for its volatility. While the currency has strengthened recently, it remains subject to significant fluctuations due to local political and economic factors. If you plan to incur future expenses in foreign currency – whether for travel, education, or retirement abroad – investing offshore can hedge against exchange rate volatility. For example, if you're planning for your children to study overseas or considering retiring abroad, building an offshore portfolio can protect your purchasing power in foreign currencies.

3. Access to stable and growing economies

While South Africa has growth potential, many global economies are larger, more diverse, and more stable. By investing in developed markets such as the United States, Europe, or parts of Asia, you can benefit from more consistent growth and reduce the risks associated with the South African market. Additionally, these regions often have better infrastructure and regulatory stability, which can provide more certainty for your investments.

4. Industry exposure not available locally

Certain sectors, such as technology, pharmaceuticals, and consumer goods, are underrepresented in the South African market. These industries are among the largest drivers of global economic growth, and by investing offshore, you gain access to these sectors. For instance, tech giants like Apple, Microsoft, and Google offer growth opportunities that are not available in the local market.

5. Planning for overseas expenses

If you're planning to retire abroad, emigrate, or have children who will study overseas, it makes sense to establish an offshore portfolio in the currency and jurisdiction where you plan to incur expenses. Doing so shields you from fluctuations in the rand and ensures that your funds are readily available when needed, without the risk of being eroded by unfavourable exchange rates.

How to invest offshore

While the idea of investing offshore might seem complex, there are several straightforward ways for South African investors to access global markets:

1. Direct offshore investment

You can open an account with an offshore brokerage or financial institution, which allows you to buy international assets directly – such as stocks, bonds, or mutual funds. This gives you control over your investments and the ability to choose the regions and sectors where you want to invest.

2. Unit trusts or exchange-traded funds (ETFs)

Many local asset managers offer unit trusts or ETFs that invest in global markets. These funds are an easy, cost-effective way to gain exposure to offshore investments without needing to transfer large sums of money offshore or manage foreign accounts. ETFs often track international indices, allowing you to invest in a diversified portfolio of global assets.

3. Using your offshore investment allowance

South African residents are allowed to invest up to R1 million offshore per year without needing tax clearance from Sars. Additionally, you can apply for a foreign investment allowance of up to R10 million annually, provided you obtain tax clearance. This allows you to invest larger amounts offshore while remaining within the legal framework.

Conclusion

Although the recent strengthening of the rand and positive sentiment in the South African markets are encouraging, it's important to remember that South Africa accounts for a small portion of the global economy. Investing a portion of your retirement savings offshore offers geographic diversification, access to global growth sectors, and protection against currency volatility. While it's possible to invest offshore on your own, the complexities of currency risk, tax implications, and choosing the right regions and sectors can be overwhelming. Consulting a professional financial planner will help you navigate these factors and ensure that your offshore investment strategy is aligned with your long-term financial goals.

Moneyweb | 25 November 2024

Resisting the lure of the two-pot cookie jar this festive season

With Black Friday and the festive season fast approaching, consumers may be considering using their two-pot retirement savings component to splurge. However, Allan Gray's Richard Carter cautions against dipping into your retirement investments for holiday spending, as this could undermine your long-term retirement goals. Each year, shoppers look forward to Black Friday and Cyber Monday, seeking discounts on everything from electronics to clothing and home goods. This year, Black Friday sales are expected to surpass last year's R26.6 billion. The recent introduction of the two-pot retirement system in South Africa may provide consumers with high levels of temptation to withdraw retirement savings to pay for discretionary festive season spending, according to Richard Carter, Head of Assurance at Allan Gray.

"We continue to worry about investors taking out money for short-term needs that aren't emergencies, undermining their long-term retirement savings goals," comments Carter. South Africa's two-pot retirement system, introduced on 1 September, divides all future contributions from retirement fund members into two components: a savings component and a retirement component. "The aim of the two-pot system is to preserve your retirement investment, while allowing access to the savings component once per tax year in case of emergencies – where not withdrawing would lead to worse financial outcomes," explains Carter.

Don't touch your vested component

As well as the retirement and savings components, there is also a vested component, which consists of retirement contributions accumulated before 1 September and growth thereon – less the amount used to "seed" your savings component. Although investors won't be able to make further contributions to this portion, they may be able to access it in certain circumstances, including if they resign, if their retirement fund's pre-two pot rules allow. Carter believes that for many investors, especially those who have been investing diligently for several years, keeping a lid on the vested component is even more important than not dipping into the savings component. "For example, for a 55-year-old investor who has been contributing to a retirement fund since they were 25 and intends to retire at 65, the vested component (plus growth) could be as much as 90% of the amount available at retirement," he says. "For these investors, the most important thing to do is to make sure that the vested component remains invested appropriately and resist the urge to take this money out," he asserts.

Could you use your savings component as an emergency fund?

"Using your savings component as an emergency fund could make sense – if you are willing to direct emergency fund contributions into your retirement fund, over and above what you are currently contributing to your retirement fund," says Carter. He explains that if you were previously contributing 12% of your salary for retirement, and that was enough, dipping into the one-third of your contributions that now go into a savings component for emergencies will leave you with a shortfall. "To the extent that you use this one-third for emergencies, you will be eating into your retirement investment, and all else being equal, you will not have enough at retirement," he says. "However, using the example above, if you want your retirement vehicle to double as an emergency fund, you could increase your pre-tax contribution to 18%. If you don't need it for emergencies, or even if you use some of it, but not the full amount, it could enhance your retirement investment. "Even if you end up needing all of it for a rainy day, you would not worsen your retirement outcome."

Plan for festive spending

Rather than dipping into your retirement investment to fund your festive season splurge, Carter believes discipline should be your first priority. "Marketing tricks entice us to spend," he says, "but it's important to protect your future financial wellbeing." Although too late for this festive season, a strategy for the future is to set aside money monthly to account for this expensive time of year. Regular contributions over time into a low-risk unit trust, such as a money market or interest fund, will preserve and grow your capital, and you can access it when you need to.

FA News | 29 November 2024

Unpaid pension funds rise to Sh47.16 billion, leaving Kenyan retirees at risk

In Kenya, employers who delay sending pension money are fined Sh20,000 or five per cent of the unpaid amount every month.

Kenyan workers are at risk of financial struggles when they retire, as unpaid pension contributions by public universities and county governments increased by 12.3 per cent to reach Sh47.16 billion in the year ending June 2024. According to the latest report by the Retirement Benefits Authority (RBA), the amount of money deducted from workers' salaries for their retirement savings but not sent to pension schemes grew from Sh42 billion. This puts many pensioners at risk of having insufficient funds for their retirement. "This challenge largely affects quasi-government institutions, which mainly comprise public universities and county governments. To address this, the authority has continued to engage various stakeholders, including the National Treasury and the National Assembly, with the aim of securing commitments for the funds to be remitted to schemes," reads the RBA report.

In Kenya, employers who delay sending pension money are fined Sh20,000 or five per cent of the unpaid amount every month, whichever is higher. However, the continued rise in unpaid contributions suggests the fines are not working or that the institutions are struggling financially. The situation is even worse for retired civil servants. For example, the Treasury failed to pay Sh23.78 billion to about 260,000 retirees in the year ending June 2024, due to "liquidity challenges," showing that workers' problems don't end when they retire.
Low savings RBA noted that the buildup of unremitted pension contributions occurs against a backdrop of low savings in the sector. The RBA also mentioned that the growing pile of unpaid pension money comes at a time when savings in the pension sector are low.

While the International Labour Organisation suggests retirees should replace at least 40 per cent of their income through pensions, Kenya only provides 32 per cent, meaning many retirees will not be able to live comfortably. Pension coverage in Kenya is at just 26 per cent, with many workers, especially in the informal sector, not saving for their retirement. The Treasury has estimated that about 85,400 public service workers will retire between now and June 2026. In the year ending June 2024, 30,155 workers are expected to retire, followed by 28,745 in the current financial year and 26,500 in the following year. General Manager for Pensions at Liaison Group Kennedy Keli, warned that the accumulation of unremitted pension contributions poses serious risks to both individual savers and the broader financial system. "When employers fail to remit contributions to pension schemes, it compromises the integrity of the pension funds and can lead to insolvency issues, ultimately jeopardising the financial well-being of retirees.

When employees observe that their hard-earned contributions are not being properly accounted for, it breeds distrust in the pension system," he said in an interview with Business Daily. "This erosion of trust not only dissuades individuals from saving but also diminishes their willingness to engage in long-term financial planning." Keli further cautioned that widespread unremitted pensions may encourage individuals to adopt short-term savings strategies, sacrificing future financial stability for immediate gratification.

The Eastleigh Voice | 2 December 2024

Provident Fund reported to Conduct Authority for undue delay

The Office of the Pension Funds Adjudicator has reported the Private Security Sector Provident Fund to the Financial Services Conduct Authority for unwarranted delay before conducting investigations to make a death benefit distribution.

The Deputy Adjudicator, Naheem Essop, said in a determination that owing to the fund’s failure in its fiduciary duties, it has been referred to the FSCA to consider any appropriate regulatory action. He said the fund was notified of the deceased’s death on 17 January 2022, but it only started conducting its section 37C investigations 17 months later on 13 June 2023. By 25 October 2024, a further 16 months, the fund was still not able to provide an update on the status of the ongoing investigation, simply stating that it was awaiting feedback from its service provider. The delay was found to be unreasonable. In terms of section 37C of the Pension Funds Act, the fund has 12 months from the date of notification of death to investigate, identify potential beneficiaries, and make a distribution.

“Given that the fund became aware of the deceased's death on 17 January 2022, if the fund had initiated its investigation immediately upon receiving notification of the deceased's death, it would have been expected to complete its investigation by 17 January 2023. “The board failed in its fiduciary duties, the duty of good faith and loyalty, the duty of reasonable skill and diligence and the duty to give attention to the deceased’s beneficiaries. “The fund's delay in initiating the section 37C investigation was detrimental and caused financial prejudice to the members and beneficiaries, and such a delay is frowned upon. The unexplained delay since it started the investigation also leaves a lot to be desired,” said Essop. He expressed concern that the fund’s administrative processes were detrimental to its beneficiaries and members and not in line with the provisions of section 7C(2)(f) of the Act.

Essop was ruling on a complaint brought by the mother of the fund member’s two children about the delay in paying a death benefit. The deceased was employed from 2 November 2019 until he passed away on 27 December 2021. The deceased had a fund credit of R26 978.93, as at 3 April 2024. The complainant stated that the deceased had three school-going children, two of whom were hers. She said she also provided the fund with documents of the other child. She stated she had been following up with the fund for a year, as she was informed that the process takes 12 months before payment is made. The fund stated that it received contributions from the employer for the period November 2019 to March 2020 (only risk and admin expenses) and April 2020 to December 2021. The fund stated that the employer ought to have commenced paying full contributions on behalf of the deceased from November 2019. Thus, the employer owed contributions on behalf of the deceased for November 2019 to March 2020. The fund submitted a benefit quotation reflecting a sum assured amount of R210 951.00 and fund credit of R29 554.73 as at 03 October 2024. The fund submitted that it is liable for payment of the insured portion to the deceased's beneficiaries. The employer stated that its records indicate that contribution schedules were submitted to the fund on a monthly basis and all provident fund deductions made from the deceased's salary were remitted to the fund. The employer provided a copy of the summary of contributions paid to the fund on behalf of the deceased.

The employer's contribution report reflects that for the period November 2019 to March 2020, the employer only remitted risk and administration expenses. The employer commenced with full provident fund contributions in April 2020. Il his ruling, Essop said the employer ought to have commenced paying full provident fund contributions from November 2019. The employer was ordered to pay the outstanding contributions to the fund. He gave the fund three months in which to finalise the investigation, identify the deceased's beneficiaries, allocate the death benefit and pay the death benefit to the deceased's dependants without unreasonable delay.

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