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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

Don’t underestimate your benefits as an employee

As this month is Workers’ month, let’s look at what you may be receiving from your company in the way of employee benefits, which may be more substantial than you realise, and must be taken into account for financial planning purposes. Your employer may be subsidising your medical scheme contributions and your contributions to a retirement fund (pension or provident fund). If you are a member of an occupational retirement fund, a small part of your contribution will go towards group risk cover: this is insurance that covers you for death or permanent disability and, in some cases, dread diseases, such as cancer and stroke.

The life cover may be for a multiple of your annual salary. If you are permanently disabled and unable to do your job, the disability cover may pay out a lump sum or, as is more common nowadays, it will pay you a monthly income (typically about 70% of salary) until your retirement date. Group risk cover is a substantial benefit that is often overlooked. There is no individual risk assessment (known as underwriting), which means that older, sicker members receive a higher level of cover than they would if they bought the insurance privately, if they could get private cover at all.

RETIREMENT SAVINGS

The biggest benefit you typically receive from your employer, apart from your salary, is the means to save for your retirement. Mica Townsend, head of business development and an employee benefits consultant at 10X Investments, says it is for a very good reason that employers of choice are those interested in helping their employees to retire comfortably. “Membership of a corporate fund gives workers structure for planning and saving, and they benefit from corporate pricing, which reduces the fees they pay. Having their contribution deducted upfront from their salary is another benefit, as is having the tax benefits applied every month rather than having to apply for a refund once a year,” Townsend says.

She says the obligation on employers should go further than providing the means: they should ensure that the fund has a solid chance of earning a decent return that too much money isn’t lost in fees, and that employees have access to all the information they need about the fund. “The more engaged with the fund that members are, the better their choices and their eventual retirement outcomes,” she says. 10X Investments’ Retirement Reality Report 2020 found that membership of corporate retirement savings schemes was widespread in South Africa, but most members admitted they had a poor understanding of the scheme they belonged to. Only

40% of members surveyed said they had a good understanding of their fund, more than a third said they wished they knew more, and 11% said they simply weren't interested or trusted that the best choices were being made on their behalf.

EMPLOYERS IN TROUBLE

So what happens to your retirement savings if, as may have happened during the pandemic, your company gets into difficulties and either goes into liquidation or is bought out by another company? Nashalin Portrag, head of Momentum's Fundsatwork umbrella funds, says the law protects employees in these cases. "There are clear legislative processes that must be followed with regard to employee benefits during a merger or acquisition. Section 197 of the Labour Relations Act facilitates the business transfer, protects employees from being treated unfairly and protects their employment, which includes their employer-provided retirement and insurance benefits," says Portrag.

"The act determines that the new employer employs transferred employees on terms and conditions that may not, on the whole, be less favourable than those they had with the old employer." Portrag says new employers may allow transferred employees to keep contributing to their existing pension or provident fund or require them to move their savings into a new fund. The transfer to the new fund must comply with section 14 of the Pension Funds Act, which ensures that process is reasonable and fair. It must also comply with the rules of the funds. He cautions: "It is important to understand that employees are not entitled to their withdrawal benefits in such a transfer."

If your company goes into liquidation, you will have access to your retirement fund savings, but only after the fund has been closed. You may take your savings as cash, or may transfer them to a preservation fund or another retirement fund. If your employer was part of an umbrella fund (a large fund run by a commercial provider, which houses a number of employers under one "umbrella"), you can preserve your retirement savings within the fund. You can also choose to withdraw some savings and preserve the rest until your normal retirement date. It is important that you talk to a qualified financial adviser when considering the different options, particularly to understand how tax will affect you.

Portrag notes that your group insurance benefits may change. "If your company undergoes fundamental restructuring, such as downscaling or changing its operating model, it may revise its group benefit structures to balance benefit levels and value with cost." This may mean a lower level of benefits, which may be insufficient for your needs.In the event of retrenchment, some group insurance schemes offer the option to convert to an individual private policy without medical underwriting.

Personal Finance | 3 May 2021

Borrowing from your retirement fund: What you need to know

The current economic climate has led some people to consider dipping into their retirement funds to access capital. But what exactly can you use these funds for, and what percentage of your savings can you access? Devon Card, a certified financial planner at Crue Invest, provides clarity on this.

As it currently stands, Section 19 (5) of the Pension Funds Act allows a retirement fund to provide a loan or guarantee to a member for housing-related purposes. The purpose of this legislation is to provide assistance to members in financing their genuine housing needs, including the purchase of a property or plot, property renovation, or paying off a home loan. Such a loan cannot be used for any other purpose. Further, in order to qualify for such a loan, the property in question must be a primary residence owned by the member or the member's spouse, or jointly owned by the two.

In the aftermath of the Covid-19 pandemic in South Africa, there have been calls to allow retirement fund members to access their funds for purposes other than home financing, although these proposals have been rejected by Treasury. With so many South Africans being under-funded for retirement, borrowing from one's future retirement nest egg can be dangerous. In this article, we explore the mechanisms for borrowing from a retirement fund, the circumstances under which it is permitted, and the effects of doing so on your broader financial planning.

Firstly, while the Pension Fund Act makes allowance for housing-related loans, it also stipulates that each retirement fund must set out its own rules in this regard, meaning that a retirement fund can elect not to allow for housing-related loans when setting out its rules. There are only a handful of retirement funds in South Africa where members are able to take a loan directly from their fund. Common practice amongst the retirement funds that do provide such loans is to facilitate pension-backed home loans by providing the member with a guarantee which can be used to secure finance with a bank or financial institution.

While the Act does provide for it, it is interesting to note that currently no individual retirement annuities make provision for such guarantees, and it is only employer-linked pension and provident funds that currently do so.If you've established that your retirement fund rules make provision for such loans, you will need to make an application to the fund in order to obtain a guarantee before applying for a home loan through a registered financial institution. Whether you are applying for a direct loan or a pension-backed guarantee, bear in mind that value may not exceed the fund credits, net of tax, that you would be entitled to should you be forced to withdraw from the fund. Further, the value cannot exceed the value of the property you are looking to purchase or the cost of the quoted renovations. However, where a member is applying for a pension-backed guarantee, it is common practice to allow a member up to 60% of the fund value, net of tax, and not more than the cost of the property or the quoted renovations. In terms of the Pension Funds Act, the rate of interest charged to a member borrowing directly from the fund cannot be lower than Prime plus 2% per year, while the interest charged by banks in the case of a pension-backed guarantee falls within the discretion of the lending institution itself.

Pension-backed home loans are aimed at helping members buy, renovate or build their primary residence and, as such, the risks are much lower than in the case of a member who simply wants to access his funds unnecessarily. Where a member borrows directly from his retirement fund, he is liable to repay the loan plus interest over a maximum term of 30 years, or by retirement age, keeping in mind that the trustees of the fund have a responsibility to do an affordability check before granting approval for the member to withdraw funds. Where the member applies for a pension-backed guarantee, which is the more common approach, the financing institution will still need to perform lending checks to ensure that the member can afford the monthly repayments.

As such, while it should not be considered irresponsible to take a direct or pension-backed loan from your retirement fund, it is always advisable to consult with an independent financial advisor before doing so – especially as you will need to understand the implications should you leave the fund or default on your repayments. When making an application for a loan, the relevant departments and financial institutions will need to do their due diligence in determining the member's affordability. Where a member's credit score is low as a result of high levels of debt or poor debt repayment history, it is unlikely that the financial institution will approve the home loan, even where a guarantee has been issued.

In making the application, the member would need to provide the fund and the financial institution with a copy of their ID, proof of residence, last three months' bank statements and payslips, proof that the loan is for housing-related purposes, and proof that there are no administration orders against his salary or wages. Keep in mind that the process of applying for a pension-backed guarantee is slightly quicker as the application is only subject to the approval of the fund's trustees. On the other hand, where a member applies for a direct loan from the fund, he will need to need to apply both to the fund and to the financial institution from which he seeks financing.

However, most retirement funds that allow for pension-backed home loans normally have partnerships with financing institutions to allow for a more streamlined application process.

Where a member is under debt review, it is highly unlikely that a pension-backed home loan will be approved. Anyone under debt review is considered heavily indebted and therefore unable to take on any new credit – keeping in mind that the applicant must be able to afford the repayments and cannot have any garnishee or administration orders against him. Before applying for a direct loan from your retirement fund or a pension-backed guarantee, our advice is always to consult with an independent advisor to ensure that you fully understand the implications of doing so in the context of your broader financial plan.

Moneyweb| 7 May 2021

No tax relief for voluntary payments to German social pension: was this right?

It would make no sense for Sars to provide tax relief for contributions to a retirement fund registered outside of the country.

From 1990 to 2006 my wife made voluntary payments to the German social pension scheme. She was and is a South African tax resident. She received no tax relief from Sars for the voluntary payments but Germany taxes her on the pension. During that payment period, was it correct that Sars rules meant that she could not have received any tax relief for her voluntary payments? If so, how could she get a definitive statement to this effect?

With regards to your query, it is important to distinguish between the tax treatment of contributions made to retirement funds and the tax treatment of withdrawals from retirement funds. Your question, from what I understand, relates to tax relief on contributions towards an offshore retirement fund. Governments incentivise citizens to save towards retirement by providing tax incentives. Incentivising citizens to save encourages them to do so, and in so doing, reduces their dependence upon the state for support in their retirement. As a result, the state encourages the use of registered retirement vehicles, being pension funds, provident funds and retirement annuities.

Therefore, contributions made to a retirement fund registered in South Africa would enjoy tax relief on the income earned and taxed in South Africa. It would make no sense for the South African Revenue Service (Sars) to provide tax relief for contributions to a retirement fund registered outside of the country. Taxpayers would be receiving tax breaks on money destined for another country. Since your wife was contributing to a German pension fund, the South African government would not necessarily benefit in any way by providing tax relief on her income earned in Germany. As a result, Sars would have very little motivation to provide a tax break on contributions towards that fund. One also needs to note that while there are tax concessions on contributions towards retirement funds, there are however tax consequences when retirees retire from those funds and begin to draw an income. The income drawn from a retirement fund by the retiree is taxed as income. So, in essence, it would make no sense for Sars to provide tax relief for contributions being made to an offshore retirement fund when they would in turn not be able to collect taxes from the annuity payments made to the retiree from that fund.

Simply put, you are given a tax break on contributions made to a retirement fund, and only once you retire from that fund are you required to pay income tax on the income you draw from it. The real benefit is in deferring the tax payable to a later date and thus enjoying investment growth on capital that would have ordinarily been paid to Sars in the form of income tax. It is important to bear in mind that any contributions towards a retirement fund 'saves you tax' at your marginal rate on every rand saved while you are working.

Drawing an income from your fund during retirement will result in the tax being withheld at a significantly lower level due to the tiered nature of the tax tables. Additionally, from age 65, taxpayers benefit from a secondary tax rebate; and from age 75, they also benefit from a tertiary tax rebate. The end result is that the income drawn would be taxed at a much lower average rate than the tax saving you enjoyed on the contributions that were made leading up to retirement. The bottom line, though, is that Sars would still receive some tax.

Moneyweb | 5 May 2021

The accrual system: Death of a spouse

Many couples fail to consider how the accrual calculation impacts their estate plan, often with devastating consequences.

All marriages come to an end – either through death or divorce. If you are married out of community of property with the accrual system, you and your spouse most definitely enjoy a more equitable and fair matrimonial property regime. That said, many couples fail to consider how the accrual calculation impacts their estate plan, often with devastating consequences. Having a valid will in place is insufficient when it comes to estate planning, particularly because the accrual system can add an additional layer of complexity in the event of death. Here's what your estate plan should take into account.

The antenuptial contract

When entering into your marriage, your antenuptial contract is undoubtedly the most important document that you will sign because it is designed to set out the financial consequences of your marriage. Whereas the financial consequences of an in community of property marriage are determined by law, you and your spouse can use your antenuptial contract to tailor-make your own matrimonial property regime. Spouses can decide to incorporate anything they like into their antenuptial contract provided the terms are not illegal or immoral.

When drafting your antenuptial contract, however, bear in mind that it is very difficult to alter the terms of the agreement later in life. Unless expressly excluded, marriages out of community of property will automatically include the accrual system. In terms of this matrimonial property regime, each spouse retains their separate estate until the marriage is dissolved through either death or divorce, at which point the accrual system becomes applicable.

Assets excluded from the accrual calculation

When drafting their antenuptial contract, spouses can choose to exclude any asset from the accrual, although they will need to ensure that specific details are included in the agreement which clearly identifies the asset. For example, if a wife wishes to exclude a piece of jewellery, she will need to include a valuation certificate and an accurate description of the item. A spouse can also choose to exclude assets that will accrue in the future, such as a retirement fund although, once again, they will need to be specific about identifying the asset they wish to exclude. When it comes to general exclusions, the following assets are automatically excluded from the accrual unless otherwise agreed to by the spouses:

- An inheritance, legacy or donation which accrues to a spouse during the subsistence of the marriage;
- Any donation between spouses;
- Any amount which accrued to a spouse by way of legal damages.

Once the spouses have made decisions as to what should be included and/or excluded from the accrual, each spouse must declare a commencement value for their estate from which point the growth in their respective estates will be gauged until such point as the marriage is dissolved.

The accrual system

By way of simple explanation, in the event of the first-dying spouse's death, the accrual is calculated by taking the value of the smaller estate and subtracting it from the value of the larger estate. The difference between the two estates is then split and the estate with the smaller values has an accrual claim against the estate with the larger value. Where the first-dying spouse has the larger estate, the surviving spouse will have an accrual claim against the deceased estate, with this claim being a preferred claim which must be paid before any portion of the deceased estate is distributed. Where the first-dying spouse has the smaller estate, their deceased estate will have a claim against the surviving spouse. Bear in mind that the accrual claim is only acquired on the dissolution of the marriage and, as such, is a contingent as opposed to a vested right. Unless both scenarios have been planned and accounted for in the form of a detailed estate plan, complications can arise which can cause heartache, frustration and financial stress both for the surviving spouse and for the deceased's heirs and beneficiaries. This is particularly the case where the spouses have children from a previous marriage or where the deceased bequeathed assets to a third party i.e. someone other than their spouse.

Accrual claim on death

During the course of the marriage, the marriage is out of community of property and community of profit and loss. This means that each spouse retains control of their own estate. Where the marriage is dissolved by death, the accrual system comes into effect whereby the spouses get to share equally in the growth of their estates calculated from the date of marriage. By way of example, let's consider Mike and Mandy who are married out of community of property with the accrual. For the purposes of this exercise, we have assumed that their respective commencement values were zero. Mike and Mandy were both previously married and have children from their first marriages.

They do not have any children from their marriage together. Mike's estate is currently valued at R20 million, including business interests of R10 million, the primary residence which is in his name of R5 million, and a retirement annuity of R5 million. Mandy owns a small art collection valued at R1 million and a unit trust portfolio of R4 million. In terms of Mike's will, he has bequeathed his entire estate to his children from his first marriage and has nominated his children as beneficiaries on his retirement fund as they are both still studying and are financially dependent on him. Mandy has bequeathed her entire estate to her only child from her first marriage.

Estate planning scenario 1: If Mike is the first-dying spouse

If Mike was to pass away, the accrual would be calculated as follows:

The value of Mike's estate: R20 000 000

Less: The value of Mandy's estate: R4 000 000

Total: R16 000 000/2

Accrual: R8 000 000

Mandy would therefore have an accrual claim against Mike's deceased estate for an amount of R8 million. This can create complications in Mike's estate because he has bequeathed the primary residence of R5 million and his business interest of R10 million to his children. As an accrual claim is a preferent claim, the deceased estate is obligated to pay Mandy her share of the accrual before distributing any assets to Mike's named heirs. This could result in the executor having to sell some of Mike's business interests which is not what Mike intended in his will. Further, as Mandy is dependent on Mike's income to help cover the costs of living, it is likely that the retirement fund trustees will consider her a financial dependant in which case she could be allocated a portion of Mike's retirement fund interest.

Estate planning scenario 1: If Mandy is the first-dying spouse

If Mandy pre-deceases Mike, her deceased estate effectively has a claim against Mike of R8 million. Mike's wealth is tied up in his business interests, fixed property ,and his retirement fund. In order to discharge the debt owed to Mandy's estate, Mike may be forced to liquidate some of his assets which is less than ideal and could severely compromise his financial future. Bear in mind that he cannot access the funds in his retirement annuity, which means that he would need to liquidate the business and/or fixed property interests in order to meet his obligations.

A couple's estate plan should always include 'first-dying' and 'second-dying' spouse scenarios to ensure that there is sufficient liquidity in each estate regardless of which spouse passes first. For effective estate planning to take place, it is always advisable that couples are transparent with each other regarding their wills so as to avoid unpleasant surprises later on

Moneyweb | 4 May 2021

Is it possible to get back my retirement fund that was attached by Sars?

You are entitled to request reasons from Sars regarding the deduction and to object to those reasons if you feel they are not valid.

I am writing to inquire if it is possible to get my retirement fund that has been taken by Sars back to me? I am 46 years old. I have been working as a security officer and I was retrenched on October 31 2020. I submitted my claim to Private Security Services Provident Fund. I was told that my payout was R64 000 but only R25 000 was paid into my account. When I followed up, I was told that it had been taken by Sars as a settlement for what I 'owe' it. So, I need your advice on how I can claim my money back. I will be grateful for your response.

It is never nice being told one thing and receiving another – especially when it comes to your money! There are broadly two reasons why any amount paid into your account is less than what you had accumulated in your provident fund. The first reason is that the amount you were due (plus other retirement fund lump sums you've previously received) was above the "tax-free" amount and was therefore subject to tax. The tax you pay on a retirement fund lump sum benefit is levied according to a sliding scale i.e. the greater the lump sum amount, the higher the tax rate. The retirement lump sum tax tables are also applied on a lifetime or cumulative basis.

Each lump sum payment is not viewed in isolation – the tax payable now will depend on whether or not you've previously received lump sums from a retirement fund, what those previous amounts were and the circumstances under which you're receiving the lump sum (i.e. did you resign, were you retrenched, or have you retired). The second and more likely reason in my opinion is that you have an outstanding liability with the South African Revenue Service (Sars) that Sars is entitled to collect. The Tax Administration Act entitles Sars (under Section 179) to instruct a third party who holds money for a taxpayer, like a retirement fund, to deduct these liabilities from the money they hold for you, without notifying you.

This is a powerful mechanism that is available to Sars to collect a tax debt. In utilising this provision, Sars may serve such notice on your bank or retirement fund, which will then be obligated to pay over to Sars the amount stipulated in the notice without notifying you. When you selected to do a withdrawal from your retirement fund, the retirement fund administrators have to request a tax directive from Sars. From the circumstances you've described, it sounds like Sars instructed the retirement fund administrators to deduct an outstanding tax liability from the lump sum. It sounds like Sars had an outstanding liability against your tax number and ID.

We are not able to say whether Sars was correct in its assessment of your tax liability. However, you are entitled to request reasons from Sars and to object to those reasons if you feel they are not valid. You can submit an electronic Request for Reasons either via e-filing or at a Sars branch. We encourage you to contact Sars and ask them for a breakdown of the amount deducted and what it relates to. That will enable you to establish whether or not you should dispute their assessment.

Moneyweb | 6 May 2021

INTERNATIONAL NEWS

Pension funds urged to help UK reach net zero climate goals

Campaigners say many investments still high carbon and call on firms to sign green pensions charter

Pension funds must set a target of net zero emissions for their investments if the UK is to meet its climate goals, influential figures in climate activism have urged. Many people are unaware of whether their pensions funds are invested in fossil fuels or high-carbon activities, and even companies that have publicly committed to reaching net zero emissions may have pension fund investments that are still wedded to high-carbon businesses. As the UK prepares to host the UN climate talks Cop26 in Glasgow this November, several prominent climate campaigners have written to the Guardian to urge pensions companies to sign up to green investment principles.

The signatories are: Christiana Figueres, the former UN climate chief who oversaw the Paris agreement; Nigel Topping, the UK government's business champion for Cop26; Richard Curtis, the film-maker and co-founder of the campaign group Make My Money Matter; and Amanda Mackenzie, chief executive of the charity Business in the Community. "[Cop26] is a unique opportunity for Britain to showcase how our financial system can be leveraged to tackle climate change on the global stage," they wrote. "To achieve this, we must all commit to making our money matter, starting with our pensions."

While an increasing number of companies are aligning their business activities with the UK's target of reaching net zero emissions by 2050, pension investments are lagging behind. "Why is it that a company working hard to achieve net zero in their operations continues to invest millions into a pension which does the opposite?" the signatories asked. They urged all companies to sign up to the green pensions charter, which requires businesses to ensure their company pension scheme achieves net zero emissions by 2050, as well as setting short-term targets to halve the greenhouse gas emissions associated with their portfolios by 2030.

Emissions targets for the next decade are crucial to ensure that the goals of the Paris agreement, of holding global temperature rises well below 2C above pre-industrial levels, with an aspiration to limit rises to 1.5C, can be met. Some big pension funds have already committed to the green pensions charter principles, including Scottish Widows, Aviva, Nest, the BT pension scheme, and some local government pension schemes. About £400bn is now invested in 15 schemes that are aligned with the net zero and 2030 targets. The UK pensions sector accounts for about £2.6tn in funds, so any shift towards investing in lower-carbon portfolios would have a strong effect in investment and business. The signatories wrote: “If we want to deliver healthy returns for our retirements, as well as ensure a healthy world for our grandchildren, 2021 needs to be the year that we unleash the power of our pensions … What’s the point in saving for retirement in a world on fire?” Individuals can write to their pension scheme managers to ask whether their investment portfolios are exposed to climate risk, and shareholders can vote at company annual general meetings.

Pension fund investors can wield substantial influence over the companies whose shares they hold, and their long-term outlook means that the risks of the climate crisis are having an increasing impact on their projections. The UK government is considering strengthening financial disclosure requirements on publicly listed companies, that would require them to assess and publish details of the risks they face from climate breakdown. Finance and business will be key to success at Cop26, and Topping is leading a Race to Zero, by which companies commit to a mid-century net zero target and emissions limits for the next decade.

Mark Carney, the former governor of the Bank of England and a UN climate envoy, recently announced a new initiative called the Glasgow Financial Alliance for Net Zero, under which banks and financial institutions, including Barclays, HSBC and the insurer Axa, have signed up to similar commitments.

The Guardian | 5 May 2021

UK university pension fund proposes net zero investment strategy

But plan draws criticism from academics seeking swift exit from fossil fuels

The UK universities’ pension scheme has pledged to pursue an investment strategy consistent with net zero carbon emissions by 2050, but its plan has sparked criticism from academics seeking a rapid exit from fossil fuels. The £80bn Universities Superannuation Scheme, the UK’s largest private pension fund by assets, has begun the process of developing a comprehensive net zero strategy after last year promising not to make investments in companies producing thermal coal that is used in electricity generation.

The USS would not make “wholesale divestments” from fossil-fuel producers but would work with other pension funds to encourage oil and gas companies to make material cuts to their carbon emissions, said Simon Pilcher, chief executive of the pension scheme’s investment management arm. New rules are due to be announced this year by the government which will require pension schemes to evaluate the risks posed by climate change as part of Britain's plan for net zero emissions by 2050. The USS has begun establishing interim targets towards net zero and intends to evaluate its carbon footprint for new reporting standards required by global regulators under their Task Force on Climate-related Financial Disclosures. "This is about taking the logical next step as responsible investors," said Pilcher.

"We recognise the transition . . . will not be easy and we have work to do to make our net zero ambition a reality by 2050 or before." The USS, which has more than 450,000 members in its pension scheme, has already committed £1bn of investment in wind energy. Pilcher said the USS had also allocated £300m to building new solar energy projects. "Unless pension schemes are wise to the risks of climate change and the need to adapt investments, there will be a knock-on effect on people's pension pots," said Stephen Timms, the Labour MP who chairs the committee.

Ethics for USS, a coalition of academics which includes Sir Brian Hoskins, chair of the Grantham institute for climate change and the environment at Imperial College London, said it was "extremely concerned" that the USS had not explained how it would meet a net zero goal that was 30 years away. A clear timetable of short-, medium- and long-term targets should be established, added Ethics for USS. "USS members want their pension contributions invested sustainably," said Paul Kinnersley, emeritus professor at Cardiff University and a member of Ethics for USS.

"USS needs to explain how it will support real cuts in carbon emissions, rather than a nebulous net zero target, which implies that it will continue to invest in fossil-fuel companies." Ethics for USS also wants the pension scheme to step up engagement with fossil-fuel producers and to clarify whether it will support shareholder resolutions proposed by Follow This, a climate activist group, at companies' annual meetings. These resolutions ask oil companies to set targets on carbon emissions that are consistent with the UN climate agreement finalised in Paris in 2016. Pilcher said the USS would not support all such resolutions. "There will be cases where we will not support adversarial shareholder resolutions but that does not imply that USS has gone soft on the need for reductions in carbon emissions," he added.

Financial Times | 3 May 2021

The World’s Largest Pension Fund Has Cooled on ESG. Should You?

Thematic indices make investors feel good. But is simple virtue enough to fatten retirement accounts and support an aging population?

If a pioneer investor in ESG is getting cold feet, should you? In July 2017, Japan’s $1.6 trillion Government Pension Investment Fund — the world’s largest — blazed a trail by putting 1 trillion yen ($9.1 billion) into three indices that track Japanese stocks that put emphasis on environmental, social and corporate governance issues. GPIF then plowed 1.2 trillion yen into two carbon-efficient indices in 2018, and another 1.3 trillion yen into two ESG foreign equity indices last December. But top officials of the pension fund have been talking up fiduciary duty lately. GPIF “can’t sacrifice returns for the sake of buying environmental names or ESG names,” a senior director at the fund’s investment strategy department told Bloomberg News in April.

At issue is poor performance. For instance, one of GPIF’s earliest ESG picks was a thematic social index, which invests in domestic companies that hire and promote women. The MSCI Japan Empowering Women Index, the so-called Win index, has fared poorly against the benchmark Topix Index. Performance is all-important to GPIF: the fund is required to pursue a real investment return of 1.7% to support an aging Japan. Second Thought:
Over the last year, the Japan ESG indices that GPIF tracked could not outperform the benchmark Topix Index

AUM 03/20	**Return Since 04/20**	
FTSE Blossom	931.4B yen	42.2%
MSCI Japan ESG	1,306.1	39.4
MSCI Japan Empowering Women	797.8	37.9
JPX Carbon Efficient	980.2	40.2
S&P Global ex-Japan Carbon Efficient	1,710.6	68.4
Topix		43.4

Source: GPIF, Bloomberg Note: AUM data as of March, 2020, the latest available

So what does this mean for the future of ESG investing? Since Joe Biden won the election in early November, passively-managed ESG funds saw a sharp uptick in investor demand. But will that strong inflow last? Could GPIF's shifting attitude foretell a cooling of this global trend? Can It Last? ESG ETFs saw sharp inflows after Joe Biden won the election in November. But that investor enthusiasm started to taper off in recent months First, flow does not guarantee returns. Just because a passive ETF has received billions of dollars of buying does not mean it will outperform, as GPIF has learned. If anything, flow tends to follow performance, leaving funds susceptible to large withdrawals.

For instance, in January, clean energy ETFs, such as the iShares Global Clean Energy ETF, were all the rage, accounting for about 40% of global passive ESG flows, data compiled by Bloomberg Intelligence shows. A month later, clean energy funds contracted to about only 10% of global flows as their performance lagged. Second, ESG is too broad a category. Funds that focus on environmental issues can have very different return profiles from social or governance thematic funds. In Japan, despite former Prime Minister Shinzo Abe's Womenomics rhetoric, gender diversity simply was not a winning strategy. Of Topix 500 companies, those with no women on the company board generated, on a five-year basis, an 8% return on invested capital, a good 1.3 percentage points higher than corporations with women board members, data compiled by CLSA analyst Nicholas Smith show.

This doesn't mean women aren't competent managers: Japan's male-dominant corporate culture may have placed women with no relevant experience into senior positions merely for show and PR. Nonetheless, the inferior return on capital of gender-diverse companies explains why the Win Index was a losing proposition. On the other hand, passive funds that claim high carbon efficiency can fare very well. The S&P Global ex-Japan LargeMidCap Carbon Efficient Index, which the GPIF started tracking since 2018, is by far the best performer of the last year. A look at its holdings shows why: Big tech FAANG stocks and Tesla Inc. are among the top constituents, and the U.S. market — the world's most resilient — accounts for 63% of the fund.

That begs the question: If carbon efficiency is simply tech, do we really need to invest in an ESG fund? We could have bought into the cheaper and more liquid Invesco QQQ Trust, which tracks Nasdaq 100, and still feel pretty good about saving the planet. The two indices are highly correlated. No doubt, with the European Union and Biden administration pushing fiscal stimulus money into clean energy and climate technology, ESG investing will remain a hot topic. But if the world's largest pension fund seems to have become more circumspect, shouldn't you? From the perspective of pure returns, passive ESG investing can still be fruitful, but one has to be nimble and practical, able to switch quickly from one thematic fund to another — or out of ESG funds altogether. Dogma won't work.

Bloomberg | 6 May 2021

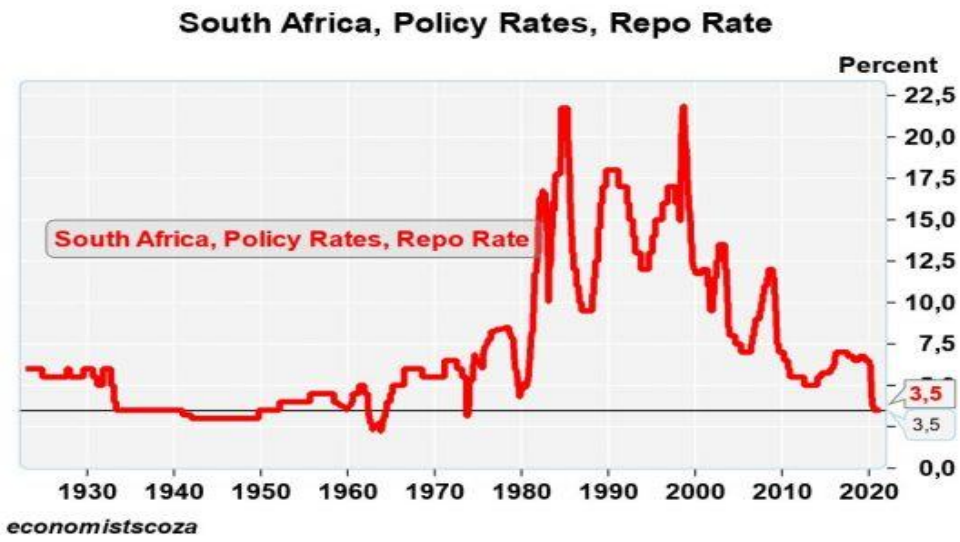
OUT OF INTEREST

Economic recovery: Low rates are playing a starring role

But only recently. They take time to have an effect, and they need to stay low for a long time.

Effectively, the nominal repo rate is at its lowest level in 48 years in South Africa. The last time South Africa had to lower interest rates to this level was during the Yom Kippur War and oil crisis of 1973. Back then the policy rate stayed below 3.5% for less than 90 days before going to 3.78% and higher within a short space of time. The last time the repo or policy rate stayed below 4% for over a year ended in June 1964. That's nearly 57 years ago!

See chart below for the long-term history of the SA repo rate.



Source: economists.co.za

Moreover, the drop in the repo rate was quick.

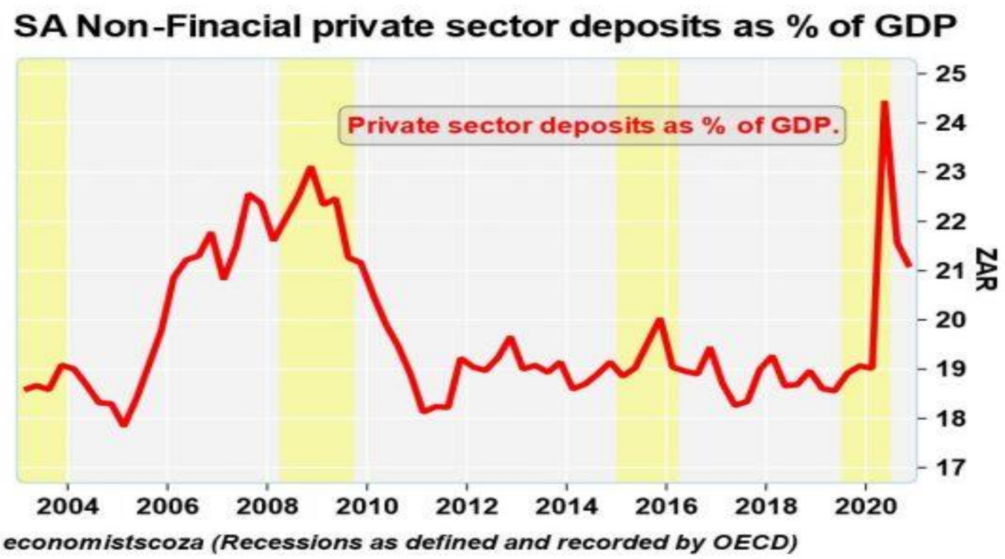
The last time the repo rate halved in less than six months was at the back end of 1998 when SA recorded a central bank policy rate of nearly 22% during the emerging market crisis. The SA repo rate does not just halve, and it does not fall below 4% much either.

South African Reserve Bank (Sarb) rate action was decisive. Savers had a more challenging time, but they knew that lower rates would help the recovery. But a low rate takes time to have an impact; it needs to stay low for a long time. Communication from the Sarb was vital, and the monetary policy made it clear that rates were to remain low for long. At times there were votes for even lower rates. The interest rate impacts an economy only about nine to 12 months later.

On May 22, a repo rate of less than 4% will have been in effect in SA for a year. I believe the rate will likely stay there for another few months. Sure, the rate will increase from the 3.5% level – but in small steps. Other central banks are also starting to hint at small increases or long periods of zero rates and no further cuts.

At long last, the hoarding of cash declines

Business, or more correctly, the non-financial private sector, responded to the crisis by hoarding money out of fear. Cash deposits by private firms went from 19% of GDP to 24% (partly due to hoarding and partly due to a decline in GDP). See chart below.



Source: economists.co.za

Cash deposits by businesses went from R874 billion in the first quarter to R993 billion in Q4. Fear drove company savings up by R120 billion. But since November, private sector cash deposits have declined R33 billion. So a quarter of business hoarding has dissolved due to the repo staying low and the economy bouncing back. The incentive to keep even more money in the bank was taken away as interest rates had more inferior returns than the return on assets the private sector made – mainly due to lower interest rates. Firms now want to employ their capital in their businesses again as economic activity returns (more on this aspect in the following section).

Consumers

In March this year, consumers spent more on their credit cards for the first time in a year. Only just – but they did, and that would not have happened if rates did not decline for a long time. As the pandemic and lockdown hit South Africa, consumers also got a fright which resulted in the fastest increase of deposits in at least a decade. Deposits by residents went from R3.97 trillion in January 2020 to R4.47 trillion a year later. Yip, that is an extra R500 billion in deposits driven at least partly by fear and uncertainty. But with a record low level of interest rates, consumers finally started spending those deposits in February and March. Remember, rates are not just there to encourage borrowing but also to promote some cash spending in times of economic distress.

In the first quarter of 2021, R30 billion left consumer deposits and was spent in the economy. Of course, more needs to be spent, but at least the excessive hoarding is over for now. Again the level of the repo rate impacted on consumer behaviour, but only nine months or so later. The economic blow was softened over time. At least now, low rates on their own will impact stronger on economic growth. Consumer confidence is at least not as low as it was last year, and if no other lockdowns take place, the confidence could reduce the ca*sh pile further.* We are not talking credit here but actual money in bank accounts. **Full Report*:*** ***https://www.moneyweb.co.za/news/economy/economic-recovery-low-rates-are-playing-a-starring-role/***

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