irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

FRIDAY, 3 MARCH 2023

TABLE OF CONTENT

LOCAL NEWS

- The Offshore Pension Environment for South Africans
- Standalone vs umbrella pension funds – which is better?
- SA hedge fund industry saw unrivalled 30% growth last year
- Trustees of retirement fund not bound by client's final wishes, court confirms

INTERNATIONAL NEWS

- South Korea pension fund's assets fall by record 8.22% in 2022
- Despite sanctions, state pension fund slow to sever financial ties with Russia

OUT OF INTEREST NEWS

- February economic update

LOCAL NEWS

The Offshore Pension Environment for South Africans

South Africa ("RSA") levies no tax arising from foreign pensions under the Income Tax Act 58 of 1962. The aim of this legislation is the entirely self fulfilling one of promoting RSA as a destination for retiring pensioners who have worked and saved all their lives in other countries. The uplift in commercial enterprise for such a policy is significant- providing much needed employment and commercial activity all paid for by pensions whose tax reliefs were generously provided by countries other than RSA. These rules were amended in March 2017 in which the exemption of foreign pensions from South African income tax will only apply to amounts received or accrued from a foreign retirement fund or amounts that were transferred to a local retirement fund from a foreign retirement fund and constitute consideration for services rendered outside South Africa in terms of past employment.

Thus contributions from overseas earnings should not be made to local schemes. The second interim Report on Estate Duty for the minister of finance by the Davis Group has recently been published. The Committee believes that offshore pensions should not be used by SA taxpayers who have never worked overseas. Believing that the arrangement is taxable in the hands of the SA resident taxpayer and recommended that the above arrangements be further investigated by SARS.

Developments

The interesting development in this whole fairly complex area is the issue of Expatriate and AfriPat workers complying with the offshore requirements but whose employers have yet to acknowledge the change in the rules and continue to offer a single RSA based pension solution no matter their country of residence for work. These employers should urgently consider the option of setting up a proper offshore occupational pension scheme for their employees that comply.

Recommendations

1. Any RSA resident who has never worked ex RSA in any meaningful capacity should be very wary of schemes promising to externalise their allowances and capital into open ended schemes.
2. Employers whose RSA based pension schemes have expatriate or AfriPat workers within the main RSA fund should look as a matter of urgency into setting up a genuine offshore arrangement for those employees that comply; this would allow those fulfilling the criteria (of

working ex RSA) to benefit from: CGT free capital growth, No donations tax, No income tax on growth, No Currency or exchange taxes, 0% tax on benefit withdrawals and a well regulated and supervised environment.

Conclusion

SARS needs to promote South Africa as a safe and stable place to retire to for expatriates and returning AfriPats. Part of that “sell" is of course improving security, but the other side is the requirement to enable these pensioners to spend their pensions earned elsewhere in a tax free environment received in their currency of choice which normally is the currency they earned the savings in the first place. RSA has 25% unemployment, an unstable currency, inconsistent government and many other challenges. The offshore pension regimen is one of the most positive initiatives that RSA needs to survive and forms an essential part of the vibrancy of an economy that needs the income taxes (derived from wages of those employed by those drawing offshore pensions) and sales taxes thus generated to survive.

FA News | 2 March 2023

Standalone vs umbrella pension funds – which is better?

A look at the benefits and disadvantages of each.

Currently, South African investors are in limbo waiting for the finalisation and implementation of the National Mandatory Pension fund. Commentators are not sure that this will be introduced successfully considering the government’s failures with entities like Eskom and the e-toll project. In South Africa, pension funds are a crucial component to assist and prepare employees for retirement. Contributing to a pension fund while working helps employees to save money to ensure the availability of sufficient funds for their retirement years. The two types of pension/provident funds available to anyone employed within South Africa are standalone or freestanding funds and umbrella funds. Both have different qualities and features that might make it challenging for companies to choose which kind of fund is appropriate for their employees’ retirement planning requirements. These are the benefits and disadvantages of each:

- **Standalone pension plans** are established and maintained by a single employer company or large group structure of companies, also known as self-administered funds, aimed at exclusive benefits for their employees. Standalone funds are expensive and more complicated than standard umbrella funds. They are difficult for small to medium-sized businesses to use as they require a lot of administrative and legal compliance to

create and manage. Standalone funds also carry a greater risk of responsibility because the trustees (the employer, group of employees) are entrusted to make sure that the fund is managed correctly and that the members' interests are safeguarded. These trustees also must adhere to the FSCA (the Financial Sector Conduct Authority).

Even with these limitations, standalone funds have certain benefits. Due to the fact that the trustees can customise the fund to meet their own needs and objectives, they get a great degree of flexibility and control. This enables the company or group of employers to offer specific investment choices and benefits to their employees and standalone funds also enable a more individualised approach to retirement planning. Additionally, independent funds are seen as less expensive in the long term compared to umbrella funds since they are not subject to the same regulatory obligations.

But with that said, too many cooks spoil the broth – analysis shows that allegedly some trustees share the Dunning-Kruger effect and may suffer from a conflict of interests within these big pension funds. The reason is, nobody questions their intentions and or competency. That brings forth the T's and C's in non-related administration costs and inflated fees seeing that several individuals are connected to these funds and each of them needs to have their payments deducted for their services. Not to mention that a certain amount of assets under management (AUM) is needed as well as specified amounts of monthly contributions towards the fund before it becomes cost-effective for the company and its employees.

- The establishment and management of **umbrella funds**, on the other hand, are the responsibility of a qualified fund administrator. Since the fund managers are in control of the administration and management of the fund, these funds typically offer lower fees and are less complicated than standalone funds. Additionally, umbrella funds have lower legal risk because the fund administrator ensures that these funds are managed and governed legally, to ensure that the members' interests are safeguarded.

Despite these benefits, there are also disadvantages to umbrella funds. Since the fund administrator manages all fund management choices, they offer less freedom and control. This is due to the fact that the fund manager often offers a standard set of investment alternatives and other additional benefits that are equal for all members. Umbrella funds also give a more universal approach to retirement planning with Life Stages investments ensuring investment risk reduces closer to retirement. Do keep in mind that if there is a third-party administrator or facilitator connected to your funds there are fees binding that relationship to a monetary income for that said company. In conclusion, employers must be cognisant of the advantages and disadvantages of standalone and umbrella funds when selecting a pension/provident fund for their employees. Standalone funds often cost more and require more work but give flexibility

and control to the employers if they are willing to accept that they will be held liable and accountable for their actions and decisions. On the other hand, umbrella funds are less expensive and complicated but provide less flexibility and the liability and accountability vests with the fund administrators. Before making any decisions on pension/provident funds, it is crucial to seek guidance from an independent financial advisory firm. The decision between a standalone fund and an umbrella fund must be decided with the correct and transparent data, accompanied by information to ensure that the employer makes the correct educated decision when choosing the right product for their employees. If you are unsure whether your current fund (standalone or umbrella) is meeting your needs it is recommended to request an audit from an experienced company to give you a clear understanding of your funds and what changes, if any could be introduced for the benefit of employees.

Moneyweb | 2 March 2023

SA hedge fund industry saw unrivalled 30% growth last year

The South African hedge fund industry grew its assets by an unprecedented 30% last year to end the year with R113.01 billion under management from R86.93bn at the end of 2021.

Speaking at annual hedge fund statistics released by the Association for Savings and Investment South Africa (Asisa) yesterday, Hayden Reinders, the convenor of the Asisa hedge funds standing committee, said the industry had had to endure several lean years following the implementation of crucial reform initiatives. This had resulted in comprehensive regulations and the consolidation and closure of funds. The number of hedge funds in South Africa has stabilised at 216, a number maintained for the past two years. “Seeing strong growth numbers for the industry is a welcome development and hopefully indicates that hedge funds in South Africa are increasingly being accepted as an important investment tool in mitigating market volatility,” Reinders said.

The industry attracted healthy net inflows of R5.33bn last year compared to the muted net inflows of R0.59bn in 2021, while having suffered net outflows of R2.45bn in 2020. Reinders said they hoped the industry would achieve even better growth this year on the back of the amendments to Regulation 28 of the Pension Funds Act, which came into effect at the beginning of this year. The amendments separate hedge funds and private equity investments, allowing local pension funds to invest 10% of assets into hedge funds, and 15% into private equity investments. Asisa said in 2015, South Africa became the first country in the world to implement comprehensive regulation for hedge fund products. The regulations provided for two categories of hedge funds, namely Qualified Investor Hedge Funds and Retail Hedge Funds.

Hedge funds fall under the Collective Investment Schemes Control Act (Cisca) and were deemed regulated collective investment schemes, just like unit trust portfolios. According to Reinders, the amendments enabled hedge funds to operate on a more level playing field, which should result in stronger inflows. “Most pension funds are nowhere near the 10% maximum, which means there is plenty of room for growth.” He said 37% of assets under management were held by Retail Hedge Funds at the end of December last year, while Qualified Investor Hedge Funds held 63% of assets. Asisa said the net inflows last year were predominantly driven by Retail Hedge Funds, which attracted net inflows of R4.1bn. Qualified Investor Hedge Funds, on the other hand, recorded net inflows of R1.14bn.

Reinders explains that Linked Investment Service Providers (Lisps) – also known as collective investment scheme (CIS) platforms had become more willing to offer retail hedge funds, making them more accessible to investors. In addition, he said, some of the bigger hedge fund managers were investing in distribution and business development teams to grow their market share. Hedge funds in South Africa were classified according to their investment strategies. The most popular hedge fund strategy in South Africa was said to be the Long Short Equity. At the end of last year, 59.2% of retail money was invested in Long Short Equity Hedge Funds and 45% of qualified investor money.

At the beginning of this month, Emma Pretorius, business development manager at Amplify Investment Partners, said hedge funds were often overlooked by investors when looking to mitigate risk in their portfolio, but many hedge fund strategies could play a crucial role in helping to protect a client’s portfolio against large pendulum-like swings. “Why is this important? Because portfolio volatility eats away at compounded returns since large losses reduce your capital base, and you have to make more than you lost just to get back to your original capital level,” Pretorius said.

Business Report | 28 February 2023

Trustees of retirement fund not bound by client's final wishes, court confirms

Pretoria - The trustees of a retirement fund are not bound by the wishes of the holder as to who should receive the money – even if the holder stipulated those wishes on the beneficiary nomination form prior to death.

This was once again confirmed by the high court in Durban when the customary law wife of a deceased complained that she and her husband's common law wife each received 40% of the pension payout of the deceased. To make matters worse, two of the deceased's adult children from another relationship were each also earmarked by the fund to receive money, while a minor child from yet another relationship was due to also receive a portion. The parties are not identified as a minor child is involved. The customary wife turned to the court to have the "nonsensical and unlawful" decision by the pension fund's trustees overturned.

She said her now-deceased husband made it clear on the beneficiary nomination form that she was due to receive 60% of his pension and that two of their children would receive 10% each. Also, she said, he nominated two of his children with his common law wife to receive 10% each of his pension. The customary wife said the common law wife was now getting the same cut as her – 40% – while none of their children (all adults) were receiving a cent. Instead, she said, three children from two other relationships – two unemployed adult children and a minor – were each getting a cut. The deceased died in September 2018. He was survived by his customary law and common law wives, as well as 10 children (three from two other women). He had been married to his customary wife since 1988 and to his common law wife since 1983.

There were five surviving adult children born of the relationship between the deceased and his customary law wife and two adult children born of his relationship with the other wife. At the time of his death, the deceased was employed by Transnet and a member of the Transnet Retirement Fund, and his pension stood at R3.9 million. In October 2000, he nominated his customary law wife and some of his children in a beneficiary nomination form. The customary wife said the fund's allocation of the money was wrong, but the fund argued it was not bound by the nomination form and entitled to make an independent apportionment of the deceased's death benefit to his qualifying dependants as defined in the fund's rules. In terms of the Transnet Pension Fund Act, the fund's administrators could determine who are dependants of the deceased. The customary wife said the fund did not take the deceased's wishes in the nomination form into account.

She said its decision to deviate from it was irrational and unreasonable because it was made without any valid reasons. She also objected to the allocation of the same percentage of benefits to her and the other wife. She accepted the other woman was a life partner of the deceased, but disputed that she was a “qualifying spouse” as defined in the fund’s rules. The fund argued that the deceased’s wishes are but one factor to be considered and that the court should not interfere in the exercise of this discretion if the decision made is reasonable and rational. The fund said it did not ignore the contents of the deceased’s nomination form – but an allocation of 60% to the customary wife and 20% to two of her adult children, with only 20% allocated to two of the other wife’s children (with no provision made for her) was not equitable.

The court concluded the fund was within its rights to do this.

Pretoria News | 27 February 2023

INTERNATIONAL NEWS

South Korea pension fund's assets fall by record 8.22% in 2022

SEOUL : South Korea's National Pension Service (NPS) said on Thursday it logged a record 8.22 per cent drop in assets in 2022 as global stock and bond markets tumbled. The world's third-largest public pension fund said its total assets fell by 79.6 trillion won ($60.75 billion) in 2022 to 890.5 trillion won.

It was the first annual fall since 2018, when the fund's assets fell by 0.92 per cent, and the sharpest drop since its establishment in 1988. By assets, local stocks and bonds fell by 22.76 per cent and 5.56 per cent, respectively, while overseas stocks and bonds each lost 12.34 per cent and 4.91 per cent. Alternative investments increased by 8.94 per cent.

($1 = 1,310.2200 won)

Reuters | 2 March 2023

Despite sanctions, state pension fund slow to sever financial ties with Russia

New Jersey's public-worker pension fund is still working to sever all financial ties with Russia a year after the military invasion of Ukraine brought on a flurry of economic sanctions, including a ban on investments.

According to Department of Treasury officials, New Jersey's $85 billion pension fund continues to hold some securities that were flagged by a divestment law enacted by Gov. Phil Murphy last year in response to the military invasion that began on Feb. 24, 2022. The divestment law covers all securities with links to the Russian government, as well as with Russia's military ally Belarus. Treasury's Division of Investment has been able to identify holdings that trigger the ban, but faced several obstacles over the past year while seeking to shed all of those investments. They include other government restrictions on investment activities enacted in response to the military conflict, as well as actions taken by securities exchanges themselves, Treasury spokeswoman Melinda Caliendo said.

Other sanctions proceeding apace

The Murphy administration has apparently had more success carrying out other state-level sanctions put in place in response to the military conflict. Another restriction enacted by Murphy and lawmakers prohibits the state and other government entities in New Jersey from doing any business with companies that have financial ties to Russia and Belarus or are affiliated with their respective governments. Over the past year, dozens of companies have been flagged by Treasury for having ties to at least one of the two countries, making them subject to the state-level economic sanctions. A long list of companies flagged under the law was most recently updated by Treasury late last month, according to Caliendo. "None of the companies on Treasury's current list have active contracts with Treasury," she said. Murphy and lawmakers rushed into action last year as part of a broader international response to Russia's launching of a war that has now lasted a full year.

NJ stands with Ukraine

Just days after the war began, lawmakers in New Jersey passed a ceremonial resolution that formally condemned Russia and expressed support for the people of Ukraine and their efforts at resistance. A separate piece of legislation drafted in response to the war also called for severing any economic ties with Russia and Belarus, in part by adding both to a list of countries that New Jersey's public-worker pension fund is legally prohibited from being linked to

financially. Already on that list are companies doing business with Iran as it pursues nuclear ambitions and Sudan's Khartoum regime in response to its treatment of villagers in the Darfur region more than a decade ago. In 2016, the state pension fund was also prohibited from having ties to companies participating in economic boycotts that protest Israel's treatment of Palestinians. By enacting a new investment ban, New Jersey could ensure Russia would "pay a price for launching a war of aggression against a free people and the democratically elected government of Ukraine," Senate Budget and Appropriations Committee Chair Paul Sarlo (D-Bergen) said last year.

Treasury officials initially identified investments worth about $200 million flagged by the law prohibiting financial ties with Russia and Belarus. At the time, they stressed the value of those investments represented just a small fraction of the overall value of the pension fund, which covers the retirements of an estimated 815,000 workers and retirees in New Jersey. Pension-fund officials also said last year that they weren't the only ones having a hard time getting rid of investments in the wake of the broader economic sanctions against Russia that were enacted around the globe after the onset of the war.

The value of the pension fund's remaining publicly traded Russian securities was just over $2 million as of Dec. 31, 2022, Caliendo said. But that amount reflects "significant markdowns due to lack of liquidity." The true-market value of the securities will only be known, "once trading resumes in properly functioning markets," she said. "Despite the obstacles it faces in divesting the Russian securities it still holds, the Division continues to seek opportunities to comply with the divestment law and move to eliminate its risk exposure in the Russian market to the extent that opportunities arise in the future," Caliendo said.

Spotlight News | 24 February 2023

OUT OF INTEREST NEWS

February economic update

With the US economy holding up and inflationary pressures lingering, investors are pricing in rates going higher for longer.

- Markets have erased some of the gains made in January as investor sentiment continues to shift with the release of new economic data. Recent releases have shown that the US economy is holding up better than expected and that inflation may take longer to come down, thereby forcing investors to raise expectations of more rate hikes by the Federal Reserve. This coupled with the lacklustre rebound in China following their reopening, has investors repositioning more defensively. Consequently, risk assets have pulled back, with the Morgan Stanley Capital International (MSCI) All Country World index losing 3.0% in February. Emerging markets have underperformed against their developed counterparts, with the MSCI Emerging Markets index falling 6.5% as compared to -2.5% for the MSCI World index.
- The US manufacturing sector remains weak, with the Institute of Supply Management's Manufacturing Purchasing Managers Index (ISM Manufacturing PMI) falling to 47.4 in January, marking the third consecutive contraction in factory activity. The big surprise was the unexpected jump in the ISM services PMI to 55.2, rebounding from the two-year low of 49.2 seen in December. Considering that the services sector accounts for around 77% of GDP, the pick-up highlights the resilience of the US economy.
- On the inflation front, the latest report showed an acceleration in inflationary pressures, with both headline and core CPI coming in at 6.4% and 5.6%, respectively. Of more concern was the jump in the personal consumption expenditures (PCE) price index to 5.4%, which is the Federal Reserve's preferred measure of inflation. With the US economy holding up and inflationary pressures lingering, investors are pricing in rates going higher for longer. The Fed Funds Futures Market now anticipates another three 25 basis point hikes, bringing the terminal rate to 5.375% (the midpoint) by June.
- Many believed that the Chinese reopening would provide an immediate tailwind for both local and global growth; however, it appears that it is not this simple. With consumers excited about having the freedom to largely do as they please again, it is unsurprising that the reopening has propped up the services sector. The manufacturing sector, on the other hand, is lagging and continues to contract. With many of the disruptions caused by the lockdowns still having effects on the economy, the reopening will most likely only feed into factory activity with a delay.

- The UK has shown signs of a modest recovery, with data pointing to an improvement in both the manufacturing and service sectors. According to preliminary projections, the manufacturing PMI is seen reaching a seven-month high of 49.2 in February, while the services PMI is expected to move into expansionary territory and increase to 53.3. Respondents have cited reduced political uncertainty and an improvement in the global economic outlook as reasons for the recovery in business activity. However, with inflation still running hot at 10.1% and the Bank of England having to raise interest rates as a consequence, any recovery may be short-lived as consumers continue to feel the pinch.
- Locally, manufacturing and mining production contracted by 4.7% and 3.5% (year-over-year) in December, respectively. This marks the 11th consecutive drop in mining activity and the second in industrial activity, highlighting the negative effects that the rolling blackouts are having on the power-intensive parts of the economy. Retail sales also fell by 0.6% month-over-month in December, as consumers continue to feel the effects of rising interest rates and prices.
- On a better note, South African inflation showed some signs of abating, with monthly headline CPI contracting for the first time since 2020. This brings annual inflation to 6.9%, just outside of the South African Reserve Bank's (Sarb) 3% to 6% target. With the rand on the back foot and the US Federal Reserve expected to continue raising rates, the Sarb will likely follow course and continue to lift the repo rate.
- South African equities have followed their global peers lower, with the JSE All Share index losing 2.2% in February. The biggest drag on performance came from the resources sector, which lost 13.2%, while financials and industrials ended the month up 2.5% and 1.7%, respectively. South African listed property also ended February down 0.7%.
- One-month index movements:
    - JSE All Share Index: -2.19%
    - S&P 500 Index (US): -2.61%
    - FTSE 100 Index (UK): 1.35%
    - Hang Seng Index (Hong Kong): -9.41%

Moneyweb | 1 March 2023

Disclaimer: The IRFA aims to protect, promote and advance the interests of our members. Our mission is to scan the most important daily news and distribute them to our members for concise reading.

The information contained in this newsletter does not constitute an offer or solicitation to sell any security or fund to or by anyone in any jurisdictions, nor should it be regarded as a contractual document. The information contained herein has been gathered by the Institute of Retirement Funds Africa from sources deemed reliable as of the date of publication, but no warranty of accuracy or completeness is given. The Institute of Retirement Funds Africa is not responsible for and provides no guarantee with respect to any information provided therein or through the use of any hypertext link. All information in this newsletter is for educational and information purposes and