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THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

Two-pot system will not make any pension savings immediately available

Access to existing retirement funds still not allowed in terms of new retirement regime

A call from National Treasury for public comment on proposed changes to legislation, as part of the overhaul of SA's retirement savings industry, discloses a very important aspect about accessing your pension fund in that members of pension and retirement funds will not be able to access their existing pension fund money once the new legislation comes into effect next year.

Three pots
In effect, the new 'two-pot' system seems to have evolved into a 'three-pot' system. The most recent statement from Treasury labels the existing funds in a pension or retirement fund as "vested funds" that will be placed in a "vested pot" when the new regulations come into effect on 1 March 2023. The vested pot remains untouchable. New contributions to retirement funds from 1 March 2023 will be split between a "retirement pot" and a "savings pot". People will not be able to access any of the funds in either the vested pot – all the accumulated contributions and accumulated returns up to 28 February 2023 – or the new retirement pot.

Only funds in the new savings pot will be accessible, which will still be empty come March next year. Treasury's statement explains it clearly: "All contributions and growth that are accumulated before 1 March 2023 will have to be valued at the date immediately prior to implementation, to enable vesting of rights (called the 'vested pot'). The rights of members in these funds will be protected – but it also means that the conditions that were attached to those contributions will remain in place. "The 'savings pot' will then be accumulated from 1 March 2023, which means that the proposal for seed finance or capital into either (new) pot is not supported."

Many requests – but 'No'
"While there were many public requests for immediate access to accumulated retirement funds, it would not be in the best interest of members or the stability of retirement funds to do so, particularly at a point when the value of accumulated assets is already under pressure," says the statement. "These products were not designed to accommodate such a withdrawal, and it is members who will suffer if their retirement interest is diminished by large lump sum withdrawals."

Treasury says the two new pots will grow from the date of implementation, while the vested pot will still operate under the rules that were in place before the current amendments to legislation.

How it works …

Treasury provides a clear and definite example of a person who has R200 000 in a provident fund at the time of implementation of the new scheme. "From 1 March 2023 onwards, one-third of their (new) contributions are deposited into a 'savings pot' and two-thirds of their contributions are deposited into the 'retirement pot'. "After two years, there is R20 000 in the savings pot, R40 000 in the retirement pot and R220 000 in the vested pot. Person A faces some financial difficulties and can withdraw the R20 000 from their 'savings pot' without resigning to gain access to their retirement savings. "No further withdrawals from the savings pot can be made for another year," says the statement.

"After another two years, Person A has R25 000 in the savings pot, R100 000 in the two-thirds retirement pot and R250 000 in the vested pot. "Person A resigns to join another company. On resignation, the one-third savings pot and the two-thirds retirement pot can either stay in the current fund or be transferred to another fund which has a savings pot and a retirement pot, potentially at their new employer. The one-third savings pot would still be accessible at any time," says Treasury. It adds that any amounts withdrawn from the savings pot would be included in a person's taxable income for tax purposes.

Eye on the long term

Treasury notes that the development of the legislation followed a long process of consultation with pension and retirement funds, fund administrators, fund managers, unions and representative bodies, as well as input from the general public. The overhaul of the pension fund system was first mooted in 2012. It has taken a long time, but providing for retirement is a long-term endeavour. There are several reasons for restricting access to money already invested in retirement funds, including:

- Treasury notes that immediate access to current funds might lead to a big outflow from funds, which might cause liquidity problems for most funds;
- Retirement funds invest in long-term assets, and large withdrawals might force funds to sell investments at low prices; and
- Administrative systems and existing fund regulations are not designed to facilitate short-term withdrawals.

Vested pot

Treasury notes that people have a few options regarding their existing retirement funds. The member of a retirement fund can transfer the vested pot to another vested pot within a provident preservation fund without any tax consequences, or the existing savings can be transferred to the new retirement pot to consolidate all the retirement funds in the same pot.

When the member reaches retirement age, they can access all the money in their savings pot (subject to tax according to lump sum withdrawals) – or transfer it without tax to the retirement pot too. The current stipulation that retirement funds must be invested in an annuity to fund the members' retirement remains in force.

Savings pot

A welcome change is that people will be able to make additional contributions to their savings pots. The benefits are obvious, not least of which is that this will encourage savings. The savings pot might provide better returns than a bank account, and the limit of only one annual withdrawal will encourage long-term savings. Treasury reiterates that the goal of the proposed changes to legislation governing pension funds remains to ensure that people have enough money to live on after retirement, and also to reduce the instances of people resigning from jobs for the sole reason of being able to access their retirement funds in time of need – leaving them unemployed and without any savings. ***Full Report***: **https://www.moneyweb.co.za/news/south-africa/two-pot-system-will-not-make-any-pension-savings-immediately-available/**

Moneyweb | 2 August 2022

Treasury releases draft rules for its 'Two-Pot' retirement savings system

On Friday July 29, National Treasury released its annual set of draft legislative changes to South Africa's tax acts. Significantly, they contain Treasury's proposals for its so-called "Two-Pot" retirement fund system, first raised in finance minister Enoch Godongwana's Budget speech in February. Under the proposed "Two-Pot" system, your retirement savings will be divided into two "pots". The "savings pot" (one-third of your savings) will be accessible for emergencies, but the second "retirement pot" (the remaining two-thirds) will be available only at retirement. This means that you will no longer have access to or be able to cash in your entire retirement savings each time you change jobs.

Albertus Marais, director at tax consultancy AJM, says this is a further effort by the government to ensure that fewer people are dependent on the state to fund their retirement. "Ultimately, the need to encourage retirement and ensure that individuals, when retiring, have access to some financial means is essential to the government, as it will, by default, become burdened by looking after its citizenry financially where those retirement savings are not in place," Marais says. "Government has, in recent years, tried to discourage early withdrawals by introducing higher tax rates for premature savings withdrawals. SARS and the retirement savings industry's

statistics indicate, however, that this has done little to dissuade South Africans from accessing savings early.” Marais says the “Two-Pot” system presents a pragmatic approach. “It encourages retirement savings yet addresses certain realities such as that, in a challenging financial environment, some relief to individuals desperately needing it in times of emergency is necessary,” he says. Marais points out that there are currently five types of retirement funds in South Africa: pension funds, retirement annuity funds, provident funds, pension preservation funds and provident preservation funds. He says the need was identified in 2012 for the treatment of these funds to be aligned.

“Previously, savings in one type of fund could be accessed, for example, only when someone retired, while in others, access was available when a person became unemployed. This has led to undesirable consequences. Often, individuals are left financially desolate despite having significant retirement savings that are not accessible. In other cases, people would resign only to be able to access retirement savings required in the short term, even though this is detrimental over the long term. “To a large extent, the treatment of these funds has now been aligned. That being so, due to the Covid-19 pandemic, it became apparent that, in some instances, limited access to retirement funds should be made available.

However, this should not apply to all savings. “Many South Africans have suffered significantly financially due to losing employment during the Covid-19 pandemic with no savings available other than from retirement funds. In such financial emergencies, it does not make sense for those funds not to be made available to individuals who may be left desolate now, with significant retirement savings available only in years to come, which is impractical. On the other hand, making all funds available to individuals prone to spend those savings prematurely, where it would be required later is also not desirable,” Marais says.

The “savings pot” portion of your retirement savings is proposed to come into effect on March 1, 2023. Another draft rule is that you will be able to access your savings pot only once a year and the minimum withdrawal will be R2 000. Treasury also proposes that you will only be taxed at your marginal tax rate on these withdrawals, unlike presently, where tax rates are higher if you withdraw your savings before retirement age. The draft rules are open for public comment and input. Interested parties have until August 29 to submit comments to Treasury.

Personal Finance | 2 August 2022

Crafting a successful retirement

There are three ‘rules of thumb’ that you can share with your clients to ensure they are on track with their retirement savings targets, and a handful of financial behaviours you should warn them about as their retirement date draws near. The 2022 PPS Retirement Summit went beyond the oft-repeated warnings about poor retirement savings outcomes to offer tangible advice for both financial advisers and your clients. Linda Sherlock, Executive Head at PPS Wealth Advisory said building capital and preparing for retirement need not be a daunting experience.

Three rules to retire by…

The first ‘rule of thumb’ is that your clients will need around ZAR1 million for every ZAR5 000,00 in monthly income from a guaranteed life annuity at retirement. So, if your client wants to retire on a gross salary of ZAR30 000,00 they will need to ‘arrive’ at their retirement date with around ZAR6 million. It is important to remind clients that their pension income is derived from the portion of accumulated retirement funding capital that they invest in either a life or living annuity. If, for example, they have plans to withdraw a third of the accumulated capital upon retirement, the maximum allowed by the tax legislation, they will have to adjust their retirement capital target accordingly.

Pension outcomes from living annuities are slightly different to those achieved in the guaranteed or life annuity space. This is because living annuitants are allowed to decide how much of their accumulated capital to draw down each year, subject to the legislative limits of between 2,5% and 17,5%. “The second ‘rule of thumb’ is that your clients draw down no more than 4% of their capital each year to ensure that the living annuity capital lasts as long as they live,” said Sherlock. “This capital needs to be invested in the right markets, with the right asset allocations and in a multi-managed portfolio that protects your clients against inflation and longevity risks”.

Budgeting is for life

You clients also need to pay close attention to their monthly expenses. According to Sherlock, financial advisers and planners should encourage clients to do an expense audit as they near retirement. “Your clients should consider their current expenses, take out the items they will no longer be paying for, and add in all the new expenses that are associated with their retirement plan,” she said. Calculating a sustainable pension becomes similar to that of balancing the monthly household budget and involves a close assessment of the income that will be generated from the ‘planned for’ retirement capital versus the expenses that will remain post-retirement.

The third ‘rule of thumb’ will give your client’s a sense of how much of their gross annual salary they should be putting away towards retirement. Clients who start saving at age 25 will be ok if they tuck away just 15% of their salary; delay until 30 and your client’s savings requirement jumps to 22% of salary; and to 42% of salary if they delay until age 40. “Put differently, your clients should have saved up to three times of their annual salary by age 45; seven times by age 55, and 11 times by age 65,” said Sherlock. Clients should be encouraged to reflect on their savings rate and accumulated retirement capital across both compulsory and discretionary savings vehicles.

The psychology of money

There are a number of behavioural finance traits that can affect your clients in the planning and draw down stages of retirement, but before you explore these you need a basic understanding of heuristics, which investopedia.com conveniently describes as “a problem-solving method that uses shortcuts to produce good-enough solutions within a limited time”. According to Sherlock, relying on heuristics for decision making in the retirement funding context is risky business. “In retirement planning you need to look at detail, you need to conduct research and you need to understand; so, heuristics work against us,” she said. Behavioural finance is an area of study that proposes psychology-based theories to explain financial decision making.

There are dozens of behavioural finance constructs, but in retirement planning, your clients should be most concerned with hyperbolic discounting, herd mentality and loss aversion. “Hyperbolic discounting is when you are prepared to give up the long-term good for some form of instant gratification,” said Sherlock. For example, those who opt for higher draw down rates to satisfy their short-term needs face increasing longevity risks. Herd mentality, meanwhile, is used to explain many of the irrational financial decisions that your clients make. In the retirement savings context, herd mentality often exhibits as switching in and out of funds at exactly the wrong time, just because everybody else is doing so.

Stripping out financial biases

And finally, loss aversion, explains many of your clients’ desires to exit the higher return portions of their portfolios during market downturns. “Many pre-retirees and retirees are extremely cautious, and they end up switching from where they need to be invested into cash or near cash; by doing this your clients are undermining their ability to achieve inflation and longevity protection,” said Sherlock. It is imperative that your clients’ portfolios are appropriately weighted to the asset classes that will produce the required savings outcomes. And you, as the financial adviser, financial planner or wealth adviser need to ensure that the aforementioned financial biases are addressed!

The presentation closed with a useful checklist to run with your clients at each opportunity. First, as your clients approach retirement, you should monitor their progress towards the needed capital growth. “You must remember that your client’s capital is not necessarily in retirement annuities or pension or provident funds, it could be discretionary capital or tied up in businesses or properties etc,” said Sherlock. At retirement, you must assist your clients to navigate the various choices they have, ensuring that they understand the long-term impact of each decision, including the choice of life versus living annuity; lump sum withdrawals; and annual draw down rates.

Do the homework, start today…

Finally, you should set up frequent post-retirement financial check-ups to ensure that your clients are informed of the erosion of capital due to draw down rates; the impact of inflation on income; and the return generated by their retirement portfolios, among others. The closing plea to 2022 PPS Retirement Summit attendees was to do the research when it came to their clients’ retirements. This research should not be delayed until 30-days before retirement; but should form part of the retirement planning process throughout the adviser-client journey.

FA News | 3 August 2022

Women save and plan more for retirement, reveals retirement study

Report highlights the importance of retirement planning to reduce uncertainty

The gender gaps in financial literacy and retirement readiness across the globe have been extensively publicised, with women supposedly lagging behind men in terms of their financial-know-how. Yet, in a **new research report** by retirement income specialist Just SA, South African women claim to have saved more on average than their male counterparts by almost half a million rand. They are also putting more thought into retirement planning than men, according to the study, which surveyed South Africans over fifty years old, in or approaching retirement.

Results revealed that around one quarter of female respondents have thought extensively about their potential cognitive decline and have made proper plans to protect their financial future, compared to just 16% of men.In South Africa, over a third of households are headed by women, who often singlehandedly support their families.[1] It is perhaps unsurprising then that female respondents claim to be more unlikely to take risks with their money (33%) compared to men (21%). And while around half of the men surveyed said they were confident they have enough money to cover their expenses in retirement, only 38% of women felt the same way.

Heather Bell, Business Development Manager at Just SA says: “It is positive to see women taking strides to improve their financial literacy and independence and being able to make greater provision for retirement. However, the results of Just Retirement Insights 2022 also reflect an overriding feeling of uncertainty from female respondents regarding their retirement future. For example, a quarter of female respondents confirmed that they cannot afford to lose any money in a market crash.” According to Bell, women typically face additional gender-related pressures as they head into retirement, such as less time and income to save, as well as a longer life expectancy.

Women live longer, but underestimate by how much

Just SA’s internal statistics show total life expectancy for a 65-year-old in South Africa to be 87 years for women as opposed to 82 years for men, with 25% of women at age 65 likely to reach 94, and a further 10% living to celebrate their hundredth birthday. Bell notes that this increased longevity makes women more susceptible to degenerative diseases, while increasing their chances of becoming a financial burden on children in their late stages of life.

The case for life annuities

A practical way to tackle uncertainty in retirement is through informed retirement planning with an independent retirement expert who is able to assess your individual circumstances and make suitable recommendations based on your unique needs. “A life annuity provides greater certainty in retirement because it provides a secure, guaranteed income for life that will never decrease, says Bell. “For retirees that are married, a joint life annuity will continue to pay the annuity income for as long as either spouse lives.

This additional insurance allows retirees to plan to cover their essential expenses for the remainder of their lives together and beyond, while also providing some peace of mind that neither will become a burden on their children in the unfortunate event of one passing away. ”
“It’s important to understand your options at retirement and make sure you are taken care of one way or another,” concludes Bell. “While having a plan is a good start, at Just SA we recommend that you add some protection to that plan using a life annuity.”

FA News | 2 August 2022

Action needed to close retirement savings gaps

Women typically reach retirement with far less saved than men.

This stark reality for many women in South Africa comes into sharp focus this month as the country observes Women's Month. "Unfortunately, this is not a positive picture worthy of celebrating. Important conversations and urgent action are now more necessary than ever to equalise the playing field so that we can close the retirement outcomes gap between men and women," says Saleem Sonday, head of group savings and investments at Allan Gray. Sonday is particularly concerned by the overall lack of retirement savings pot in South Africa. "We know that only 6% of South Africans can afford to retire. By adding a gender lens, the picture becomes scarier," he says.

There are several contributing factors to this problem, including the persistent gender pay gap, which is when contributions to the workplace are equal in value, but men are paid more. According to an article published by the University of Stellenbosch Business school, originally derived from a paper entitled Gender pay transparency mechanisms: Future directions for South Africa, the country has various pieces of legislation aimed at preventing gender discrimination in the workplace. Yet, South Africa has a stagnant median gender pay gap of between 23% and 35%, affecting women in the middle and upper wage bands the most.

The research further suggests that around 38% of households in South Africa are headed by women, and female-headed households are approximately 40% poorer than those headed by men. When it comes to the rest of the world, South Africa is not alone. Research recently conducted by UK financial services provider Legal & General of more than 4.5 million savers in the UK, found that the gender pension gap was 16% at the beginning of women's careers, reaching 55% at the point of retirement. It found that the gap widens as women reach their forties due to the impact of career breaks, as well as unequal caring responsibilities. But what can be done to solve the gender pay and resultant retirement savings gap?

To debate this question and address the large gaps in gender pay, knowledge and regulation, which inhibit the ability of many South Africans to retire securely, Allan Gray is hosting its second retirement benefits conference on 16 and 17 August 2022. Free to attend for anyone with a stake in the world of work, this virtual two-day event will bring leading local and international thought leaders together to share ideas that can challenge the status quo and begin to bridge and close societal gaps.Headline speakers include world-renowned economist, Dr Mariana Mazzucato, and Daniel Susskind, senior research associate and University of Oxford Fellow in Economics. Some of the key issues that the event will tackle include how to

close the gender pay gap, whether the world of work really has changed, what the future of compensation in the world of work looks like and evaluating the post-pandemic shifts in the benefits landscape. Stakeholders who will benefit from attending include policy makers, CEOs, decision-makers, business owners and employers, human resources executives, financial advisers and retirement funds, boards of trustees and administrators. To register, click here: https://allangray.zoom.us/webinar/register/WN_ByQmKADDRLqLJPojkK7UKQ

FA News | 2 August 2022

Consistent saving is key for retirement – start today

Insurance – The key to ensuring that you have enough money for when you are retired and can no longer work is to start saving today and then to not cash in your pension when you change jobs. Whilst the best time to start saving for retirement is when you land your first job, there is no such thing as leaving it too late. Even if you have failed to start saving for retirement, you can still start today. You just have to contribute more than if you started earlier. Either way, "You are not alone in the struggle to prepare for retirement," says Graeme Young, Group Head of Private Equity and M&A at Hollard Insurance. Only one in three adults in South Africa, including those already on pension, have some form of retirement plan, and nearly two thirds of these pensioners still can't make ends meet each month.

In fact, more than 50% of people with pensions will receive less than 20% of their last salary at retirement. "These scary stats should not put you off or make you give up, but rather help you understand the importance of putting some money aside regularly – investing wisely now, so that your savings will be worth something in retirement, when you need them most," says Young. "When it comes to retirement, the three crucial success indicators are your total contributions, the time invested in the market and the investment returns earned. Time is on your side once you start saving and earning interest. The longer you save the more you earn," says Young, "thanks to the magic of compound interest."

Compound Interest, is one of the most powerful tools that everyone can use to make sure that even regular, small amounts put away for retirement, grow into something meaningful. Compound interest happens when you reinvest the interest that you earn on savings rather than take it out. This means that you earn interest not only on the amount you have invested, but also on the interest that you earn as well. Compound interest is "interest on interest". Fortunately, there are many ways to save and prepare for retirement where you can leverage the power of compound interest.

Savings Accounts are one of the most accessible methods to save for retirement. By simply starting a "retirement fund" in a regular bank savings account from which you can easily deposit or withdraw funds, your money will remain accessible as and when you need it. While certainly easy and convenient and a good place to start, "Using a basic savings account will not, however, earn the appropriate investment returns," says Young. In addition your contributions are not tax deductible and if you are not disciplined, you could dip into these funds for other needs before retirement. Savings accounts are very useful to build up your **Emergency Fund**, which should ideally be equal to 6 months take home pay. Having an emergency fund prevents the need to cash out your pension in times of crises such as retrenchments and job loss, as we saw happen during Covid.

Unit Trusts and Exchange traded funds are pooled investments vehicles that give you exposure to different asset classes, such as property and shares in which you can earn higher returns than savings accounts. They are excellent ways to use the power of compound interest to build up your savings, especially if the funds are left for long periods of time such as 10 or 15 years, or even longer.

Pension and **Provident Funds** or **Retirement Annuities** also all allow you to save a certain amount each month, such as 10% of your salary. All three are great tools to building up a fund that, along with all the interest and investment returns earned over the years, is either paid out to you on retirement in a lump sum (certain rules apply) – or, paid out in installments to provide a monthly income in your retirement. From a savings and interest perspective, "It is better to receive monthly payouts so that the savings remaining in the fund can stay invested and you can continue to earn interest in retirement," advises Young.

Pension and provident funds are mostly only available to salaried individuals with full-time positions where employers offer these saving and investment structures as benefits. Retirement annuities, on the other hand, "can be opened by any individual, regardless of whether they have a fulltime position or not," explains Young. Many of these funds also provide benefits that protect retirement savings from tax. And even once you actually retire, you can continue saving, adding to your retirement capital and extending the period that your pension will keep paying out. On retirement, **Insurance Products**, can be purchased to provide a monthly income. **Term Annuities**, for example, pay out a certain amount each month for a fixed period of time.

Living Annuities, on the other hand, will allow you to draw out a certain percentage each month from a larger overall fund, while the remainder continues to earn interest. There is a risk that your funds could run out, however the benefit is that any remaining fund at death, those will be paid to your dependents **Life Annuities** will pay out a guaranteed amount each month, and

unlike living annuities, life annuities do not run out, and pay out each month till you pass away, but you cannot leave anything to your dependents. “There are simply no alternatives to saving for retirement,” says Young. “Families today are already under immense financial pressure to provide for their needs with bond payments or rentals, to pay school fees, and cover transport and food. Few will have either the space or additional income to look after retired parents as well. And, with SASSA grants only paying R1 890 a month, total reliance on the government is not an option, especially when one considers that as you age medical expenses increase. The longer people live, unfortunately the more they spend on health.”

“To ensure you are financially taken care of when you reach retirement, you need to start planning in your younger years, because you will need more money than you expect. That said, even if you haven’t started young, it is never too late.” “There are many products and solutions designed to leverage the power of compound interest, to provide a comfortable retirement. If you start later in life you will need to contribute more each month to reach the same savings goal as someone that started in their twenties.” “If this is you, I encourage you to contact a banker, insurer, or financial advisor and ask them about how you can start saving for retirement – today,” concludes Young.

FA News | 25 July 2022

How do you decide between retirement income options in the retail market? Part 2

It is crucial to note that no one financial solution will suit all investors.

In my previous article, which you can read here if you have not yet done so, I compared a living annuity and a life annuity, narrowing it down to the differences between “investment-linked living annuities” and “compulsory guaranteed annuities” (also called compulsory life annuities). I touched on the notion that it may only become worthwhile considering a life annuity later in life, as the starting income offered within these products is calculated based on your life expectancy.

The reason for this is that, as interest rates are being hiked as part of the economic cycle (as with the cycle we currently find ourselves in), the offered starting income from a guaranteed/life annuity will also increase. This is not to say that insurers offering life annuities only utilise interest-bearing investments within these structures, but these rates do have a significant effect on the income offered. It is also crucial to note that no one financial solution will suit all

investors, and it is of great importance to seek professional advice when considering these options.

The inner workings

To compare these two types of annuities, let's look at the example of Sue Smith. Sue is 60 years old, single, and retiring. She has a R1 million retirement fund benefit, which she has decided to wholly transfer to an annuity.

Scenario 1: Sue decides to invest the full amount in a **living annuity**, from which she wants to draw a sustainable income, up to the age of 78 (As we would like to compare Scenario 1 with Scenario 2, we used the life expectancy from the mortality tables of the Actuarial Society of South Africa, as published in the South African Financial Planning Handbook of 2016.).

One challenge here is that if you start with a high drawdown rate in a living annuity, and implement an annual increase, you may very well reach the maximum drawdown rate of 17.5% per annum of the market value of your investment before age 78. Once that happens, you will not be able to apply an inflationary increase every year, your capital will start to diminish, and your 17.5% will get less in rand value every year. Thus, for this scenario, we incorporated an increasing income up to the age of 78, after which no inflationary increase was applied, and the drawdown rate was capped at 17.5% per annum.

We assume the following:

- An average, long-term, investment growth of 10% per annum net of all fees;
- Income drawdown rate starting at 6.95% per annum *(bearing in mind that an income drawdown rate of between 2.5% and 17.5% may be chosen);*
- Annual income escalation of 5%; and
- Long-term inflation average of 5% per year.

In this scenario and for the purposes of these calculations, Sue's income starts at a 6.95% drawdown as a fixed rand amount. This rand amount is increased by 5% every year. Once Sue retires, she will start drawing a gross (pre-tax) monthly income of R5 791 (R1 million x 6.95% / 12). On the first anniversary of her living annuity, the income will escalate with the assumed inflation rate and increase to R6 081 per month. If all the assumptions hold, then this withdrawal plus annual escalations should be sustainable until the age of 78, meaning that up to this point Sue will receive an annual income increase.

The capital will not be depleted at this age, but from this point onward the capital and income will gradually decrease. At age 90 the capital equates to R335 099, and the monthly income should be R4 886, still at the 17.5% drawdown rate. When Sue passes away, her nominated beneficiary will inherit the balance of the annuity available upon her death and continue to receive the income, or the beneficiary may choose to receive the capital value in cash (subject

to the lump sum withdrawal tax tables), or a combination of these two options may be chosen. What we've also seen in practice, is that it's not always necessary to implement an annual income increase. During some annual reviews with clients, it is decided that the current income amount is sufficient. If no increase is taken, it obviously bolsters the long-term growth of the investment.

Scenario 2: Now Sue decides to invest the full amount in a **life annuity**:

It is important to note that the income from a life annuity is calculated almost exclusively based on the average life expectancy of the annuitant, taken from the mortality tables of the Actuarial Society of South Africa, as previously mentioned. The starting income for a male investor will typically be higher than a female because the average male life expectancy is lower than the average female life expectancy. Also, if an investor does add a spouse as an additional life assured on a life annuity, both their ages will be considered when the insurer calculates a starting income.

Other factors impacting the starting income, for example, is the income pattern you choose, whether you elect a guaranteed period or not, or whether you opt for a capital guarantee (insurers use different jargon but it is effectively life cover). Firstly, the income pattern: you can either choose a fixed-escalating income (as in our example below), an inflation-linked annual income escalation, or a fixed/level income from your life annuity. The latter will start at a higher percentage drawdown, but it will never increase (thus become unable to keep up with inflation and increasing expenses).

Looking at the guarantee period: you can choose, for example, a guarantee period of 10 years. This will mean that if you pass away within 10 years of buying the life annuity, your beneficiary will inherit the capital left in the investment. The upside here of course is that Sue is guaranteed this income for life. The downside comes down to the fact that the income percentage is fixed (including a fixed increase, if chosen) and not flexible at all, and of course, Sue will forfeit the capital, if no capital protection was included.

Here we assume the following:

- Life expectancy according to the actuarial table – 18 years, to age 78;
- Annual income escalation of 5%;
- From Sue's perspective, the investment yield, as well as the income percentage, does not matter as the capital is out of her hands and the income is guaranteed.

With these specs, the starting income rate for Sue as a 60-year-old female should be somewhere around 7.35%, depending on the insurer and the pool of lives assured. She will thus earn a gross monthly income starting at R6 125. After the first year, this will increase to R6

429. So, between Scenario 1 and Scenario 2 and based on the assumptions used, the life annuity does offer a slightly higher starting income. However, the living annuity is affected by several factors, such as the investment growth of the underlying funds and the age to which an income is planned. If either of these changes, then the outcome will inevitably also change – and this is where the risk lies of 'outliving your capital'. The life annuity's income (and escalation, if applicable) on the other hand is set and guaranteed for life. Even if Sue becomes older than 78, she will still receive the income.

Additionally, it is also interesting to note the difference between buying a life annuity at different ages. As I've mentioned earlier, the starting income offered is based on the annuitant's life expectancy. Thus, the older you become, the higher your starting income should be, based on the same capital amount. If Sue decided to buy a life annuity at age 60, her starting monthly income would be R6 125, and at age 65 it would be R6 660 etc:

	Buying a life annuity at different ages, with R1m, with no income increases, no guarantee period	
Age	**Monthly income amount**	**Annual income drawdown**
60	R6 125	7.35%
65	R6 660	7.92%
70	R7 433	8.92%
75	R8 257	9.91%
78	R9 173	11.01%

Back to Scenarios 1 and 2, the table below sets out the following, based on current quotations:

1. What Sue's living annuity would be worth, and the monthly income at that age, based on *Scenario 1;*
2. What Sue's life annuity income would stand at, at different ages, after also escalating by 5% per year, based on *Scenario 2* above:

	Column A			**Column B**		
	a) **Investing R1m in a living annuity at 60, with an 8.4% starting income drawdown, with a 5% annual income increase**			b) **Buying a life annuity at 60 with R1m, with an initial income rate of 7.35% offered, and a 5% annual income increase, with no guarantee period**		
Age	**Living annuity value**	**Monthly income amount**	**Annual income drawdown**	**Capital value**	**Monthly income amount**	**Annual income drawdown**
60	R1 000 000	R5 791	6.95%	R0	R6 125	7.35%
65	R1 126	R7 392	7.87%	R0	R7 815	–

	975					
70	R1 190 389	R9 434	9.51%	R0	R9 974	–
75	R1 120 046	R12 040	12.89%	R0	R12 730	–
78	R963 035	R13 938	17.36%	R0	R16 247	–

Looking at this table, we can see that if you only want to make use of either a living annuity or a life annuity, you will have to essentially choose between:

Living annuity:

- A non-guaranteed, flexible income that can be chosen on an annual basis. Hence, you as the investor take the risk of outliving your capital;
- A probable lower starting income (to prolong financial longevity) than what a life annuity will offer;
- The beneficiary will inherit the remaining funds at the death of the policyholder; and
- Preferably appointing a financial advisor to manage your ongoing investment fund choices and drawdown levels.

And

Life annuity:

- A guaranteed, fixed income for the rest of your life (either escalating or remaining level);
- Possibly a higher starting income than with a living annuity but it depends on various factors;
- Possibly leaving no inheritance unless capital protection is opted and paid for;
- If there is a surviving spouse, the income from the annuity will still be paid for the lifetime of the spouse, at the percentage level chosen at the start of the investment if opted for it;
- Initial assistance from a financial advisor, but no ongoing monitoring and advice will be necessary.

Conclusion

Again, it is important to note that a decision like this will differ significantly for each individual, depending on your specific circumstances, and especially across different ages. The good news is that if you don't want to choose between these two options, some financial service providers offer combined annuities or hybrid annuities. By utilising a combination of life and living annuity you can strike a balance between the pros and cons of each – like having a partially guaranteed income for life while maintaining the ability to leave an inheritance for your beneficiary. I'll elaborate on these options in part 3 of this series. In the meantime, if you need any guidance or advice regarding this and other financial topics, please don't hesitate to get in touch

Moneyweb | 3 August 2022

INTERNATIONAL NEWS

Brand new pension scheme launches in Great Britain

The pensions sector has received an injection of innovation today as a brand new type of pension scheme officially opened for applications in Great Britain. Collective Defined Contribution pension schemes, or CDCs for short, will offer an alternative to the UK's two primary pension scheme models, Defined Contribution (DC) and Defined Benefit (DB). CDCs have the potential to provide improved retirement returns for savers, with more predictable costs for employers. Both employers and employees contribute to a collective fund from which individual retirement incomes are drawn, with trustees responsible for oversight to ensure schemes are viable and can meet their legal requirements and commitments to members.

Minister for Pensions, Guy Opperman, said: CDC schemes have the potential to transform the UK pensions landscape. We have seen the positive effect of these schemes in other countries and it is abundantly clear that, when well designed and well run, they have the potential to provide a better retirement outcome for members, and can be resilient to market shocks. I have no doubt that millions of pension savers will benefit from CDCs in the years to come. The new schemes were made possible following the passage last year of the landmark Pension Schemes Act 2021. Regulations currently provide for single or connected employer CDC schemes.

Some parties have already expressed an interest in expanding CDC models, including multi-employer CDC schemes, as well as the potential for CDC schemes which offer "decumulation only" – when pension savings are converted to retirement income. Nigel Peaple, Director Policy & Advocacy, PLSA, said: The PLSA supports innovation within the pensions sector where it improves people's retirements. CDC blends some of the desirable elements of Defined Benefit (DB), such as clearer target outcomes for the saver, and of Defined Contribution (DC) schemes, such as predictable contributions for the employer and member. By pooling longevity risk and the ability to invest money over a longer period, CDC has the potential to provide new and better approaches for benefit provision.

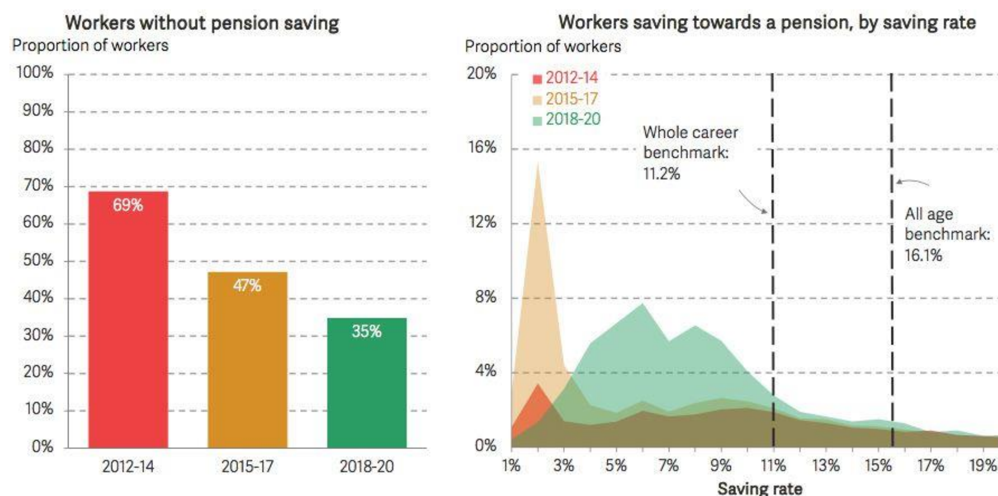
There are, of course, challenges, including how to ensure savers understand the variability of benefits, and ensuring new models can deliver in practice once reserving and regulation is in place. Nevertheless, we are confident that this ambitious proposal will provide the incentive and momentum to overcome them. The DWP plans to consult later this year on a package of prospective design principles and approaches to accommodate new types of CDC schemes.

This will bring the potential benefits to more savers in the UK, while also capitalising on the enthusiasm shown for innovation in this area.

GOV.UK | 1 August 2022

Cost of living crisis deepens pensions shortfall for UK's lowest paid

Eight-in-ten workers are not saving at levels which are likely to deliver an acceptable standard of living in retirement, according to new research. As the cost-of-living crisis means workers have to prioritise meeting needs now over meeting needs later, employers need to do more to enable sufficient pensions contributions. Around the world, record rates of inflation are seeing the average salary spread thinner and thinner. As a result, many companies report that they are being asked by employers to raise pay in line with inflation, as the cost-of-living crisis sees households struggle to make ends meet. However, while an increasingly common line of argument from businesses is that they are raising prices 'due to labour costs', the vast majority are not actually meeting these demands.

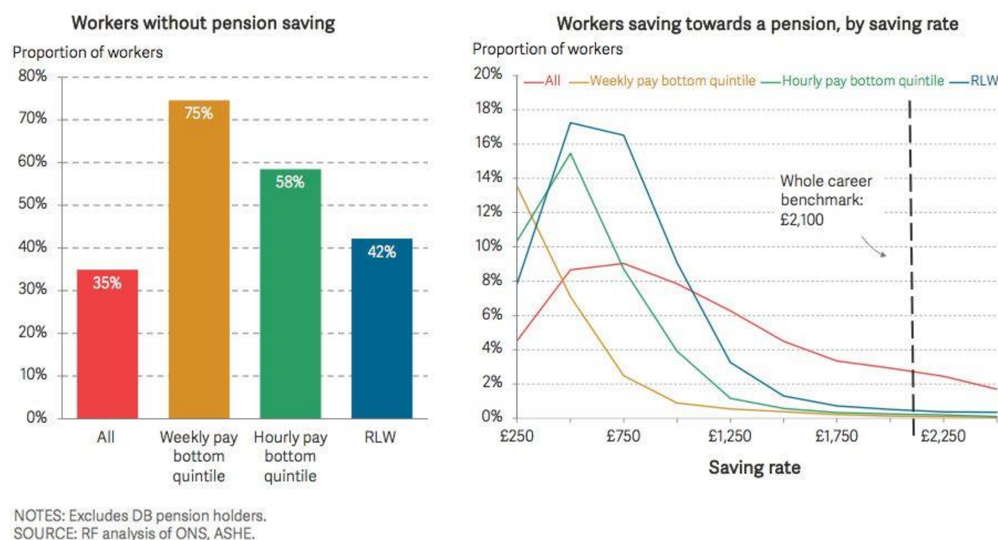


Recent research by business performance consultancy Ayming found that only 8% of employers had given all employees inflation-matching pay rises. For contrast, 13% of firms told the researchers they favoured tactics like "allowing dogs into the office" to help attract and retain talent. As consumers are left with less and less once they have paid rent, met their spiralling energy bills, and contended with a hyper-inflated food-shopping expedition, many are left with little choice but to scale back spending. This is having major impacts on the economy at present – with many experts contending that plummeting demand has left the UK on the brink of a recession. But the impact of wages falling in real terms also have a long term impact, which may well lead to a crisis of another kind in decades to come.

Not saving enough

According to a study from pensions advisory Isio and the Resolution Foundation, commissioned by the Living Wage Foundation, of the UK's working population, four-out-of-five people are not saving at levels which are likely to deliver them adequate funds in their retirement. While the number of workers not saving at all for a pension has fallen, and the most common saving rate has increased, simply taking this at face value risks obscuring a growing divide between the highest paid workers and the wider labour pool, who are being left behind.

Low savings levels are a long-standing issue, however, among the bulk of the population, the cost-of-living crisis is exacerbating the problem. With people having to reign in spending now just to keep their heads above water in the immediate future, many are having to sacrifice pensions contributions. By the researchers' reckoning, as things now stand, 16 million people will have less retirement funds than needed for an adequate standard of living in their lives after work.



Katherine Chapman, Director of the Living Wage Foundation, said, "The current cost-of-living-crisis has hit low paid workers hardest, and many are not only struggling to keep their heads above water today, but also worrying about an uncertain future. This report shows that 16 million people are not saving at levels which are likely to prevent poverty beyond their working lives. Today's cost-of-living crisis risks becoming tomorrow's pensions crisis." It is a problem which is proportionally even worse among low-paid workers. The analysts found that of workers without any workplace pension savings, 75% were in the bottom weekly pay quintile.

Meanwhile, their saving rate was well below average. As a result, fewer than 5% are able to save at a rate that will see them retire adequately. Looking ahead, this information is set to be used to inform a campaign for a Living Pension policy for UK employers and the Government,

which could help improve the situation. Paul Moffatt, Director & Pensions Tax Lead at Isio, which is working with the Living Wage Foundation on exploring the findings of the research, said, “We work with a wealth of industries to help their employees prepare for the future, but the research highlights the challenges being faced and the impact this will have on future generations. As an industry we have a responsibility to provide support now, before it’s too late and a Living Pension could help provide financial confidence for those that need it most.”

Consultancy.UK | 1 August 2022

OUT OF INTEREST NEWS

July 2022 economic update

All sectors of the JSE ended the month in the green.

- Market sentiment improved in July as investors ramped up bets that the United States (US) Federal Reserve would pause its aggressive rate hikes early next year and that the recent decline in commodity prices would help ease inflation. Consequently, the Morgan Stanley Capital International (MSCI) All Country World Index gained 6.9% in July, with developed markets following suit as the MSCI World Index advanced 7.9%. Despite the improved sentiment, there was still a selloff in the emerging markets, with the MSCI Emerging Markets Index losing -0.7%. The disparity is likely because the MSCI China Index, which makes up around 35% of the emerging markets index, lost 10.0%.

- The US Institute of Supply Management’s Manufacturing Purchasing Managers Index (ISM Manufacturing PMI) fell for the second month in a row to 53 in June, as compared to 56.1 in May. New orders also contracted for the first time in two years, hinting that tightening policy may be hurting demand. The ISM Services PMI fell to 55.3 in June, indicating that, while the sector remains strong, it faces numerous challenges, including supply chain disruptions, a tight labour market, and inflation.

- US inflation accelerated to 9.1% in June from 8.6% in May as energy and food prices continued to soar. The jump in prices prompted the Federal Reserve to raise the Federal Funds Rate by another 75 basis points at their meeting in July, bringing the target range to 2.25%-2.50%. More importantly, Chairman Jerome Powell stated that if there is evidence that inflation pressures are easing, the Fed may slow the pace of rate hikes.

- Shortly after, the US released GDP figures for the second quarter, which showed that the economy shrank by 0.9%. This marks the second consecutive quarter of contraction, meeting widely accepted criteria for a technical recession.

- The Chinese economy shrank for the first time since the outbreak of Covid-19, with GDP (quarter-on-quarter) losing 2.6% in the second quarter of 2022. Persistent lockdowns brought about by their zero-Covid policy are the biggest contributor to the drop-off in economic activity. Their statistics agency also stated that "the foundation of sustained economic recovery is not stable" as the world continues to battle off inflation with higher interest rates as well as the prospect of further lockdowns.

- Boris Johnson, the prime minister of the United Kingdom (UK), announced his resignation following immense pressure from his own political party to do so. More than 50 ministers had quit prior to his resignation, and many MPs had been pushing for Johnson to step down following a string of scandals. The Conservative Party will now elect a new leader who will need to contend with a nation full of political and economic uncertainty.

- On the data front, the UK annual inflation rate increased to 9.4% in June, beating forecasts of 9.3%. Despite consumers having to contend with rising food, fuel, and energy prices; the Bank of England governor, Andrew Bailey, has warned that interest rates may have to rise by a further 50 basis points at their meeting in August.

- Locally, load shedding has caused manufacturing production to fall by 2.3% (year-on-year) in May, marking the third consecutive month of contraction. Glimmers of hope can be taken from President Cyril Ramaphosa's energy action plan that was announced to address the country's ongoing energy problems. It is, however, too early to tell if the government will be able to effectively implement the much-needed reforms.

- Local inflation data also showed a sharp jump to 7.4% in June from 6.5% in May. Of more concern is that core CPI, which excludes volatile items such as food and energy, also increased to 4.4% in June from 4.1% in the prior month. Rising prices, as well as a weak rand, prompted the South African Reserve Bank to raise rates by 75 basis points, the largest hike since 2002. This brings the repo rate to 5.5% and the prime lending rate to 9%.

- Despite the rate hike, fears of a recession continue to keep demand for the safe-haven dollar elevated, causing the rand to lose 2.3% against the greenback in July. The rand also lost 2.2% against the pound, however, gained 0.3% against the euro due to their ongoing energy problems and the near certainty of them facing a recession.

- South African equities followed the developed markets higher, with the JSE All Share Index advancing 4.1%. All sectors ended in the green, with industrials returning 5.8%, followed by 3.9% and 0.8% for financials and resources, respectively. South African listed property ended its three-month losing streak and posted a monthly gain of 8.7%.

- One-month index movements:
  - JSE All Share Index: 4.09%
  - S&P 500 Index (US): 9.11%
  - FTSE 100 Index (UK): 3.54%

Moneyweb | 1 August 2022

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