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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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Strengthen your retirement plan: activate the right levers

A recent Forbes **article** states that "people who check their accounts frequently and trade more frequently tend to buy high and sell low compared to people who rebalance once a year". Amid global concerns over the performance of retirement savings during these volatile economic times, it's natural for people to be concerned about reductions in their savings. However, a successful retirement plan is about much more than investment returns.

According to Andrew Davison, Head of Advice at Old Mutual Corporate Consultants, there are six important factors that drive retirement outcomes. "We think of these crucial factors as levers, and it's important to realise that they are dependent on each other. Often, people don't appreciate the ways that the various levers interrelate — they adjust one of the levers without making compensatory adjustments to one or more of the other levers.

Now more than ever, as the world continues to battle the economic fallout of the pandemic, investors should take into account the potential consequence of every move." Malusi Ndlovu, Old Mutual Corporate Consultants General Manager, says simply activating all six levers haphazardly will not produce the intended results. "There are combinations that make sense and many that don't. Ultimately, as you examine the six levers, you'll come to understand what makes sense for you," he says.

Lever 1: Contributions

"Your contributions don't do the heavy lifting," says Davison, "but they are your ticket to the game. If you don't contribute enough to your retirement pot, and do it early enough, there won't be enough to grow."

Lever 2: Investment strategy

Time is every investor's friend, especially if you want to leverage the 'secret sauce' of compound interest. It is worth noting that the secret sauce only works when you have a long-term investment horizon. "An example is Janet who left her previous employer and their pension fund in 2004. She preserved her retirement savings in a preservation fund. Since then she hasn't touched it, but she also hasn't added anything to it (as it's not possible to add to a preservation fund)," says Davison.

"Today, it's worth more than five times the amount she initially transferred, thanks to the magic of compound interest." This is despite the fact that the investment strategy for these savings has navigated a journey through the 2008 Global Financial Crisis and now the Covid-19 pandemic.

Lever 3: Preservation

The strategy of leaving savings untouched when changing jobs is probably one of the most difficult for retirement investors to heed, yet it is especially crucial if you want to meet the target of having nine or ten times your annual salary saved up at retirement date.

Lever 4: What to do with your capital at retirement

Your retirement date presents you with an array of important choices that will determine the quality of your retirement. For many people, it's the point in time that they finally get their hands on all that loot that's effectively been out of bounds until then. It's a critical juncture and one that requires a cool head. "The decisions you make when you retire really are momentous and will determine how you live from then on," Ndlovu says.

These decisions include how much to take as a lump sum, what type of annuity to use to convert capital into a monthly pension – which also includes the level of benefit you'd like to leave to beneficiaries, the level of future increases in pension you'd like to have and also how to plan for a spouse or other partner to receive income when you predecease them. There are also tax considerations and, potentially, decisions about where to live and hence about property. "Savers ought to be aware that a bad decision can undo a lifetime of good savings behaviour. To avoid getting into a difficult situation, investors should make use of an adviser or a free retirement benefits counsellor".

Lever 5: Retirement age

Ndlovu says the most important question concerning retirement date is not at what age you plan to retire but rather at what point you will be financially prepared to retire. To this end, Ndlovu suggests that "the word 'normal' retirement age should probably be removed from the lexicon", as this will vary from one individual to another based on their circumstances and the preparations they have initiated.

Full Report: ***https://www.fanews.co.za/article/retirement/1357/general/1358/strengthen-your-retirement-plan-activate-the-right-levers/29322***

FA News | 11 June 2020

Surviving a recession: Pay off debt and don't dip into retirement savings

- The economy could contract by between 8% and 10% this year, endangering some 800 000 jobs.
- Recovery could take years.
- Experts warn against making "knee-jerk" decisions when it comes to investments.

With several analysts projecting the economy to contract between 8% and 10% this year, which would result in massive job losses, consumers might be tempted to dip into their retirement savings to buoy their cashflows, but experts have warned that they should not. South Africa will see one of the deepest contractions of its history, as the impact of the lockdown to slow the spread of Covid-19 has exacerbated an already poor economic situation. Before entering the lockdown, the domestic economy was facing a technical recession. Senior economist of FNB, Siphamandla Mkhwanazi said that as many as 800 000 job losses are projected.

A recovery could take between two to three years, and largely depends on steps taken by government in rolling out structural reforms, especially in the energy sector, he said. In the meantime, consumers and businesses will be facing pressure. The Reserve Bank slashed interest rates by a whopping 225 basis points so far this year, to try and inject liquidity into the economy, but the effects of these aggressive rate cuts have not yet been felt in the economy, which is still in lockdown.

The partial reopening of the economy has helped to spur on the recovery. But Mkhwanazi said that it is possible that even if we transition to lockdown level one, some businesses might still not be able to operate. Furthermore, consumers might likely change their behaviour – such as going out for entertainment or travelling. There could be further job losses, if say for example corporates opt for automation instead of physical labour, and if households change their spending behaviour. Mkhwanazi said that low demand might persist into 2022.

This could lead to a deflationary effect on some items such as clothing and even rentals. On the upside, the recovery period could see a new jobs being created, for example retailers employing health practitioners in response to consumers becoming more health conscious.

Full Report: ***https://www.news24.com/fin24/money/surviving-a-recession-pay-off-debt-and-dont-dip-into-your-retirement-savings-20200610***

Fin24 News | 10 June 2020

You should not treat your retirement fund as an ATM

In these current market conditions, if you have a job, hold on to it. This is logical. However, there is a new trend on the rise – financially desperate people resigning from their jobs without new ones lined up, just so they can access the money saved in their pension funds.

The size of the unemployment problem

It seems logical, especially in light of the current unemployment statistics – if you have a job, try not to lose it. According to Stats SA, the unemployment rate was around 29.1% in the third quarter of 2019. Some argue that it's closer to 36%, which equates to around 10 million working-age South Africans. Nobody knows for sure what the actual count will be in 2020 in the context of Covid-19.

As a result of the pandemic, the subsequent market turmoil in its wake, and the unrelated investment downgrade that followed, many industries in South Africa will shrink this year. It is likely that many companies in those industries will close and thousands of jobs will be lost. These numbers provide a stark reminder that jobs are scarce and finding a new one will not be easy if you lose the one you have.

Steer clear of your pension fund

When you resign from your job, you are allowed to cash out the total of the savings accumulated in your employer's pension fund, but you will pay a hefty sum in taxes. The tax laws around cashing out your pension fund are in place to dissuade you from doing so, and with good reason. You may be financially desperate, but here is a summary of why you need to stay put in the job you have, and step away from your pension fund:

Don't play Russian Roulette with your financial future. Resigning from your job purely to access your pension comes with huge risks and costs. There is way too much uncertainty in the job market, so don't be confident about getting hired elsewhere soon. Also, consider what resigning could mean for you and your family if you are a breadwinner. Don't rob your retired self. Retirement savings is your money, but it belongs to you when you retire. Spending it now could mean that you won't have enough saved to live on when you retire. Not having enough retirement savings means you will need to find income-generating employment after you retire. If jobs are scarce now, what will the job market look like when you're 60?

Cashing out your pension fund is taxing, literally. You can only cash out your pension fund if you withdraw from the pension fund i.e. when you resign. Resigning and retiring are two completely different scenarios.

- If you retire, you can only cash out up to one-third, and the balance must be used to purchase an annuity.
- If you withdraw, (when you find a new job and resign), you could typically transfer as much of your funds as possible to a preservation fund at a registered financial services provider. Other options would be transferring to a retirement annuity or the new employer pension fund. However, you can cash out the full amount, but the tax you pay on the cash lump sum would be more than if you retired from the fund. The tax payable when cashing out your pension fund is calculated as follows:
- the first R25 000 is not taxed;
- the balance up to R660 000 is taxed at 18% of the amount over R25 000;
- the balance up to R990 000 is taxed at R114 300 + 27% of the amount over R660 000; and
- the remainder is taxed at R203 400 + 36% of the amount over R990 000.

Consider all the money you will be losing in compound interest. You are giving up a lot of the "magic" of compound interest, especially if you cash out 100% of your pension fund now. In the table below is an example of the financial outcomes of two people, Chris and Thandi, who both have resigned and withdrew money from their pension funds. ***Full Report: https://www.iol.co.za/personal-finance/retirement/you-should-not-treat-your-retirement-fund-as-an-atm-49199352***

IOL News | 11 June 2020

Risks facing retirees in the COVID-19 era

The worldwide Covid-19 pandemic has cast a spotlight on the risks facing those about to retire or already retired. But no matter the economic environment, preparing for one's best possible retirement takes careful planning and consideration of the available retirement options as well as the risks of each.

There are three main risks facing retirees:

- Outliving your retirement savings
- Having your spouse or dependents not taken care of when you die
- Your income does not increase as fast as your expenses

To deal with these risks, it is of no use worrying about things you cannot control or influence. One needs to focus on things within your control. To effectively manage these risks, you need to manage your expenses within your budget; choose the best type of annuity for your needs; and get good advice.

Managing your expenses within your budget

What can you do to prepare and take control of your retirement? We believe there are five simple steps that can be followed to make sure you understand your expenses and thus your income needs. You can take control by:

1. Understanding your situation so that you know where you spend your money and know what resources you have. Make lists

2. Reviewing your expenses in detail to find out which expenses can be reduced, delayed or stopped.

3. Planning. Work out how long you will be able to pay your bills, by calculating your total household income, savings and other possible sources of income. Work out how much you will need going forward each month. Also spend some time thinking about which expenses may increase, for example medical expenses.

4. Being proactive: Once you understand your financial position, you can start planning for when and how you will reduce, delay or stop any non-essential expenses. Also, consider taking other necessary actions to ensure that your money stretches as far as possible and for as long as possible.

5. Starting a good habit. Now that you have a budget and a plan, stay on top of your finances by recording your expenses, compare your expenses to your budget every time you spend money and check your plan every month and adjust it if needed. By starting a good habit, you'll be using this opportunity to put yourself in a better position to achieve what matters most to you.

Choosing the best type of annuity (pension income) for your needs

There are two broad categories of annuity types – a “guaranteed”, or life annuity is the first type, and a “flexible” or living annuity. Each has its benefits and drawbacks, plus a host of options within each broad category. More recently there are hybrid options that combine the best features of each.

In terms of guaranteed pension options, the decisions which need to be made are:

- Future pension increases – these can be level which pays the same income for the rest of your life (generally not advised as inflation erodes this value over time), or a fixed increase pension pays a lower starting income and increases each year at a fixed percentage chosen. There is also an inflation-linked pension is guaranteed to keep up with inflation up to certain limits and a with-profit pension has increases linked to investment performance in an underlying reference portfolio.
- Including a spouse’s pension
- Including a minimum period for which payment will continue regardless of death

These decisions affect the level of income at the start. A higher starting income is not always better as it may set you up for low or no increases and severe financial hardship later. On the other hand, a flexible pension is not guaranteed to last for life, and how long your money (or rather level of income) will last depends on how much income you take, as well as the growth of your underlying investments. The law allows you to draw a pension of between 2.5% to 17.5% of your money per year and a financial adviser can help you manage your investments and decide how much you can afford to take each month.

Get good advice

The value of good advice cannot be underestimated. Especially at an important and often irreversible decision point like retirement. It helps you decide which goals and needs to prioritise while understanding your options and the costs and benefits of each. This means you are fully informed to choose the option that best meets your needs. A good adviser will help you make decisions in time to receive your pension when you need it and help you with your ongoing decisions if you choose a flexible pension or more complex pension option.

With large financial decisions to be made, there are many benefits to playing an active role in your retirement journey. You are not a passenger on the journey, but the driver.

FA News | 9 June 2020

SA's post-Covid revival: why harnessing pensions for infrastructure may just work

The latest proposal has sparked formal discussion, in contrast to talks that were previously conducted inelegantly, to resolve longstanding contentions

Forget prescribed assets. They're a diversion from the potentially solid proposal now on the table that seeks a social compact through retirement funds, representing millions of South Africans' long-term interests, for investment in growth and employment-generating infrastructure projects. The introduction of prescribed assets would have been the government's blunt instrument to force a proportion of retirement fund assets into the dark holes of virtually unaccountable state expenditure.

The state would have been raiding pension assets while simultaneously, and in contrast, urging retirement provision. Instead, what seems now to be emerging is the opposite. If the state isn't to force the markets, it must be friendly towards them. At least the latest proposal has sparked formal discussion, in contrast to talks that were previously conducted inelegantly, to resolve longstanding contentions about the deployment of retirement fund assets.

On the one hand there's a state desperate for investment. On the other there are retirement funds screaming for a broader range of investable opportunities. The crisis over Covid-19 brings the issues to a head:

- How to fund SA's huge infrastructure requirements when the fiscus has no money; and
- How the mega-billions of rand in retirement funds can be put to more productive use in SA's real economy. There would be alternatives to hedging against the rand (by investing offshore or piling into large-cap giants on the JSE whose revenues are earned primarily outside SA) and being trapped in the ever-shrinking pool of domestic mid-cap JSE-listed equities (especially when the post-Covid scenarios for many old favourites range from speculative to sombre).

To dispense with the political wrap, the ground is being prepared for retirement funds to invest much more heavily in the unlisted space than the limits at present allowed under the Regulation 28 prudential guidelines. The principle is well and good, so long as established rights, enshrined by the Pension Funds Act for the protection of fund members, remain inviolate. What is unclear is the origin of this new proposal, which is quickly generating heat and suspicion over its intentions.

Full Report: [***https://www.businesslive.co.za/fm/opinion/2020-06-08-sas-post-covid-revival-why-harnessing-pensions-for-infrastructure-may-just-work/***](https://www.businesslive.co.za/fm/opinion/2020-06-08-sas-post-covid-revival-why-harnessing-pensions-for-infrastructure-may-just-work/)

Business Day Live | 8 June 2020

INTERNATIONAL NEWS

U.K. deficits rise as coronavirus continues to hit markets

The total deficit of U.K. defined benefit funds covered by the Pension Protection Fund's 7800 index worsened 37% in May to £176.3 billion ($217.6 billion).

The deficit was £128.5 billion as of April 30. The deficit of U.K. defined benefit funds also deteriorated over the year ended May 31, from £38.1 billion as of May 31, 2019, London-based PPF said Tuesday in an update. The funding ratio of the corporate pension plans covered by the index decreased over the month to 90.9% as of May 31, down from 93.1% as of April 30. The funding ratio was 97.7% a year ago, the update said.

Assets increased 1.4% during the month and rose 8.6% for the year ended May 31, to £1.769 trillion. Liabilities increased 3.8% over the month and increased 16.7% for the year, to £1.945 trillion. The FTSE All-Share index improved 3.4% for the month but fell 11.2% for the year ended May 31, the PPF said. The PPF is the lifeboat fund for the defined benefit plans of insolvent U.K. companies. Five- to 15-year index-linked gilt yields decreased 29 basis points in May, and fell 51 basis points over the year. As of May 31, 66.8% of the 5,422 pension funds covered by the index were in deficit, compared with 64.6% as of April 30. A year ago, 70.6% of the 5,422 pension funds were in deficit.

"The impact of (the COVID-19 pandemic) continued to dominate global markets in May. Whilst equity markets continued their rebound throughout the month, widening inflation expectations saw a sharp decrease in real yields and therefore a corresponding jump in liability values," Sion Cole, head of U.K. fiduciary business, at BlackRock said in an emailed comment.

Pensions & Investments | 9 June 2020

COVID-19: How Nigerian pension funds has performed so far

There is need to watch out for any style shift that may increase the risk attributes of pension fund portfolio structure.

In what looked like sayings from Nostradamus (the man who saw tomorrow), various media houses all over the world predicted that pension funds would be hit hard by COVID-19. On April 1st 2020, Bloomberg news prophesied that pension funds would be hit. In like manner, the CBC News, Canada, noted on Mar 18, that public pensions take a hit from COVID-19 concerns. UK’s Guardian news wrote on February 29th 2020, *“British pensions set to take a hit from market tumble”* and the Telegraph caped it up with a caption that *read,*" Pensions hit by "double whammy" of bank rate cuts and falling markets". *The same predictions were made by many other news outlets*.

From the look of things, and going by the March 2019 edition of the Summary of Pension Fund Assets released by the National Pension Commission (PenCom), Nigeria, those predictions seem to have come true for the Nigerian pension fund industry. According to the March 31st Summary of Pension Fund Assets, the total value of pension assets stood at N10.327 trillion, a reduction of N180 million or 1.71% when compared with the February 29th total value of N10.507 trillion.

The reduction came from sell-offs of pension fund investments in domestic ordinary shares and Treasury bills. In the month of March actually, pension funds saw N200.4 million flowing out of the industry with only N20.28 million flowing in. Of the fund types, RSA fund (fund 2) was the hardest hit as it suffered most of the reductions in net asset value.

April Fool: The industry, however, made a quick recovery in April when the asset value increased by 2.42%, according to Summary of Pension Fund Assets of April 30th 2020. ***Full Report: https://nairametrics.com/2020/06/10/covid-19-nigerias-pension-funds-take-a-hit/***

Nairametrics | 10 June 2020

British companies seek extra time to plug ballooning pension gaps: sources

LONDON (Reuters) - An increasing number of British companies, trying to conserve cash through the coronavirus crisis, are seeking more time to plug pension scheme deficits, forcing pension trustees to make some tough choices, industry sources say. Many of these "defined benefit" pension schemes are closed to new members, but more than 7 million people are still paying into them, including thousands of workers from the country's biggest companies.

The pension deficit issue also has an impact on investors, as the country's pension watchdog has said companies should resume payments into pensions schemes ahead of dividends to shareholders. And big pension scheme deficits can also become major hurdles to M&A activity. Pension deficits have ballooned during the pandemic because of its impact on stock markets and bond yields. The country's 5,000-plus defined benefit, or "final salary" schemes, had a collective funding gap of 176 billion pounds ($222.66 billion) at end-May, its widest since August 2017 and compared with only 11 billion pounds at end-2019.

Two-thirds of the 5,422 defined benefit pension schemes in the PPF 7800 index are in deficit. The index represents pension schemes outside the public sector. Mindful of the pressures facing company boards, with whole swathes of the economy out of action, the pensions regulator in March said pension fund trustees should be open to deferrals of top-up payments by companies to fix deficits, usually for three months. The regulator said it would review this guidance by end-June. here

Industry sources told Reuters they expect the watchdog to support further payment holiday requests, in line with government extensions to furlough schemes for companies under pressure from the months-long quarantine. A spokesman for the Pensions Regulator said the watchdog might issue more guidance before the end of June, but did not give more detail.

As many as 15% of companies have sought a deferral already, according to the regulator. Mike Smedley, partner at consultants Isio, said this is likely to represent a record drop in pension fund contributions. The companies include threadmaker Coats Group (COA.L) and media companies Reach (RCH.L) and ITV (ITV.L), with more expected to follow when they publish their next set of earnings. Bina Mistry, senior director at consultants Willis Towers Watson, said given loss of earnings due to the economic crisis, the number was likely to grow: "The longer this goes on, the harder it becomes."

Full Report: ***https://www.reuters.com/article/us-health-coronavirus-britain-pensions/british-companies-seek-extra-time-to-plug-ballooning-pension-gaps-sources-idUSKBN23H279***

Reuters | 10 June 2020

OUT OF INTEREST

How does a recent court ruling affect living annuities in divorce?

The SCA ruled that the right to receive annuity payments is an asset in the annuitant's estate and can be taken into account for the determination of accrual.

I was told there was a recent court case in relation to accruals from living annuities including drawdowns that changed the legal stance significantly. I hope you had sight of this and can give us an explanation of how exactly it will work and how it will be calculated.

"I assume the question relates to a recent judgment handed down at the beginning of May by the Supreme Court of Appeal in the matter of CM vs EM Case No: 1086/2018. This was a divorce matter where the parties were married out of community of property, subject to the accrual system. The question before the court was whether the husband's living annuities form part of his estate for purposes of calculating an accrual.

Before I go into the detail of the judgment, it is important to remember that a living annuity does not fall under the definition of 'pension interest' as defined in the Divorce Act and, as such, an annuitant cannot give part or all of the living annuities to an ex-spouse in terms of a divorce order, or agree to split the annuity income with an ex-spouse. This is different from a position where the assets are held in a pension, provident or retirement annuity fund. In determining if the living annuities held by the husband formed part of his estate for purposes of calculating accrual, the court made a distinction between (a) the capital invested in the living annuities and (b) the right to receive a regular annuity payment from the insurer based on the capital value of the underlying investment. The court confirmed the current position that the capital portion of the living annuity belongs to the insurer who issues the living annuity contract. The capital is reflected on the balance sheet of the insurer and, in return, the annuitant only has a contractual right to receive a regular payment from the insurer. As such, the capital value of the living annuities cannot be taken into account for the determination of a person's accrual. Where the judgment did go further was in relation to the contractual right of the annuitant to receive annuity payments from the insurer.

The court decided the right to receive annuity payments is an asset in the annuitant's estate, and therefore can be taken into account for the determination of the accrual. How the value of this right to receive the annuity is to be determined was not decided; this part was reverted back to the trial court. How the right to receive regular annuity payments is to be valued is still to be seen, but I would assume this will have to take into account factors such as the annuitant's life expectancy, the level of drawdown and the expected investment return.".

Moneyweb | 9 June 2020

Switchboard : 011 450 1670 / 081 445 8722
Fax : 011 450 1579
Email : reception@irf.org.za
Website: www.irf.org.za

2nd Floor Leppan House
No 1 Skeen Boulevard
Bedfordview 2008