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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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FSCA: Its full steam ahead for Default Regulation compliance

On 1 March 2019, retirement funds will be expected to be fully compliant with the Default Regulations that were implemented on 1 September 2017. The key question that needs to be asked is what some funds have been doing with their time? The Default Regulations were implemented in September 2017 and funds had an 18 month grace period to ensure compliance; why then are there still concerns in the market that some funds will not be ready for full compliance come 1 March?

FAnews spoke to Olano Makhubela, Divisional Executive for Retirement Funds Supervision at the FSCA, to find out what the regulator has to say about this key issue.

Immensely beneficial

Makhubela feels that while the change may catch some retirement funds, and the Boards of these funds, off guard, the Default Regulations will be immensely beneficial to the industry.

He points out that the default regulations address both the accumulation and de-accumulation phases of retirement savings and are intended to make the product offering of retirement funds less opaque to members and to offer better outcomes.

“The benefits to the retirement funds industry will include more transparency on costs and investments to fund members and trustees, better consideration by funds of the needs and requirements of their members, less leakage from the retirement savings net, and more competitive offerings and lower costs for funds and their members, which will result in more retirement savings for members,” says Makhubela.

Pertinent concerns

The Default Regulations have raised a few eyebrows with some funds questioning whether the Boards that govern these retirement funds have the necessary skills and knowledge to make the decisions that the Default Regulations will require them to make.

“Funds and their boards have been aware of the content of the default regulations for several years, and many in the retirement funds industry have welcomed these regulations as long overdue. The regulations themselves provide the broad decision-making framework for board members. Further, section 7D(1)(e) of the Pension Funds Act does provide for the Board of a fund to obtain expert advice on matters where board members may lack enough expertise; this would equally apply in this case,” says Makhubela.

So, the Boards of retirement funds have been thrown a lifeline when it comes to the skills that are necessary to make important decisions. However, that is not the only concern in the industry.

The other concern is time. Boards of retirement funds don't meet often, and there are concerns that they will not meet again in 2019 to address the Default Regulations. Has the FSCA given the industry enough time to come to terms with the requirements of the Default Regulations?

"Yes. National Treasury undertook an extensive consultation process with the public and industry participants over several years and the Draft Default Regulations were published for comment on 22 July 2015. The Default Regulations were changed after this consultation process and the final regulation was published on 25 August 2017 with an effective date of 1 September 2017. Funds were thereafter provided with a further 18 months from this date (1 March 2019) to comply. It is therefore evident that not only was the industry consulted and made aware of the default regulations many years in advance, but funds were afforded a further 18 months after this date to comply," said Makhubela.

A cardinal sin

The Boards may not have the knowledge to make the right decisions 100% of the time when it comes to the Default Regulations and they may not have time to consult with relevant experts prior to making these decisions. These are undeniable facts.

However, Boards will also be reluctant to make the wrong decision and then be held liable for that decision further down the line. This leads to the next industry concern; many industry experts feel that Boards will revert to a *tick box* approach when it comes to the Default Regulations. This approach is something that the FSCA has vehemently been fighting against for the past three years.

"The latest financial services laws and the latest FSCA Regulatory Strategy discourages a tick-box approach to regulation and compliance. The focus, instead, must be on clear and transparent decision-making and an outcomes-based approach by funds, which will deliver better and long-term benefits for their members. Instead of being overly concerned about making wrong decisions, Board members should focus on applying themselves to whatever decision they need to make, obtain as much knowledge on the subject-matter as is reasonable, obtain further advice and guidance where necessary, and make an informed decision on any subject-matter.

This will at least ensure that Board members can demonstrate if and when they are asked to account for decisions they made, they did so reasonably and rationally. Therefore, they would not be held personally liable for such decisions if, with hindsight, it turns out to be wrong," says Makhubela.

The FSCA will monitor funds' adherence to the default regulations on an ongoing basis and the outcomes of these regulations for funds and their members, which will also indicate to the Conduct Authority whether funds are in fact considering the objectives of the default regulations on an ongoing basis and adjusting accordingly. “A skilled and able Board can still make incorrect decisions. It is also the case that Boards are not expected to be right 100% of the time. However, it is reasonably expected that Boards take appropriate and timely action as and when it is discovered that there may have been a wrong decision,” says Makhubela. He adds that the FSCA expects funds and their boards to properly apply their mind to the implementation of the default regulations in their funds and to monitor the outcomes of their decisions.

FA News | 5 February 2019 | Jonathan Faurie

Retirement saving needs to start sooner than you think

Save first, then spend.

The biggest financial mistake a young person can make is believing that planning for their retirement is something they can worry about when they are earning better salaries in the future, or that their retirement savings are being adequately taken care of via monthly deductions by their employer.

“It is astonishing how many young people only save via their employers’ pension or provident funds and how many have no idea how much they are saving, where that money is invested, and in what,” says Jac de Wet, national head of sales at PSG Wealth.

There is often a mistaken belief that saving makes more sense once you are earning more and therefore have more disposable income to save. In reality, says De Wet: “As people are promoted and their salaries increase, so does their standard of living and their monthly expenses tend to go up in line with their increase in income.” But retiring comfortably is first and foremost about the period invested rather than the amount, he adds. The most important thing to know is that the earlier you start, the less you need to save monthly.

And if you haven’t, catching up is not about catching up on the amount of savings you have missed out on in the past couple of years. It is really about catching up on the compounded returns you have missed out on. To illustrate, De Wet says that if you want to retire with R1 million at age 65 and you start saving at age 25, you’ll need to save R180 a month (assuming a 10% annual return and not taking inflation into account). If you want to end up with R1 million at age 65 but only start saving at age 45, you will need to save almost R1 400 a month, so the longer you postpone saving, the more you need to save.

This is equally important for people working for themselves who need to fund their own retirement. Many tend to pump any money they make back into the business without making formal provision for retirement – but this provision is even more crucial for the self-employed as there is no employer making automatic retirement savings on their behalf. “The moment you formalise your retirement savings plan, and don’t deviate, the better the outcome at retirement.”

According to PSG Wealth, apart from starting as early as possible, to be part of the 6% of South Africans who are able to retire comfortably, you can actively plan and maximise your saving by following a few steps:

Save more by cutting back on expenses and dropping your standard of living. According to PSG Wealth, an additional R1 million at retirement today buys you an extra R4 100 a month (based on an annuity rate of 5%).

Allocate a higher percentage to growth assets like equities. De Wet says a rough rule of thumb is to deduct your current age from 100 (the age to which you could live), and the result is the percentage exposure you should have to equities. So, at age 40, you should have 60% in equities and at age 60, you should have 40% in equities. Preserve your retirement funds. Never take the option to cash out your pension benefits when you change jobs or get retrenched, and don’t be tempted to use your retirement savings for anything other than retirement.

Make use of all the tax benefits available. All contributions to retirement annuities, pension funds or provident funds are tax-deductible up to 27.5% of your taxable income, up to a maximum of R350 000 a year. This is particularly important for those who are self-employed, De Wet says, and retirement annuities are an ideal vehicle for saving and making use of tax benefits.

Work for longer, even if it is part-time after formal retirement.

Get financial advice.
Given that the local equity market has not given positive returns recently, it has become increasingly difficult to convince people to invest for their retirement. But markets are so cheap at the moment. “People who start saving and investing now are doing so at the lower end of the cycle and the upside is much bigger than the downside,” De Wet says. “The upside and the opportunities, especially in South Africa, are phenomenal, with many quality companies trading on single-digit price-to-earnings ratios (P/Es). The potential upside far outweighs current risks.”
For those nearing retirement, De Wet says that if they can keep working for another few years – at a time when compounding their savings “really hits the ground” – the effect on their retirement savings will be immense. ***Full Report: https://www.moneyweb.co.za/moneyweb-opinion/soapbox/sa-hedge-funds-outperform-warren-buffets-million-dollar-bet/***

Moneyweb | 30 January 2019 | Marcia Klein

Is there any tax benefit in saving over the annual tax deductible amount towards retirement?

One of the key benefits of investing for retirement using a retirement fund is the generous tax deduction for contributions, subject to a maximum of 27.5% of the greater of your taxable income or remuneration, with an annual ceiling of R350 000.

While most of us may find it difficult to get anywhere near these limits in the midst of all of our monthly expenses, from time to time we may be lucky enough to get a bonus or another windfall, or perhaps our expenses adjust down as our children complete their studies or our homes are paid off. Under these circumstances, is there any benefit in contributing beyond the maximum annual tax deductible amount to a retirement fund?

The answer is yes. Retirement fund contributions can help to reduce your tax bill in more ways than one.
They can:

- Reduce your tax bill in the current tax year
- Reduce your tax bill in the next tax year or in future tax years (any unused portion carries over indefinitely)
- Reduce your tax bill when you withdraw or retire from a retirement fund
- Help you to get tax back from SARS on your living annuity income when you file your tax return
- Reduce the tax bill on cash your beneficiaries may choose to take from your retirement fund or living annuity on your death

These are explained in more detail below.

1&2. Reduce your tax bill this year and in future years while you earn

Contributing in excess of the maximum annual amount can benefit you in future years. This is because these excess contributions carry-over to the following tax year, and may reduce your taxable income during the next tax year, even if you don't make any new contributions in that year. If you still make additional contributions in the next tax year, those contributions and the carry-over amount from the previous tax year are added together and are subject to the 27.5% annual limit again, with any excess carrying over to the following tax year. Carry-over can happen indefinitely throughout your lifetime.

3. Reduce your tax bill when you withdraw or retire from a retirement fund

If you choose to take a cash portion from your retirement fund, the taxable amount of this cash lump sum may be reduced by any excess contributions SARS has on record for you. Your fund may ask you for a copy of your latest ITA34 (Notice of Assessment) from SARS to attach to your tax directive application. This is because the ITA34 contains the excess amount of contributions that SARS has on record for you at the time you filed your most recent tax return. If this amount is still available (and has not been used between when you filed your latest tax return and when your tax directive is applied for), it may reduce the tax you pay on the cash you are taking from the retirement fund.

It is important to note that the tax bill on your retirement cash lump sum takes all previous taxable cash lump sums you have received into account, including severance benefits and cash lump sums withdrawn from a living annuity (which is allowed if the value of your account falls below the prescribed limits).

Calculation 1 illustrates how SARS calculates your tax liability on the cash amount when the fund applies for a tax directive, and how excess contributions are taken into account. This calculation assumes that you are retiring from your Allan Gray Retirement Annuity and that the following applies:

• You have not taken any previous taxable lump sums, therefore the R500 000 that is made available to you during your lifetime at 0% tax is still available on retirement. This R500 000 amount is built into the retirement lump sum tax tables (see "Step two" in the calculation below). If you had taken previous taxable lump sums, you may not have the full R500 000 available, as the lump sum tax calculation takes the accumulated value of all previous taxable lump sums into account when you withdraw or retire.

• You have R200 000 of excess contributions on record with SARS.

• The market value of your Retirement Annuity (RA) is R2.5 million and you choose to take one-third in cash (R833 333). ***Full Report:*** ***https://www.fanews.co.za/article/retirement/1357/savings-investments/1359/is-there-any-tax-benefit-in-saving-over-the-annual-tax-deductible-amount-towards-retirement/26148***

FA News | 6 February 2019

Be Warned: Your retirement benefits may not end up where you plan

If you are formally employed you might have been required to join your companies contracted retirement scheme, and they would have asked you to nominate a beneficiary for the proceeds in case you die before retirement. However, if you chose a beneficiary that is not your dependent then the chances are that the retirement fund trustees won't honour your wishes!

This is according to David Knott, of Private Client Trust, a division of Private Client Holdings, who says that legislation surrounding Retirement Annuities, Pensions, Provident and Preservation funds favours dependants over other beneficiaries, and the fund trustees are then obliged to override your wishes if dependants exist. "Dependants could be a spouse, biological, adopted or step-children, or anyone - such as an ex or a parent - who can prove that they were financially dependant upon you."

Things can get complicated

Knott highlights an example of when things can become complicated – delaying the payment of funds. "A man nominates his current wife as the beneficiary of his retirement benefits. When he dies the trustees find out that he had young children from a previous marriage. In this instance they would need to consider the claims of all claimants and call for evidence – looking at the financial situation of each claimant before deciding how to distribute the money."

One year claim period

Any dependant should obviously come forward with their claim as soon as possible following death, but the law allows up to one year for claims to be considered. Because of this - unless it is easy to identify exactly who the claimants are – there can be delay in payments to needy claimants.

"If no dependants come forward and the deceased estate is solvent, the fund trustees will make payment over to the nominated beneficiary once they are satisfied that no claimants will come forward – or after the one year period has lapsed. If the estate is insolvent, the trustees will first satisfy the estate shortfall with creditors being settled first. Any surplus would then be paid to the nominated beneficiary," explains Knott.

Other things to keep in mind

If you don't nominate a beneficiary, or the chosen beneficiary dies before you do, the fund trustees will pay the lump sum over into your estate.

A benefit payable to a minor may be paid to that child's guardian or alternatively, if the sum is substantial, the trustees may elect to pay to a trust created for the benefit of that minor.

A benefit owed to a dependant may either be paid as a lump sum (after deduction of any tax payable) or can be used to purchase an annuity for the benefit of that dependant.

"You should always consult with the Human Resources manager within your organisation and your financial advisor or wealth manager to ensure that the beneficiary you nominate for your retirement benefits does not create any unexpected consequences after death," concludes Knott.

Personal Finance | 6 February 2019

With #StateCaptureInquiry who is looking after SA's retirement savings?

As we hear daily of new horrors about the plundering of state coffers – frequently with the assistance of the officials elected to protect them – 10X Investments is running workshops aimed at ensuring the security of another pool of South African citizens' assets: private and corporate retirement savings.

The Zondo Commission into state capture and the commission of inquiry into the Public Investment Corporation have shown how vulnerable the massive assets under state control are to corruption and greed; the same is true of the nation's pension and provident fund assets.

He said the workshops were designed to be practical and informational rather than to push a particular agenda or products. "10X's interests are served when the truth is exposed and trustees can make the most informed and objective choices regarding the retirement funds they serve."

Rosemary Hunter, the former pensions regulator and now partner at international law firm Fasken, will be addressing the trustees at the event. Hunter, who is a leading pension lawyer and academic, will be sharing her thoughts on some of the numerous challenges trustees face in trying to ensure that funds fulfil their objectives and mission.

Hunter, the former deputy pension funds registrar at the Financial Services Board, came to public attention as a vigilant public official who took on her own employer as part of efforts to protect the interests of thousands of members and beneficiaries of pension and provident funds that had been deregistered without proper prior checks to see that the funds had no assets or liabilities.

She has been quoted as saying: “Retirement funds are precious. If they are well governed and managed and their assets invested in a sustainable way, they can provide ‘fit for purpose’, ‘value for money’ benefits for their members and their families; give their members collective financial muscle; promote good governance, transformation, sound labour relations and environmental protection by their suppliers and by the companies and other entities in which they invest; and contribute towards long-term economic stability and growth for the benefit of us all.”

Teri Solomon, the Head of the financial and professional division at Marsh & McLennan Companies Inc, and Steven Nathan, founder and chief executive of 10X Investments, will also be addressing the seminar.

Personal Finance | 6 February 2019

Playing catch-up: compound interest adds up to a comfortable retirement

If statistics are anything to go by, many South Africans delay saving for retirement. When we are young, retirement seems just a speck in the future, and other life expenses and events distract us.

While the best course of action is starting as early as possible and saving for as long as possible, there are still options available to you if you find your retirement is suddenly around the corner and you realise you haven’t saved enough. “It is never too late to play retirement catch-up,” says Jac de Wet, Head of Sales at PSG Wealth. “However, you need to be realistic and understand the trade-offs you need to make.”

Use your time wisely

Investors often think retiring comfortably is only about the amount of money invested. However, the period of investment is even more important. Saving for retirement can be summarised as easily as this: The earlier you start, the less you need to save monthly. The catch is just as easy: it’s not only about catching up on the amount of savings you have missed out on contributing (a challenge in itself). It’s really about catching up on the compounded returns you have missed out on.

Let's look at an example to illustrate this. The table below shows that if you want to retire with an extra R1 million at age 65 and you start saving at age 25, you'll need to save R180 per month. If you want to end up with R1 million at age 65 but only start saving at age 45, however, you will need to put away a far greater amount – almost R1 400 per month! The longer you postpone saving, the more you need to save, but, says de Wet, the table also shows that even at 45 and older, it is not too late to start.

Table 1: How to save R1 million by age 65

Age at which saving starts	Years to retirement	Monthly investment (starting amount)	Total contributions	Growth on investment	Total investment value at age 65
25	40	R180	R86 481	R913 519	R1 000 000
30	35	R294	R123 573	R876 427	R1 000 000
35	30	R485	R174 516	R825 484	R1 000 000
40	25	R811	R243 245	R756 755	R1 000 000
45	20	R1 392	R334 141	R665 859	R1 000 000
50	15	R2 510	R451 757	R548 243	R1 000 000
55	10	R5 003	R600 409	R399 591	R1 000 000
60	5	R13 061	R783 686	R216 314	R1 000 000

Source: PSG Wealth. Assumptions: 10% return. Inflation is not taken into account.
Remember to adjust your contributions by inflation and/or escalate your targeted amount for inflation.

Quantifying the impact of additional savings

What does an additional R1 million buy you at retirement? It could be an extra R4 100 to your monthly income (assuming a withdrawal rate of 5% from a living annuity). "If you ask any retiree, they'll tell you that will make a vast difference to your standard of living," de Wet says. "Keep in mind that the current old age pension grant in South Africa is only R1 700 a month."

Calculating how much you need

The general 'rule of thumb' is that your monthly income during retirement should be at least 75% of your last monthly pay cheque to be able to retire comfortably. This is assuming that you won't have large outstanding debts such as still paying off a car or house. This in turn implies that you will have fewer expenses and more disposable income. However, de Wet says it is best to make provision to live much longer than we may typically expect due to medical advancements and the associated costs, which could mean that a 90% 'replacement ratio' (instead of the commonly accepted 75%) may be more reliable for planning purposes.

An example of how much you'll need to retire comfortably

If you were to retire at age 65 with a monthly income of R50 000 (R600 000 per year). You will need 90% of that (which would be R45 000 p.m. or R540 000 p.a.). Every year after retirement, this required amount will increase by roughly 6% (catering for inflation) and your retirement capital grows by 9%. Assuming you live until age 100, this means you will need to have saved more than R12.2 million by the time you retire.

Realistically reaching a bold retirement goal

The message is clear: regular monthly contributions early enough can make it possible to reach a bold retirement target. If you start at age 35 or earlier, it is much easier to achieve this than starting later. But remember that escalating your contributions to keep pace with inflation can make all the difference to your capital or enables you to catch up.

"Successful investing is about accumulating easy wins and watching them compound over time. Small incremental returns, day after day, month after month really add up, so you should make the most of this to help you reach a comfortable retirement," de Wet concludes.

FA News | 7 February 2019

What's next for tax-free savings accounts?

Calls to increase the annual and lifetime limits, but is there money for this?

Almost four years have passed since National Treasury introduced tax-free savings accounts (TFSAs) to improve South Africa's dismal savings rate.

The accounts provide a tax-free wrapper that investors can use for investments in various asset classes by opening accounts with banks, asset managers, life insurers and stockbrokers. Currently, individuals can invest up to R33 000 per annum in one or more TFSAs (collectively) up to a maximum of R500 000 over their lifetime. The investment returns are completely tax-free.

When TFSAs were introduced on March 1, 2015, Treasury stopped adjusting the annual interest exemption (R23 800 for people younger than 65; R34 500 for those 65 and older) in line with inflation every year. In this way, the incentive would be revenue neutral. The tax revenue the fiscus would 'lose' by offering TFSAs would be 'gained' by not increasing the interest exemption.

The intention was that the annual limits should be increased on a regular basis for the impact of inflation, but that the lifetime limit would remain static – at least in the short term. On March 1, 2017, Treasury increased the annual limit from R30 000 to R33 000. The question is whether it will do so again this year, or whether fiscal constraints make it unlikely? Unfortunately, significant pressure on state finances means that government increasingly prioritises funds for immediate concerns (such as Eskom) and that money for savings incentives may need to wait in line.

Denver Keswell, senior legal advisor at Nedgroup Investments, says as much as they would like to see an increase in the contribution limits, there has not been any indication that it will happen this year.

Another (pleasant) surprise?

"However, when the annual limit was raised to R33 000 from R30 000 two years ago it did take us by surprise, so let's hope that happens again."

Keswell says the hope is that South Africa will follow a similar trajectory to the trend of the UK equivalent, the individual savings account (ISA). About five years ago, the annual cap for ISAs was just below £12 000, but it was increased to £20 000 two years ago.

"While much of the focus to date has been on the annual contribution limits, what we would really like to see is an increase in the lifetime limit."

By not increasing the lifetime limit, there is an unintended consequence of a barrier to entry for any investor who intends to withdraw and replace their funds in the short to medium term, because once an investor withdraws funds from the account, they are unable to replace them. This means that if they do then 'replace' the funds they withdrew, they will be reducing their remaining allowance within the R500 000 lifetime limit, he adds.

"Obviously, this can have a real impact on an investor's financial outcome in the tax-free investment."

Annual allowance

Pieter Hugo, MD of Prudential Unit Trusts, says the only change they would like to see is an increase in the annual allowance, which has only been increased once since the introduction and hasn't kept up with inflation.

"We're in an economy with an extremely low savings rate, and if the intention of government is to encourage (regular) savings, then you would expect government to increase this every year by a minimum of the official inflation rate to maintain the incentive."

While it isn't critical at this stage, they would also expect the lifetime limit to increase in line with inflation. "What we wouldn't want to see is a situation similar to the old R1 750 per annum retirement annuity contribution limit, which wasn't increased for decades." Since March 1, 2018, investors in TFSAs may transfer accounts directly between product providers for the first time without affecting their annual or lifetime contribution limits.

Moneyweb | 7 February 2019 | Ingé Lamprecht

SA hedge funds outperform Warren Buffett's million dollar bet

The global hedge fund universe is broad, and Buffett said some managers would outperform a passive index over time.

In 2007, Warren Buffett, one of the richest and most renowned investors in the world, bet a million dollars that an index fund would outperform a collection of hedge funds over 10 years. Over the period of the bet, the S&P 500 index fund returned 7.1% compounded annually, significantly more than the basket of funds selected by an asset manager at Protégé Partners, who took Buffett up on the wager. That hedge basket only returned an average of 2.2%. The global hedge fund universe is very broad and Buffett by his own admission stated that some managers would outperform a passive index over time. Passive providers are quick to extrapolate this bet to mean that passive is the only way to achieve your financial goals. However, Protégé would have been better placed focusing its attention on the tip of the African continent.

A basket of some of the largest and longest running hedge funds in South Africa has delivered US dollar returns over and above that of the S&P 500, global equities represented by the MSCI All Country World Index and Berkshire Hathaway Class A .The table below reflects actual performance numbers for these funds over the period in US dollars and after all fees including foreign exchange hedging costs. As you can see, a simple equal allocation to these funds generated close to 10% of annualised return at a third of the volatility and significantly lower drawdowns.

January 1 2008 to December 31 2017

	Cumulative Return %	Annualised Return %	Std Dev	Max Drawdown %
S&P 500 NR USD	111.83	7.80	15.08	-48.90
BERKSHIRE HATHAWAY cLASS A	110.17	7.71	16.85	-44.49
MSCI ACWI NR USD	57.55	4.65	16.79	-52.31
Fund 1	149.87	9.59	6.54	-12.00
Fund 2	155.39	9.83	8.11	-12.88
Fund 3	106.33	7.51	6.89	-16.89
Fund 4	196.80	11.49	5.53	-3.21
Basket of SA Hedge Funds USD	152.61	9.71	5.10	-6.39

Had Buffett made that wager against a basket of South African hedge fund managers the outcome would likely have been very different. Not only does a composite index of South African hedge funds as published by HedgeNews Africa outperform passive equity index funds in South Africa, but there are a number of South African hedge funds that run offshore US dollar denominated funds that have outperformed the S&P 500 and Buffett's Berkshire Hathaway shares.

South Africa is the only country in the world to formally regulate hedge funds to this extent, with the introduction of board notice 52 of 2015. That means they fall under the Collective Investment Schemes Act, just like well-known South African unit trusts, and are regulated in the same way.

In summary, this differentiates the South African hedge fund industry which can boast the following:
* Direct and fund-of-fund hedge managers with more than 10 years of audited track records.
* Majority of managers have outperformed benchmark equity indexes.
* Hedge funds are now formally regulated.
* South Africa is an emerging market and therefore enjoys all the alpha opportunities that accompany these markets due to foreign flows and mispricing, which has been lacking for global developed-market peers the last decade.

If an investor needs more convincing about this asset class, the broader HedgeNews Africa composite index and the Alpha Asset Management fund-of-fund portfolio Alpha Prime Equity Hedge (APEH) ended 2018 positive while the South African equity market and global equities were down significantly.

January 2019 has also gotten off to a good start with APEH up almost as much as the market, providing recent support for the downside protection offered without sacrificing upside. This is because active management has taken advantage of opportunities from last year's sell off, just as it has done time and time again over the last decade.

This is not a continuation of the tired active-versus-passive debate, but highlights the quality of the hedge fund manager in South Africa and why a combination of hedge in your portfolio alongside passive products can add tremendous value given the superior returns and low correlation to equities.

The goal of diversification is to achieve your performance objectives and take the smoothest route to get there. Clearly hedge funds will assist. ***Full Report:*** ***https://www.moneyweb.co.za/moneyweb-opinion/soapbox/sa-hedge-funds-outperform-warren-buffets-million-dollar-bet/***

Moneyweb | 6 February 2019

February could 'make or break' for your tax plan

But should you go for an RA or a tax-free savings account?

Taking stock of your finances at the start of February can make or break your tax plan for the year ending 28 February. Now is the ideal time to spot the gaps where you haven't yet fully used all of your tax-free allowances, whether it's via a retirement annuity (RA) or a tax-free savings account (TFSA).

Option 1 – max out your TFSA

February is a good time to log into all your tax-free savings accounts and double-check how much you've contributed in total since 1 March last year. Are you still under the R33 000 annual contribution limit across all accounts? Great, there's a gap for you. Do you have spare cash to invest? If not, do you have any investments in taxable products, such as standard (pre-TFSA) unit trusts? You may want to consider converting some of that investment (if no penalties apply) and investing the money in a TFSA version of the same unit trust instead. To do that, you would need to withdraw money from your existing taxable unit trust to reinvest into your TFSA. Remember that the withdrawal would trigger a capital gain with SARS, but the first R40 000 of your taxable gains every tax year is currently exempt from capital gains tax.

Option 2 – top up your RA

By the start of February, you should have a fairly good idea of what your total income – salary, business income, interest, rental income, bonus and included capital gain for the current tax year will be. If you add all those figures up, you can contribute 27.5% (capped at R350 000) of the sum to a retirement fund and enjoy tax relief. A retirement fund can be your employer's fund or your personal RA. If you haven't used the full allowance yet, do you have any spare cash to make a lump sum contribution to your RA before 28 February?

Like many South Africans, you may only have enough cash for one of the above options, not both. How would you choose between a TFSA and an RA?

If you need the money before age 55, don't use only an RA

If you're one of the fortunate (and diligent) people who can afford to save a substantial chunk of your income every month because you plan to be financially free before the age of 55, then putting more money into an RA may not appeal to you. That is because, under current laws, the earliest date that you may withdraw money from an RA is age 55, and on your retirement date your withdrawal is limited to a lump sum of only one-third of the value of your RA.

If you plan to 'retire' early, don't disregard an RA completely, though. It's possible to use both a TFSA and an RA as long-term savings products. Once you've reached your financial freedom goal you could use your

TFSA to withdraw the money needed to survive up to age 55, or longer if it lasts. After age 55 you can officially retire with your RA and use the one-third lump on retirement and subsequent annuity income to live from.

You can only invest R33 000 per year in a TFSA

Currently, you may invest up to R33 000 per tax year in a TFSA. Any additional contributions are taxed at a heavy 40% of the excess above the R33 000 limit. In contrast, there's no limit on contributions to a retirement product, such as an RA, pension or provident fund. You can invest as much of your income as you please, although only the first 27.5% - capped at R350 000 – is tax-deductible. There's nothing stopping you from exceeding this limit. You will not be hit with a tax penalty; a tax penalty only applies to excess contributions to a TFSA.

With an RA you pay tax in retirement

A great benefit of both a tax-free investment account and a retirement annuity (RA) is that all the growth and income of the investment are tax-free while you remain invested. This includes tax on interest, dividends and capital growth.

However, an important difference between a TFSA and an RA is that with a TFSA you pay no tax on withdrawals.

With an RA, only the first R500 000 of your lump sum taken at retirement is tax-free. When you start withdrawing an annuity income, that income is taxable as per the normal income tax tables of the South African Revenue Service (SARS). It's, therefore, more accurate to call it a 'tax-deferred' investment instead of a tax-free investment. However, for most high-income investors, the income tax rate in active employment is higher than when drawing a retirement income in the future. For example, you might be getting a 41% tax relief now if you're earning more than R708 310 per year, but your retirement income might only be in the 36% or 31% tax bracket one day when you retire. This makes deferring your tax by contributing to an RA in your higher-earning years worth it. And, on top of that, all the income and growth earned within the RA before you retire is tax-free.

So, should you go for an RA or a TFSA? That will entirely depend on your unique tax bracket – now and once you are 'retired'. It will also depend on whether you would need access to your savings before age 55, whether you want to invest 100% in shares, property or offshore assets (not allowed with an RA) and whether you need protection against potential future claims from creditors.

Your needs are unique and therefore how much you need to allocate to your RA compared to your TFSA will vary from person to person.

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INTERNATIONAL NEWS

UK plans to ease cap on workplace pension fees

Unions concerned about schemes expanding into assets with performance charges

UK workplace pension rules are to be relaxed to make it easier for trustees overseeing £60bn worth of retirement funds to invest in assets with performance fees, according to new government plans. Millions of workers saving in workplace pensions are protected from excessive fees, which can erode returns, through a cap on the charges levied on the most widely used retirement funds.

On Tuesday, the government announced plans to amend the regulations governing how schemes comply with the 0.75 per cent charge cap to enable them to invest more easily in funds with performance fees. These are often associated with illiquid assets, such as infrastructure, and private equity. Performance fees are where the fund manager is paid a fee if returns exceed a benchmark, but this charging structure has proved contentious due to investor concerns over a lack of transparency on performance and how benchmarks are set. The government said that easing the rules would open up opportunities for schemes with billions of pounds of pension cash to expand their investments from liquid assets, to fund start-up companies and infrastructure projects.

“We can do more to attract new investment into important sectors of the economy which would boost employment and help to build stronger, more sustainable communities,” said Guy Opperman, minister for pensions and financial inclusion. “We would like to explore an extension to the way compliance with the charge cap is measured, to make it easier for trustees to consider investments which levy performance fees, whilst retaining the same level of protection for members.”

In a consultation published on Tuesday, the government said there was scope within the cap for trustees to consider investments beyond liquid assets. “We know that average annual charges for pension schemes which are subject to the charge cap are between 0.38 per cent and 0.54 per cent,” the consultation said. “It is therefore clear that trustees have scope, within the existing level of the cap at 0.75 per cent, to consider innovative investment opportunities which may attract higher charges, should they wish to. It may, however, be the case that the way compliance with the charge cap is currently determined does restrict trustees’ options.”

As part of its effort to redirect billions of pension cash into alternative assets, the government unveiled plans to require the country’s biggest defined contribution schemes to document and publish their policy in relation to investment in illiquid assets, and report annually on their approximate percentage allocation to this kind of investment. In addition, the managers of smaller pension schemes will be required to explore whether members could not get better value by pooling with another bigger fund. But plans to incorporate performance fees into workplace assets were met with concern by unions. “The only availability for pension funds to invest in infrastructure is through some of the most expensive assets classes with performance fees,” said Colin Meech, a national officer with Unison, the public sector union with 1.3m members.

“I can’t see how a decent pension scheme can invest in these assets as there is a risk they could wipe out significant amounts of members’ money due to astronomical fees.” Alan Miller, co-founder of the True and Fair campaign for fund transparency, said it would be a “dereliction of duty” on behalf of the government to encourage pension savers to be invested in illiquid assets, with high charges and low transparency. “It is a basic fact that without knowing the full price, including all the various layers of charges that investors bear, whether individual or institutional, there is no hope of being able to make rational, informed investment decisions on behalf of underlying pension savers,” said Mr Miller. But Jonathan Lipkin, director of policy, strategy and research at the Investment Association trade body, said defined contribution schemes should have access to a wide range of asset classes. “With the right regulatory and product environment, schemes will be able to invest in a diverse range of products and make the best long-term investments for pension savers. If this is done properly, then it will benefit both pension savers,” he said.

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