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Institute of Retirement Funds Africa

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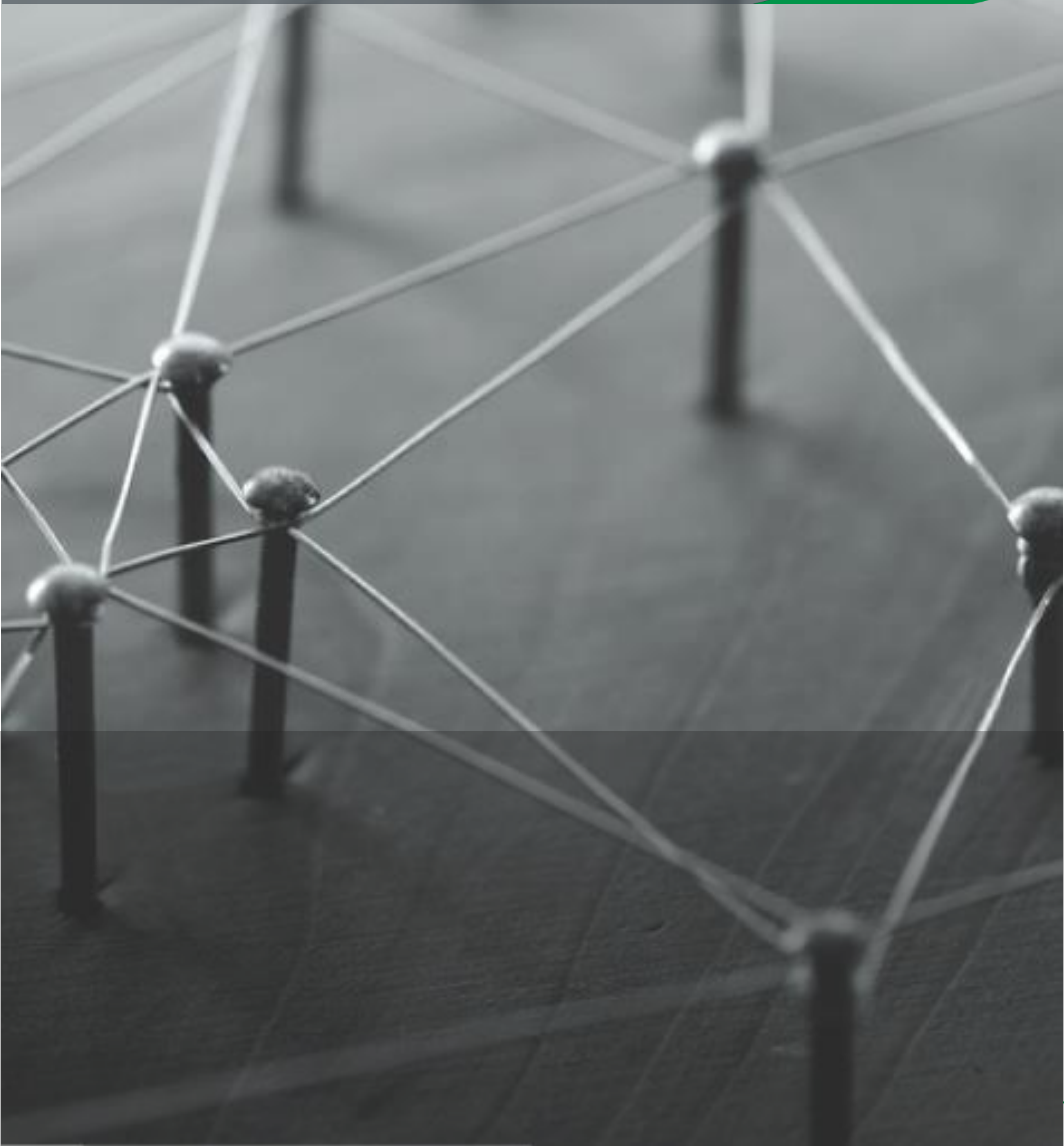

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Is it two pots or three? Navigating the complex two-pot retirement makeover

As the dust settles on the implementation of new retirement legislation, Linda Kleynscheldt, Head of Actuarial and Product, PSG Wealth unpacks why having a quality financial adviser will help retirement savers make the most of what is a complex set of new rules.

The road to 1 September 2024 – the implementation date of the new two-pot retirement system regulation – has been long and winding. But we have finally arrived at the point where the proposals, discussions and all the pot analogies and memes have ended, and the system has become a reality.

Three pots, or two?

Under the new system, saving for retirement from your pre-tax salary will be split into savings which can be accessed before retirement (referred to as the 'savings pot') and savings which cannot be accessed before retirement (called the 'retirement pot'). Let us keep this principle in mind before going into the exceptions and the third pot, referred to as the 'vested pot'. The vested pot came about to allow for Government's goal to keep the management and accessibility of retirement funds accrued to date unchanged. All funds saved in retirement products up to 1 September 2024 will retain the same accessibility and tax treatment as before the legislation took effect. The only impact of the two-pot system on accrued retirement savings is that an amount of 10% from the vested pot (up to a maximum of R30 000) has been used to pre-fund the savings pot, so that all policyholders will be able to benefit from the new system from the start.

With great freedom, comes great responsibility… and complexity

While we know that with freedom comes responsibility, the two-pot retirement system has shown us that with flexibility comes complexity. For new retirement savings plans, the two-pot retirement system should bring a good balance between protecting savings for the future and giving some relief should life take an unexpected turn. In such cases, an annual withdrawal from the savings pot can come to the rescue of retirement fund members who require access to their savings. However, for existing retirement fund members, it might take some time to fully understand and get comfortable with the different rules now applicable to their savings, with vested savings continuing on old rules and new savings on new rules. Add onto that the exception that pension and provident fund members aged 55 and older when the previous change came into effect in 2021 could opt to retain their current status or move onto the new system. All of this has highlighted the significant value financial advisers bring to the industry and how they can help investors navigate the maze of rules and options available.

The good, the bad and the ugly

The two-pot retirement system is trying to find the right balance of providing for the future through compulsory preservation, while addressing the concerns and realities of South Africa's socio-economic environment through access to savings. Unfortunately, the added complexity and the fact that accessing your savings is a loan against yourself (and your future self as a retiree) are real concerns. In the first week of accessibility, the South African Revenue Service (SARS) said that two-pot claims rose to around R4 billion, and it had received 161 607 tax directive applications from retirement fund administrators between 1 September and 10 September. Even if contributors view accessing retirement savings as a temporary loan, it may not always be possible to replenish their savings, potentially reducing the already low percentage of South Africans retiring comfortably. Different tax treatments on withdrawals in the old and new regimes will also take some time to get used to and should be taken into consideration before deciding to withdraw from your savings pot. For PSG clients, withdrawals have been negligible, demonstrating that our higher income earner client base are committed to their long-term investment goals.

FA News | 14 October 2024

More than 1 million taxpayers withdraw from their savings pot

The South African Revenue Service (SARS) wishes to announce that to date it has received 1,213,646 applications for tax directives for withdrawals from the Savings Withdrawal Benefit of the two-pot system. Of the total number of applications 1,148,729 tax directives were approved for funds to be released. The remainder were declined for a variety of reasons, including incorrect Identity Numbers, incorrect tax numbers, amongst others. A total gross lumpsum of R R21.4 billion has been paid out to date. In line with SARS' intent for taxpayers to use digital channels, SARS is happy to announce that the simulated WhatsApp calculator was used 51,547 times since implementation of the process. The simulated calculator on the SARS website, which forms part of the SARS Online Query System, has been used 655,801 times. SARS has also received 53,519 and queries through the voice channel, and 8,655 at branches. Taxpayers are encouraged to continue to use the digital channels, which are simple, easy and user-friendly.

Using these channels means taxpayers do not have to leave their homes or places of employment to stand on undignified queues. SARS would like to thank retirement fund management entities for their friendly and professional co-operation that has allowed SARS to play its part effectively and efficiently by speedily issuing the volumes of tax directives needed to date. SARS reminds taxpayers who want to apply for a withdrawal to make sure that they verify their tax numbers, have supplied the correct Identity Numbers and that they do not have any outstanding debt with SARS. After a registered taxpayer has applied, a successful tax directive informs the fund management how much tax to deduct from a withdrawal. Directive applications are accepted by SARS 24/7 and processed within an hour 365 days a year from 8:00 to 19:00. Unless a directive application is submitted outside of these hours, the response if the taxpayer is compliant be sent to the fund within an hour.

Before a final amount is paid to the applicant, the pension fund will be informed to also deduct any outstanding debt on behalf of SARS before any payout is made to the member. If a person has a debt arrangement with SARS, the withdrawal will not be affected. If there is a debt owed to SARS, it will be deducted in terms of such arrangement. Taxpayers are reminded that tax will be imposed on a withdrawal at a marginal tax rate ranging between 18%-45% depending on their scales. Despite this public information, there are taxpayers who are wilfully understating their incomes. SARS Commissioner Mr Edward Kieswetter said that “SARS is deeply concerned that 213,654 taxpayers have been identified where they have declared incorrect taxable income with the view to have a more favourable tax rate. If a taxpayer understates their income, they are intentionally involved in evading their tax obligation. A penalty will be imposed on taxpayers who have understated income. Finally, I wish to caution taxpayers to refrain from this conduct that borders on criminality as there are real consequences for this behaviour”.

FA News | 14 October 2024

Regulatory shifts impact default investing strategies

The move from defined benefits (DB) to defined contributions (DC); the introduction of regulation 28 to the Pension Funds Act (PFA); and more than a decade’s worth of incremental retirement reforms have forever changed South Africa’s pre- and post- retirement funding landscapes.

Passing risk from employer to employee

“The move from DB to DC changed the landscape because the risk [in funding a pension] transfers from the employer to the employee; suddenly employees must think about asset allocation, investment risk and many other things they have not had to deal with before,” said Muitheri Wahome, founder of the Asset Management Research Institute (ARMI). She set the scene for a panel discussion on default strategies, held on day one of the 2024 Allan Gay Retirement Benefits Conference, themed ‘Through the Noise’. Panel moderator, Radhesen Naidoo, Joint head: Institutional Clients at Allan Gray, had a broad swathe of topics to explore under the broad heading of essentials for suitable default investment strategies. In no particular order, he explored active vs passive; fee structures; local vs offshore; product types; and regulation. Bev Bouwer, independent investment consultant, has seen huge changes in the retirement funding space, spanning over three decades.

“Advice on life stage defaults became more important with the introduction of DC funds,” she said, before applauding the effort and energy that consultants and trustees put into designing investment options. To get default investment option design ‘spot on’ requires thinking about investments, manager appointments, portfolio construction and asset allocation, to name a few. “For fund members who happen to be in standalone retirement funds, trusting the default [usually pays off because] most of those default options are well managed, well considered and planned,” Bouwer said. Nowadays, both standalone and umbrella funds can create a wide variety of options for their members, with life-stage appropriate solutions being structured using regulation 28 compliant balanced funds among other investment products.

A balanced, market-linked option

“The product type world has evolved quite a lot; but at a high level, the balance fund option is really a market-linked option where you diversify between different asset classes,” said Sonja Saunderson, CIO at the Eskom Pension and Provident Fund. “Most funds in South Africa are following a multi-manager line-up of going into balanced funds [provided this is] appropriate for their strategy.” A balanced fund gives retirement fund members direct market exposure, locally and offshore; but it remains up to the fund managers to choose the optimal, risk-appropriate mix of asset classes. Balanced funds are not protected from market volatility, meaning that investors’ capital is at risk. According to Saunderson, the industry initially responded to this volatility risk by investing conservatively; but over time a wide range of guaranteed and smooth bonus products emerged. Smooth bonus products involved an insurer ‘absorbing’ the volatility spikes that occurred from higher exposures to growth asset classes over time, providing more consistent returns to the investor, at a cost of course. “Guaranteed products typically have either a capital guarantee or some sort of a minimum floor level so that your capital is protected to some extent,” she said, conceding that these structures were complex with lots of embedded fees.

Keeping things simple

Naidoo interrogated the panel on how they balanced product types in standalone funds. Bouwer was first in the ‘hot seat’, saying that trick was to keep things simple and ensure that members could understand the default. It is also important to balance complexity and cost. “You have to think through all the options available, and put them together in a package that is well suited to the final target audience, your fund members,” she said. Consultants bring much-needed experience and innovation to the decision making; but it is ultimately up to the trustees to make the decision. “The trustees understand who their membership is; the consultant’s role is to listen and give the right options,” Wahome said. “Together, as fiduciaries, you deliver something that will help the member retire comfortably at some point.” Delivering a sustainable retirement result is a common objective across the standalone and umbrella fund environment.

“The considerations on a standalone and umbrella fund will be fairly similar; the key difference is that the umbrella fund caters to a wide number of companies, and should therefore have more options available,” she said. The discussion then turned to new thinking in life-stage ‘switching’ in the pre-retirement funding space, especially given improving mortality rates. A decade ago, switching to a conservative portfolio 10-years pre-retirement was quite common; but nowadays, the focus is more aligned with savers’ evolving needs. Bouwer hinted that retirees were less obsessed over retirement dates, freeing them up to stay invested in more aggressive fund options for longer, both pre- and post-retirement. “The pension fund reforms, and the default regulations coming in, have placed an onus on trustees to make sure they consider better default annuitisation options for members,” Saunderson said.

Double-edged flexibility?

There are a couple of recent developments that have forced a rethink about pre- and post-retirement investing including changes to the regulation 28 offshore limits and the trend from active to passive investing. Naidoo asked the panel whether the flexibility introduced by these factors had the potential to cut both ways. Bouwer commented that increased allocations to alternative asset classes came with higher costs attached. “You need to think carefully about balancing the most efficient solution for your members: that that add value at an attractive cost,” she said. This focus on reducing costs partly explains the shift into the passive world. The active-passive and offshore-local concepts are somewhat intertwined in default investment strategy decision making. Saunderson contended that wide variances in asset allocation across strategies would result in wider variances in default outcomes.

“The investment toolbox has expanded, introducing a lot of responsibility and options; but it also potentially introduces a lot of risk,” Saunderson said. Commenting on going offshore she noted two approaches: one being to capture the higher potential for global via ETFs and passive solutions, the other in partnership with fund managers. The panel moderator asked why the South Africa retirement fund industry was slower than its global peers in transitioning towards passive investing. The consensus was that while the industry was slow off the mark, it was catching up. “Anecdotally, it is no longer active or passive and we are seeing a lot more hybrid default constructions; much of this is driven by the costs of investing in various asset classes,” Wahome said. There is, however, another way to explain the divergence in approaches.

A function of market size

According to Saunderson, it is easier to predict stock performance in South Africa versus large markets in Europe and the United States. “This is really as a function of the size of the market,” she said. “The smaller the universe, the more difficult it becomes for fund managers to add value through stock selection.” She added that while she remained an advocate for passive investing, the real clincher was making the right asset allocation. This explains the perhaps higher than trend role of balanced managers in the South Africans savings landscape. To close this newsletter, your writer backs the following wisdom from Saunderson: The more efficient a market becomes, the more passive you should go because you cannot add much value from a stock selection effect.

FA News | 14 October 2024

Two-pot payouts top R21bn – Sars

More than 200 000 claimants lied about income to sidestep high taxes. The South African Revenue Service (Sars) has received over 1.2 million applications for tax directives for pension fund withdrawals under the two-pot system, with payouts totalling R21.4 billion to date. In a statement released late on Friday, Sars said of the total of 1 213 646 applications altogether 1 148 729 tax directives were approved for funds to be released. “The remainder [64 917] were declined for a variety of reasons, including incorrect ID and tax numbers.” However, Sars has also come across 213 654 individuals who declared incorrect taxable income to get a more favourable tax rate on their withdrawals from the savings pot. Withdrawals from the savings pot are subject to the marginal tax rate, ranging from 18% to 45% which is far steeper than the former early withdrawal tax rates which were applied before the two-pot regime took effect. “If a taxpayer understates their income, they are intentionally involved in evading their tax obligation,” says Sars Commissioner Edward Kieswetter. A penalty will be imposed on taxpayers who have understated income, says Kieswetter, cautioning that such conduct “borders on criminality”. “There will be consequences for such behaviour,” he declared.

High volumes

The two-pot retirement system came into effect at the beginning of September, whereby pension fund members’ contributions are split into a one third savings pot and a two thirds retirement pot. Fund members are allowed to withdraw money from their savings pots once every tax year, while the contributions in the retirement pot are preserved. Administrators of pension funds have been inundated with claims from members to gain access to a portion of their savings with daily volumes exceeding those typically seen during a whole month. Sanlam for example processed more than 20 000 claims in just the first two working days of September, far exceeding the typical monthly average of 7 000 to 8 000 claims, it said in a statement recently. The South African Reserve Bank (Sarb) estimates that pension funds will likely see withdrawals totalling R40 billion in the fourth quarter of 2024.

Digital channels get traction

Sars says South Africans who consider withdrawing from their savings pots should use its digital channels, which mean they don’t have to queue or leave their homes and workplaces. The tax agency’s simulated WhatsApp calculator – to indicate to fund members what amounts they are likely to get as a payout – have been used over 50 000 times since the implementation of the two-pot system. In addition, Sars’s simulator calculator on its website, has been used close to 656 000 times. Sars also received more than 53 000 queries through its voice channel. Sars reminds taxpayers who want to apply for a withdrawal to make sure that they verify their tax numbers, have supplied the correct ID numbers and that they do not have any outstanding debt with Sars. “After a registered taxpayer has applied, a successful tax directive informs the fund management how much tax to deduct from a withdrawal. Directive applications are accepted 24/7 and processed within an hour – 365 days a year from 8:00am to 19:00,” it notes. Before a claimant receives the money from the savings pot, the fund may deduct outstanding debt on behalf of Sars, unless they have payment arrangements with Sars in place.

Moneyweb | 11 October 2024

UK's pension sector falls outside top 10 in global rankings

The UK is facing a challenge, like other countries, to ensure that people have saved enough for an adequate retirement, those behind the report said.

The UK has slipped out of the top 10 in a global annual report which ranks pension systems. It was ranked 11th in the Mercer CFA Institute Global Pension Index 2024, which benchmarked 48 countries around the world. Last year the UK was in 10th place, and in 2022 and 2021 it was placed at number nine. The report gave the UK a "B" grade, alongside other countries including France, Germany, Switzerland, Ireland, Canada and Sweden. Ireland was placed 18th on the list.

The report described countries in the B category as having "a system that has a sound structure, with many good features but has some areas for improvement that differentiate it from an A-grade system". Those behind the report said that overall, scores have seen a slight decrease. Part of this is because of the impact of rising living costs, as well as people living for longer, meaning their pots have further to stretch. The Netherlands' retirement income system retained the top spot on the list, with Iceland and Denmark remaining in second and third places respectively. All three countries were graded A in the report. The pensions system in the Netherlands features strong regulations and offers participants guidance regarding their pensions, researchers said. Benoit Hudon, Mercer's UK president and chief executive, said: "Like most countries, the UK is facing a challenge to ensure people have saved enough for an adequate retirement.

"The UK's pension sector has fallen outside of the top 10 in the global rankings, illustrating the need for reforms. The Government should expand auto-enrolment, address the fragmented pension system, and support productive asset investment." Retirement systems around the world are increasingly moving away from defined benefit (DB) plans and shifting to defined contribution (DC) arrangements, the report said. DB pensions promise people a certain level of income in retirement, while DC schemes put the risks of the eventual size of a retirement pot onto the individual saver. David Knox, lead author of the report and a senior partner at Mercer, said: "There is no single solution to getting retirement systems onto more solid ground. "Now is the time for governments, policymakers, the pension industry and employers to work together to ensure that older populations are treated with dignity and can maintain a lifestyle similar to what they experienced through their working years."

Earlier in October, the UK Government launched a six-week consultation into expanding a new type of pension called collective defined contribution (CDC) schemes. With CDC schemes, employer and employee contributions are pooled into a single fund, spreading out risk and potentially providing a more predictable pension income, based on collective investment performance. The consultation applies to England, Scotland

and Wales. Occupational pensions are a devolved matter for Northern Ireland and the UK Government has said it is anticipated that Northern Ireland will make corresponding legislation. The UK Government plans to introduce legislation in 2025. A Department for Work and Pensions spokesperson said: “The UK is the highest ranked G7 country in this study, being eight places above France and 19 places above the USA, but there is much to do to provide people with the security they deserve in retirement. “Restoring our economic stability will grow the economy and drive-up living standards for people across the country. Through our landmark pensions review, we are exploring options to expand on the success of automatic enrolment while boosting investment and increasing pension pots. “More than 15 million pension savers could benefit from our new Pension Schemes Bill, with the potential for an average earner to have £11,000 more in their defined contribution pot by retirement when saving over a career.”

Independent | 15 October 2024

3 Reasons why you need a Tax-Free Savings Account in your Retirement Plan

Avoiding needless tax deductions to your limited retirement savings is important consideration when planning for retirement.

Having a diversified portfolio is key to ensuring the security and growth of your savings and investments portfolio. This is true for all life stages of investing, those saving for retirement, nearing retirement and those that are retired. Ilse Smuts, Business Development Head: FNB Retail Cash Investments says, “Including a Tax-Free Savings Account (TFSA) into your retirement strategy is an excellent way to diversify your savings and investments while also enjoying significant tax benefits. The tax-free growth and flexibility of the account makes them a smart addition to any portfolio. It is best to start contributing to your TFSA early so that you can benefit from the tax-free growth as you approach retirement or when you are in retirement.” She highlights three main reasons why South African retirees should consider adding TFSAs to their retirement plans:

1. Tax efficient compounding: The most significant advantage of a TFSA is its potential for compounding growth in a tax-efficient way. Whether you’re earning interest, dividends, or capital gains, all returns in a TFSA are tax-free, allowing retirees to keep more of their earnings. Even if you start later in life, reinvesting those returns ensures that they continue to grow without being taxed, which is especially beneficial for those on fixed incomes. Over time, the compounding effect can significantly enhance your savings, providing additional financial security throughout your retirement.”
2. Flexibility and accessibility: TFSAs provide a level of flexibility that is unmatched by many other saving and retirement products. You can withdraw funds, tax free, at any time without incurring penalties. This is crucial for retirees who can use their TFSA savings or interest growth to cover regular or emergency expenses without having to dip into their pension income or annuity capital.
3. Protection against inflation: Investing in a TFSA helps protect your savings from inflation. Over time, inflation can erode the purchasing power of your money, but the potential for competitive returns in a TFSA - without the burden of taxes - can help offset these effects. This is critical for retirees who need their savings to last throughout their retirement years.Samukelo Zwane, Head of FNB Wealth and Investments says, “Having a TFSA product is especially important for retirees as they will be consuming tax-free growth in retirement. The income that they take from their TFSA product will not be taxed. Furthermore, it’s important that the type of TFSA selected in retirement should reflect the amount of risk you can tolerate and your investment objective.:

• Tax-free cash deposits: If your priority is safety and liquidity, a cash deposit TFSA allows you to earn tax-free interest on your deposits and access your money at any time. The FNB Tax-Free Cash Deposit Account is a stable way to grow your savings, tax-free, while ensuring funds are available when needed. This makes it a good choice for retirees who want easy access to their savings and prefer low-risk investments.
• Tax-free share investments: For retirees with a higher risk tolerance and a longer-term investment outlook, Zwane points to a share investment account as an option. “Retirees willing to accept more risk in exchange for higher potential returns should consider a TFSA like the Tax-Free Shares Accounts, that invests in top companies on the JSE,” says Zwane.
• Tax-free unit trusts: For retirees seeking a balance between growth and security, Zwane points to Tax-free Unit Trusts as a great way to customise and diversify their investment strategy based on their risk tolerance and financial goals.

“Whether you are nearing retirement or already retired, incorporating a TFSA into your savings and investment portfolio can provide tax-efficient growth, flexibility and peace of mind, with a range of tax-free savings solutions, you can tailor your investment to suit your unique financial needs and goals”, concludes Smuts.

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