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Table of Content

LOCAL NEWS

INTERNATIONAL NEWS

OUT OF INTEREST NEWS

Financial regulator cautions against prescribed assets plan

Mandating pension funds to bankroll projects would not be advisable – FSCA executive Olano Makhubela.

South Africa's financial regulator said it is opposed to any proposals that would compel pension funds to plow money into government-approved investments, as it could compromise market returns. The African National Congress (ANC) pledged to introduce so-called prescribed assets after the 29 May elections to ensure the financial sector makes adequate funds available for the nation's industrialisation and economic development. It's unclear if the ANC will still pursue the policy after it lost its outright majority in the elections, which led it to form a coalition government with 10 parties, some of whom are opposed to the plan.

Mandating pension funds to bankroll projects would not be advisable as it could compromise market returns and affect retiree's outcomes, said Olano Makhubela, a divisional executive at the Financial Sector Conduct Authority (FSCA). "There's a fiduciary duty in the Pension Funds Act, which requires trustees to exercise proper duty toward the fund and the members," Makhubela said Tuesday on the sidelines of a forum in Johannesburg. "Any interference with that is tantamount to a breach to the Pension Funds Act, and so we remain of the view that prescribed assets is not something that we should be considering."

Policy tried before

The policy was first tried in South Africa in 1956 during White-minority rule to force investment in government bonds, but was scrapped decades later. Plans to revive it have been criticised by the pension industry, which fears funds may be threatened if invested in under-performing state-owned enterprises. "You are compromising the overall return of the fund and we don't think that is right," Makhubela said. "The moment you weaken that due diligence because you have prescribed assets, you are going down a very slippery road." He also said such a step is unnecessary as recent amendments already allow pension funds to put as much as 45% of assets into infrastructure as an investment class. As such, the government need only provide bankable and investable projects that can pass due diligence checks, and provide attractive returns to lure investments, he said. "Prescribed assets is the prerogative of government and particularly Treasury," he said, "But we are quite unequivocal on this one; we don't think prescribed assets are the way to go."

Moneyweb | 13 August 2024

Pensions: cultivate a saving culture

South Africa’s new retirement system could boost GDP growth by 0.1-0.3%, adding up to R79 billion.

It seems like good news that our economy – and specifically our household income – could get a shot in the arm of up to R79 billion next month when the two-pot retirement system comes into operation. The Reserve Bank estimates this boost – R31 billion at the low end and R79 billion at the higher – could add 0.1 to 0.3 percentage points to gross domestic product (GDP) growth in 2024 and 2025. Another bonus is an expected boost to tax revenues as the SA Revenue Service taxes the pension pot withdrawals. Although pre-retirement withdrawal will boost consumption and growth over the short term, this system should, over the long term, increase the pool of retirement savings as employees will be unable to withdraw all their pension fund savings on resignation. Such as system has become necessary because South Africans do not have a culture of saving – studies indicate that just 6% of those in employment will have enough money to retire.

Making matters worse is that almost half of all adults struggle to grasp basic financial concepts like interest rates and savings. To be fair, more people are struggling financially as unemployment hits record levels and price inflation far exceeds wage increases. So, withdrawing early from a retirement pot will be highly tempting to many people as a financial lifeline. The boost in consumption which will undoubtedly flow from the withdrawals may make a dent, even if small, in unemployment but, in the longer term, the overall pension pot will be smaller, meaning there will be a crunch as people near retirement age. This shows that South Africa needs to make financial education a priority. That is partly what mathematical literacy is designed to do in the school curriculum… so perhaps the “intellectuals” need to stop being so dismissive of the subject.

The Citizen | 13 August 2024

Compliance excellence demands 24-7 attention

Compliance officers taking 14-days of annual leave risk finding themselves in a similar boat to investors who miss out on the best upward moves in financial markets. This may sound like muddled thinking; but please allow your writer to explain.

A somewhat stretched comparison
The comparison emerged as your writer delved into the latest in a long list of regulatory updates published by South Africa’s Financial Sector Conduct Authority (FSCA). His initial thought was that one would soon need a doctorate in law or finance to navigate the increasingly complex morass of laws and standards. And his second, was a feeling of empathy for those tasked with financial sector compliance who dare to step away from their desks for a week or two. Upon your return, you will almost certainly face a backlog of reading that would fill a volume or two of the old world Encyclopaedia Britannica. Ok, but what does that have to do with stock market investing? Well, a study by JP Morgan Asset Management revealed that investors who ‘missed’

the 10 best return days on the S&P 500 between 1999 and 2018 would have cut their overall return in half. And your writer's hypothesis is that compliance officers who miss the 10 most saturated 'regulatory update' days risk having a significant hole in their compliance portfolio and / or understanding. Ugh. It. Is a stretch, dear reader, but one is always seeking a fun way to introduce dry topics. Which brings me to the subject of today's newsletter, the 2024 FSCA 3-Year Regulation Plan (the 2024 Plan). "The ongoing review and development of the regulatory framework is critical to ensure that it is robust, aligned with international standards, fit for purpose and sufficiently flexible to position the FSCA to meet its legislated objectives and functions," reads the first line of the 2000-plus word executive summary (sic). According to the FSCA, the 2024 Plan sets out high-level details of the review of the prior year plan; insights into new approaches and revisions informed by said review; and regulatory focus areas for the period April 2024 to March 2027.

Compliance content similar, timelines tweaked

There was some good news in that the priorities identified in the 2023 Regulation Plan were largely unchanged, only the timelines had to be tweaked. And here's where the need for a PhD becomes apparent: the authority then set about explaining the process of mapping each of the projects contained in the 2024 Plan to "one or more" of its strategic objectives. This, dear reader, is to ensure alignment with another document titled FSCA Regulatory Strategy (2021-2025). Suddenly, to make sense of the 2024 Plan, your compliance crew needs digest the regulator's strategic objectives and study a strategy document that is also frequently reviewed and updated. So, let us begin at the beginning and attempt a matric-level explainer of the status quo. The FSCA mentions four "key strategic factors" that are baked into the 2024 Plan. First and foremost, the regulator seeks alignment of South Africa's regulatory frameworks with international standards.

This seems fair enough; but the regulator said something troubling, namely that our framework "has lagged behind certain international standards, especially in the financial markets context". Honestly, up to this point your writer had firmly believed that the raft of twin peaks regulation put South Africa at the top of the regulatory tables. Then again, there was that whole Financial Action Task Force (FATF) grey-listing debacle. The second key strategic factor was spelled out as "actively pursuing the harmonisation and consolidation of laws governing cross-cutting themes and transforming the legislative landscape to one that is more outcomes- and principles-based". Wow, that is a bit of a mouthful that some compliance officer wannabe may yet turn into a doctoral thesis; but once you wrap your mind around needing to identify and incorporate overarching themes into your compliance mindset, you should be ok. The FSCA identified the long-awaited Conduct of Financial Institutions (COFI) Bill and their COFI Bill Transition Project as important focuses in this area.

Cross-sector is only the beginning

Next up, we have emerging and topical risks at both an international and local level. Alas, each of the fields mentioned under this heading require reams of reading too. To stay ahead of the third key strategic factor requires knowledge of AI and machine learning; crypto assets; fintech; open finance; and sustainable finance to name a few. "Many of these issues and risks require a response in the form of legislative interventions," the FSCA wrote, perhaps explaining why financial sector lawmakers are expanding their reach into almost every aspect of the economy and society.

And finally, the fourth factor, is to tackle identified sector-specific risks. “The FSCA still closely monitors industry-specific risks and developments and in many instances legislative interventions are necessary to mitigate the identified risks and / or deal with a specific identified development’” the regulator wrote. This focus could be thought of as a throwback to traditional law-making, where you had the FAIS Act to address conduct of intermediaries rather than a COFI Bill to address the conduct of all financial institutions, or separate laws for businesses in the life and short-term sectors rather than an overarching Insurance Act. Armed with this background information, you can start delving into both existing and new projects to get a feel for how the regulatory landscape is changing. There are four new projects that financial services providers (FSPs) and their compliance team or partners should keep an eye on. These include Joint Standard – Third party service provision / outsourcing; Joint Standard – Capital requirements and risk management rules for ODPs; Prudential Standard – Quarterly Regulation 28 Reporting; and Amendments to FSRA Conduct Standard No. 1 of 2019 (PFA). You will, no doubt, have a better grasp than the writer with regards which of these apply to your business.

The second ‘third party provider’ Joint Standard

Given the number of brokers and financial advisers among the FAnews readership it may be worth delving into the first project mentioned here. The outsourcing project stems from “the need to harmonise and strengthen requirements pertaining to third party service provision or outsourcing,” explained the FSCA. The regulator commented on the rapid rise of outsourcing in the context of digitalisation before warning of the potential for disruption to critical financial services if these relationships were not properly managed. PS, this Joint Standard should not be confused with the insurer-specific Joint Standard – Outsourcing by Insurers which was issued as final in May of this year. There was some basic information in the 2024 Plan, which described the initiative as a cross-cutting, sector-regulatory framework project. The FSCA and Prudential Authority will consider various important considerations set out in the FSB paper as they develop the new Join Standard over 2024-2025. But for more on the regulatory approach to third party services provision you may wish to dive into a paper published by the Financial Stability Board (FSB) in December 2023, titled ‘Enhancing Third-Party Risk Management and Oversight toolkit for financial institutions’.

Is there time for a breather?

To close this newsletter on a high note, it seems the compliance gurus in the financial intermediation and insurance disciplines can take a bit of a breather between now and 2027. The reason: there are no FAIS- or insurer-focused interventions earmarked for completion within the next three years. Under the insurer heading, the regulator says, “various insurance related matters will be considered as part of the process focused on transitioning the existing sectoral laws to the COFI Bill framework”. And similarly, under FAIS, “the focus will be on how to transition the existing FAIS framework to the COFI Bill”. Do not, however, become too complacent. There is plenty more to come as the FSCA and PA build out the conduct regulatory framework and ensure the domestic financial markets regulatory framework is better- aligned to international standards.

FA News | 12 August 2024

How can I minimise tax on my retirement income?

Here a few strategies to help manage tax liabilities while optimising investment growth and retirement savings. I retired at the end of April 2022 and received a lump sum, which is currently in a savings account earning about 9.5% interest. I also receive a monthly pension payout from the Government Employees Pension Fund (GEPF) with taxes deducted and a monthly payout from a retirement annuity (RA) with no taxes deducted. The combined income from the RA and interest resulted in a tax return of around R50 000 for this year. I plan to have tax deducted from my RA in the new financial year to reduce the large annual payment to Sars. My questions are: What should I do with the lump sum to minimise my tax liability? And would it be advisable to take out an additional RA to reduce my tax burden?

Dear reader,

When weighing your options, consider the following:

Lump sum investment to minimise tax liability

Investing the lump sum strategically can help minimise tax liability and optimise returns. Here are some options:

- A tax-free savings account (TFSA) allows for tax-free growth and withdrawals. Contributions are limited to R36 000 per year (as of the 2024 tax year), and it's a great way to shield investment growth from tax.
- Unit trusts, while not tax-free, offer diversification and can be tax-efficient depending on the underlying assets and structure. Consider funds that focus on tax-efficient strategies.
- Endowment policies are suitable if you are in a higher tax bracket and can afford to lock in your investment for at least five years. They offer tax benefits since tax is paid within the policy at a flat rate, which may be lower than the personal tax rate for high-income earners.
- Retirement annuity (RA): Additional contributions to an RA can reduce taxable income since contributions are tax-deductible up to a specific limit (27.5% of the higher remuneration or taxable income, capped at R350 000 annually). This can be a strategic way to lower current tax liabilities while saving for future retirement needs.

Deducting tax from RA payouts

Having tax deducted from RA payouts can help manage tax liabilities and avoid sizeable year-end tax bills. Here's how it can be done:

- Adjust tax withholding: Request the RA provider to deduct tax at source. This aligns with PAYE (pay-as-you-earn) principles and can smooth out yearly tax payments.

Considering additional RAs

Taking out an additional RA can be beneficial, especially if you haven't yet reached your annual contribution limits. Here are the benefits:

- Tax deductibility: Contributions reduce taxable income, significantly lowering tax liabilities.

- Long-term growth: RAs provide a disciplined way to save for retirement, with growth compounding over time.

Summary recommendations

- Maximise TFSA contributions: Use this account to maximise tax-free growth each year.
- Consider additional RA contributions: Assess current contribution levels against limits and increase RA contributions to optimise tax efficiency.
- Review investment strategy: Consider a mix of investments that align with risk tolerance and retirement goals, optimising for both growth and tax efficiency.
- Consult with a tax professional: Personalised advice from a tax consultant or financial advisor can provide tailored strategies that align with specific financial situations and goals.

These strategies should help manage tax liabilities while optimising investment growth and retirement savings. It's essential to regularly review your financial plans to adapt to changing circumstances and tax regulations.

Moneyweb | 13 August 2024

Get policies right for pension planning

Economic policies form the foundation upon which pension funds thrive or falter. When the economic environment is favourable such that there is sustainable growth and inflation is kept in check, pension funds can fulfill their obligations to retirees. Otherwise, the financial security of pensioners is threatened. The NSSF Act of 2013, which mandated an increase in NSSF contributions, was one of the new legislations that had a favourable effect on pension contributions in Kenya. This occurred in February of last year when the Employment and Labour Relations Court's earlier judgment to halt the NSSF Act's implementation after finding it illegal was overturned by a Court of Appeal ruling. The contribution rates increased from Sh200 to Sh600 to a maximum of 12 percent of a worker's monthly salary, with the employer matching six percent of the worker's deductions.

But this law did not bring a 'happy-ever-after'. One year later, in February this year, the Supreme Court overturned the decision of the Court of Appeal that had declared that the NSSF Act 2013 was constitutional. The court held that the Employment and Labour Relations Court (ELRC) has jurisdiction to determine the constitutional validity of a statute in matters concerning employment and labour as provided in the Constitution. More recently, in what appeared to be part of a solution to service the national debt, the government recently attempted to introduce extensive fiscal policy reforms, through the Finance Bill 2024. The bill would have directly impacted taxation, public spending, government operations, and public debt management. However, this was met with significant backlash from the public.

The changes were also designed to tackle a growing budget deficit worsened by inadequate tax revenue, escalating debt obligations, and rising expenditure needs. The economy, however, was grappling with issues such as low productivity, high unemployment, and a cost-of-living crisis, driven by a combination of geopolitical tensions, tight financial markets, environmental challenges, global inflation, and domestic financial mismanagement. Inevitably so, these economic stringencies have led to a constantly diminishing savings culture among Kenyans, who are left with little to save after various tax deductions have been made to their pay slips, not to mention their day-to-day living expenses.

The savings culture in Kenya has, historically, been very poor – the poorest in East Africa. A 2022 report by Enwealth Financial Services found that only 12 percent of Kenyans have an established savings culture. Even though there has been a slight improvement, as seen in saccos' 9.8 percent increase in deposits, according to KNBS Economic Survey 2024, we are not there yet. Inflation manages to creep up on people and water down their efforts towards this.

As of June 2024, the inflation rate was at 6.22 percent as per the Central Bank of Kenya. This increase in the prices of goods and services means less money is left to save. But some policies are like double-edged swords. While rising interest rates have challenged businesses' borrowing capacity from commercial, they've conversely presented opportunities for lenders, including pension funds, to earn higher returns at lower risk through government securities. This highlights the complex interplay of economic policies and their multifaceted impacts. Retirement Benefits Authority (RBA) gave the nod to pension funds to allocate their investments to alternative assets like infrastructure, real estate, and private equity.

Yet, government securities remain the favored class for the sector with a portfolio share of 47.5 percent as of December 2023, according to data from RBA. Despite the noteworthy efforts to improve the pension sector, savers in the country face serious impediments such as increasing unemployment, inflation, growing public debt, high taxation, and other fiscal policies that threaten retirement planning and their pockets in general. Finding a way to balance these issues is key to maintaining or increasing saving potential, ensuring the safety of the pension sector, and guaranteeing retirees in this country a decent lifestyle after retirement.

Business Daily | 11 August 2024

Blackstone sells 3,000 homes worth £405m to UK's biggest pension fund

Universities Superannuation Scheme acquires shared ownership properties from US private equity group

The US private equity group Blackstone has sold more than 3,000 shared ownership homes to Britain's biggest private pension fund in a £405m deal, the latest by big investment companies in the UK housing sector. The New York-based company sold the portfolio to the academia pension fund, the Universities Superannuation Scheme (USS), which manages more than £75bn of assets. The sale is one of the biggest in the UK housing sector this year, and the largest involving shared ownership homes since the creation of the shared ownership scheme in 1990. The scheme allows people who cannot afford to buy a home outright to get on the property ladder by buying part of it, with the option of acquiring the remainder in the future.

The scheme is open to people whose household income is up to £80,000 a year, or up to £90,000 a year in London, and if they cannot afford all of the deposit and mortgage payments "for a home that meets your needs". Blackstone has been investing heavily in rental and social housing, and agreed to buy 1,750 rental homes from the housebuilder Vistry for £580m in June. The firm has ramped up investments in British housing, betting on long-term returns in a market where demand far outstrips supply in a long-running housing crisis that experts say will take more than a decade to fix. The new Labour government has promised to build 1.5m new homes over the next five years, with a focus on affordable housing, in particular social homes, and laid out changes to the planning system. Blackstone sold the homes via its Sage Homes vehicle, a housing joint venture with the private equity investor Regis Group that was launched in 2017.

The portfolio, which is located across the UK, consists of shared ownership properties across 250 Sage Homes sites. USS has launched Sparrow Shared Ownership, a registered provider of social housing, to manage the homes. James Seppala, the head of real estate Europe at Blackstone, said the company had “created an institutional-grade portfolio which has, in turn, attracted more long-term institutional capital into the sector”. He said the sale proceeds would be invested in Sage to help alleviate the undersupply of housing in the UK. “Through Sage Homes, which was established in 2017, Blackstone has been the largest provider of newly built affordable housing in the country for the last three years,” he added. Sage has committed £3.7bn to fund the development of 22,600 affordable rent and shared ownership homes, of which more than 17,000 have been built so far. Institutional investment in UK housing is still small compared with the US and continental Europe, and makes up just 2% of the total rented stock, compared with more than 35% in Germany and the US, according to Savills.

The Guardian| 13 August 2024

Two-pot cheat sheet

Given the overwhelming amount of information available about the new two-pot retirement system, below we provide a "cheat sheet", which includes 10 "did you knows" and an infographic, which we hope will be a useful overview for members, employers and advisers.

Did you know?

1. Two pots – but one investment

From 1 September 2024, all new contributions to retirement funds will be split into two components, as shown in the infographic below: One-third will be allocated to a savings component, which members can access once a year before retirement, and the remaining two-thirds will be allocated to a retirement component, which will be inaccessible before a member retires, and at retirement must be used to purchase a retirement income product. Existing retirement savings will go into a vested component, which will be treated in the same way as it was before 1 September 2024, except that no further contributions can be allocated to it.

While the two-pot system will offer a measure of flexibility by providing some access to savings in case of severe financial stress, it should not change how you think about or invest your retirement savings. You should view the components in your retirement account holistically and remain invested in funds that will offer you the best chance of having sufficient savings to provide an adequate post-retirement income.

2. Your savings pot will receive a once-off opening balance

Your savings component will be funded with an initial once-off amount transferred from your vested component. This process is called "seeding". The amount to be seeded will be 10% of the market value of your account on 31 August 2024, subject to a maximum of R30 000.

3. Retirement savings accumulated before two-pot will not be subject to the new rules

The existing value of your retirement account on 31 August 2024 (your vested component plus future growth), will not be impacted by two-pot – other than the amount that will be deducted for seeding. You will not be able to make further contributions to the vested component.

4. Withdrawals could reduce your retirement savings by up to one-third

Accessing your savings component before retirement reduces the amount you will have available at retirement to purchase a retirement income product or to take as a cash lump sum. It also robs you of the full benefit of compounding.

5. You are unlikely to get the withdrawal amount you request

Withdrawals from your savings component will be taxed at your marginal tax rate, which is the highest rate of tax that is applicable to you, according to the personal income tax table. These taxes are higher than those applied at retirement if you decide to take your savings component assets, or a portion thereof, as a cash lump sum at that point. You will receive the after-tax amount, less any outstanding taxes you may owe to SARS.

6. You may find yourself in a higher tax bracket

You could be pushed into a higher tax bracket for the year of assessment as SARS will include the withdrawal when calculating your marginal tax rate.

7. You only get one withdrawal per tax year

Even if you only make a partial withdrawal from your savings component, you are not allowed to make another withdrawal until the following tax year. Tax years run from March to February.

8. There are no penalties for not withdrawing from the savings component

The amount that is invested in your savings component remains invested and will continue to grow. The full amount, less applicable taxes, will be available to you once, annually.

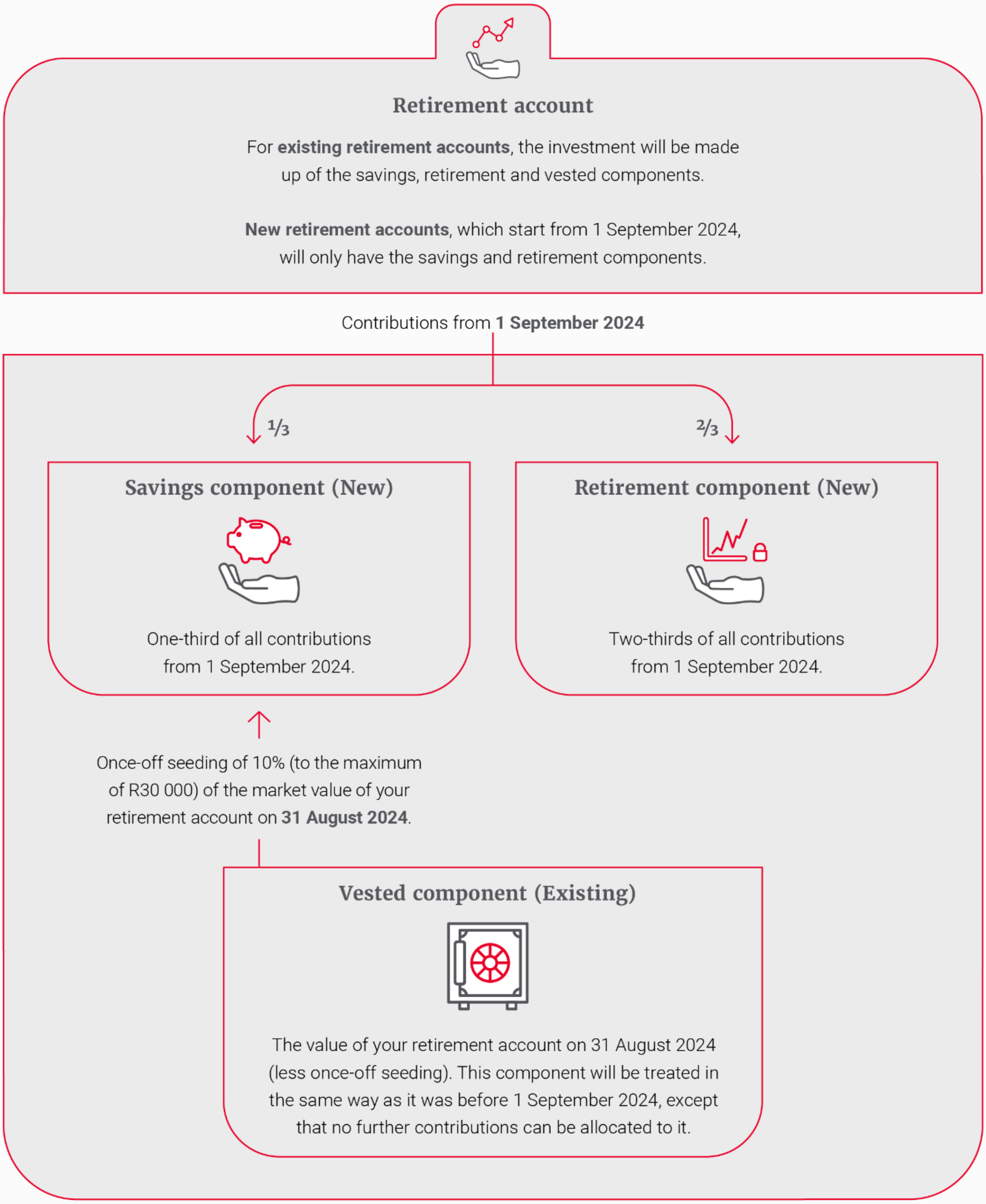
9. Certain members will be excluded, but can choose to opt in

If you have been a member of a provident fund since before 1 March 2021, and you were 55 or older on that date, you will automatically be excluded from the new system, and it will not have any impact on you for this specific investment. You will, however, be able to opt in if you would like to.

10. The new rules alone do not ensure an appropriate and sustainable income in retirement

While the two-pot retirement system will assist with better preservation, it is still up to you to avoid the withdrawal temptation and invest appropriately for real returns.

The two-pot retirement system explained



Source: Allan Gray

Allan Gray | 12 August 2024

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

3 William Road
Bedfordview
Johannesburg 2008