THURSDAY, 1 APRIL 2021

irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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Can changes to Regulation 28 be a panacea for our ailing economy?

A group of panellists at the recent SAVCA Private Equity Conference debated National Treasury's proposed amendments to Regulation 28. The regulation is part of the Pensions Funds Act and limits local retirement funds' exposure to certain investments to ensure portfolios are well diversified and do not take on undue risk. Tanya van Lill, SAVCA CEO said they expect the changes to provide much needed economic stimulus to South Africa's struggling economy: "The proposed changes to Regulation 28 provide retirement funds with an opportunity for a higher degree of diversification, greater access to sustainable and impact investing, and improved overall financial security for pension fund savers in the long run."

A welcome proposed change is that private equity was delinked from hedge funds and the investment limit for private equity will be increased from 10% to 15%. The proposed amendments also include increasing the limit local retirement funds can invest into South African and African infrastructure. Should the proposed changes become effective, retirement funds will be allowed to hold up to 55% of their value in infrastructure. It is hoped that such changes will make investing in infrastructure easier, which in turn should create jobs and spur economic growth.

Van Lill added: "SAVCA's 2020 private equity industry survey showed that investment in African infrastructure has been an emerging theme over the past decade. Active investments from funds in various regions were funnelled into projects in energy, transport and ICT sub-categories. "This serves as a catalyst for development on the continent, in a way that fosters the achievement of targeted and specified developmental goals. Furthermore, infrastructure investment opens up new opportunities for add-on or related investments."

Changes are "hitting the mark"

Panel moderator Anne-Marie D'Alton, CEO of Batseta kicked off the session by asking Thomas Mketelwa, Principal Officer of the Kwa-Zulu Natal Municipal Pension Fund as to whether the changes hit the mark or not. His response was that they were indeed hitting the mark but that things could be improved in places. "The changes may not have introduced the issue of infrastructure in the way we were hoping it would be introduced – as an asset class on its own," he said. "But the bottom line is that we're happy and would like the changes to be implemented without further delay. It's an investment opportunity for us."

Mantuka Maisela, Chairman of the Motor Industry Retirement Fund, was also positive about the changes. “Regulation 28 is going to bring hope to our people,” she said. She pointed out that unemployment is high and infrastructure development should uplift people by creating jobs.

Better definitions will help

Another change involves providing a more precise definition of what infrastructure investment means. Tebogo Kgosi, Deputy Principal Officer of the Transport Sector Retirement Fund, believes this will have many benefits. “It will enable better data collection and measurement,” she said. According to the proposed definition, infrastructure includes installations, structures, facilities, systems, services, processes that relate to matters specified in Schedule 1 (of Section 1 of the Infrastructure Development Act of 2014). “To us, the beauty of Schedule 1 is that it is diverse and a well-thought out definition that covers all areas relating to infrastructure,” said Kgosi. She did, however, comment that it would be preferred if the definition of infrastructure is included as part of Regulation 28 rather than in a separate Act.

New allocation limits

According to Soyisile Mokweni, Chairman of the Consolidated Retirement Fund, the most important change is that hedge funds are no longer linked to private equity. “It’s fantastic that private equity investments now get a 15% allocation on their own,” he said. “This regulation is giving us an opportunity to look at private equity and infrastructure investment as a way of having a meaningful impact on developing our own country,” commented Mokweni.

Execution by diverse and transformative boards is key

However, the changes to the regulation are only one part of the conversation. D’Alton questioned the panellists as to what else needs to be in place to ensure infrastructure investments materialise. Maisela’s response was: “Diversity, including of expertise, is very important for boards, as is transformation and inclusivity. Trustees must use service providers who understand the plight of the people – who understand that some members may be in rural areas where there are no roads, toilets or bridges.” She also advised boards of trustees to assign assets or give mandates to black asset managers who have roots within those communities and who truly understand the socioeconomic challenges they face.

Steps in the right direction

Drawing the session to a close, D’Alton highlighted the widespread support for the proposed changes to Regulation 28 across the panel and encouraged trustees to actively participate in the public consultation process. Commenting on the session, van Lill said: “Overall, the session highlighted just how much work still needs to be done in this area for the implementation and execution of the proposed changes to be successful.

"However, ensuring alignment between retirement funds, that proper classification and definitions exist and that oversight and monitoring is effectively undertaken are all steps in the right direction," she concluded.

FA News | 25 March 2021

Why your house or business is not an adequate retirement solution

You wouldn't take the risk of gambling your livelihood away – but relying on your business or other assets like your home as your sole retirement income solution isn't much different. Find out why experts suggest a combined approach to secure your financial future.

The state of South African retirement planning

Many South Africans are planning to rely on the sale of their business or home to fund their retirement. A Sanlam Reality survey conducted in conjunction with TaxTim in 2019 suggests that business owners are more intent on drawing lower salaries from their businesses now in order to reap the future benefit of growth so that it can one day be cashed in to fund their retirement.

The survey also suggested that while salaried employees save more towards retirement (16%) than entrepreneurs do (10%), this doesn't necessarily mean they earn more. Other indicators in the survey, like medical aid contributions, showed that on average, they were equally financially stable. This points to the likelihood that discretionary income that could be invested in a secure retirement solution is instead reinvested into the business, in the hope that it will one day pay off by funding their retirement.

The problem with the plan: It lacks portfolio diversification

As Suzanne Pope, a Business Development Manager at Glacier by Sanlam, says, relying only on the sale of a single asset like your house or business to fund your retirement is a dangerous bet to make with yourself. "Whether a business or a house, you're pegging your retirement value to an asset whose value you potentially do not have control over at the point of your retirement," says Suzanne. "Meanwhile, markets could plummet and property values could drop; there are so many external factors. If the business crashes or liquidates, the retiree will sit with no capital for retirement and will not be able to retire," she continues. "Relying solely on these assets is not a viable solution in terms of retirement planning."

Even if you can sell, you're not guaranteed your price

Having a solid retirement plan in place, and your house, business or other asset as an additional investment is better, as you're not dependent on the sale of the asset, says Suzanne. "But ultimately the sale of the asset depends on the market conditions at the time of the sale, and on the buyer. So your property is only the value of what somebody is prepared to pay for it."

It isn't tax-efficient

If you've left an employer to start your own business, it could be tempting to cash in your accumulated provident or pension fund for a cash injection to your new project. However, the tax tables won't work in your favour. "What we see is people under the age of 55 exiting an employment contract and they take their retirement savings," says Suzanne. "Those are retirement savings that you are now paying tax on at a withdrawal tax rate, which is not as generous as your retirement tax tables."

Further down the line, if you're relying on your business to fund your retirement, there are further tax implications:

1. "You will not receive the annual tax deductions you could've received for your own contributions into an RA (Retirement Annuity)."
2. The sale of your business will be subject to capital gains tax (CGT). "It's important to factor in this tax, which you'll have to pay off the top of the capital value that you receive from the asset," notes Suzanne.

You may not even be able to access your capital

"If you're in partnership with other parties, you may assume that they are also going to want to sell the business at the time you're planning to cash in, and that you'll be able to unlock the capital that you perceive is going to fund your retirement," says Suzanne. This is a recipe for disappointment – and a sticky financial situation.

The value of partnering with a financial adviser

Running a business means that you need an expert by your side to help take care of your personal financial decisions. Your business can hold plenty of financial and personal value to you, but recognising that your retirement needs and your business's needs are separate is vital to a functional retirement plan. A financial adviser can assist in identifying the risks that could derail your retirement plan, and formulating a disciplined strategy that protects you, your family and your business.

Retirement solutions right for you

"A financial adviser can help you set up a retirement annuity fund membership in your name, funded by your business so that there's a more disciplined approach," says Suzanne. "The business would contribute on your behalf and pay the premium for you." Alternatively, in the case of a larger corporate, a group benefit scheme could be an option. "Depending on the size of the business and the number of employees and contribution, you can set up an employee benefit scheme like a pension benefit scheme and risk cover for you and your employees," explains Suzanne.

She points out that the retirement annuity fund route could be preferable in some cases though, because the business can simply stop contributing if a member or owner leaves, and the business owner can take over the debit order. The tax benefits of a retirement annuity fund also make it an appealing option in comparison to relying solely on the sale of a business at retirement. In summary, relying on proper retirement solutions for your income plan means your savings are more tax efficient. Retirement tax tables will apply to any cash that is paid out into your bank account when retiring from the retirement solution. This can be more tax efficient than possible capital gains tax liabilities on the sale of an asset. "And the growth is tax-free within the retirement solution," says Suzanne.

FA News | 29 March 2021

How to gain the most from your tax-free investment plan

It's been six years since National Treasury introduced tax-free savings accounts (TFSAs) to encourage South Africans to invest. With a TFSA there is no tax on interest or dividends received, and no capital gains tax (CGT) on funds withdrawn.

Annual limit remains at R36 000

Although there was no increase to the annual limit in this year's budget speech, the limit was increased from R33 000 to R36 000 last year, effective 1 March 2020. The overall lifetime limit has, however, remained unchanged since 2015, at R500 000.

Maximising your TFSA

To take full advantage of the tax-free growth, investors who already have an existing monthly recurring contribution into a TFSA would benefit by utilising the full allowance of R3 000 a month. Roenica Tyson, Investment Product Manager at Glacier by Sanlam, says that those who prefer to invest via a lump sum will benefit by doing so at the beginning – rather than the end – of the tax year, giving their investment an extra 12 months of tax-free growth.

Example:

A R36 000 lump sum investment on 1 March can grow by R3 600 over the year (assuming a balanced fund investment with CPI+4% return). Tax on interest, dividends and capital gains in a such a portfolio would amount to R600*. By rather allowing this lump sum to grow in the TFSA from day one, the investor gets to keep and further grow this R600, which will have a meaningful impact over a long investment horizon. *Assumes: CPI at 6%; 30% marginal tax rate; portfolio return consists of 15% interest, 25% dividends and 60% capital; interest and capital exemptions are not taken into account.

Three tips to maximise your TFSA

1) Invest the full R3 000 per month.
2) Invest your lump sum now to enjoy a full year of tax-free growth.
3) Include sufficient growth assets (no limits apply) to maximise long-term growth.

Less tax means happy clients

While National Treasury has been generous with the TFSA, interest and capital gains exemptions have not been adjusted in recent years. The R23 800 / R34 500 annual interest exemption amounts have remained unchanged since 2014 and the R40 000 annual exclusion from capital gains has been in force since 2017. To maximise the tax efficiency of an investor's discretionary investments, the TFSA is becoming an integral part of a financial plan.

A long-term investment

While investors can access the money at any time, any amount withdrawn will be regarded as a further contribution (towards your lifetime contribution limit) when re-invested in the TFSA. Given this restriction, investors should view their TFSA as more of a long-term investment. There are other investment vehicles more suited to short-term savings or emergency funds. A TFSA has no limits on how much may be invested in growth assets, such as equity, foreign equity and property. This further enables investors to maximise their growth, tax-free, over the long term. Investors should consult with a qualified financial adviser to ensure their investment portfolio is in line with their personal circumstances and risk profile.

FA News | 25 March 2021

Planning to retire early

Here's what to consider.

Planning an early retirement is a goal that many ambitiously set for themselves, but it takes an enormous amount of discipline, planning and sacrifice to make it happen. It also means you'll need to start dreaming and planning early on in your career to ensure that your goals can be met. While you are earning, maximising tax deductions and attacking debt will be priorities as you move to build assets faster than the norm. But the dream of early retirement may not be as simple as it sounds. Here's what you'll need to take into account.

Your vision of an early retirement

Understanding what retirement looks like for you is the first step in the process, as this will form the platform on which your retirement plan is built. Start by asking yourself why you want to retire and at what age. Do you want to continue generating an income in retirement? Do you intend to downsize your home? Are you retiring to escape a job that you hate? Does your spouse want to retire at the same time? What does financial freedom mean to you? What is your number? A successful early retirement involves making and stress-testing a number of assumptions and then building a plan that is flexible enough to withstand multiple decades.

Longevity

Being one of the most important assumptions to get right, you will need to give careful consideration to your life expectancy and that of your spouse. If you plan to retire at age 55, you could well have 40 years' worth of living expenses to plan for – that's 480 withdrawals from your accumulated capital. Importantly, keep in mind that your monthly living expenses do not necessarily reduce after retirement and, in fact, as you age you can expect your medical and associated healthcare costs to escalate.

Retirement funds

You will need to make some important decisions around your retirement funding quite early on, and the timing of many of these decisions can be pivotal to your future planning. For instance, you will need to decide when best to retire from your retirement annuity, which is permitted any time from age 55 onward. Retiring as early as possible will allow you to make a lump-sum withdrawal from the fund (assuming no previous withdrawals have been made), and will give you the opportunity to incorporate more offshore exposure through a living annuity structure. From an estate planning perspective, you will also be able to nominate the beneficiaries to your living annuity.

On the other hand, remaining invested in your retirement annuity will allow your investment more time to grow before you begin drawing from it. On the downside, Section 37C of the Pension Funds Act means that the distribution of any retirement fund monies will remain at the discretion of the fund trustees, and this could hamper your estate planning strategy. Furthermore, while invested in a retirement fund, your asset allocation is subject to Regulation 28 of the Pension Funds Act which limits your offshore exposure to no more than 30% of the fund. Once you retire from a retirement fund, your investment is no longer governed by the Pensions Fund Act. Another important decision that will need to be made is whether to invest in a living annuity or life annuity, or a combination of both.

Drawdowns

Retiring from your retirement funds marks the transition from saving towards retirement to drawing from your capital and pitching your drawdown rate at the right level at the outset is critical. The 4% rule, which has its critics, assumes that if you withdraw 4% of your savings annually, adjusted for inflation, you will be able to continue drawing at that level for a period of 30 years. However, an earlier retirement will mean that you need to withdraw significantly less from your living annuity because your capital needs to survive 40 years or more, keeping in mind that the annual minimum drawdown rate is 2.5%. Managing your drawdowns and strategically supplementing your income needs from your discretionary investments in the most tax-efficient manner to ensure that you don’t run out of capital will be a critical component of your planning.

Healthcare costs

It goes without saying that ensuring you can manage your long-term healthcare expenses will be an important aspect of your plan. Generally speaking, you should base your planning on the assumption that your medical aid and associated healthcare costs will increase annually at a rate of inflation plus 4%. If you enjoy a medical aid subsidy through your employer, you will need to factor this into your planning. Retiring while you are young and healthy may mean that you do not give sufficient thought to your healthcare costs later in life which could involve the need for frail care facilities, home care or assisted living accommodation. Your monthly healthcare costs at age 55 are likely to be very different in real terms than when you are 80, so be sure to build a buffer in your budget.

Accommodation

An early retirement may mean remaining in the family home until you feel the need to downscale at a later stage. A long retirement horizon could also mean that you transition from the family home to a smaller retirement home, and eventually on to a retirement village. Your plan will therefore need to take into account the costs of buying and selling property after retirement, as well as the costs of renovating and/or altering the property. If you are dependent on the equity in your property to help fund your retirement, the timing of the sale of your property will be important to ensure that you don’t find yourself short of cash. With the above in mind, your plan should include assumptions regarding where you intend to live in retirement, when you intend to downscale, and how the proceeds of any sale will be invested.

Life cover

If you’re retired from employment, you will need to consider that your group life and disability cover will fall away so be sure to determine your need for insurance cover before this happens. Assuming that all debt will be settled by the time you retire, you may still require life cover for estate planning purposes so you will need to take into account the costs of securing life cover at age 55.

Investment portfolio

A retirement at age 55 means that you still have a potentially long-term investment horizon and, as such, you will need to ensure that you are invested appropriately for this time period. You will need to ensure that your investment portfolio is resilient and flexible enough to withstand multiple withdrawals from different income streams with different tax implications over an extended period of time. With a 40+ year time horizon, inflation is your number one enemy as the only growth that really matters is the increasing purchasing power of your money. Inflation can be considered a tax on your assets and if your investment returns don’t outstrip inflation over the long-term you can find yourself financially compromised later on in retirement. Investing for growth while at the same time drawing down from your invested capital may cause anxiety, and you need to take this into account when building an early retirement investment strategy.

Boredom

Retiring from an occupation that kept you busy 40 to 50 hours a week means that you will need to give careful thought to how to fill your days. Many early retirees attest to feeling bored, depressed and without purpose which, in turn, can affect one’s mental health. Ask yourself: what will my daily diary look like? How will I fill my time? What will I do to remain intellectually stimulated? How will I remain connected and engaged with society? Also important to consider is that eating out, entertainment, travel, clubs and hobbies can add another layer of expenses to your post-retirement budget, so be sure to account for these costs in the planning stage.

Your dependants

You may build your early retirement plan on the assumption that you will have no financial dependants when you retire, but this may not necessarily be the case. What happens if your adult children experience financial hardship such as that brought about by the pandemic and need your help? Do your parents have enough retirement funding in place? What would happen if your ageing parents need financial assistance with their retirement? Give careful thought to these eventualities to ensure you are buffered against them.

Your legacy

Lastly, you will need to consider your retirement plan in view of your desire to leave a financial legacy to your loved ones. If you plan to leave assets to your adult children, determine how this maps against your overall plan. How much would you like to leave your adult children and in what structure? Will there be enough in your estate to achieve your estate planning goals? Are your retirement plan and estate plan fully aligned?

Moneyweb | 25 March 2021

INTERNATIONAL NEWS

China bonds set to draw billions of dollars after FTSE WGBI approval

SHANGHAI (Reuters) -Index provider FTSE Russell has given its final approval for Chinese sovereign bonds to be included in its flagship bond index from later this year, setting the stage for billions of dollars of inflows into the world’s second-largest economy. But a longer-than-expected inclusion period - of 36 months, rather than one year, as FTSE had previously announced - reflects persistent concerns among some global investors about investing in the world’s second-largest bond market. Chinese government bonds (CGBs) will be added to the FTSE World Government Bond Index (WGBI) over three years from the end of October, FTSE Russell said in a statement released after the U.S. market close on Monday.

FTSE said “a more conservative” schedule was appropriate because of feedback from market participants, which had included concerns from Japanese investors around settlement and liquidity.“The nature of the investors (tracking WGBI) is very different from other indexes,” said Zhanying Li, Asia Pacific ex-Japan head of product sales and relationship management at FTSE Russell. “There’s a large passive investor base behind WGBI ... the preference was for a small monthly increment.” Japanese investors, including Japan’s 172 trillion yen ($1.56 trillion) Government Pension Investment Fund (GPIF), are the biggest users of WGBI. Analysts say that historical animosity between China and Japan has contributed to concerns over investment in Chinese assets.

A source familiar with negotiations over China’s inclusion said it continued to draw “emotional” opposition from investors in Japan. “Public pension is in the end citizens’ money and some citizens may not like allocation to China," the source said. FTSE Russell is able to provide custom variants of the index for investors with concerns about investments in CGBs, said FTSE Russell's Li. "Since there is still some time before the actual inclusion, we will have internal discussions to study how we will deal with it," said a spokesperson for GPIF. Li said that smaller monthly increments over a longer period are also less likely to cause inflow-related volatility in Chinese markets, but added that Chinese regulators had not expressed concerns to FTSE Russell over issues caused by possible rapid inflows.

China's top banking and insurance regulator said in early March that Beijing is studying ways to manage capital inflows to prevent turbulence in domestic markets. Chinese government bonds were previously included in index suites from JPMorgan and Bloomberg Barclays, but FTSE WGBI inclusion is expected to have a larger effect due to the size of passive flows tracking it. HSBC said that with roughly $2.5 trillion tracking the WGBI, some $130 billion in inflows could be expected, given China's eventual 5.25% weighting - about $3.6 billion a month. "From a global perspective, it improves inclusion statistics of the index - not having the second-largest country in it was a gap," said Binay Chandgothia, a portfolio manager at Principal Global Investors in Hong Kong.

"It will also pull up the index yield a bit," he said, though adding that would be limited by China's modest weighting. China's debt is already increasingly popular with global investors, attracted by its yield and its relative insulation from movements in other bond markets. Foreign investors held a record 2.06 trillion yuan ($318.7 billion) of Chinese government bonds (CGBs) in February, even as premiums over U.S. debt shrank as a bond sell-off dented global markets. Benchmark 10-year CGBs yielded 3.202% on Tuesday, compared with a 1.7419% U.S. 10-year yield. In its statement, FTSE Russell also said India and Saudi Arabia were being considered for potential inclusion, and that Malaysia was no longer on a watch list for exclusion from WGBI. ($1 = 109.9400 yen)

Reuters | 30 March 2021

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

2nd Floor Leppan House
No 1 Skeen Boulevard
Bedfordview 2008