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Institute of Retirement Funds Africa

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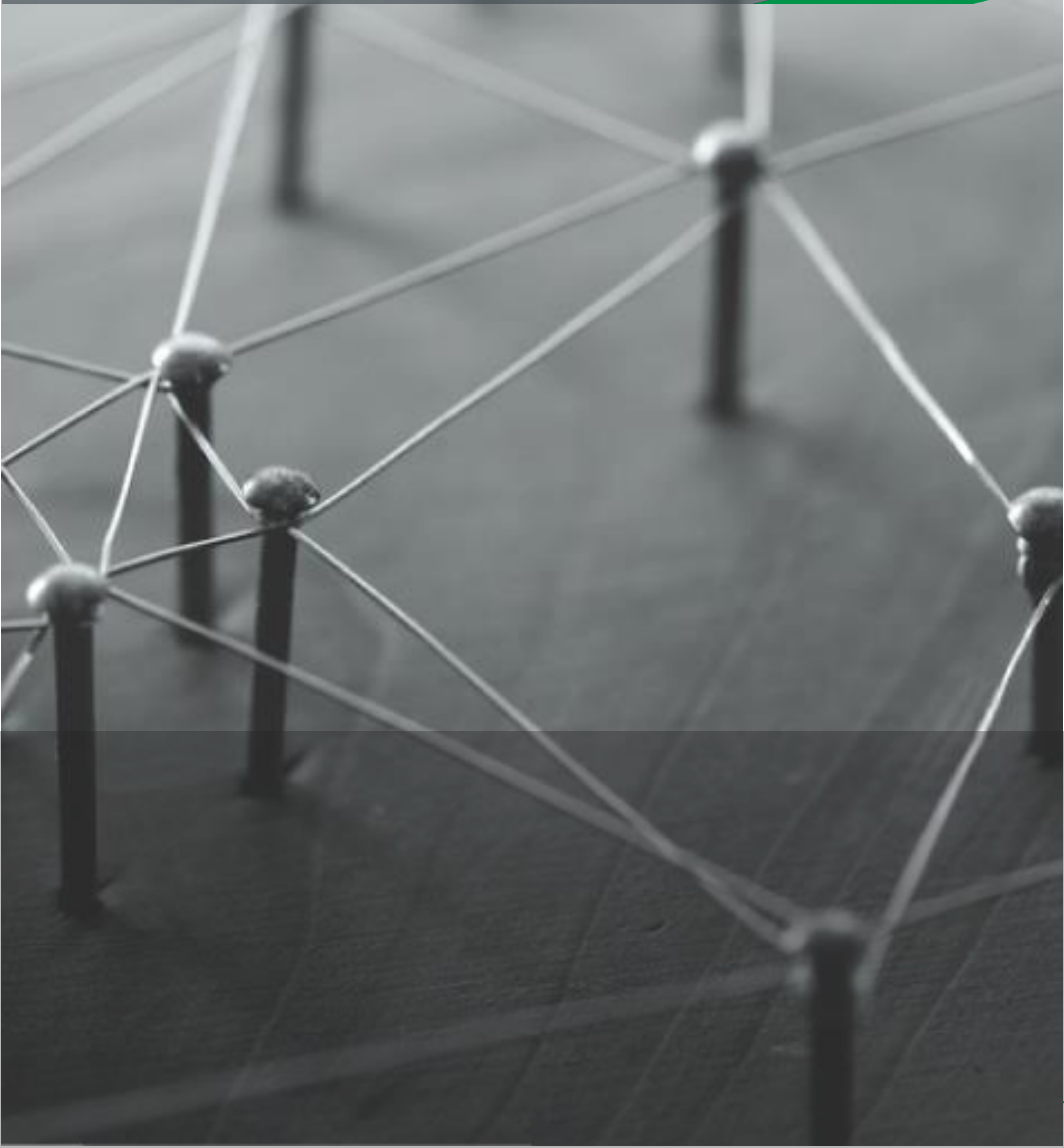

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Which is worse: A two-pot withdrawal or an expensive RA?

A look at which causes the most damage to retirement capital.

The media is teeming with articles on the statistics of retirement fund members drawing from their savings pot under the new two-pot system. There are warnings from insurance companies, in particular, that withdrawing from your savings pot is bad for your retirement. Several of them have developed free calculators using generous return assumptions to show you just how bad a withdrawal from the savings pot will be for your retirement. These same insurers sell retirement annuities (RAs) to the public and have been doing so for many years. These products are unnecessarily complex and come with more bells and whistles than a circus on parade.

The bells and whistles are important because they distract investors from the hideously expensive fees that they charge on many of their RA products. My article published on Moneyweb titled Stop the two-pot hypocrisy pointed out that these insurers are quick to show retirement fund members the destructive impact of a withdrawal on their retirement capital, but they've been slow to show RA investors the impact of high fees on retirement capital. A reader contacted me to discuss the article. He wanted to understand the numbers behind this assertion. Surely, a lump sum withdrawal would have more of an impact than a few extra percent in fees?

Withdrawal vs fees

Consider Members A and B. Both are 40 years old. Both have R300 000 in their RAs, which allows us to run the calculation using the maximum two-pot seed capital of R30 000. Both will retire at age 65. Member A is withdrawing R30 000 from the savings pot but is invested in a cost-effective, new-generation RA product. Member B is heeding the warnings of their insurer and will not be withdrawing the R30 000 from their savings pot. The table below shows the typical pricing of a new-generation RA and an expensive RA with bells and whistles. All costs include value-added tax.

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	Member A	Member B
Investment management	1.3%	2.2%
Advice	0.58%	0.58%
Administration	0.58%	1.5%

An important assumption in the calculation is the long-term return of the different RAs.

Here, I have assumed that the funds will return 12% per annum, which is a reasonable assumption for a high-equity balanced fund. This would be a suitable investment for someone with 25 years to retirement. From that return, we would need to deduct the fees above. So, Member A earns 9.54% per annum while Member B earns 7.72% per annum. Member A, who withdrew R30 000 from their savings pot but earned 9.54% per annum net of fees, reaches retirement age with R2.6 million in their RA. Member B, who *did not* make a withdrawal but was unfortunate enough to be invested in an expensive RA, retires with R1.9 million in their RA. So the fees had a more detrimental impact than the withdrawal.

What about serial two-pot withdrawals?

Two-pot has been around for all of two months, so it is still early days to make claims about retirement fund members' behaviours. However, it is a reasonable assumption that many members will be serial withdrawers from their savings pot in the years to come. Will a cheap RA product be able to bail out these investors? Let us consider the same two members above and assume that Member A is a serial withdrawer, while Member B is disciplined enough to remain fully invested until retirement. Member A is still investing through a new-generation RA product, while Member B is invested via an expensive RA.

Both members contribute R6 000 per month to their RA.

	Member A	Member B
Contributions	R6 000	R6 000
Withdrawal from savings pot	Yes (every year)	No
Expected return (net of fees)	9.54% p.a	7.72% p.a
Investment term	25 years	25 years
Expected value in RA at retirement	R4.9m	R5.5m

While the cheap RA bails out the member who makes a once-off withdrawal from their RA now, it is helpless in the face of continuous withdrawals. In the above example, the investor in the cheaper RA still ends up with more total capital (R4.9 million + R2.6 million = R7.5 million), while the member in the expensive RA ends up with R7.4 million in total. It is clear that a habit of withdrawing from the savings pot neutralises the effect of the lower cost structure. If Member A had not made withdrawals after the first withdrawal, they would have reached retirement with R9.9 million capital. What is clear from the above analysis is that an expensive RA is a significant drag on building retirement capital. Investors need to pay as much attention to the fees they pay as to the withdrawals they make from their savings pot in future.

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Legislative change will speed up resolution of tax disputes

Allowing alternative dispute resolution proceedings earlier in the proceedings will save time and money and see fewer cases proceeding to the courts.

National Treasury has proposed an amendment to the Tax Administration Act that will allow taxpayers and the South African Revenue Service (Sars) to use alternative dispute resolution proceedings to resolve disputes at the objection stage. The alternative dispute resolution (ADR) process is currently only available at the appeal stage. The move will result in quicker resolutions of disputes, a reduction in the backlog of cases, and see fewer cases proceeding to the appeal stage or the courts. ADR proceedings are often the first opportunity for the taxpayer to meet with the Sars auditors in person or virtually to discuss the merits of the dispute, says Joon Chong, tax partner at Webber Wentzel. Treasury says in a response document to the draft Tax Administration Bill that currently, 97% of all appeals are resolved during ADR proceedings (at the appeal stage). Other jurisdictions are already using ADR at the objection stage, which has “greatly assisted” in the early resolution of disputes. “It is submitted that the introduction of ADR at objection stage will have the same effect and assist taxpayers to attain the early resolution of their disputes without incurring unnecessary legal expenses,” says Treasury.

Factual and legal disputes

Where there is a factual dispute, the taxpayer may be able to discuss the evidence to prove the factual averments. Big disputes usually involve large volumes of documents, and the ADR process can be used to highlight essential parts of key documents, remarks Chong. In a legal dispute the ADR process allows the taxpayer and their tax practitioner/s to engage in a discussion on the interpretation of the relevant tax provisions using case law or legislative history. “Even when ADRs are unsuccessful, the taxpayer and their tax practitioners have a better understanding of how Sars views the dispute, which will then inform their strategy at litigation,” she adds. Nico Theron, founder of Unicus Tax Specialists, says allowing for discussion, debate and more human interaction at the objection level is welcomed. “In principle, it should make for more effective resolution of tax disputes.”

Practical implementation

Theron and several other tax commentators have however raised concerns about the practical implementation as the change could equally result in disputes being further delayed if not properly implemented in practice. Treasury gives the assurance that the current dispute resolution rules will be reviewed to make provision for the introduction of ADR proceedings during the objection phase and will also make provision for all the procedural steps. “If the taxpayer is of the view that the proceedings are delaying the finalisation of the dispute, the taxpayer may terminate the proceedings and move forward to the next stage of dispute resolution. However, if the proceedings are successful, it will significantly shorten the time-period within which the taxpayer’s objection will be finalised,” Treasury notes. The opportunity to have an

ADR process before Sars decides on the objection is welcomed. Taxpayers can augment their objections with further written submissions if necessary, after the ADR meetings, says Chong.

Appeals stage

This new information would be considered by Sars in the disallowance, partial disallowance or acceptance of the objection, which would be sent to the taxpayer before the appeals stage. Chong says the updated rules would clarify what would happen if the ADR is unsuccessful and whether the second ADR at the appeals stage will still be allowed. “We submit that the second ADR at the appeals stage should still be allowed. Further, we submit that the Sars committee considering the recommendations of ADR at the objections stage should be different to the Sars committee considering the recommendations of ADR at the appeals stage to ensure that the taxpayer’s dispute is considered afresh by the second committee.”

Independent arbitrators

One commentator on the proposal in the draft bill requested that ADR proceedings be headed by “truly independent arbitrators for neutrality and not Sars employees”. Chong says ADR facilitators are usually Sars officials, but the tax dispute resolution rules introduced in 2023 allow for non-Sars officials to be facilitators.

Treasury adds that the rule dealing with the appointment of the facilitator provides that a facilitator may be a Sars official, must be a person of good standing who has appropriate experience in the field of tax, and “must be acceptable to both parties”

Moneyweb | 29 October 2024

Two-pot savings are a tool for financial freedom, not a quick fix

Industry experts weigh in on why South Africans should leverage the two-pot savings system alongside short-term insurance as tools to achieve long-term financial goals

Many South Africans consider the recent implementation of the two-pot retirement system in South Africa a gift from above, offering much-needed relief amid the widespread financial uncertainty, the high cost of living and mounting debt in South Africa. At the same time, there has been growing concern from insurance providers and financial institutions about how this will impact consumers’ short- and long-term financial decision-making. Industry expert Mark Sanders, COO of GIB Insurance Brokers says that now more than ever, consumers must take a strategic approach to their financial planning, particularly when it comes to insurance. “Since the implementation of the two-pot solution in September this year, financial services providers have already received claims totalling over R21 billion.

While it’s understandable that many consumers are prioritising short-term financial pressures, this can lead to decisions that may compromise their long-term financial security,” says Glenn Gamsy, MD of Financial Services at GIB. Sanders notes “using two-pot savings as a fallback for emergencies may seem practical and attractive in the short run, he adds, but warns that using retirement funds to address short-term problems, like replacing damaged assets or covering debts, may be damaging to the stability of consumers' financial futures." "Consumers must be wary of using their two-pot savings for costs that can easily be covered through conventional insurance products," Sanders explains. "Short-term insurance is designed specifically to provide immediate protection without touching your long-term savings. This ensures that your retirement funds are preserved for their intended purpose – your financial security in retirement." Gamsy adds that the uncertain economic climate many South Africans are facing is even more reason for consumers to think more carefully before making hasty withdrawals. "The two-pot system should not be seen as a substitute for insurance. Rather, it serves as an additional safety net for unforeseen emergencies. Tapping into retirement savings prematurely could compromise your financial future," he says. Sanders adds that consumers need to view insurance not as an optional add-on but as an integral part of a comprehensive financial strategy. "Short-term insurance products protect you from having to dip into your savings for asset loss or damage. This is crucial because premature withdrawal from your retirement savings has both immediate tax implications and long-term effects on your retirement plan."

Balancing short-term insurance with long-term planning

Many South Africans, across income levels, have traditionally focused on short-term financial needs, such as paying premiums, covering bills and protecting immediate assets. However, with the introduction of the two-pot system, there's an opportunity to shift this mindset toward more balanced financial planning. Sanders explains, "Insurance should be part of a broader financial plan that includes both short- and long-term strategies. It's important for consumers to continue using short-term insurance for asset protection and to reserve the two-pot funds for true emergencies that cannot be covered by conventional means. "Thinking of two-pot savings as an alternative to insurance could also lead to underinsurance or even a complete disregard for the insurance products available to them," he says. Sanders says that South Africans should be using both short-term and long-term financial products in tandem with the two-pot system.

"Short-term insurance is your first line of defence, while your two-pot savings should be reserved for emergencies that cannot be insured. It's crucial for consumers to maintain a long-term view of financial security." The two-pot system presents a unique opportunity to shift consumer attitudes towards financial planning. "We've noticed a trend where consumers are becoming more focused on product value rather than simply opting for the cheapest options," Gamsy notes. "With the introduction of the two-pot system, there's an opportunity for even greater awareness about long-term planning and the importance of protecting assets without compromising retirement funds." Both Sanders and Gamsy assert that educating the consumer market about these potential risks is vital. As Sanders emphasises, "It's incumbent upon brokers and advisers to inform consumers about the long-term implications of withdrawing from their two-pot savings for short-term needs. Insurance is there to prevent exactly that.""The two-pot system shouldn't be seen as an immediate fix for today's problems," concludes Gamsy. "Instead, it's a tool to enhance financial security, and it should work hand-in-hand with appropriate insurance products to create a robust, holistic financial plan."

FA News | 28 October 2024

New categories for unit trusts investing exclusively in South Africa

Unit trust investors will find it easier to compare the performances and risk profiles of South Africa's 1 852 local collective investment scheme (CIS) portfolios following an update by the Association for Savings and Investment South Africa (ASISA) of its Fund Classification Standard.

The update came into effect on 1 October 2024.

Sunette Mulder, senior policy advisor at ASISA, says the review of the Standard was necessitated by the 2022 increase in offshore investment limits to 45% by the South African Reserve Bank (SARB). At the time, the Standard limited offshore exposure for South African CIS portfolios to 40% (30% outside of South Africa and an additional 10% of assets in Africa, excluding South Africa). Mulder says the previous version of the Standard had been in force since January 2013. "Since the Standard had to be amended, we used the opportunity to do a full review of the Standard to ensure that it continues to meet its key objective, which is to provide investors with a classification system that enables meaningful comparison of performance and potential risks when investing in a particular type of CIS portfolio."

The Standard provides for a three-tier classification of CIS portfolios based on the investable universe. The first tier classifies portfolios based on their top-level geographical exposure. The second tier classifies funds according to their underlying asset classes (equities, multi-asset, interest-bearing, and real estate). The third tier classifies funds in line with their primary focus within the investment universe, for example, Equity—General, Multi-Asset—High Equity, Interest Bearing—Variable Term, or Real Estate—General.

What changed

Mulder says the main change under the first-tier geographic classification redefined South African (SA) portfolios as portfolios that invest at least 55% of their assets in SA investment markets in line with the new offshore limit. In addition, the split between offshore and rest-of-Africa exposure was removed, meaning the remaining 45% can be invested anywhere outside of SA. "We also removed the Regional Portfolio category since very few portfolios used this classification. These portfolios have moved into the Global Portfolio category." According to Mulder, no changes were made to the second-tier category, and the four asset classes remain as Equity, Multi Asset, Interest Bearing, and Real Estate. Mulder says of most interest to investors are the changes made to the third-tier category, which reflects the investment focus of portfolios.

• Equity Portfolios:

Under the Equity Portfolios category, a new category, the SA Equity – SA General category, was introduced for CIS portfolios that invest exclusively in local shares. Mulder explains that the difference in the return profile of portfolios invested in local and foreign markets, often amplified by currency fluctuations, created an environment where funds grouped together often no longer had a comparable investment universe. This caused a categorisation that did not allow for meaningful comparison. Mulder says that some 60 portfolios moved from the SA Equity – General category to the SA Equity – SA General category when the revised

Standard came into effect on 1 October 2024. Furthermore, a new Equity – Africa category was created under the first-tier Global Portfolio category.

• **Multi Asset Portfolios**

Mulder says in line with the changes made to the Equity – General category, a new category was added to the Multi Asset Portfolios category called Multi Asset – SA High Equity category. Portfolios in this category invest in SA equity, bond, money, or property markets and hold 100% of their market value in South Africa.

• **Interest Bearing Portfolios**

In addition to changing the name of the money market classification to Interest Bearing – SA Money Market, this category also introduces two new classifications:

• **Interest Bearing – Variable Term Inflation Linked Bonds:** These portfolios invest at least 80% of their market value in Inflation Linked Bonds (ILB).

• **Interest Bearing – Unclassified (Global Portfolios only):** These portfolios invest in a spectrum of bonds, fixed deposits and other interest-bearing securities. Due to their unique investment objectives, portfolios in this category cannot be compared

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UK pension experts push for stronger ESG manager engagement over more disclosures

Pension professionals call for laws or clearer guidance to boost real-world ESG impact in the UK

At a recent event hosted by the UK's Society of Pension Professionals (SPP), more than 100 pension professionals reached a consensus on prioritizing "more focused manager engagement" over imposing additional Environmental, Social, and Governance (ESG) disclosure requirements. When asked about the future actions needed to make a real impact on ESG issues, 47 percent of participants advocated for improved engagement from investment managers, while none supported further disclosure requirements. Additionally, 35 percent of respondents favoured 'a change in the law,' and 16 percent sought "'clearer guidance on best practice.' Craig Campbell, SPP member and UK Head of Responsible Investment at Aon, chaired the session, remarking on the strong support for enhancing manager engagement in achieving real-world ESG impacts. Campbell observed, "It was good to see that pension professionals are so supportive of improving manager engagement to deliver real-world ESG impacts.

Given the substantial increase in ESG disclosure requirements in recent years, it is perhaps not surprising that there was no support for additional disclosure requirements to be imposed." Campbell added that pension professionals remain committed to ESG principles and are determined to continue advancing these goals. "What is clear is that pension professionals remain very much committed to ESG principles and outcomes. We have achieved a great deal but there remains much more to do," he said. Held on 22 October, the event featured notable industry speakers, including Stuart O'Brien, partner at Sacker & Partners LLP; Brendan Walshe, principal investment consultant at The Pensions Regulator; Natalie Winterfrost, director at Law Debenture Pension Trustees; Timothée Jaulin, head of ESG Business Development & Advocacy at Amundi; and Craig Campbell, who chaired the event. The SPP, a representative body for UK pension advisers and service providers, encompasses professionals such as actuaries, accountants, investment managers, and administrators. Through its 85 corporate members, employing over 15,000 professionals, the SPP leverages their collective expertise to promote positive impacts for savers, the pensions industry, and its stakeholders.

BPM | 29 October 2024

Epic showdown looms over proposed early retirement for government workers

The government is set to collide with public-sector workers' unions in the months ahead following the proposal for an early retirement of at least 30 000 employees in a bid for the State to reduce its wage bill. The National Treasury yesterday announced that the government has allocated R11 billion to implement early retirement measures over the next two fiscal years in a bid to contain the escalating wage bill. This is contained in the documents of the Treasury's 2024 Medium-Term Budget Policy Statement (MTBPS) tabled in Parliament by Finance Minister Enoch Godongwana yesterday. The MTBPS documents state that Cabinet has approved an early retirement programme to reduce government employment costs while retaining critical skills and promoting the entry of younger talent into the public service.

Treasury said the government was proposing to reactivate early retirement without penalties in 2025/26 and 2026/27 in a bid to further contain public service wage costs amid a deteriorating fiscus. "To support this initiative, an additional R11bn will be allocated over the next two fiscal years. Details will be set out in the 2025 Budget," stated the budget documents. "Accounting officers and executive authorities will have the authority to approve early retirement applications that do not reduce the pool of highly skilled individuals within government agencies." South Africa's average spending on public-sector salaries is well above that of many countries, with the general government wage bill constituting 13.6% of the GDP in 2022 - the third highest in the world after Iceland and Denmark, according to the OECD - while the general government employment was the seventh at 18.6%.

Treasury's Director-General, Dr Duncan Pieterse, said the reduction of the government employees headcount will eventually save the fiscus around R2bn annually. "The number of employees that have been provisionally used in order to inform the numbers is 30 000 over the next two years. But it's important to note that this is a voluntary program, so employees have to opt-in and the executive authorities have to approve. So, it's very difficult to say exactly what the outcome will be," Pieterse said. "And, of course, the Department of Public Service and Administration will have to release the directive for early retirement in the next few weeks to give effect to this." Over the past decade, the wage bill has decreased as a share of consolidated spending, falling from 35.7% in 2013/14 to 32.1% in 2023/24. By 2027/28, the wage bill is projected to decrease to 31.4% of consolidated spending. Godongwana said this was a early retirement proposal was a measure to build a capable State that delivers a reasonable and reliable standard of public service that will foster the necessary environment for more growth and jobs.

“We are also implementing initiatives like early retirement, not to merely reduce the size of the workforce, but also to introduce younger talent to the public service,” Godongwana said. “This is part of building a capable, ethical and developmental government. We will be harnessing digital infrastructure to roll out critical systems in the provision of service delivery in the following focus areas: digitising and simplifying the application and disbursement process for social grants; broadening access to employment pathways; rolling out digital identification documents; building a centralised and accessible website for all government services; and digitising health records management for the rollout of National Health Insurance.”

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