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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

Retirement savings outcomes remain in the doldrums despite regulatory push

The 2019 Alexander Forbes Member Watch ™ confirms that South Africa has made little progress on the road to sustainable retirement outcomes for fund members in the formal savings environment. The latest report, which is a quantitative assessment of the more than one million retirement savings accounts administered by the financial services firm, shows that fewer than one in 12 fund members will achieve a replacement ratio of 80% or better in retirement. It offers valuable insights about member decisions insofar contributions, investment choices, and retirement age, among other factors.

Getting to grips with the RR

The replacement ratio is the preferred measure used by the retirement savings industry to assess whether retirees are achieving sustainable incomes in retirement. The ratio represents a retiree's income in his or her first year of retirement expressed as a percentage of his or her final pre-retirement pensionable salary. The phrase 'pensionable salary' is important because many retirement fund members receive benefits that are not part of their pensionable salary. The replacement ratio for someone with a pre-retirement salary of R50 000, which included R5 000 in non-pensionable benefits, would thus be determined using the R45 000 per month pensionable salary only. In this example a 50% replacement ratio would be equivalent to a R22 500 post-retirement income.

There are countless factors that financial advisers and their clients must know about the formal component of their retirement funding journeys, whether as members of a pension or provident fund or retirement annuity. These include the overall level of contributions to the retirement funding vehicle; the administrative expenses and risk premiums deducted from said fund contributions; the investment fees and returns on the member's investment portfolio; the member's salary progression; and the impact of preservation on the retirement savings journey. Factors that have a major impact at retirement centre on how much cash is available for conversion into a pension and the prevailing annuity rates. The Income Tax Act requires that retirees use at least two thirds of their accumulated capital to purchase an income upon retirement.

A dismal replacement ratio experience

What does the 2019 Member Watch reveal about some of these measures? First, and perhaps most importantly, it shows the average monthly contribution to retirement funding to be just 12,3% of gross pensionable salary. The total contribution is slightly higher, at 14,2%, but includes administration expenses and deductions for life, disability, and other group risk benefits. There was a significant skewing towards the employer, who contributed on average 9,2% of the pensionable salary per month versus only 5% from the employee. The retirement fund members assessed for the report achieved an average actual replacement ratio of just 26,2%.

Alexander Forbes projects a 40,5% average replacement ratio for all fund members considered for the 2019 Member Watch provided they save adequately, exit their funds when expected, and preserve retirement benefits whenever necessary; but warns that such rigorous adherence is unlikely. “The biggest factor affecting retirement outcomes remains the lack of preservation,” said Vickie Lange, Head of Best Practice at Alexander Forbes. She observed that only 8,8% of members opted to transfer their fund balances into a preservation fund when the opportunity presented.

Statistics also point to a clear correlation between the amount of accumulated retirement capital and the likelihood of it being reinvested. As a rule of thumb, you will need 12 times your annual salary to ensure 75% of your pre-retirement pensionable salary as an income in retirement, with most experts suggesting that 14 times is preferable. An individual would have to contribute about 17% of his or her gross pensionable salary for a period of 40 years to achieve this. Those who embark upon the savings journey too late face an uphill battle to reclaim the lost ground due to missing out on the benefits of time in the market and compounding.

Alexander Forbes offered two examples to illustrate the difficulty in catching up by either increasing monthly contributions or delaying retirement. In the former case, someone starting his or her retirement journey at age 40, and contributing 17% of gross pensionable salary per month, would only achieve a replacement ratio of 38% by age 65. In the latter case, you could double your replacement ratio by delaying retirement from age 55 to 65 years.

Finding solutions to lacklustre outcomes

How can employee benefit consultants and financial advisers improve retirement outcomes? According to Alexander Forbes there is a need to correlate advice with key inflection points in the retirement fund member’s financial journey. “We need to talk about issues and solutions nearer the decision point,” said Lange. Another important consideration is that members shoulder a part of the responsibility. “The member must take responsibility for their financial wellbeing and there is only so much that the other stakeholders can do,” she said.

Belinda Sullivan, Principal Consultant of Multinational Consulting and Best Practice at Alexander Forbes said there was a growing need to instil financial discipline among younger savers. Principle among these requirements is to illustrate the future value of small amounts of money; to highlight the trade-off between less take-home pay early on in one’s career versus the benefit of a larger accumulated sum at retirement; to illustrate the power of compounding over 40 years; and to encourage preservation. It is also important that employees establish their financial goals as soon as they start working.

The financial services industry has considered various initiatives to improve retirement funding outcomes, most notably through the September 2017 implementation of default regulations, which had to be fully implemented by 1 March 2019. There were three main components to these regulations, namely default investment portfolios per regulation 37; default preservation under regulation 38; and default annuities as set out in regulation 39. The default preservation regulation meant that someone who resigned from a retirement fund, regardless of the reason, would have to inform the fund what to do with his or her accumulated capital, or else the capital defaulted as a paid-up amount in the employer fund. Other options were to take the amount in cash, to transfer to another retirement fund; or to transfer to a retail preservation fund.

Default preservation still simmering

The expected positive outcome of the implementation of default regulations does not appear to have filtered through to the latest Member Watch statistics. “We were a bit disappointed when we completed our assessment; but it is still a bit early to see the impact,” concluded Lange. The firm is closely monitoring its funds to quantify the effect of default regulations and will report on any trends that exhibit in due course.

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Popi Act is now in force

Five steps to ensure POPI compliance for direct marketing

The Protection of Personal Information Act 4 of 2013 (POPI) has now come into effect and it is important that South Africa businesses adhere to the new regulations. The use of personal information is everywhere and it’s almost impossible to do direct marketing without using personal information collected from customers, suppliers and employees. The POPI Act was designed to serve as one of the measures to protect consumers from direct marketing, regulating direct marketing via electronic communications and making it stricter.

Direct marketing is often favoured as a popular means of product marketing, especially for start-ups looking to grow their customer base. It is, however, often also a source of irritation for many consumers as suppliers are increasingly testing the boundaries of what is allowed. Justine Krige, Director in the Corporate and Commercial practice at Cliffe Dekker Hofmeyr (CDH), says South African marketers need to do better to ensure that they are POPI compliant - whether it’s direct marketing by post, telephone, email or SMS.
Krige highlight five key ways to ensure that marketers do not cut corners:

1. Obtain consent

Direct marketing in any form of electronic communication including automated calling machines, faxes, SMSes and email is no longer allowed now that POPI has come into effect, unless the person has either given his/her consent to receive such electronic communication, or is an existing customer. Marketers can only send direct market electronically to a customer whose contact details were obtained through a sale of a product or service and for the purpose of direct marketing of similar products or services.
The customer must be given a reasonable opportunity to object to the direct marketing at the time the personal information was collected and on every communication thereafter. In respect of direct marketing via

telephone, post and in person, every person similarly has the right to refuse to accept the unwanted direct marketing and require the supplier to discontinue such activity.

2. Don’t forget the “unsubscribe” option

All electronic direct marketing communications must contain an “unsubscribe” option. Similarly, physical post boxes containing a direction that “no junk mail” will be accepted cannot be used for direct marketing. Companies need to manage their customer databases a lot more effectively – where, how and when was the personal information initially obtained; whether the person is an existing customer and which products or services they use; whether the person has consented to receiving direct marketing; and whether the person has unsubscribed from receiving direct marketing. In particular, companies need to adopt a vigilant approach in enforcing requests from consumers to discontinue any marketing activities.

3. Include the sender’s details

All communications for direct marketing purposes must contain the details of the identity of the sender or the person on whose behalf the communication has been sent, an address or other contact details to which the recipient may send a request that such communications was terminated.

4. Stick to permitted contact times

The POPI Act has now prescribed specific days and times of days for direct marketing, and businesses must not engage in any direct marketing directed to a consumer at home for any promotional purpose outside of these times. The prohibited times for contacting consumers at home (this includes via telephone, SMS or email) are as follows: Sundays or public holidays; Saturdays before 09h00 and after 13h00; and all other days between the hours of 20h00 and 08h00 the following day, unless the consumer has agreed otherwise. “However, the responsibility is on the direct marketer to prove that the direct marketing communication was sent out within the prescribed period even if the consumer received the direct marketing outside of the prescribed times,” add Krige.

5. Beware the “cooling-off” period

Companies must remember that consumers have an entitlement under the CPA to cancel a transaction resulting from any direct marketing without reason or penalty by writing a notice to the supplier. This must be done within 5 days after the later of the transaction was concluded or the goods were delivered to the consumer. Krige stresses that if South African marketers do not follow the law and the regulations outlined, the face getting heavy fines. “It is critical that marketers realise that POPI does not prohibit their direct marketing efforts, it does however mean that marketers are deliberate with their communications and they must ensure that the requisite approvals are in place from the consumer,” she concludes.

FA News | 7 July 2020

How to catch up on your retirement savings

For many South Africans who were already finding it difficult to save for retirement, Covid-19 has created additional financial pressures which may take years to overcome. If you stopped contributions to your retirement annuity, or took a payment holiday on your pension or provident fund, you might be worried about the shortfall created, and how you're going to catch up.

Stop worrying and take action to avoid retiring with insufficient funds. There are many ways to contribute to your retirement, from employer and employee contributions to pension or provident fund, monthly contributions to a Retirement Annuity or a tax-free savings account.

With many people having a reduced income due to the economic ramifications of Covid-19, it might be impossible to contribute a large monthly amount to catch up while having concerns such as debt to pay, but I recommend starting with your budget.

This will aid you not only by freeing up extra funds to catch up your retirement contributions with, but could also create some peace of mind with an opportunity to pay debts off faster or save some discretionary money. There are many reasons why it is important to follow a monthly budget. Besides reducing stress levels by keeping an eye on your spending habits, it also allows you to track your debts, finding opportunities to top up emergency funds or save extra towards your retirement. A budget goes hand-in-hand with setting and achieving financial goals.

A budget does create an additional administrative burden and requires time to update. I have my budget on an Excel spreadsheet and update it monthly when making EFT payments. Costs for entertainment, groceries and petrol are variable in nature and change each month. You might end up not using all the funds set aside for these variable costs. Adding these leftover funds at the end of the month to your savings is a good habit to inculcate. The immediate impact might seem small but over time will make a positive outcome to both your retirement and the development of a savings mind-set.

When you are able to free up some money each month, start automating your savings. Instead of having a variable amount go towards savings, set up an automatic contribution, where you "pay yourself first". Set up an automatic debit for your retirement savings and you'll grow these funds without having to think about it. One of the most important decisions you can take to help make your retirement comfortable is preserving your retirement funds when changing employer. When starting new employment or if you are coming out of a payment holiday, try matching your employer's monthly contribution toward your pension or provident fund, or if on a total cost to company structure, start on the maximum employee contribution percentage.

By doing this as well as automating your savings, you get use to contributing those amounts and could potentially have a larger nest egg at retirement. Remember that life happens, and your budget might come under strain – many of us have experienced this during the pandemic. If you have been going through a difficult financial time, it is time to reassess and ask yourself, what in your budget is necessary and what is actually a luxury? It is never too late to start sorting out your finances, but the earlier you start, the better, and more achievable, the outcome will be.

FA News | 8 July 2020

Pension fund 'with history of unlawfully withholding withdrawal benefits' to be probed

Cape Town – The Pension Funds Adjudicator (PFA) has referred a fund with a "history of unlawfully withholding withdrawal benefits" to the regulator for investigation. In yet another determination against Oasis Crescent Retirement Fund, Muvhango Lukhaimane said her office had received several complaints against the fund for the unlawful withholding of benefits. She said despite alerting the fund that withholding of a benefit as a result of a breach of employment contracts was unlawful, the fund had "not refrained from such conduct".

"Such wilful non-compliance requires regulatory intervention, which would ultimately ensure that members' interests are not prejudiced by the first respondent's failure to adhere to the Pension Funds Act and its rules. "Further, this tribunal can avail to the Financial Services Conduct Authority similar complaints against the fund to assist in its investigation process," Lukhaimane said. She was commenting in the wake of two determinations she issued against Oasis Crescent Retirement Fund. In the first case, the complainant was employed by Oasis Group Holdings (Pty) Ltd from October 2014 until September 2018. She said when she resigned, she elected to transfer her withdrawal benefit.

However, despite several follow-ups, Oasis Crescent Retirement Fund failed to effect it. She had a fund credit of R39 301. In a second similar complaint, another complainant said that he, too, was in the employ of Oasis Group Holdings, and when he resigned in June 2016, he was not paid his withdrawal benefit. He did not sign an admission of liability and no judgment was issued against him. He said he was served with summons which reflected he owed the company R118 945 in respect of recruitment costs.

In arriving at her decision, Lukhaimane said the failure of the complainant to comply with his employment contract –- in respect of his alleged failure to reimburse expenses incurred by his employer on his behalf – did not fall within the ambit of misconduct as contemplated in a section of the pension act. Therefore withholding of his benefit on these grounds was unlawful, the PFA found. Oasis Group chief regulatory officer, Nazeem Ebrahim said: "Journalists know about the matter before they know about it. You in the press have it, before we had it – we haven't been able to study this."

In responding to the enquiry sent to the fund at 10.40am, Ebrahim said he received the email five minutes before the Cape Times deadline at 5pm. “I was working hard in Covid-time to see to it that we can afford to pay our salaries to all our employees and when you are in a team, you are not rude to the people around you – by being busy looking at WhatsApp, answering calls and emails,” he said.

IOL | 7 July 2020

South Africa – The 1% country

A recent presentation by a top financial planner highlights that if you’re concentrating on South Africa’s markets, you’re going to lose out on investment returns and global growth. Wouter Fourie, a top-flight financial planner, recently delivered a presentation on offshore investment at the first Global Matters virtual engagement online conference, sponsored by Momentum Investments. He demonstrated that most people who invested offshore, using their assets in their investment-linked living annuities (living annuities or illas), had made gains – it didn’t matter about Covid-19 or the Jacob Zuma kleptocracy regime.

This is what the data now looks like:

Market ups and downs (30 June 2020)

Security	High last 24 months	Date	COVID-19 low	Fall/gain %	Date	High after fall	% increase on low	Date
JSE All Share	60 165	29.08.18	50 467	-16.12%	19.03.20	55 474	9.92%	23.06.20
S&P 500	3 380	02.10.20	2 237	-33.82%	23.03.20	3 193	42.74	27.05.20
Rand/ dollar	R12.68	01.06.18	19.26	51.89%	06.04.20	R18.84	-2.18%	23.06.20

In his presentation, Fourie referred to South Africa as the “1% country” – not in a nasty way, but in a realistic way.
His reasons are:

- The gross domestic product of South Africa is about 0.5% of the world GDP,
- The JSE stock exchange accounts for about 1% of global investment opportunities, and
- The rand accounts for less than 1% of world currency markets.

We are actually quite a small economy, only equalling one of the US’s smaller states.
Fourie says if you are going to concentrate on South Africa’s markets, you are going to lose out on investment returns for the following reasons. You will not:

- Participate in global growth, and
- You lose out on the compounding growth on the investments you have not made,

- You will not receive the diversification and the reduction in risk by spreading your risk to more types of industries and services. This means you will not receive the benefits of an income stream that will flow from these sources. This is particularly important for pensioners,
- You will not benefit from receiving guidance from world-class financial investment professionals, or from world-class international financial centres, and
- Finally, you will not have the peace of mind that those who did invest offshore have. The political risks of all our local crises are an add-on benefit.

Fourie says that in investing offshore, you have two main choices, namely:

- Investing through a local or offshore endowment policy, which opens the way to more underlying investments, or
- Through a direct share portfolio or more traditional Financial Sector Conduct Authority (FSCA) category 3 investment, namely a unit trust fund. This is the option used more usually by living annuity pensioners. This avenue is also open to pre-retirement annuity funds, pension funds, provident funds and preservation members. Investment in retirement funds, retirement annuity funds, provident and preservation funds are governed by Regulation 28 of the Pension Funds Act that only allows 30% to be invested offshore. Regulation 28 is a prudential investment regulation that limits how much you may invest in different assets and percentages of underlying assets.

However, living annuities are not affected by Regulation 28. You can take all your money in a living annuity and invest it offshore. This is not being suggested, but it gives you more freedom of movement. Again, how much you invest offshore will be dependent on how wealthy you are and the drawdown rate in your living annuity. One of the issues with default annuities is that they limit your offshore investments to 30% in line with Regulation28.

Everyone has a choice on what vehicle to use. The main limitation is the extent of your wealth. Someone who is well off with both a living annuity and other assets can choose both with those less wealthy using local unit trusts or life assurance policies while those who are wealthy choose to use both rand and foreign-denominated vehicles. For example, they could

use a rand-denominated unit trust fund, which invests offshore, for their living annuity, while using their R10-million annual foreign investment allowance to invest directly offshore. To invest directly offshore does take a lot of money, if it is not to be eaten away by costs. Fourie says there are a number of steps involved in investing directly offshore from getting a tax clearance, buying foreign exchange, choosing a foreign no-tax, or low-tax investing environment, while also considering your tax situation and estate planning.
Fourie says that people investing:

- In a rand-denominated (South Africa platform) unit trust or life assurance policy need the following: international diversification, reduced emerging market risk, a hedge against any fall in the value of the rand as well as a geographical and political hedge. You invest rands and you get any withdrawals in rands in South Africa.

- In a foreign-denominated (international platform), you use rands to buy a foreign currency. You can withdraw that money anywhere in the world to reinvest or spend where you like. When planning to emigrate, you can use your annual foreign currency allowance to transfer funds without impacting on the allowance for emigration. Fourie, however, warns that you must take care in choosing the offshore jurisdiction through which you choose to invest. You must ensure that it has proper consumer protection policies as well as the international company handling your investment.

Inside a retirement fund either in the build-up, or in an annuity, you will not be taxed. South African residents who invest directly through a rand-based unit trust or life assurance policy or in using the foreign investment allowance, will pay South Africa tax at the applicable rates. Fourie's presentation, "Fundamentals of Offshore Investments", which can be watched here, is worth watching as it goes into all sorts of things from taxation to international financial centres to what happens if you die.

Much of what he deals with will not affect the ordinary living annuitant. It is important, whether you have a low-level living annuity income or you're very wealthy, that you get advice on offshore investments. Compare the returns and different options, including whether to invest through a unit trust, or direct shares, or a life assurance policy (endowment), or using a passive investment or active managed investment. **DM/BM**

Daily Maverick | 7 July 2020

INTERNATIONAL NEWS

Why pension funds need to invest more in private equity

The National Treasury proposal to subject private equity (PE) firms that tap public funds (read pension schemes) to Capital Markets Authority (CMA) regulations, are welcome – if that's what it takes to open up pension fund coffers. Otherwise, regulatory hurdles at this early stage are unwelcome. More obstacles complicate Retirement Benefits Authority's (RBA) long-term plan of reaching 10 percent of pension assets allocated in private equity. And ultimately, small and medium enterprises (SMEs) stand to lose. But we give the government the benefit of the doubt.

So, why should pension funds invest in private equity?
First of all, today, more companies are choosing to stay private. Due to high levels of capital allocated to the private equity funds, small firms no longer need to go public to access capital. As a result, SMEs can get to focus on improving their businesses without the quarterly-and-half yearly reporting requirements and other pressures of being a listed company. They also get to avoid markets short-termism. Secondly, as with all

investing, it is wise to maintain a diverse portfolio. Pension funds, like all portfolios, benefit from holding assets that provide diversification.

Currently, pension assets investments in private equity account for less than one percent of the total pension assets estimated at Sh1.2 trillion. Lastly, pension funds are among the most obvious candidates to invest in this asset class, given their targeted returns and liquidity requirements. Crucially for SMEs, the “equity gap” can be narrowed. This “equity gap” arises where SMEs with viable investment propositions are unable to attract investment due to a number of factors, such as sector, stage of development and location.

It is precisely these situations, which the pension funds can help address indirectly. According to the 2016 KNBS MSME survey, less than six percent of licensed SMEs surveyed sourced capital from banks while over 70 percent obtained it mainly from family. The study also showed that almost half (45 percent) of new MSMEs shut down within a year of operation with the main reason for folding being shortage of working capital. Only about five percent of SMEs survive to celebrate their 10th anniversary.

For inspiration, local pension funds can look at more experienced jurisdictions. In Europe for instance, pension funds provided the most funds (31 percent) of all capital raised and investments made in the private equity European space, according to European Private Activity (2018). Funds of funds & other asset managers followed at 18 percent, family offices and private individuals (11 percent), insurance companies (11 percent) and sovereign wealth funds (nine percent). In the US, pension fund investments in private equity are estimated at over Sh30 trillion.

In all, the idea is to encourage local pension funds to operate in a part of the market which presents mutual benefits. With an average fund life cycle of 8-10 years, it is the long-term nature of private equity that makes it a particularly well-suited investment for pensions. More importantly, as the rise of the gig economy and informal entrepreneurship pose the risk of underfunded schemes, pensions must continue to invest in private equity.

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