FRIDAY, 14 MAY 2021

irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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Why retirement income is about more than just the best quote…

Retirees, in general, battle with the concepts of longevity, safety and inheritance when they reach retirement and it seems as if many tend to consider fees as one of the most important aspects when deciding which retirement income solution to choose. The notion is still for financial intermediaries to present the client with either a guarantee (from a life company, pension fund or the government), or a living annuity from any of the providers. The cheapest and most impressive solution (based on past performance) often tends to get the nod.

However, the correct answer does not lie in which solution to use, but rather which combination of solutions will protect the client against longevity, while still allowing options for future income stream management. The focus should therefore move away from the use of a single solution, to an optimised combination of solutions to manage an income stream. Retirement income stream management is perhaps the most important aspect of a retiree's post-retirement investment, to ensure that the income lasts as long as it is needed.

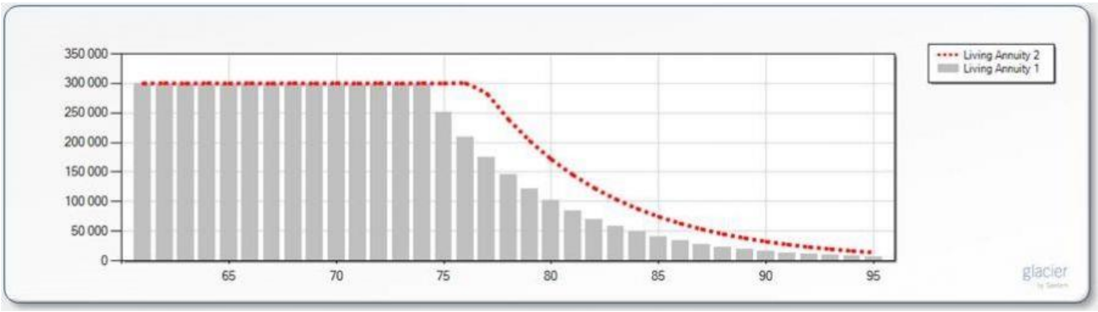
How does a guaranteed solution limit income stream management?

When a guaranteed solution is used, the income is known for the rest of your and your spouse's lives, but it does not allow flexibility should a crisis strike (e.g. unexpected medical expenses etc.). People tend to live according to their income, which could result in difficulties should such an event occur. Also, individuals often have a higher inflation rate than the official inflation rate. This could, for example, be as a result of increased spending on medical expenses, which typically have a higher inflation rate than most consumer goods.

This in turn will raise the inflation rate of your overall spending. So even if your income escalation from a guarantee keeps pace with inflation, it more often than not doesn't keep pace with your own individual rate, as referred to above. You tend to get poorer, and with all your income fixed in a guaranteed solution, you will not have any flexibility to manage your income stream in future.

What are the limitations of a living annuity?

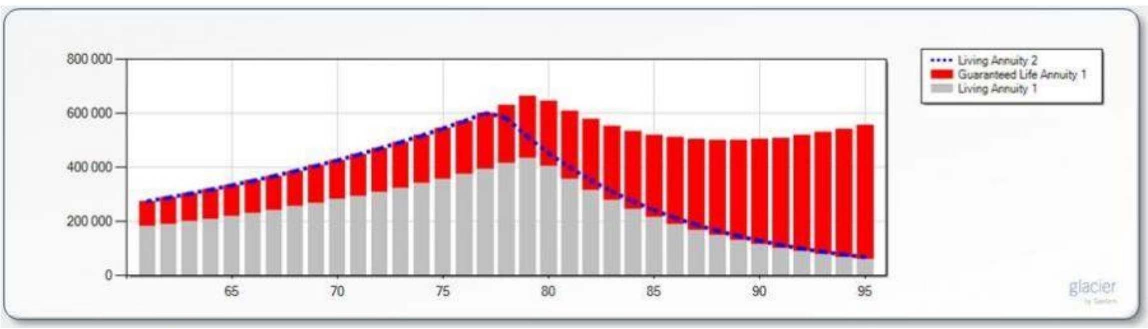
A living annuity allows for flexibility, but unless your portfolio consistently grows in excess of inflation (at a higher risk of volatility), the risk of outliving your capital is a real concern. Some people think that by focusing on cheaper fees this impact can be avoided, but the reality is that even if the portfolio is 1% cheaper, it only provides an inflation-related income for two more years, as is evident in the following graph. Fees alone will not make a big difference in managing a client's income stream.



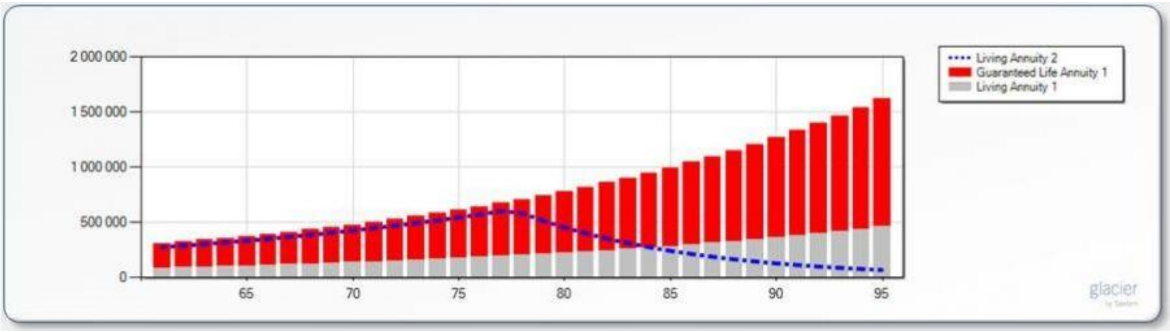
How can one best manage a client's income stream in retirement while retaining some amount for an inheritance and reduce longevity risk?

By combining a living annuity and a guaranteed life annuity, one builds in protection against longevity risk while maintaining flexibility to manage an income stream. In the following example, 70% was allocated to a living annuity, and 30% to a guaranteed life annuity (grey and red bars in combination). This is compared to 100% in a living annuity (blue line). The following becomes evident:

1. The income from the combination solution keeps pace with the living annuity up to a point, but then the living annuity reaches the 17,5% income threshold while the combination still protects the income.
2. The portion of the income that comes from the guarantee (red bars) becomes a larger portion of income as time passes (5% guaranteed escalation was used), thereby reducing the client's exposure to market volatility.
3. The portion in the living annuity still allows the client the flexibility to adjust their income once a year should inflation catch up, or should a crisis happen.
4. The reality in this example is that the income from the 70% living annuity, at age 85, is projected to be similar to the income from 100% in the living annuity. Therefore, as far as inheritance is concerned, the heirs will roughly inherit the same amount after age 85, but should the client live longer, they will be protected against longevity.



Some clients, who may not be concerned about leaving an inheritance, would prefer a guaranteed solution, but even with guaranteed rates as good as they are currently, it is wise to keep 30% in a living annuity to maintain a level of flexibility. The following graph uses the same data as the previous one, but in this case 70% was allocated to the guaranteed life annuity. However, the 30% in the living annuity would still allow for income stream management during a crisis or when an increase in income is needed.



It therefore makes sense to focus on overall income stream management in retirement, rather than only considering a single quote.

FA News | 7 May 2021

Rebound for retirement

If your retirement savings were invested in balanced funds through the market turmoil of 2020, there is some good news. You can currently secure a guaranteed income for life that is over 15% higher than it would have been had you invested on the 1st of January last year before the market crash; an income that targets growth in line with inflation. “This demonstrates the value of establishing a robust retirement plan and sticking to it, especially through market turmoil,” says Deane Moore, CEO of retirement income specialist Just. “By contrast, if you were one of the many investors who became unsettled and switched to more conservative options, you would have watched your portfolio lose about 15% during March/April last year.

Furthermore, you would have locked in your losses and missed out on the subsequent market recovery,” says Moore. It is estimated that South Africans lost **R100 million** of their savings overall between April and December of 2020 by switching funds. After many investors moved their savings into cash, SA equities delivered a huge 54% return in the 12 months to March 2021, which many missed out on. If you switched to more conservative investments inside of a standard living annuity, you would have negatively impacted your retirement income, which would already have been affected by the five years of relatively poor market returns that preceded 2020.

“This exposes the risks associated with standard living annuities where, because you can change investment decisions, you carry your own investment risk and your own longevity risk, which is the risk of your money running out of road before you do.” Unfortunately, according to Just’s 2020 **Retirement Insights** survey, many retirees fell into this camp. Only 40% of respondents said they were content that they have enough retirement savings to last for their whole retirement. The survey showed that many retirees realised that they can’t afford the effects of market volatility, and some shifted some of their capital to lock in what they could.

So, if you are facing retirement, Moore offers some tips to consider:

1. Think about your retirement savings in two pots

• A pot to ensure you have enough income to cover your essential expenses for life.

• A second pot for discretionary spending or to leave a legacy.

2. Choose appropriate investments for each pot

• An appropriate investment for the first pot is a life annuity, which you can access as a standalone product or as an investment choice within certain living annuities.

• Once the first pot is secured, you can consider options that provide flexibility, growth, and a legacy for beneficiaries.

3. Choose the right life annuity

• New-generation with-profit annuities are designed to withstand market conditions to guarantee your income for life, while providing annual increases linked to the performance of a balanced fund.

• You can use your retirement savings or discretionary savings to invest in these annuities.

• As mentioned above, you can also access a life annuity in certain living annuities through some of South Africa’s leading living annuity providers. “Because long-term interest rates are high, it's a good time to lock-in a retirement income for life, particularly if your savings benefited from recovering markets because you stuck to a sound investment plan,” Moore concludes.

FA News | 11 May 2021

Sustainable investing - fast becoming a non-negotiable for younger investors

The term “sustainable investing”, describes investments that aim to produce positive returns as well as a positive long-term impact on society, the environment and the overall performance of a business.

The relevance of ESG factors

Some asset managers began including ESG (environmental, social, governance) factors in their company analysis a few years back, to determine if these are relevant to the company’s performance. As an example, San Francisco-based Dodge & Cox – the manager behind the Glacier Global Stock Feeder Fund – believes governance factors are material for every company. The asset manager invests for the long term and looks for sustainable practices in the companies it invests in. Key is to understand how decisions are made and how key risks are managed.

Environmental factors include emissions and pollution; raw material sourcing; and supply chain management.

Social factors include community relations; customer satisfaction; and safety practices.

Governance factors include board structure; management incentive structures; shareholder rights; and capital allocation.

According to a recent paper from McKinsey and the World Economic Forum it’s clear that changing climate conditions and nature loss are closely linked. We’ve also seen an increasing commitment from the private sector to look at ways to reduce their collective carbon footprint.

Looking beyond the COVID-19 pandemic, there’s a general consensus that curbing greenhouse-gas emissions and protecting the natural environment are critical to an overall global economic recovery. According to the World Economic Forum’s 2021 global risk report, extreme weather, climate action failure and human environmental damage are rated as the top risks, most likely to happen and with the most material impact.

Francis Marais, Head of Glacier Research, says that sustainable investing is about creating long-term sustainable value for the companies, the consumers and investors, as well as the environment. “Understandably someone drawing a retirement income is going to be more focused on higher returns, whereas a younger investor who is a lot further away from retirement is likely to be more focused on the environment,” he says. “But it doesn’t have to be a trade-off – sustainable investing can also deliver good returns.”

How are companies responding?

While the pandemic has brought challenges and suffering, it has also caused people to be more aware of how they live, what they consume and how they allocate their spending, and companies are taking note of this. Overall, we're seeing more and more instances of companies proactively taking steps to improve the sustainability of their operations. A few examples include the following:

In 2010, a major US motor manufacturer set a goal to use 30% less water per car by 2014. We also saw a personal-care products manufacturer partner with a water-technology company to assist in meeting its sustainability goals for one of its plants in a water-scarce area of Mexico. In 2014, a leading clothing manufacturer set sustainability reporting standards for its suppliers by requiring them to meet certain limits in terms of recycling (especially with regards to water) and reusing materials.

A new generation of investors seeks sustainable investments

Millennials have been seen to care more about sustainability than previous generations. According to the World Economic Forum, they are twice as likely to invest in companies with ESG goals; 90% want sustainable investing as an option on their retirement plans (or 401K plans as they are known in the US); 75% believe investments can influence change; and 84% believe it can alleviate poverty. Much has been said about the upcoming wealth transfer. Over the next two decades, baby boomers in the US will transfer at least $30 trillion in wealth to the next generation. This has vast implications for sustainable investing and for investment managers and advisers too.

What about performance?

With the global pandemic came a level of market volatility last seen with the global financial crisis. Interestingly, sustainable investments (using the MSCI ACWI ESG Leaders Index as a proxy) outperformed regular investments (using the MSCI ACWI Index as a proxy) in Q1 of 2020. While the ESG Leaders Index experienced a drawdown, this drawdown was not as severe as the MSCI ACWI. Over the longer term, the ESG Leaders Index has kept pace with the MSCI ACWI and has marginally outperformed the index over the past seven years and ten years as at the end of April 2021. This return was 10.12% and 9.60% in US dollars, respectively.

Despite the increased attention, sustainable investing still has a way to go to become mainstream – particularly in South Africa. This is largely due to incorrect perceptions that there has to be a trade-off between performance and sustainability. In a 2019 study, Morgan Stanley noted that eight out of ten respondents were interested in sustainable investing, but that only 52% of respondents were actually doing so. These figures are higher when it comes to millennials. 95% of millennials were interested in sustainable investing and 67% were actually going ahead with those investments. It is expected that this trend will increase at a faster pace once the global pandemic settles and as investors become more aware of, and interested in, how companies operate, how they treat their employees and other stakeholders and how sustainable their business practices are.

The Glacier Sustainable World Enhancer

The Glacier Sustainable World Enhancer (open to investments until 19 May 2021, with more issues to follow in 2021) lets investors grow their capital while contributing to global sustainable development goals at the same time. It is a five-year, tax-efficient, structured investment that provides the certainty of capital protection and is set up in the Glacier Vantage Plan (a sinking fund policy underwritten by Sanlam Life Insurance Limited).

The **Glacier Sustainable World Enhancer** caters to investors' changing demands when it comes to investing. At the core of the Glacier Sustainable World Enhancer are the ESG factors that are essentially the solutions behind the problems facing us.

FA News | 13 May 2021

Is now a good time to buy a fixed annuity?

In addition to the rates currently being offered, it's advisable to consider whether a life or living annuity will be the best strategy for you.

Is now a good time to buy a fixed annuity? What's the forecast on annuity rates?

Dear reader,

I am assuming you may be approaching retirement and need to select a suitable strategy. When using voluntary money to purchase a guaranteed/fixed annuity, you will only be able to purchase a life annuity. At retirement, you will, however, have more options that can be selected. You can select a guaranteed/fixed annuity (also referred to as a life annuity), living annuity – or a combination of both. To answer your question if it is a good time to buy a fixed annuity, it is important to consider the rates currently offered for annuities, and question whether this will meet your income need for the remainder of your life.

Current voluntary annuity rates, as depicted on Moonstone's website:

Voluntary annuity				
Comparison of monthly annuity income (R100 000 voluntary, five-year term certain)				
	Gross income	Taxable portion	Tax-free portion	Taxable percentage
Absa*	R1 845.75	R179.08	R1 666.67	9.702%
Momentum	R1 805.86	R139.19	R1 666.67	7.708%
Metropolitan	R1 768.54	R101.87	R1 666.67	5.760%
Old Mutual	R1 764.89	R98.22	R1 666.67	5.565%

** As per April 19 2021 rates*

With a life annuity, an initial income is selected at the beginning which will pay out for the remainder of your life. The said income can either remain at a similar level or increase yearly if selected at the start. There are however various reasons why I would rather advise going the route of a living annuity. There will not be a specific rate involved here, but rather an investment philosophy that I expand upon below. Opting for a life annuity commits your investment for the remainder of your life, and therefore you are "opting out" of being invested in the markets. This contrasts with a living annuity, which operates on market exposure.

However, we do understand that an individual's special circumstances may necessitate making use of a life annuity. That will then need to be determined on an individual basis. A life annuity does not offer flexibility in cases where you may, for instance, require a higher income or where your beneficiaries are to inherit its remaining funds, or where market returns are promising. A life annuity, in essence, may limit its own investment return potential in favour of a guaranteed income stream.

A living annuity does however give you the benefit of retaining flexibility, optimising returns, and keeping your options open for the future. Your retirement is likely to spread over a 30- to 40-year term, during which many things can change globally. Making a long-term commitment with so many unknowns in life might create more constraints than benefits.

Benefits of a living annuity:

- You have the option of choosing an income between 2.5% and 17.5% per annum.
- You can manage your returns by following a diversified investment approach.
- Your beneficiaries will inherit the funds on your passing.
- You can always change to a life annuity or a hybrid annuity should you so wish.

The most important decision you need to make at retirement is the investment strategy you follow. As you will require an income from these funds, finding the perfect balance between safety and market volatility to your monthly income, together with capital growth and an appropriate draw-down rate, is imperative to ensure that these funds will last until you pass away. At PSG Wealth we follow a diversified approach that includes a balance of asset classes. We also follow a multi-manager approach to ensure you have optimal diversification of an investment approach. PSG Wealth has applied an investment philosophy that focuses on asset/liability matching (the 'bucket philosophy'). According to this philosophy, a client's funds are invested into different buckets based on their investment horizon and income and capital liquidity requirement. The bucket philosophy has formed the cornerstone of our advice to clients and has proven its worth over time.

Moneyweb | 4 May 2021

INTERNATIONAL NEWS

State pension rule changes to kick in next January - check if they affect you

Under new rules, UK citizens in certain countries, including Australia, will no longer be allowed to count the time they spent abroad as part of the qualifying period for their state pension

The government has announced plans to change how state pensions are calculated for Brits preparing to retire abroad. The main changes, which come into effect from January 1, 2022, affects whether a person qualifies for a state pension or not. Under the new rules, UK citizens living in Australia (before March 1 2001), Canada or New Zealand will no longer be allowed to count the time they spent abroad as part of the qualification period for their state pension. At present, expats in these countries can still get National Insurance credits while abroad, however the rule change will put them in the same group as most other countries – meaning the period abroad won't count towards their retirement pot.

The government states that the change will affect people who move to live in the EU, EEA or Switzerland and those who have previously lived in:

- Australia, before March 1, 2001
- Canada
- New Zealand

The Department for Work and Pensions, explains that from next year, you will no longer be able to count periods living in Australia (before March 1, 2001), Canada or New Zealand, towards calculating your UK State Pension if both the following apply:

- You are a UK national, EU or EEA citizen or Swiss national

- You move to live in the EU, EEA or Switzerland on or after January 1, 2022, including if you move to live in another EU, EEA country or Switzerland on or after January 1, 2022

“The change will affect you whether or not you have claimed your UK State Pension yet,” the government explains. “Your UK State Pension will be calculated, or recalculated if already in payment, using only your UK National Insurance record.” James Andrews, senior personal finance editor at **money.co.uk**, said people heading abroad need to ensure they have a financial plan in place ahead of retirement. “The recent changes to state pensions serve as a timely reminder that you have to put a comprehensive financial plan in place if you’re intending to retire abroad,” he said.

“For starters, the process of moving your money overseas can take quite some time, so it’s best to start as early as possible. “In some countries for example, you can’t even set up a bank account without a residential address there, so it might be worth applying for a prepaid travel card or current account to act as a stop-gap while you sort out the Ts and Cs. “The quickest and easiest way to get an overseas bank account set up is to speak to your existing bank to see if they have a presence abroad – it’ll make moving your money to your desired country much easier.

“The other issue that needs careful consideration is your credit history. When you emigrate, your credit history unfortunately doesn’t move with you – meaning you’ll be starting completely from scratch. “He said regardless of your pension, expats should ensure they have a financial buffer to cover them in unforeseen circumstances. “Since you might not be able to rely on a credit card or qualify for a loan, it’s a good idea to have some emergency funds in place to see you through any financial difficulties,” James added.

Mirror | 13 May 2021

U.K. pension fund surplus surges 57% in April

The total surplus of U.K. defined benefit funds covered by the Pension Protection Fund's 7800 index increased 57% in April to £53.7 billion ($74.9 billion).

The surplus was £34.2 billion at the end of March. A year earlier, U.K. corporate DB funds recorded a total deficit of £84.5 billion, the London-based PPF said in an update Tuesday. The PPF is the lifeboat fund for the defined benefit plans of insolvent U.K. companies. The funding ratio increased to 103.1% as of April 30, up from 102% as of March 31. The funding ratio was 95.4 % as of April 30, 2020, the update said. As of April 30, 49.3% of the 5,318 pension funds covered by the index were in deficit with a total £135.8 billion, compared with 51.3% and £144.3 billion as of March 31.

As of April 30, 2020, 61.8% of pension funds were in deficit with a total £232.5 billion. Assets were up 1.5% during the month and rose 1% for the year ended April 30, to £1.78 trillion. Liabilities increased 0.4% over the month and declined 6.5% for the year, to £1.73 trillion. The FTSE All-Share index was up 4.3% for the month and gained 25.9% for the year ended April 30, the PPF said. Five- to 15-year index-linked gilt yields increased 3 basis points in April and declined 1 basis point over the year.

Pensions&Investments | 11 May 2021

OUT OF INTEREST

10 sustainability terms every investor should understand

Our commitment to responsible investing is growing and we would all do well to brush up on our sustainability jargon.

In a world first, New Zealand lawmakers announced this week that the country will be introducing a law that will require banks, insurers and investment managers to report the impacts of climate change on their business. While we aren’t quite there yet in South Africa, our commitment to responsible investing is growing and we would all do well to brush up on our sustainability jargon. According to the most recent Schroders Global Investor Study – an annual survey that canvasses the views of more than 23 000 wealth investors from 32 locations around the world – almost three-quarters (73%) of local investors refuse to compromise on their personal beliefs when investing, even if higher returns were on offer.

The results support the growing trends that returns are not the only aspect that influences our investment decisions. People want their values reflected in the way they invest, and are increasingly looking to contribute to a more sustainable society through their investments.

But even if the principles are fairly simple, the field has become a sea of acronyms and technical terms, which can leave investors confused. That's where we can help. We've pulled together the 10 key terms every sustainable investor, or anyone new to the topic, needs to know.

2°C limit or "2 degrees":

It is widely agreed that limiting the average rise in global temperatures to less than 2°C above pre-industrial levels by the end of this century may help stave off the worst of the natural disasters associated with global warming. Although there is some disagreement as to whether this limit is sufficient or even possible, the idea of restricting global warming to less than a 2°C rise has consistently been a major part of the debate. Schroders has been tracking progress being made to limit the rise in global temperatures to 2°C with its Climate Change Progress Dashboard tool.

Active ownership:

Actively exercising your shareholder rights, such as general meeting voting rights, and engaging with investee companies to encourage responsible corporate behaviour and improve long-term shareholder value. This applies to both individual investors and fund managers.

Carbon pricing:

The cost of emitting carbon dioxide, or CO_2, into the atmosphere, either in the form of a fee per tonne of CO_2 emitted, or an incentive (money) that's offered for emitting less. Putting an economic cost on emissions is usually said to be the best way to encourage polluters to reduce what they release into the atmosphere. South Africa is the world's 14th-largest emitter of greenhouse gases, thanks largely to its heavy reliance on coal. In an attempt to meet our commitment to the Paris Climate Accord, the government has created a framework for the transition to a low-carbon economy. The Carbon Tax Act came into effect on June 1, 2019 and compels carbon emitters to pay for their manmade greenhouse gas (GHG) emissions – the deadline for the carbon tax returns is the end of June 2021.

ESG integration:

Environmental, social and governance (ESG) factors are the sustainability considerations a lot of us are very passionate about, and they're relevant to the ongoing performance of companies we're invested in too. ESG integration is an investment approach that takes into account ESG-related risks and opportunities in addition to traditional financial analysis. Broadly speaking, while environmental issues are self-explanatory, social factors could be about treatment of workers or community relations, and governance factors are things such as the composition of the board and its performance. Schroders announced earlier this year that it fully integrates ESG into financial analysis of all its investments. Schroders' investors are now integrating ESG factors into their decision-making across all investments the firm manages, fulfilling our intention announced in November 2019.

Ethical investing:
An investment strategy where you invest in line with your ethical principles and exclude (or you might hear some people say "screen out") companies that you consider unethical.

Impact investing:
Investments that are made with the primary goal of achieving specific, positive social benefits while also delivering a financial return. Impact investments create a direct link between portfolio investment and socially beneficial activities, and historically most of the examples of impact investing have been in unlisted assets (i.e. privately not publicly-owned, as firms listed on a stock market are). Schroders recently announced that it has joined the influential Global Impact Investing Network (GIIN), a leading non-profit organisation dedicated to increasing the scale and effectiveness of impact investing.

This is a further step in our commitment to building a leading position in sustainability and impact investing. GIIN focuses on reducing barriers to impact investment to enable more capital to be directed to fund solutions in this space. It has 350 members globally, including impact investment pioneer BlueOrchard, part of the Schroders Group, which has generated lasting positive impact for communities and the environment across the globe, while providing attractive returns to investors since 2001.

Physical risks of climate change:
The risk posed by climate change on a company's physical assets such as equipment, its supply chain, operations, markets and customers. Schroders analyses what businesses would have to pay to insure their physical assets against hazards caused by rising global temperatures and weather disruption, for example flooding.

Stewardship:
An ongoing dialogue between shareholders and boards that aims to make sure a company's long-term strategy and day-to-day management are effective and aligned with shareholders' interests. This means monitoring a company's practices and performance, engaging on areas of concern and voting on shares held to ensure management is acting in the long-term best interests of its shareholders. Good stewardship should help to enhance and protect the value of investments.

Sustainable investing:

An investment approach in which a company's sustainability practices are paramount to the investment decision and in which ESG analysis forms a cornerstone of the investment process.

Transition risk:

The financial risks that could result from significant policy, legal, technology and market changes as we move to a lower-carbon global economy and climate-resilient future. "This is especially relevant in developing nations such as South Africa, where the majority of our primarily poor population relies on jobs and communities centred on carbon-heavy industries such as coal production.

Moneyweb | 8 May 2021

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