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irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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LOCAL NEWS

How to manage your living annuity in uncertain times

The primary goal of a living annuity is to provide a reasonable level of income that keeps up with inflation and lasts for the rest of the annuitant's life. A common secondary goal is to leave a capital legacy for beneficiaries. There are four long-term rules to facilitate achieving the primary goal.

Rule 1: Plan for a reasonable number of years in retirement

While it is true that not everyone will enjoy a long retirement, there is a very real possibility that your retirement could last almost as long as your working life. According to the Actuarial Society of South Africa's South African Annuitant Standard Mortality Tables 1996-2000, if you want to be at least 90% sure that you are planning for enough years in retirement, you need to plan for approximately 40 years at age 55, 30 at age 65, 20 at age 75 and 10 to 15 at age 85. Therefore, regardless of your age, your living annuity remains a long-term investment for a long time.

Rule 2: Invest for above inflation (i.e. real) returns

So how do you need to invest to maximise your chances of achieving the required real returns and sustaining your income over time? Our research looking all the way back to 1900, reveals that growth assets, particularly equities, have been required to generate the necessary levels of real returns and to sustain real incomes.

For example, with a 4% starting drawdown rate and needing income for 30 years, having 0% in local equities would have had approximately a 30% probability of success, while a 50% or 60% exposure to local equities would have had approximately an 80% and 90% probability of success, respectively. Our conclusion is that as a living annuitant, you should have a minimum of 50% exposure to growth assets, such as equities, and exposures of 60% to 70% would have led to even higher probabilities of long-term success.

Rule 3: Manage volatility (but not at the expense of real returns)

Our research reveals that being able to reduce volatility without (significantly) reducing real returns, or being able to increase real returns without (significantly) increasing volatility, increases the probability of success in a living annuity. How do you achieve the right balance?

Offshore diversification can help. According to the analysis of our long-term dataset, investing 30% offshore would have allowed lower volatility while maintaining the same or higher levels of real returns, equaling or bettering the likelihood of success. Another way to manage volatility is through quality active management. Over the 20 years from 2000 to 2019, the Allan Gray Balanced Fund has generated higher real returns than its benchmark and a passive investment of 60% equities and 40% bonds, with 30% offshore across the investment. It has also managed to generate these higher real returns at roughly equal (relative to the passive investment) and lower (relative to the benchmark) levels of volatility.

Rule 4: Draw a reasonable level of income

With 30 years of income required, starting drawdowns in the region of 4% to 4.5% and below have had probabilities of success of 90% and above. Beyond this range of drawdowns, the probabilities of success start to decrease.

What about the current context?

After returning just more than 10% over 2019, South African equities fell 34% from top to bottom as a result of COVID-19. While the market has somewhat recovered, it was still down 12% at the end of May 2020. Our historical analysis reveals that there have been six other occasions where South African equities have been in an equally bad or worse position and a number of other points where real returns have been low or negative over a five-year period. The same has also been true for global equities. Let's examine more closely whether the "Rule Book" holds under these circumstances by considering the questions below:

1. Should you have lower growth asset exposure?

History shows us that reducing growth asset exposure at difficult points has not been in annuitants' best interests over the longer term. For almost all 30-year periods, including those starting at equally or more difficult points than we are experiencing now, reducing growth asset exposure would have led to lower income over the next 30 years.

2. Should you use a combination of unit trusts and draw from cash?

Our analysis shows that the probability of being able to sustain different levels of income for different lengths of time hasn't depended on the number of unit trusts that are combined, how capital is allocated and rebalanced between those unit trusts, or which unit trust income is drawn from; rather it has had to do with the underlying exposure to growth assets of a given strategy over time. ***Full Report:*** ***https://www.fanews.co.za/article/retirement/1357***

FA News | 23 June 2020

There is a way retirement funds can pay special Covid-19 relief benefits to members undergoing financial distress

Pension funds and provident funds can lawfully amend their rules to provide for the payment of 'special relief benefits' to members still employed by participating employers, but in financial distress due to circumstances other than a strike or lock-out and funded by reductions in member fund credits. To facilitate these payments, all Parliament needs to do is make a few amendments to the Pension Funds and Income Tax acts.

In his latest weekly letter to the nation, entitled From The Desk of the President, Cyril Ramaphosa has painted a grim picture of South Africa's economic prospects, warning of further job losses, salary cuts and a hugely weakened fiscal position. The president's address follows announcements by major corporations — both in the private and public sector — of far-reaching liquidations, business downscaling and mass retrenchments. South Africa, which already holds one of the worst unemployment rates in the world, will be severely affected by the downturn.

"For a country such as ours, which was already facing an unemployment crisis and weak economic growth, difficult decisions and difficult days lie ahead," the president said. Ramaphosa added that while relief efforts undertaken by both government and the private sector — including loans, tax relief, debt restructuring, extended credit lines and retail rental exemptions – had managed to mitigate some of the worst of the financial fallout, the long-term prospects remained ominous. But it seems that not all relief possibilities have been tapped into just yet.

The time has come for pension and provident funds to step up to the plate, not to bail out Eskom, but to help some of South Africa's most vulnerable individuals weather an economic storm in this country not seen since World War I. This is especially applicable to workers who had to take a pay cut or have been temporarily suspended from employment during the lockdown. For the context of this article a "special relief benefit" is a benefit which may be paid to a member of a fund who is still employed, but is in financial distress due to loss of or reduction in pay resulting from circumstances other than a strike or lock-out.

These include the Covid-19 Temporary Employer-Employee Relief Scheme (TERS), the deferment of the payment of employee tax, and additional measures announced on 21 April 2020. According to Rosemary Hunter, partner at Fasken Attorneys and a pension funds specialist, some bargaining councils have concluded agreements in which provision has been made for the replacement of a portion of the normal remuneration of employees with payments by employers of a part, or the whole, of the shortfalls remaining after TERS benefits have been taken into account.

In its Communication 11 of 2020, issued in March this year, the Financial Sector Conduct Authority (FSCA) reminded local retirement funds subject to regulation in terms of the Pension Funds Act (PFA), that they are permitted to have rules that allow for the non-payment of contributions to pension funds and provident retirement funds during periods in which employees are temporarily laid off or are remunerated at rates lower than normal.

"This is an important measure," says Hunter, "because, the less that is required to be deducted from an employee's remuneration and paid to a fund in the form of contributions, the more may be available to the employee as 'take-home' pay in these difficult times. "Nonetheless, while these measures represent significant attempts to mitigate the financial distress, they are unlikely to be sufficient to replace the whole of their normal incomes for the whole of the periods during lockdown or other economic restrictions," she adds.
Full Report: https://www.dailymaverick.co.za/article/2020-06-22-there-is-a-way-retirement-funds-can-pay-special-covid-19-relief-benefits-to-members-undergoing-financial-distress/#gsc.tab=0

Daily Maverick | 22 June 2020

When it comes to your retirement, Covid-19 doesn't have to be a total gamechanger

After the lockdown was implemented, Liberty Executive Wealth Adviser Carlo Gil was telling his clients to delay their retirements if possible. Weeks later, the markets are recovering and it's safe to reinvest – with expert help. For those of us who have retired or are on the verge of retirement, the Covid-19 pandemic has been a terrifying experience. Not only are the health implications of the virus at their most severe for people in this age bracket, but the negative financial impact on savings and retirement funds has been seen worldwide.

Retirement savings are intrinsically linked to financial markets, and as global lockdowns brought economies to a grinding halt, so too did we see a broad-based fall across most asset classes. What this means is a noticeable decrease in retirement savings value. However, the market volatility that was so prevalent just a few weeks ago is already starting to stabilise, and the recovery period means that not only are there opportunities to recoup any losses, but there may be opportunities to grow your investment. This is the time to speak with a financial adviser, because just a slight re-managing of your retirement plan could mean the difference between a loss or potential growth of your life's savings.

Retirement going into the lockdown

Liberty Executive Wealth Adviser, Carlo Gil, specialises in investment and risk cover, and prior to the lockdown was receiving numerous calls for advice from his clients – particularly those on the verge of retirement. "I had a client who was set to retire the week that the lockdown was about to start, and in that week, we saw a 30 percent drop in the (FTSE) All-Share Index. This client was invested both locally and internationally, and in that scenario, we told him to hold, to postpone his retirement because he stood to lose a significant amount," said Gil.

But just five weeks later, Gil explained that there was already a 20% market recovery, locally and abroad, which allowed the same client to retire that week without significant loss. "Typically, at this point, when I looked at my older clients' portfolios, the initial reaction was that we had to hold off on selling because the losses were too big. But now, there are a lot of opportunities arising during the pandemic, and after the recent Moody's downgrade," he said.

Where are the opportunities for reinvestment?

While every retiree's circumstances are different, there have been some markets that are becoming more lucrative across the board, even in the face of continued volatility. The bonds market, Gil explained, has become a top investment priority, as well as safe investments in currency or cash markets. "We are now third in the world on the highest bonds rates. This is due to the fact that the reserve bank and treasury are trying to attract foreign investment; however, this won't last very long," he said.

Gil said that certain clients have also been able to invest in life annuities, because the rates have gone up so much. “I had a client who, pre-lockdown, was on an income of R55 000 – but for the same capital amount, with the new bond rates, we increased his income to R73 000,” he said. However, it may not be possible for all investors to alter their portfolios so easily, especially if they’ve already experienced major losses.

“We are advising clients who have seen very negative effects to hold off on selling for now, because many of these markets can still bounce back, as we’ve seen in the past,” said Gil. “But even with depleted portfolios, we have some opportunities. We’ve seen the rand strengthening, as well as the S&P 500 Index and European markets improving. You do need to look at the various options,” he said.

Innovative packages that provide investment security

Many financial services providers offer stable and secure investments to ensure that your retirement savings are protected, some products on the market even have features that allow you to invest in a high-growth portfolio while locking in a minimum investment value, giving you the safety-net you need during market downturns; thus enabling you to take more risks and make bolder investment choices while securing your retirement income.

Try not to panic

It’s understandable that many people of retirement age are making knee-jerk decisions to try and “save” their retirement funds. After all, these are their life savings that we’re talking about. However, everyone’s situation is different, meaning there could be opportunities for growth that you might be missing. In the unprecedented age of Covid-19, now is the time to take advantage of having an expert financial adviser at your fingertips.

IOL | 17 June 2020

INTERNATIONAL NEWS

U.K.’s Pensions Regulator urged to help savers re-enroll in plans

The Pensions Regulator should consider whether U.K. participants opting out of retirement contributions because of the impact of the coronavirus should be helped to re-enroll at a faster pace than under normal circumstances. The Department for Work and Pensions made the recommendation Monday in its response to the COVID-19 outbreak, published by the government's Work and Pensions Committee.

While employees cannot legally be encouraged to opt out of making contributions to retirement plans, the DWP acknowledged that many participants may choose to opt out if their incomes fall due to the impacts of the pandemic. "We recommend that the Pensions Regulator consider whether employees who do opt-out during the pandemic should be helped to re-enroll earlier than would happen normally under auto enrollment," the DWP said.

As it stands, employers are required to re-enroll eligible employees back into a retirement plan every three years. The department also made recommendations related to defined benefit plans, in particular with regard to deficit repair contributions. TPR has published guidance for sponsoring employers that have decided to reduce or suspend agreed contributions to plug deficits. "A solvent employer is the best way to fund a defined benefit pension scheme," the DWP said, noting that it supports TPR's "more lenient approach" to deficit contribution reductions.

However, TPR "must remain alert to the risk of unscrupulous employers not in financial difficulty seeking to take advantage," the DWP warned. The DWP also reiterated that employers that have reduced pensions contributions should not be paying dividends to shareholders or bonuses to senior executives. It urged TPR to keep a close eye on the situation and to raise the alarm if abuse is detected.

Pensions & Investments | 22 June 2020

Government proposes restrictions on foreign investment in pension funds

Foreign investment in pension funds is governed by the Pension Fund Regulatory and Development Authority and is capped at 49% via the automatic route. As India-China tensions simmer, the finance ministry has proposed limitations on foreign investment in pension funds while explicitly suggesting additional checks on Chinese investment. The Draft Pension Fund (Foreign Investment) Rules, 2020, stated that government approval will be required for investments from bordering countries “including China”, on Friday.

Foreign investment in pension funds is governed by the Pension Fund Regulatory and Development Authority and is capped at 49% via the automatic route. The latest proposal is in continuation of earlier restrictions placed by the government on foreign direct investment in companies, targeted at China. However, the earlier notification did not explicitly mention China. The move comes amid heightened tensions between the Indian and Chinese armies at the Galwan Valley and other points in Ladakh. According to experts the latest proposal is aimed at preventing hostile investments in a sensitive and socially important financial instrument.

Unlike in Europe or the US, there is no state-sponsored social security in India. Indian pension funds are privately funded and represent a large portion of the social safety net post-retirement for many Indians. “Pension funds play a vital role in Indian social security framework and therefore such restrictions by the government to regulate foreign investment in such crucial sectors seems to be in long term security of the country,” said Shailesh Kumar, partner at Nangia & Co LLP. ET had earlier reported that the government plans to put up more comprehensive restrictions to curb its reliance on Chinese funds and products. From tariff and non-tariff barriers on imports to curbs on investment in infrastructure projects, the government is considering all its options to limit China’s presence in the economy.

The Economics Times | 20 June 2020

OUT OF INTEREST

Inflation fears 'unfounded for now'

Central banks around the world are pumping money into their respective economies, sparking fears of soaring future inflation rates, but these fears are unfounded for now. Instead, we are seeing inflation collapsing at present, even while money supply explodes upwards as a result of the efforts to counteract the fallout from Coronavirus' (COVID-19) crippling lockdowns.

Governments and central banks around the world have unleashed extraordinary levels of monetary stimulus to support economies hard-hit by the global pandemic. In South Africa (SA), the Reserve Bank (SARB) loosened monetary policy by cutting the repo rate from 6.25% to 3.75% and has also stepped in to buy South African government bonds to prevent bond yields from rising too high. These similar massive levels of stimulus globally have raised concerns that the extreme liquidity could result in runaway inflation down the line. This is unlikely.

In the United States (US) and other major economies, money supply and inflation have become largely disconnected in the decade since the 2008 global financial crisis. Despite massive injections of fiscal and monetary stimulus in the aftermath of that crisis, inflation in developed economies has remained benign and we have not seen a surge in consumer prices. Similarly, in SA core inflation has been stable, remaining within the SARB's 3-6% target range. Inflation as measured by Consumer Price Index (CPI), is expected to remain muted, falling as low as 2% in the next few months and averaging around 4% in the next 12 months.

We do not expect the inflationary environment to change in the next year as a result of the exploding liquidity around the world. Instead, the additional liquidity in markets will more likely be fuel for an equity fire. Investors will favour equities simply because few other asset classes are expected to deliver healthy returns in this environment. With interest rates close to zero or even negative in some economies, the yields on developed market bonds, for example, are not attractive.

We therefore see the abnormal levels of global liquidity underpinning the equity markets for the next six to 12 months. But, given the COVID-19 crisis, it is likely to be a bumpy ride, with highly volatile periods. In this type of environment, we favour high quality resilient companies. Despite this view, now is not the time to go overweight equities, however. Given the nature of how the COVID-19 spreads and the possibility of a second wave of infections, leading to further lockdowns of some sorts, don't bet on a quick recovery in company earnings as there may still be the threat of a relapse.

In that environment, one would want to favour those companies that are able to ride out a storm for an extended period – those with resilient balance sheets and a resilient business model. A vaccine for COVID-19 is absolutely critical to the full recovery of economies and the health of companies. But the development of a safe and effective vaccine in the time scale envisaged has never been done before, which calls for a cautious approach when it comes to equities, despite the liquidity underpin.

FA News | 23 June 2020

South Africa looks to green infrastructure bond to spur growth

Government is on its biggest drive ever to kickstart private investment.

South Africa's government is considering selling a green infrastructure bond worth tens of billions of rand as part of its biggest drive ever to kickstart private investment in projects ranging from energy to water reticulation. The proposed instrument is one of several mechanisms the country could use to raise finance for projects worth as much as R1.5 trillion over the next decade, said Kgosientsho Ramokgopa, head of the South African presidency's investment and infrastructure office.

"An idea that's finding traction is a green infrastructure bond," he said in an interview on Monday. "It will be substantial." The infrastructure programme will be officially unveiled at a symposium in Pretoria on Tuesday, where President Cyril Ramaphosa will announce investment commitments by private investors and international finance institutions. It is seen as a way of trying to counter the fallout of the coronavirus outbreak, which the central bank expects to cause a 7% economic contraction this year.

Rising debt

With a debt-to-gross domestic product ratio that's expected to exceed 100% by 2025, according to a Treasury document, the state has little room to fund infrastructure despite South Africa's need for everything from power plants to additional housing and water supply. State companies also have limited scope to fill the gap because they too are already saddled with billions of dollars of debt.

Ramaphosa has previously announced plans for a R100 billion infrastructure fund and is now pushing for more involvement from private investors, who have more funding capacity. Privately held mutual funds oversee about 2.5 trillion rand in assets, according to the Association for Savings and Investment South Africa, while the Public Investment Corporation, which mainly manages the pensions of state workers, has R2.1 trillion.

Futuregrowth Asset Management, the country's biggest specialist fixed-income money manager, has said the projects could attract investment if returns are attractive. The green infrastructure bond could make it easier for private investors to participate as the security could be bought and sold easily when they need access to their funds. The government could use the infrastructure fund to make the first investment in key projects to reduce risk for private investors, Ramokgopa said. It may also seek to have private investors fund projects and then repay them over several years while simultaneously providing them with a return. Ramokgopa's office began engaging private investors in February and pitched projects to them late last month at an event that had 230 attendees from 60 institutions, he said.

Senior representatives from the New Development Bank, the World Bank and the African Development Bank will attend Tuesday's meeting. As many as 88 of the 272 infrastructure projects in the pipeline may be bankable, while the rest need additional work and some may not prove viable, according to Ramokgopa. "We want to get the economy going," he said.

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