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The ‘two-pot’ retirement system: something is cooking

On 29 July 2022, the National Treasury released the 2022 Draft Revenue Laws Amendment Bill for public comment until 29 August 2022 to introduce the “two-pot” system for retirement savings that was flagged in the National Budget. The Revenue Laws Amendment Act was the first law approved by Parliament in 2023 and signed into law, giving effect to the new system and setting the implementation date. The Pension Funds Amendment Bill was approved by Parliament in May 2024. It introduces changes to the Pension Funds Act and includes funds not regulated by the Pension Funds Act in the new system. President Cyril Ramaphosa officially signed the Pension Funds Amendment Bill into law on July 21, 2024.

The two-pot retirement system in South Africa (to be implemented on 1 September 2024) divides retirement savings into two distinct components: 1) the savings and 2) the retirement pot:

1. Savings Pot: About one-third of the contributions go into this pot that is designed for short-term financial goals and emergencies. Members will be able to access a portion of these savings before retirement if necessary, and can withdraw from it once a year (minimum withdrawal amount of R2 000) under specific conditions. However, according to the Citizen (22 July 2024) 30% of pension fund members in the Old Mutual Stable fund will have less than R2 000 in their savings pot and will not be able to claim. Informal sector workers often lack coverage, and traditional family-based care for the elderly is breaking down as urbanisation increases. Therefore, this system seems to benefit the middle-income group and (again) fail the poorest of the poor. Keep in mind that access to the savings pot’s money has implications on both the tax that the individual pays and legal requirements during divorce proceedings. More specifically:

• Withdrawals are subject to taxation at the individual’s marginal tax rat
• Retirement fund administrators must be notified when divorce proceedings are initiated to ensure that no payments are made from the savings pot during the legal process. This ensures that the division of assets is handled correctly according to the legal requirements.

2. Retirement Pot: The retirement component ensures that the bulk of retirement savings – two-thirds – remain untouched until retirement age as stipulated by the fund. This preservation is crucial for securing long-term financial stability post-career. These funds are strictly preserved until retirement age, ensuring long-term financial security. Upon retirement, members can access these funds as a regular income stream, like a pension annuity. Is it wise to take a portion of your pension? There are also two sides to the Pension Funds Amendment Bill. Individuals and Financial Companies welcome this new law, as it allows the Financial Sector

Conduct Authority (FSCA) to start approving rule amendments – submitted by various funds before 31 July 2024 – once gazetted. Discovery was the fund to react the quickest with its proposed amendment rules. Some of the other retirement funds and administrators still have a substantial amount of work to do before they will be able to pay claims, including ensuring administration readiness and integration with SARS. SARS anticipates a R5 billion revenue windfall from taxing two-pot retirement system withdrawals in the next financial year. Thus, the government expects many hundreds of thousands of South Africans to access the savings component of their retirement funds as soon as the two-pot retirement system goes live.

Making use of the government's lifeline – to protect the dignity of those in need and overcome financial stress – can be understood given the economic constraints facing individuals such as high unemployment, excessive debt, and inflation. However, a wiser approach by the government should be to address the consequences and not the causes of citizens' financial dignity. Given that less than 6% of individuals in South Africa can retire "without worries", individuals should also have a good understanding that this "lifeline" is no quick fix for financial stress. Hidden costs and other implications: Members of South African pension funds may generally access their pension pot from the age of 55. If you withdraw before the age of 55, there will be tax implications. This means that the withdrawal will be taxed similarly to your salary or other income. Any withdrawal is included in your gross income for the year, potentially pushing you into a higher tax bracket.

There will also be hidden costs in the form of penalties as stipulated by the member's fund. The Institute of Retirement Funds Southern Africa has indicated an administration fee ranging from R300 to R600 on each withdrawal. South Africa has a progressive tax system, where tax rates increase as taxable income rises. It is designed to be fairer by imposing a lower tax rate on low-income earners and a higher rate on those with higher incomes. Therefore, the amount that a member will get out depends on his/her marginal rate. Should a member be paying 45% tax on his/her taxable income (when earning more than R512 801 per year), a member might end up only getting slightly more than half of the withdrawal amount – once your tax-free benefit at retirement is exhausted. Some further long-term benefits can be jeopardised when a member withdraws from the retirement savings.

These are:

1. Tax-Free Benefit at Retirement: Keep in mind that withdrawals may reduce the tax-free benefit you enjoy at retirement. Up to R550 000 of the lump sum you take in cash at retirement may be tax-free, but this benefit can be eroded if you frequently withdraw from your savings pot before retirement.
2. Lost Tax-Free Growth: Additionally, withdrawing from your savings pot means losing out on tax-free growth. Savings in your retirement fund grow free of tax on interest income, dividends, and capital gains. Apart from the tax implications, some pension providers will charge fees for withdrawals. Therefore, it is advisable to check with your pension administrator to understand any costs involved. In addition, withdrawing from your savings pot will reduce the remaining balance. Early withdrawals can significantly affect your retirement savings. Every R1 withdrawn at age 35 could equate to as much as R30 less at retirement 30 years later.

"Two pots" may spoil the broth

Statistics from the Nedfin Health Monitor (2023) reveal that 90% of South Africans have inadequate savings for retirement, and a significant 67% of people in the country have no retirement savings beyond what they are putting into their employer-provided pension funds – which is often too little to be able to retire comfortably. The general rule of thumb is that individuals start saving as soon as possible, as much as possible, for as long as possible. There is a saying that "too many cooks spoil the broth". My personal view is that individuals need to be careful that "two pots" do not spoil the broth. Although the system aims to balance immediate financial needs with long-term security, there is simply no way that individuals can eat their cake and have it. If the two-pot system is regarded as a bailing-out system, worry-free retirement remains a challenge for many. There is still a lot of thought needed for the two-pot system. Policymakers should consult the pension systems of the Netherlands, Iceland, Denmark, and Israel – which are regarded as having the best pension systems globally – to get an understanding of how adequacy, sustainability, and integrity are prioritised.

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The significance of international retirement planning and a Savings Trust

Saving and alternative savings vehicles are important to everyone, and they underscore the need for more robust strategies to foster a savings ethos and ensure that all individuals are well-informed about the diverse financial instruments and opportunities available to them. Contrary to popular belief, going offshore is not something that is limited to the rich and famous. Instead, offshore opportunities are more accessible than many may think and can be done cost-effectively when structured properly. Much of the success and effectiveness of going offshore, is a subtle change in mindset. It centres on the premise that this savings vehicle is built around planning with purpose as opposed to solely planning for tax purposes.

This structuring is done with longevity in mind. As such, people need to ask themselves whether they want to protect their assets whilst living or for the family's legacy upon demise or both. Let me turn the spotlight to investment savings trusts and international retirement plans. South Africans can set up an international retirement plan with a minimum of £25 000. This investment does not attract any tax in Guernsey, and there is no need to make regular contributions to the plan. Furthermore, there are no limitations on the number of contributions a person would like to make over time. Some might question the reasons for going offshore in this way. However, with hard currency investment choices, political instability, wealth preservation, and more effective retirement planning, all combine to make this an effective option.

It also provides South Africans with an efficient structure for the safety, protection, and growth of their assets in hard currency as well as a secure and reputable jurisdiction with a stable economic environment. When it comes to funding such an international retirement plan, South Africans can use their after-taxed funds to contribute. Some have funds sitting offshore already that have been cleared by the SA Reserve Bank. These individuals generally like to consolidate and invest part of their funds in the retirement plan. As such,

the main member will contribute the funds to use their allowances or leverage the funds that are already offshore. However, no third party can contribute to this plan. The only exception is if a spouse gifts to the fund. As part of this, there is no donations tax associated with the fund. Of course, tax clearance will be required for values above ZAR 1 million. Distributions will be made from the capital component first and then move over to the capital gain component once the capital is depleted. A matter of trust
The main purpose of an offshore savings trust is to provide individuals with a vehicle to secure their wealth which is currently held in a volatile currency. The vehicle utilised is a trust which means that all the benefits traditionally associated with a trust, are available within the savings trust.

Some of the advantages of going with an offshore trust include flexibility, efficient tax, and succession planning. Individuals can also save on executor’s fees while protecting their assets. Even though assets in someone’s personal estate are frozen during the finalisation of a deceased estate, trust assets are accessible at all times. To add to this, trusts offer the opportunity to reduce one’s tax burden, and these can include estate duty, income tax, capital gains tax, donations tax, and transfer duty. Consider an investment savings trust for offshore investments through direct holdings within the trust. An investment advisor can be appointed as well to assist with the investment direction rebalancing. A savings trust can hold direct investments, such as platforms, bonds DFM and invest in direct funds. There are two ways to fund this trust: Donation: Values above R100,000 will incur a 20% donations tax.

When the settlor contributes to the trust via a donation, attribution rules will likely apply when there is growth. Another avenue to settle a trust is with an interest-bearing loan: The loan agreement must include market-related interest in the currency of the loan. Without this, it could be seen as a donation, triggering donations tax. The interest rate must meet specific requirements, and the loan must be on commercial, market-related terms. Trustees will draft a loan agreement with interest paid annually or on the anniversary date of the loan and the trustees must act in the beneficiaries' best interests, unlike retirement plans, which benefit only the main member. It is important to understand the various structuring options by heeding the advice of experts in the field. They will be able to provide the best advice based on different scenarios. Offshore planning and saving for the future are not a one-size-fits-all approach. With all of the options available offshore, be sure to understand what is required of you as an individual and what you are able to do within your country of tax residency.

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Companies Amendment Bills Signed: Why Retirement Fund Trustees Should Take Notice

It’s been a busy time for the Presidential pen. Shortly after signing the Climate Change Bill on 18 July 2024 and the Climate Change Act being published on 23 July 2024, an announcement was made on 26 July 2024 that the President has also signed the long-awaited First and Second Companies Amendment Bills into law. Once gazetted, the effective date, including any possible transitional periods, will become clear. Among several amendments, some of the most material ones relate to remuneration and have been the topic of heated debates and several comments over the past few years. In addition to these amendments being critical considerations for boards of directors and remuneration committees (Remco’s) alike, boards of trustees should also concern themselves with these company law changes.

As stewards of capital and in accordance with Regulation 28, trustees are required to take environmental, social and governance (ESG) factors into consideration in their decision-making. Several of the amendments deal with ESG elements, like remuneration and Social and Ethics Committees. In terms of the amendments, public and private companies that are required to be audited under the Companies Act 71 of 2006, as amended (the Act), will now need to list each individual director and prescribed officer's remuneration by name in their annual financial statements, rather than grouping these together as many companies have done since the Act became effective in 2011.

This is one of several meaningful disclosure enhancements for companies that may form part of private market portfolios. The requirement to have shareholders vote on a company’s remuneration policy and remuneration reports (previously only applicable to listed companies through advisory or non-binding votes) has been made mandatory for all public and state-owned companies. The remuneration policy will now require approval by ordinary resolution at the company's annual general meeting (AGM) and thereafter every three years or upon making any material amendments. A failed vote will require the policy to be resubmitted to the next AGM or special meeting and changes to the policy may not be implemented until approved.

Similarly, the remuneration report will require an ordinary shareholder resolution for approval. In addition to individual remuneration disclosures, the remuneration report will also need to include:

- The total remuneration of the highest and lowest earner in the company.
- The average and median remuneration of all employees in the company.
- The pay gap between the highest paid 5% and the lowest paid 5%.

If the report is not approved, the Remco must explain at the next AGM how shareholder concerns have been considered. Additionally, Remco members are required to stand for re-election at the AGM where the report is presented. If the prior year’s implementation report is not approved at the second AGM, the Remco members may continue to serve as directors, if re-elected, but may not serve on the Remco for the following two years. Remco members who have served for less than 12 months are excluded from this requirement.

To effectively consider ESG in decision-making, trustees must be able to assess the quality of a remuneration policy and report, particularly how they link to and enable or detract from company performance and sustained value creation. These amendments place significant power in the hands of shareholders, requiring them to be increasingly informed and responsible in utilising this power. Amendments have also been made to the requirements for Social and Ethics Committees (SECs), highlighting some which trustees should be aware of:

• Public and state-owned company SECs will be required to consist of a majority of independent (as defined in the Act) non-executive directors.
• Public and state-owned company SEC appointments will require approval by an ordinary resolution of shareholders at the AGM, like the annual election of Audit Committee members at present.
Given the scope and breadth of ESG matters that SECs are responsible for, appointing appropriately skilled and experienced individuals on these committees should be of paramount importance for trustees.

Other amendments that active owners and stewards should note, include:
• Relaxation of approval requirements for share buy-backs.
• Relaxation of intra-group financial assistance requirements.
• In response to the Zondo Commission recommendations, changes to director liability and delinquency prescription periods and delinquency and probation periods.
• Reduction of auditor appointment cooling-off periods.

Many retirement fund trustees rely on consultants, asset managers and proxy advisers to vote on these matters. However, Circular PF130 is clear: regardless of any delegation, the board of trustees is not relieved of their accountability for the delegated functions. Delegation is not abdication. Trustees should therefore gain a deep understanding of these matters in preparing to incorporate the amendments in their governance processes and arrangements with service providers. For support or guidance on preparing boards of trustees or addressing sustainability-related questions, trustees can contact the Alexforbes Impact Advisory team.

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SA is changing its retirement rules to help boost country savings

How it will work – with some historical context and a look at how things work in other countries.

A study of 160 countries, spanning 60 years of economic history, establishes that there is no country that has been able to transition from 'poor to prosperous' without a high savings rate. And that households – in other words you and me – are one of the most important contributors to a country's overall level of savings rate. Yet, South Africa's household savings rate is among the lowest in the world at only 0.5%. This is far below that of many emerging market peers like Brazil, Chile, or India, where households save between 5% and 9% of gross domestic product. Around the world, household savings don't stay 'under the mattress' but generally are channelled via banks and other financial institutions to serve as one of the main domestic sources of funding for capital investment.

This means that ultimately your and my savings become the funder of harbours, highways, and hospitals which, in turn, are the major drivers of long-term economic growth, job creation, and rising incomes. The two-component retirement system which is being put in place in South Africa – or colloquially the 'two-pot system' – aims to make a contribution to repairing the country's weak state of saving. The changes have important implications for people planning for retirement. The new system, set to be implemented in South Africa on 1 September 2024, will apply to both private and state pensions, including the country's largest fund, the Government Employees Pension Fund (GEPF). The new system introduces two components to an individual's retirement savings:

- The retirement or preservation 'pot'; and
- The savings 'pot'.

This makes a dramatic change to the current system, which allows individuals to withdraw all their compulsory pension savings when they leave a job. The temptation to withdraw all the savings when changing employment will be removed by the new regulations, guaranteeing better retirement outcomes in the long run.

How it will work

The retirement or preservation component makes up two-thirds of contributions. Here, two-thirds of what individuals save towards retirement via a fund (not their own private savings) must go into this first pot. This component is designed to preserve a portion of the retirement fund for retirement purposes. Under the new regulations, this portion of a person's retirement savings must be retained in this 'pot'. Withdrawals are not allowed until retirement age. This is intended to ensure that individuals will have sufficient funds to support themselves in retirement and, in turn, will give the South African economy a more stable and growing pool of savings to fund economic growth and employment. The savings component, comprising one third of contributions, allows the early withdrawal of some of a person's retirement fund before retirement age. This gives flexibility in meeting unexpected financial needs. A minimum of R2 000 (US$110) can be withdrawn, and there is no maximum limit (subject to the size of this pot), although only one withdrawal may be made per year. Withdrawals from this second pot will be taxed at the member's marginal tax rate (the rate applied to your last rand of income) and will likely incur additional administration fees. There is no doubt that South Africa is a country of immense disparity between those who are financially stable and those who are financially fragile. For those facing financial hardship, the need to access funds set aside for retirement can be very real. With a Gini coefficient of 63.0, South Africa's income distribution ranks as the most unequal in the world. In part, this is a reason why the proposals have been made to give individuals the opportunity to access a portion of their retirement funds in the case of dire need.

This makes some sense given the financial fragility of households, but it comes at a potential cost of compromising households' long-term savings, and it also will be of no impact to the employed who do not belong to retirement schemes or the unemployed. However, the tragedy is that those who need to get hold of their funds ahead of time are exactly the people who should not. They will need every cent of their retirement savings to provide for themselves in their retirement years. It is estimated that fewer than one in 10 South Africans has sufficient funds to maintain their standard of living when they retire. So, what does the two-component system mean for retirees and investors ahead of retirement?

Pros and cons

Under the new system, the retirement component can never be touched or spent until you retire. This is a huge advantage over the current system in which, if a person leaves his or her employment, they can take the full amount in cash and spend it. This has resulted in less than 10% of people being financially able to retire. In future, more and more people will have at least two-thirds of their retirement assets preserved. This will benefit individuals by ensuring a permanent savings pool, and it will also be good for the country as, over time, this growing pool will place less reliance on the state. About 3.9 million people in South Africa receive the monthly Older Persons Grant, also known as the Old Age Grant, currently at R2 080 per person per month. Researchers have found that, in most cases, this amount is not sufficient to meet the needs of elderly people in South Africa.

National Treasury could also see the benefit of higher tax revenue: whatever is withdrawn from the savings component will be taxed at the member's marginal rate.

Despite these positives, I would like to sound two notes of caution:

- The impact on an individual's future wealth by removing the power of compounding (the accumulative effect of earning interest on investments over time); and
- The propensity of South Africans to favour consumption over investment.

The purpose of a retirement system is to look after your future self. By giving people access to retirement assets early or along the way, you are permanently removing their capacity to look after their future selves.

Then there's the impact on South Africa, which is a savings-starved country. Most people retire with insufficient assets – in effect they face 'bankruptcy in retirement'. There will be a huge temptation to dip into this pool of capital. Worse, a key reason South Africans find themselves in this situation is that they have a bias towards consumption. I fear that a disproportionate amount of the money that comes out of the retirement savings system will be pointed towards consumption rather than looking after the balance sheet.

Alternatives

The new system could have been better structured. A number of other models show how.

In Singapore, it is compulsory for all Singaporean and permanent resident workers earning a monthly wage of at least SG$50 (equivalent to roughly R650, or about US$40) to contribute to the Central Provident Fund, which is a defined contribution scheme. Under this scheme, the employee and the employer contribute a set amount of money regularly into the employee's individual account, and the amount the employee receives at retirement depends on the investment performance of those contributions over time – but, importantly, the full amount accrues to the employee. Under the Singaporean scheme, employers are required to approximately match employees' contributions to the fund.

This discipline ensures that individuals build up a substantial retirement fund. While the Central Provident Fund encourages long-term savings for retirement, it also offers flexibility in withdrawals for certain purposes only, such as housing, healthcare and education. It provides a safety net for unexpected expenses, but not for wanton consumption. The Chilean pension system, introduced in 1981, has been widely regarded as a successful model that involved shifting from a pay-as-you-go system to individual retirement accounts. It has significantly increased national savings and provided better financial stability for retirees. Under this system, workers have to contribute a percentage of their income to individual retirement accounts managed by private pension funds known as Administradoras de Fondos de Pensiones. Despite its success in many areas, the system has faced criticism for not adequately addressing income inequality and for the low pensions received by some contributors. Also, there have been concerns about high administrative fees charged by the pension funds, and disparities in retirement outcomes. Still, Chile's pensioners are materially better off today than they were at the beginning of the 1980s.

What next?

Countries as diverse as India (10.8%) and Chile (9.7%) have achieved savings rates that challenge the supposition that households in low-income countries cannot save. In fact, experiences across a number of countries make a nonsense of this belief. Auto enrolment (compulsory savings) is expected to be the 'next big thing' to happen in the retirement industry, which would have enormous benefits for individuals, the retirement sector, and the country.

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The impact of Section 7C

This legislation has introduced critical changes to how trusts operate in SA, particularly concerning interest-free and low-interest loans.

Many South Africans utilise trusts for estate and asset protection planning. However, legislation introduced in 2017 addresses the tax implications of how trusts acquire assets from individuals, focusing on the dynamics and consequences of such transactions. This article aims to clarify key aspects of Section 7C of the Income Tax Act and its implications for trusts.

The nature and purpose of trusts

A trust is a legal arrangement where assets are transferred to a trustee, who manages them on behalf of the trust's beneficiaries. The primary objective is to ensure that these assets are administered for the long-term benefit of the beneficiaries, providing a structured and secure means of succession planning. Trusts can protect beneficiaries, sometimes even from their own imprudent actions, by embedding the founder's core values and principles into the trust documents. Trustees acting as guardians of these values must adhere to these principles in their management and distribution of assets, ensuring continuity and stability even after the founder's demise.

Pre-Section 7C: A loophole in asset transfers

Before the enactment of Section 7C, it was common practice for individuals to transfer assets to trusts via interest-free loans. This method allowed individuals to move ownership of assets from their personal estates to trusts without incurring immediate tax liabilities. By lending money to a trust that is interest-free or at very low interest rates, individuals could effectively reduce their taxable estates, thereby avoiding estate duties and donations tax.

The impact of Section 7C

The introduction of Section 7C was a strategic move to close this loophole. This section specifically targets interest-free or low-interest loans made to trusts by connected persons, such as the founders or beneficiaries of the trust. Under Section 7C, the forgone interest on these loans is deemed a donation, which is then subject to donations tax. This change aims to curb the use of trusts as a means to shift wealth and avoid taxes, ensuring that the tax base is preserved and that such transactions are conducted with greater fiscal responsibility.

What it means for taxpayers

The introduction of Section 7C has significant implications for taxpayers who utilise trusts in their financial planning and wealth management strategies. For those who have previously transferred assets to trusts through interest-free or low-interest loans, Section 7C introduces a new layer of complexity and potential tax liability. Taxpayers must now account for the deemed donation resulting from the forgone interest on these loans. This means that the interest that would have been payable had the loan been at a market-related interest rate is treated as a donation, subject to the donation tax rate of 20% on amounts up to R30 million and 25% for amounts exceeding R30 million. It should be noted that the South African Revenue Service (Sars) makes provision for a donations tax threshold of R100 000.

Moreover, taxpayers need to re-evaluate their current trust structures and loan agreements to ensure compliance with Section 7C. Failure to do so could result in unexpected tax liabilities and penalties. It also necessitates reviewing estate planning strategies, as the benefits of using trusts to reduce estate duty may significantly diminish.

Examples of how Section 7C works and is applied

Example 1: Interest-free loan to a trust:

Mr. Smith, a founder of a family trust, provides an interest-free loan of R1 million to the trust. Under Section 7C, Sars would calculate the deemed interest that would have been payable had the loan been at the official rate of interest, which is currently 9.255% per annum.

The deemed interest for the year would be: *R1 000 000 x 9.25%* = R92 500

This R92 500 is considered a deemed donation and is subject to donations tax at the applicable rate.

Example 2: Low-interest loan to a trust

Mrs. Jones provides a loan of R2 million to her family trust at an interest rate of 2% per annum, which is below the official rate. The deemed donation is calculated based on the difference between the official rate and the actual interest rate charged. The difference in interest for the year would be *R2 000 000 x (9.25% – 2%)* = R145 000. This R145 000 is treated as a deemed donation and taxed accordingly.

How are funds taxed upon distributions from a trust in terms of return of capital and repayment of a loan

When a trust makes distributions to its beneficiaries, the tax treatment of these distributions depends on the nature of the payment.

1. **Return of capital:** Distributions that constitute a return of capital are generally not subject to income tax in the hands of the beneficiary. This is because these payments are viewed as a return of the initial contributions made to the trust. However, it is essential to maintain accurate records to substantiate that the distributions are indeed capital in nature.

2. **Repayment of a loan:** Loan repayments made by beneficiaries to the trust are also not subject to income tax, as they represent the return of the principal amount lent to the trust. Nonetheless, any interest earned on the loan repayments is taxable in the beneficiary's hands as income.

Trustees must clearly differentiate between capital distributions and income distributions, as the tax implications for beneficiaries differ significantly. Additionally, trustees must ensure compliance with Section 7C when dealing with loans to avoid any unintended tax consequences.

Costs

The tax benefits and estate duty savings provided by a trust must be weighed against the associated costs. Depending on the trust's complexity, fees for professional trustees and administrators can range from R20 000 to R100 000 per trust per annum, excluding Vat (Investec, 2023).

Conclusion

Section 7C has introduced critical changes to how trusts operate in South Africa, particularly concerning interest-free and low-interest loans. Taxpayers and financial planners must stay informed and adapt their strategies to comply with these regulations while maximising the benefits of using trusts for succession planning and asset protection. By understanding the implications and requirements of Section 7C, taxpayers can navigate the complexities of trust administration and taxation effectively. For more insights, visit us here.

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Myth busting in the ethics, morality and values realm

Behaving ethically goes beyond just following the law; it involves navigating tricky situations where doing the right thing might not always align with the rules. The good news for financial and risk advisers and their clients is that there are fewer opportunities in the financial services realm for such obfuscations. Why? Because South Africa boasts a no-nonsense, principles-based regulatory framework that does not tolerate the blurring of lines between ethics, morality and values.

"The concept of ethics does not change as one's desires or motivation changes; ethics is not relative to a situation but is immutable and unchanging," said Advocate Jan Dijkman during a recent presentation to the South African Underwriting Managers Association (SAUMA) 2024 Conference. The legal and ethics consultant set out to answer an open-ended question: Does business ethics matter? Your writer was so impressed with his delivery that he penned two pieces covering the event: the first a newsletter titled 'Right versus wrong in ethical financial decision making', and the second, today's piece, which aims to dispel a number of myths on the ethics topic.

Understanding ethics, law, morality and values

An understanding of the subtle differences between ethics, law, morality and values is a good starting point for today's discussion. According to the advocate, ethics and values are not the same; nor are ethics and law. "Values are basic, fundamental beliefs that guide or motivate actions or attitudes; they are concerned with how a person behaves in certain situations and are based on personal beliefs that may or may not be ethical," he said. "Ethics is concerned with how a moral person should behave in order to be considered ethical." In the law-abiding context, he explained that while ethical people strive to be law-abiding, there are instances where a sense of ethics may supersede the law.

To explain away the next ethics-related misconception, the discussion unpacked the phrases 'ethical relativism' versus 'situation ethics'. The former phrase, explained Dijkman, "is a philosophical view that what is right or wrong and good or bad is not absolute, but variable and relative according to the situation, person or circumstances". In colloquial English, you might say 'when in Rome, do as the Romans' to explain different cultural approaches to ethics. This philosophical view is rejected by most ethicists who hold that notwithstanding different cultures, fundamental moral principles apply universally.

Ethics in business

Situation ethics is described variously as evaluating the morality of an action based on context and likely outcomes, with its practitioners arguing that what is right depends on the situation rather than fixed rules. It would appear that many South Africans struggle with this concept, using situation ethics to justify their behaviour when paying bribes for road traffic offences or to facilitate business transactions. Redirecting the conversation towards ethics in business, the advocate noted that "the extent to which ethics is embraced within a business affects both the perceptions of its stakeholders and the performance of the business; the confidence of investors in organisations; the loyalty of customers to companies; and the willingness of talented individuals to offer their skills to the organisation".

If only it were this 'cut and dried'. In reality, there are many schools of thought on the integration of ethics in the business world. Dijkman noted that despite ethics being prominent in the modern business environment, there are many who argue that the very nature of capitalism excludes a concern for ethics. "There are those who do not regard capitalism as excluding ethics but are nevertheless sceptical about being able to run a financially successful business whilst adhering to decent, ethical standards," he said, before singling out six ethics-related myths that are blighting the 21st-century business landscape.

Debunking those pesky ethics-related myths

The first myth was introduced as dog-eat-dog in acknowledgment that the business environment is hostile. "You need to trample on others or be trampled yourself, and it is a sign of weakness to take the interests of others into consideration when weighing up matters of business," the presenter said. The truth is that businesses are relational and social and that "a balancing of interests" is necessary to achieve sustainable success. Enter the second myth, survival of the fittest, which holds that only the toughest will survive in a competitive environment. The advocate contended that instead of ‘win at all costs’ business should strive to be competitive within the rules. “There is nothing wrong with healthy competition as it can improve the quality of the product or service being provided,” Dijkman said, before shining a spotlight on the third myth, being that unethical conduct is not serious. Here the argument goes that “although unethical conduct is wrong, it is not really harmful to society and may even benefit society by a redistribution of wealth or stimulation of economic growth ... [in addition] it does not lead to a loss of life”. The ‘does no harm’ argument was quickly dispelled with reference to the financial and personal hardships in the wake of South Africa’s Fidentia, Masterbond, Steinhoff and BHI Trust scandals.

The fourth myth returned the audience to the ‘when in Rome’ argument that it is counterproductive to push against the tide of unethical behaviour. “If unethical behaviour in business is the norm, simply accept this as the way business must be done; one person’s efforts will not make a difference,” Dijkman offered, playing devil’s advocate for a second. He suggested that ‘going with the flow’ often appealed to our senses of accepting the will of the majority before countering that the majority does not always know best. “Just because the majority is doing it does not make it right,” he said.

Should we forget the bottom line?

The fifth and sixth myths, being ‘all that matters is the bottom line’ and ‘nice people come second’ were easily countered too. It is a myth that business is only about profit and that anything that impacts positively on the bottom line should be encouraged and all else discarded, the presenter fumed. Yes, your business must make a profit; but profit cannot be its sole purpose. “To operate as a legitimate business, a company must be seen to be providing products and services that are not harmful to society; a narrow financial focus can harm a business; and by only focusing on [profit you risk] devaluing all the other values of your business,” Dijkman said.

Being ethical is not easy, and being committed to your values takes moral strength. “Business ethics might come at a price; but recent studies are beginning to show that ethics is a prerequisite for sustained success [and] that more and more investors are choosing ethical companies to invest in and avoiding those perceived as unethical, or involved in unacceptable activities,” he said. When your business needs to make an ethical decision, he suggested asking: Is it legal? Does it meet company standards? Is it fair to all stakeholders? And can the decision be disclosed? For a fitting conclusion, the audience was left with words by businessman, philanthropist and self-help book author W. Clement Stone who said: “Have the courage to say no, have the courage to face the truth. Do the right thing because it is right. These are the magic keys to living your life with integrity.”

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Still 'early stage' of UK efforts to tap pension pots for growth

LONDON, July 30 (Reuters) - Progress on boosting UK growth by channelling private pension cash into unlisted companies is being hampered by barriers that need removing, a first annual update, opens new tab showed on Tuesday. Last July, then finance minister Jeremy Hunt said that under the 'Mansion House Compact' (MHC) nine insurers and pension funds would voluntarily commit to investing 5% of their direct contribution (DC) pension schemes in unlisted companies by 2030, a total of around 50 billion pounds ($64.29 billion).

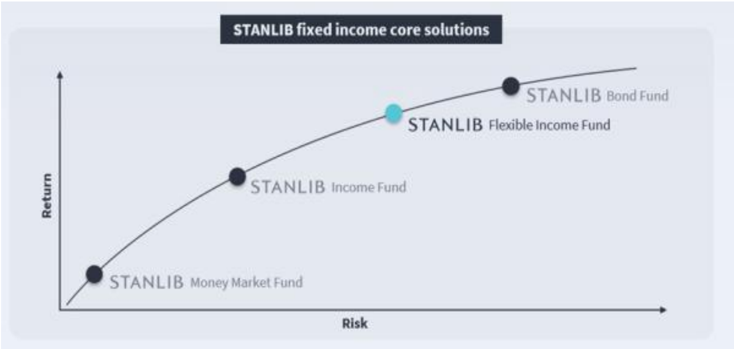
Less than 1% of cash was invested in unlisted equity at that time.
The Association of British Insurers (ABI), charged with keeping track of progress in collaboration with the City of London, said on Tuesday the total was 0.36% by February, the basis for measuring progress in future years, given it was still 'early stage'. The ABI said signatories, which now total 11 and include Aegon, Aviva, Legal & General, NEST, Phoenix and NatWest Cushon, currently hold 793 million pounds in unlisted equity assets in their DC schemes, out of a total of 219 billion pounds of assets. "More investment in unlisted equity has been committed and is expected to grow," the ABI said in its report.

The new Labour government elected this month, which said on Monday it faces a 22 billion pound overspend in the country's finances, has backed the compact, and launched a review of pensions in a bid to increase private investment. The ABI said signatories are putting in place expertise, setting up Long Term Asset Funds, undertaking research, and making other preparations to invest more in unlisted equity. L&G launched a fund this month for DC savers, and Aegon announced in June plans to introduce private market investment into its largest workplace default fund from the third quarter. Signatories said a key barrier is the focus among fund trustees and their consultants on costs of schemes rather than longer-term value. It was "absolutely essential" therefore to get the planned 'value for money' framework right, the ABI said.

Reuters | 30 July 2024

Multi-asset income funds: more return for less volatility

Dramatic volatility in bonds and equities in the past five years has given investors looking for stable income and capital growth many sleepless nights. Investors in a well-managed multi-asset income fund would have slept a lot more soundly. The efficient frontier, which maps the highest level of achievable returns against the risk incurred, is lowest for money market funds, in the middle for income funds and is highest for bond funds. A multi-asset income fund can hold assets from all three types of funds.29 July 2024



The reason this is important is that over the past five years cash has delivered smooth and steady returns through various crises, e.g. SA's credit rating downgrade and Covid, but it is not the best asset to hold in a falling interest rate environment. The return from bonds has been higher, but with significant volatility. Managers of multi-asset income funds are able to actively shift between different fixed income asset classes and property, to deliver a smoother return profile, at lower risk. With interest rate cuts on the horizon, it might be prudent to step up from an income fund or cash to a multi-asset income fund. If SA enjoys a structural shift in its economy under the new Government of National Unity (GNU), the effect will be to lift every asset class except cash.

The STANLIB Flexible Income Fund currently holds 62.4% of its assets in bonds, 21.9% in credit, 2.5% in cash, 5% in property, 4.9% in offshore bonds and 3.3% in offshore property (as at 26 June 2024). Between March and May, ahead of SA's National Election, the fund held some dollars in the event the outcome was negative for markets, but by end-June the fund held no dollars. In May the managers took further precautions, by reducing holdings of both nominal bonds and credit and increasing cash. By end-June, the fund had reverted to higher-returning asset classes. The managers have also invested again in property, on which they realized profits for the fund earlier in the year, as they believe that in a more positive economic environment property will appreciate.

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National Savings month: Mastering compound interest: everyone's financial superpower

As we enter the final week of National Savings Month, it's an opportune time to highlight the power of compound interest, a cornerstone of long-term financial growth. Warren Buffett famously described compound interest as the "eighth wonder of the world." His wealth, largely accumulated after his 50th birthday, underscores the transformative power of time and patience in investing. The secret? Start early, invest consistently, and allow compound interest to work over time. As Buffett himself noted, "My life has been a product of compound interest." Theodore Johnson's journey illustrates the power of compound interest. Starting with the United Parcel Service in 1924, Johnson never earned more than $14,000 annually. However, he implemented a simple but effective strategy: setting aside 20% of his pay check and Christmas bonuses to purchase UPS shares. Consistently investing a portion of his income, Johnson capitalised on the magic of compounding. Over time, his investment grew significantly, reaching a value of over $70 million by age 90.

So, what is compound interest?

It occurs when the interest you earn on your principal is reinvested, allowing you to earn interest on the new total. This "interest on interest" creates a snowball effect, significantly increasing your investment's value over time. For example, if you invest R10,000 at a 10% annual return, you'll have R11,000 after the first year. This R1,000 gain is simple interest. However, if you reinvest the interest, the next year's calculation will be on R11,000, leading to a greater total. After two years, your investment grows to R12,100, thanks to the power of compounding. The power of compounding becomes more significant with larger amounts. For instance, a 10% return on R10,000 is R1,000, but the same percentage on R100,000 yields R10,000. The more you invest, the greater the impact of compound interest. Consider this: if Investor A invests R2,000 per month from age 25 for 40 years at a 10% annual return, the investment grows to R12,879,287.82. Notably, the investment earns R1,194,844.35 in the final year alone, demonstrating the exponential growth compounding provides. As Charlie Munger advised, "The first rule of compounding: Never interrupt it unnecessarily."

Starting early is crucial

Comparing two investors highlights this: Investor A, who saves R2,000 monthly from age 25 for 10 years, ends up with R12,879,287.82 by age 65. Meanwhile, Investor B, who starts saving at age 35 and saves for 30 years, ends up with R4,803,306.42. Despite contributing more in total, Investor B's later start results in a smaller final amount, illustrating the advantage of starting early.

Why don't more people harness compound interest?

Many fail to do so due to a lack of planning, often withdrawing investments prematurely for emergencies or other needs. Additionally, debt mismanagement can negate the benefits of compound interest, as it also works against you by compounding debt. Impatience and reacting to short-term market fluctuations can disrupt the compounding process, leading to suboptimal returns.

Compound Interest Tips:

1. Start Early: The earlier you start investing, the more time your money has to grow.
2. Be Consistent: Regular contributions to your investment can significantly enhance the compounding effect.
3. Reinvest Earnings: Ensure that any interest or dividends earned are reinvested to maximize growth.
4. Avoid Unnecessary Withdrawals: Keep your investments intact to benefit fully from compounding.
5. Pay Off Debt: Manage and reduce debt, as interest on debt compounds just like investment interest, but works against you.

Harnessing the power of compound interest is straightforward yet requires discipline. By eliminating debt, starting to invest early, and remaining invested for the long term, you can maximize the benefits of compounding. This National Savings Month, commit to understanding and leveraging compound interest to secure your financial future.

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