THURSDAY, 15 OCTOBER 2020

irfa dispatch

THE RETIREMENT INDUSTRY NEWSLETTER

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National Treasury confirms emigrant retirement 3 year capture

South Africans who have emigrated or plan to permanently leave South Africa have until 28 February 2021, just over four months from now, to effect financial emigration. National Treasury has laid down the new law and made it clear - the consequence otherwise is your retirement money will be locked in for three years, you are not allowed to touch it, and best apply it to your personal circumstances. On Tuesday 13 October 2020 in Parliament, National Treasury ("Treasury") and SARS presented to the Standing Committee on Finance on a number of proposed amendments to legislation, which amongst others, would directly affect South Africans who have already moved abroad, or are planning on moving abroad. The feedback to stakeholders, specifically around the withdrawal of retirement funds upon financial emigration, was certainly one which was foreseen after it was proposed in the draft Taxation Laws Amendment Bill ("TLAB") in July 2020.

Retirement Fund Lock-in Confirmed

As proposed in the draft TLAB, Treasury would be changing rules around financial emigration and the ability to withdraw one's retirement funds, upon the conclusion thereof, replacing it with a new 3 year lock-in. Treasury has confirmed, despite the arguments from stakeholders, including written and oral submissions from Tax Consulting SA, that the 3 year lock-in will be implemented from 1 March 2021. Treasury stated, "*The 3-year rule is a mechanism to ensure that there is a sufficient lapse of time for all emigration processes to have been completed with certainty*." Consequently, from the effective date of the proposed amendments, one will need to be able to prove under both South African residency tests that they are non-resident for a period of 3 consecutive years, post 1 March 2021, before they will be allowed to withdraw these funds from South Africa.

"Modernisation" or Something More Sinister

Ever since the announcement of a changed financial emigration process in the February 2020 Budget Speech, the comments from Treasury have been that the system is being "modernised". A term which has yet to be fleshed out by Treasury, with only simple explanations that provide no sense of understanding, such as, "*One of the main objectives of the reform is to modernise the capital flow oversight system in a manner that balances the benefits and risks*…".

With the various submissions made by stakeholders on the issues foreseen with the proposed changes, Treasury provided little feedback on the important issues raised, often providing no explanation but for a one sentence response. Government's unwillingness to budge on the lock-in, incites fears of the looming worries of taxpayer's retirement funds falling into the hands of government to fund social infrastructure in SA, changes to Regulation 28 and perhaps even an easy target for higher taxes on pensions or a wealth tax. This concern was brought up by National Treasury previously, where it was denied that the so-called "modernisation" and lock-in had any link to this possibility. However, with the unwavering determination to lock-in retirement funds from 1 March 2021, this becomes less believable. There is clearly a massive downside to anyone having their retirement funding captured in a system; so the question remains unanswered what corresponding benefit National Treasury plans to achieve by keeping retirement under state control.

Treasury Provides A Small Window

For those South Africans who heeded the call to formalise their affairs by financially emigrating, the opportunity to withdraw retirement funds remains, and there is still time to do so. For those who decided against this, Treasury has announced that those who still intend to financially emigrate may do so, however they require that, "*complete applications [must be] received by the SARB before 1 March 2021*…" If complete applications are received by this deadline, they "*will be finalised through the existing process*."

Treasury noted specifically that, "*The amended provision will apply to all cases that meet the requirements on or after 1 March 2021*."

FA News | 14 October 2020

Verdict on retirement fund withdrawal coming soon

The time for South Africans who consider emigrating to learn their fate around their pensions is drawing closer. We have come a long way since publication of the draft tax Bills on 31 July this year, and on 7 October 2020, the Standing Committee on Finance ("the Committee") heard oral submissions on the proposed tax amendments. As one of the few tax firms who made oral submissions to Parliament, we can confirm the most debated amendment remains the one around government's intention to impose a three-year lock-in period on retirement funds when a person emigrates.

Background

In the February Budget Speech, government announced it will modernise the exchange control system and as a by-product thereof, the current process of emigration through the South African Reserve Bank ("SARB") will be phased out. The announcement was profound from a tax perspective because this emigration process (commonly referred to as "financial emigration") is the trigger for emigrating South Africans to withdraw their retirement funds. True to their word, when the draft tax Bills were published, it was revealed that the withdrawal of retirement funds upon emigration will be subject to a new test. It is now proposed that a person will only be permitted to withdraw their retirement fund if they can prove they have not been tax resident in South Africa for at least three years. This immersed prospective emigrants in uncertainty.

Key issues

The proposed amendment was met with immediate opposition. Before anything else, the recent murmurs of "prescribed assets" raised questions on the motive behind the lock-in period. But National Treasury has given its assurance that this is not the driver behind the amendment. National Treasury and the Committee have mostly kept their cards close to their chest, but we have learned that the reason behind the three-year lock in is to prevent cases where individuals withdraw their retirement fund under the pretences of emigration, only to return to South Africa shortly after.

The validity of this argument is questionable, but the real problems lay with the new proposed test itself. Determining residency is not a tick box exercise and considering the burden of proof rests with the taxpayer, the question is what will be accepted as proof of cessation of residency? On the other hand, with the SARB now taking up to a year to conclude the financial emigration process, will taxpayers who initiated the process prior to the effective date of 1 March 2021 be permitted to withdraw their retirement fund under the old dispensation?

When will we know?

Thus far stakeholders have raised their concerns in written submissions to National Treasury, which was followed by a public workshop. Now these issues have been ventilated in Parliament but, to date, we are still not sure if our concerns will be taken to heart. Fortunately, National Treasury will publish their official response document on 13 October 2020, at which point we should know where the amendment is headed – watch this space.

FA News | 9 October 2020

Beware the pension fund loan proposal

A private member's Bill proposed by Democratic Alliance MP Dion George would amend the Pension Fund Act to enable fund holders to get a percentage of their pension fund before they retire as a guarantee for a loan. But experts in the industry say the proposal could spell doom for fund holders who choose to get the funds, because they will be required to spend more paying off the debt rather than saving for retirement. The Act allows fund holders to use a portion of their savings as a guarantee for a loan, but it is restricted to loans related to immovable property.

In an explanatory memorandum, George said the proposed amendment would ease restrictions to allow members to access up to 75% of their funds to alleviate financial strain "during the Covid-19 emergency or any other emergency similar". But, according to Mica Townsend, the business development manager at 10X Investments, many South Africans are already reaching retirement age with insufficient savings and, should the Private Member's Bill become law, even more people could find themselves at risk. According to the 10X retirement reality report released last year, only 6% of South Africans had enough savings to retire comfortably. One of the key issues highlighted in the report shows that consumers are facing mounting pressure and that is preventing them from being able to save enough to see them through retirement. "The danger is that this amendment would give retirement savers another way to prioritise today's needs at the expense of their much older — and likely more vulnerable — selves," Townsend said. In addition, many people choose to cash in their savings when they leave their jobs, and the loans would have to be settled.

If people are given another way [through the Bill] to get their funds, it will probably "make this phenomenon even worse, because you will now have more people accessing their savings earlier rather than being incentivised to keep it untouched until they reach retirement," Townsend said. Michael Prinsloo, the head of products at Alexander Forbes, said the wording in the Bill — "emergency similar to Covid-19" — was too broad and could be exploited. Fund holders could use retirement savings for consumption purposes or debt repayment instead of in an investment.

Giving credit through pension-backed loans to "individuals who are unable to repay their debts any other way" would amount to reckless lending, he said. No study has been undertaken to show that the benefits proposed by the Private Member's Bill would be worth the costs that will be incurred. Prinsloo said that to judge whether the pension-backed loans could be fair, various conditions would have to be met, including analysing the number of people who could benefit and ensuring fund holders would be able to repay the loans.

In addition, administrators of the funds would have to assess whether the loans would be the best possible solution to get credit in a time of crisis. "We don't know what those [pension-backed] loans could look like to judge whether or not they could be fair," he said. People should save enough to receive a substantial post-retirement income of about 75% a year of their final annual salary if they are to maintain their standard of living during retirement, said Anne-Marie D'Alton, the chief executive officer Council of Retirement Funds for South Africa.

If these savings are tampered with during the period of employment, it could reduce the amount of savings at the time of retirement. "Using retirement savings as a 'piggy bank' should be carefully considered in addressing the need for emergency funding and potential hardships during old age," she said. Covid-19 has battered the economy, leaving millions of South Africans either unemployed or with significantly reduced incomes. Data from the National Credit Regulator released this week showed that lenders rejected 67% of applications received during the second quarter of 2020. This is the highest number of rejections recorded by the regulator.

The period also coincided with the implementation of the hard lockdown, which prevented consumers from shopping for higher-end goods. The hard lockdown also showed the country's workforce decreased by 2.2-million, according to the latest unemployment figures from Statistics South Africa. George said the amendments would alleviate the financial strain on households. The pandemic presented a unique opportunity to "do things differently" and that included how people received credit. At the heart of his proposal, he said, was choice and opportunity. “This is not a silver bullet to solve every personal financial crisis. It is enabling legislation that would give members the option to decide how best to navigate their financial futures,” he said.

Mail & Guardian | 11 October 2020

Five things to watch out for in the medium-term budget

We expect real growth to average -0.8% between 2020 and 2023 vs Treasury’s June forecast of -0.4%: Momentum Investments

1. Post-pandemic nominal growth expectations

The loss in momentum behind growth to 1.2% in the past decade from 3.5% in the previous decade reflects chronic policy uncertainty, stretched government finances, infrastructure constraints and dwindling confidence.

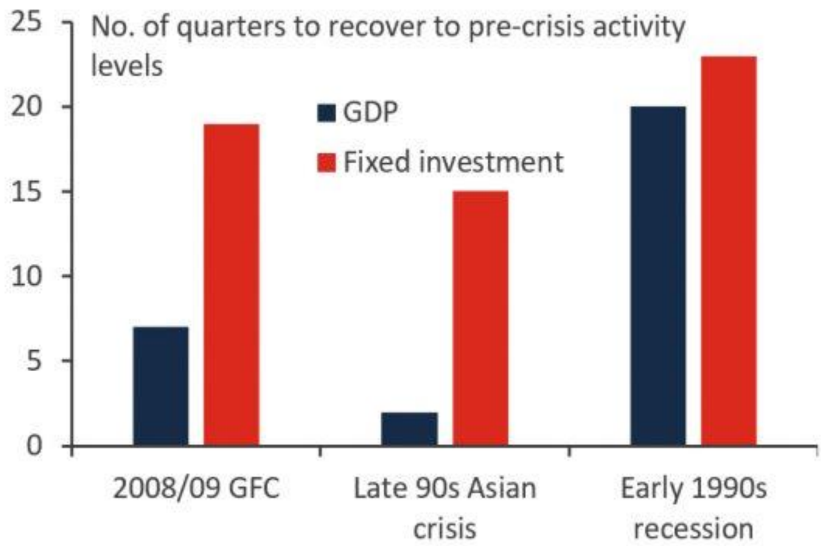
Sentiment remains in the doldrums

Source: Bureau of Economic Research, Momentum Investments

The growth contribution from fixed investment to overall GDP has waned during the past 10 years, slipping from 19.5% a decade ago to 17.2% in the second quarter of 2020. A reluctance to invest in the SA economy, given concerns about insufficient levels of demand and uncertainty about the political climate, has left growth in private fixed investment at a paltry rate of 0.4% on average for the past 10 years relative to 7.2% in the previous 10-year period (which had included a construction works-related investment boom in the run-up to the 2010 FIFA World Cup).

Considering that it typically takes fixed investment spend longer than overall GDP to recover to pre-crisis levels (see chart below), we cannot rely on growth in fixed investment alone to yank the economy out of its growth slump. Incremental progress on the implementation of economic and regulatory reforms should see local sentiment levels edge higher from a gloomy base in the coming years, but no quick turnaround is projected in our view until the crisis in confidence can be adequately addressed.

Protracted recovery to pre-crisis levels



Source: BNP Paribas, Momentum Investments

Heightened consumer and business stress in SA has been exacerbated by the seventh most stringent lockdown restrictions in the world and this should keep a lid on growth prospects in the medium term. Moreover, export growth is unlikely to strengthen significantly given that the wind has been taken out of the sails of globalisation by unfavourable trade developments between the United States and China (even prior to the pandemic) and the souring of the global attitude towards trade interlinkages, thanks to the pandemic and the associated lockdowns which accentuated supply chain dependencies. **Full Report:** ***https://www.moneyweb.co.za/in-depth/budget/nine-things-to-watch-out-for-in-the-medium-term-budget/***

Moneyweb| 14 October 2020

INTERNATIONAL NEWS

Managing retirement funds means prioritizing their growth, not social activism

The U.S. currently allows managers of ERISA retirement plans to participate in shareholder votes without considering the interests of the employees and retirees they represent. That is the issue that the Department of Labor is trying to address now. A new regulation proposed by the agency will protect workers' interests, and it is crucial that this proposal succeed in an era in which a culture of social and environmental activism has overtaken boardrooms and investment decisions. This proposed rule would impact about $2.1 trillion worth of retirement funds in 29,000 defined contribution plans and 5,500 defined benefit plans. Currently, the managers of these plans are able to vote in shareholder elections without consideration for the financial well-being of the plans they manage and the workers whose money they manage.

ERISA plan managers can robo-vote, or vote blindly in alignment with the recommendations of third-party proxy advisers. In other words, they are permitted to take the easy way out, but when they robo-vote, they are assigning their power and neglecting their duty. America's workers and retirees deserve better. This regulation is particularly important in today's age of heightened political and social pressure to believe and act one way or another. Political and even moral concerns do not protect the retirements of America's workers.

There is a movement in investing that values amorphous environmental and social goals — often at the exclusion of the goal of financial gain. It's fine for an ERISA plan manager to prioritize environmental or social goals with his or her own investment, but it's not fine if the manager does that with others' retirement money. Take, for example, the trend for environmental activism in business and investment decisions. European energy giants such as Shell and BP are shifting strategy to focus on renewables and move away from the legacy money-maker, oil. To do this, they argue that the change is best for the company's profitability. But is it? Exxon, Chevron and oil companies the world over disagree.

When it comes to the opportunity for shareholders to participate in corporate strategy and governance through shareholder votes, it would be irresponsible for ERISA plan managers to simply robo-vote in line with a move away from oil. It would be irresponsible to choose alternative energies over oil because that is the trendy decision, or the manager believes it is the moral decision. In this new investing environment, safeguards must be put in place to ensure that those managing the retirement funds of Americans are prioritizing the protection and growth of those funds. Too many recommendations by proxy advisers are not in the best interest of the ERISA plan beneficiaries, the workers and retirees.

That is why the managers should not be allowed to blindly rubber stamp the proxy adviser recommendation with a robo-vote. The regulation under consideration by the Labor Department would ensure that managers investigate votes, determine what they believe is in the best financial interest of the beneficiaries and maintain records showing their determination process. This protects beneficiaries' interests from managers who might otherwise prioritize something other than the pecuniary health of the funds. Moreover, the proposed regulation would finally clarify that a manager may decide to abstain from voting if, for example, the plan owns only a small percentage of shares in a firm or if investigating the vote is more costly than the financial benefit of a decision.

For several years, ERISA plan managers have believed they might be required to participate in every shareholder vote. Because it takes time and expense to investigate each vote, some managers have simply robo-voted in accordance with the recommendations of proxy advisors. This can lead to voting against the financial interests of the plan beneficiaries. For example, robo-voting could lead to votes in favor of environmental or social or other priorities that the manager would not deem independently beneficial to financial outcome. If your retirement money is at stake, you probably want to be sure those managing it are doing everything they can to protect it and help it grow.

That includes how managers handle shareholder proxy votes. You want to make sure they are voting for the right board members who will pursue the best vision for the investment, and the right strategies that will maximize the investment. At least, you want to be assured that those managing your money are reasonably making decisions on those matters based on financial considerations. You do not want them robo-voting. You do not want them basing decisions on non-pecuniary considerations such as their personal morals, which may differ from yours. If you worked hard for that retirement money, you want it to be protected. That is what this proposed regulation would do.

The Hill | 8 October 2020

401(k) Fees are eating your retirement savings

Reform could put billions into the pockets of American savers.

Half of Americans aren't saving enough for retirement. Blame for this problem is usually pinned on some combination of low wages or irresponsible choices, but there's another culprit: an expensive and antiquated 401(k) system. Reforming it could put billions more dollars into savers' pockets. Our current system favors costly middlemen in ways that were perhaps necessary when 401(k)s were first established 40 years ago, but are largely superfluous today. Consider that by various estimates, the average fees levied on 401(k) savings hover in the range of 0.5% annually, with much higher costs for small employers. That compares to annual expenses well under 0.1%, and often near zero, offered by widely available stock and bond index funds and ETFs in many flavors and stripes outside of 401(k)s.

That excess cost — roughly 0.4% annually — may not sound like much. But for a worker who dutifully puts $10,000 a year for 40 years into a portfolio that earns 6% annually, the difference in final savings can be north of $150,000 — greater than 10% of the end sum. With more than $5.5 trillion invested in 401(k) plans, cutting costs to savers by even 0.4% would add more than $20 billion annually to the nest eggs of American workers. I recently got a glimpse of the damage that expensive fund offerings can do to 401(k) savers. A close friend asked me to look at the plan he's been investing in for 20 years. Instead of cheap index funds, the plan offers a menu of high-priced (and underperforming) actively managed vehicles. Its only index-tracking choices are expensive "collective investment trusts" costing about 0.5% more than index mutual funds and ETFs.

Even more outrageous? The trusts allow their sponsor to make even more money by lending out the securities that it holds. Over two decades, the excess fees have likely cost him about $25,000, or about 5% of his $500,000 retirement stash. Any of his colleagues who invested in the active funds gave up significantly more — thanks to higher fees and worse performance. To cut costs and ensure that workers retain every penny of their 401(k) savings, policy makers should simply eliminate 401(k) intermediaries. Let American workers save for retirement using their choice of designated, IRA-like accounts offering the same, cheap index-tracking funds and ETFs available outside of retirement plans. All the other incentives that encourage Americans to save through their 401(k)s could be maintained, including preferential tax status, employer matching contributions and enrolling employees by default. Depending on how heavy a regulatory hand one prefers, retirement accounts could even be required to hold a diversified portfolio to qualify for tax benefits and employer matching. There's plenty of precedent for a better, cheaper approach to saving. For example, take the 529 plans sponsored by states. New York's 529 plan offers a range of index and age-based fund choices, many with expenses as low as 0.13%.

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