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Institute of Retirement Funds Africa

THE RETIREMENT INDUSTRY NEWSLETTER

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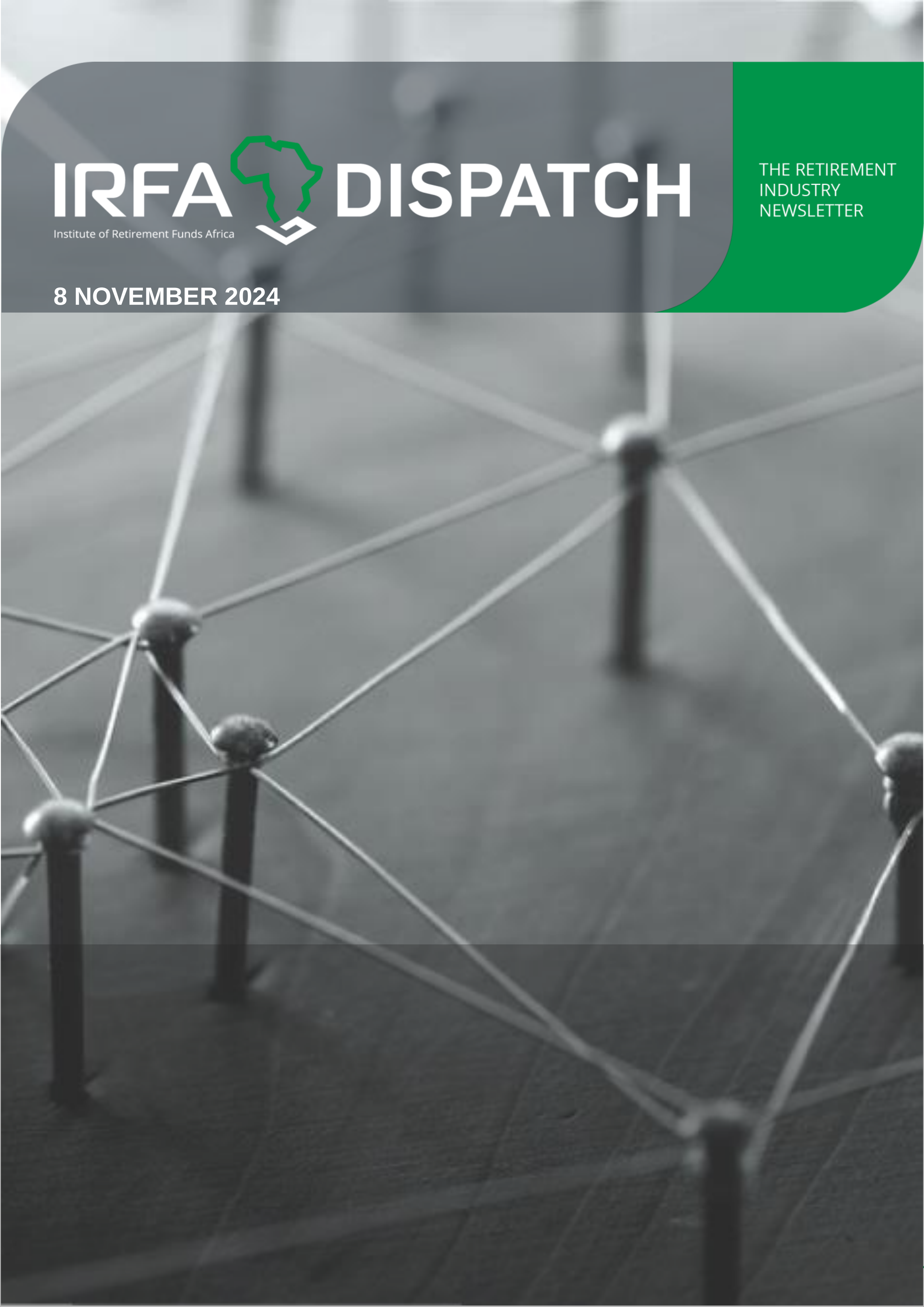

Table of Content

LOCAL NEWS

INTERNATIONAL NEWS

OUT OF INTEREST NEWS

Unclaimed Benefits and the 'Two-Pot' System: A Powerful Economic Stimulus

A substantial amount of wealth is either locked away in retirement funds or sits dormant in unclaimed benefits, these assets represent a missed opportunity for economic growth and individual financial empowerment. Transformation within the Retirement Industry can be the ultimate stimulus to the South African economy. The introduction of the “two-pot” system is the beginning of this transformation. According to the Special Occasional Bulletin of Economic Notes published by SARB in August 2024, the “two-pot” system is set to release billions into the economy. The publication estimates that if citizens act prudently up to R40 billion is expected to be withdrawn from pension funds in the 4th quarter of 2024. This withdrawal rate is projected to halve and be spread over the full year in 2025 and 2026. This results in South Africans having an additional R31 billion in disposable income for last quarter of 2024 and approximately R16 billion in each of the follow two years.

In parallel with the implementation of the "two-pot" system, the Financial Sector Conduct Authority (FSCA) and National Treasury have once again highlighted the issue of Unclaimed Benefits in South Africa. Reports indicate that Unclaimed Benefits have reached an alarming total of R90 billion, with R48 billion of this amount remaining unclaimed in Pension and Provident Funds owing to a near 4.5 million members. These funds constitute a substantial financial resource that, if returned to their rightful owners, could transform lives, provide a significant boost to the economy, and generate millions in tax revenue, much like the "two-pot" system. Unclaimed benefits refer to funds that belong to individuals which have remained unclaimed, often due to a lack of awareness, outdated contact information or administrative issues. Tracing beneficiaries is largely a manual process which is plagued by inefficacies and credibly challenges.

FinTech startup, Robin Hood in pilot partnership with Standard Bank’s OneHub has developed an innovative solution to reunite citizens with their unclaimed benefits. According to Rowan Gordon, CEO of Robin Hood, “Unclaimed benefits have reached this magnitude due to a lack of investment in technology to deal with both the tracing of individuals and then administrative tasks required to make payments. We have built new digital solutions to solve this societal problem. We look forward to returning money to citizens and benefiting the economy.”. In a nation grappling with poverty and unemployment, unlocking these funds can empower citizens to invest in education, launch businesses, enhance their financial stability, and serve as a catalyst for a stronger, more resilient economy.

FA News | 7 November 2024

Are there tax-free investment options when drawing my RA at retirement?

There are no utterly tax-free investment options, but you can use a combination of strategies to minimise your overall tax burden As a 64-year-old retiring next year, are there tax-free investment options available when withdrawing from my retirement annuity to help reduce Sars taxes?

Dear reader,

When drawing from your retirement annuity (RA) at retirement, you can use a few strategies and tax-efficient options to minimise or defer your tax liabilities. While there isn't a way to eliminate all taxes, a few methods exist to optimise your withdrawals and use tax-free or tax-efficient investment vehicles for subsequent growth. Let's break down these strategies:

1. Understanding the tax-free portion at retirement

Upon retirement, you can take a portion of your RA as a lump sum, and the rest must be used to purchase an annuity that will provide you with a regular income.

Lump sum withdrawal at retirement:

The first R550 000 of your lump sum withdrawal is tax-free. This is applicable if you haven't previously utilised this tax-free amount in any other retirement withdrawal (e.g., withdrawals from a provident or pension fund).

Tax on lump sum withdrawals (2024 table):

- R0 – R550 000: 0% (tax-free);
- R550 001 – R770 000: 18%;
- R770 001 – R1 155 000: 27%; and
- Above R1 155 001: 36%.

2. How to maximise tax-free amounts and minimise Sars taxes

To minimise taxes when withdrawing from your RA, you can:

- *Use the tax-free lump sum efficiently:* Take advantage of the R550 000 tax-free portion. You can withdraw the entire amount tax-free if your RA is relatively small and within the de minimis threshold (R247 500 or less).
- *Avoid excessive lump sum withdrawals:* Any amount above R550 000 will be subject to tax, so consider withdrawing only up to R550 000 as a lump sum and using the remainder to purchase a living annuity or other tax-efficient investments.

3. Tax-free and tax-efficient investment options after RA withdrawal

Once you have withdrawn from your RA, you can reinvest the proceeds in other tax-efficient vehicles:

a) Tax-free savings account (TFSA)

- You can invest up to R36 000 annually (as of 2024) in a TFSA with a lifetime limit of R500 000. All growth within a TFSA is tax-free – this includes interest, dividends, and capital gains.

- While the contribution limits are relatively low compared to your expected lump sum withdrawal, it is an excellent way to reinvest a portion of your tax-free amount for additional growth.

b) RA rollover to a living annuity

- If you use your RA to purchase a living annuity, any growth within the living annuity is tax-free. This means no tax on interest, dividends, or capital gains while the funds are invested in the annuity.
- You only pay tax on the income you draw from the living annuity, and you can control the drawdown rate (between 2.5% and 17.5%), allowing for tax-efficient income management.

c) Reinvesting in discretionary investments

- After withdrawing the lump sum, you can reinvest the amount in discretionary investments, such as unit trusts or balanced funds. While these investments are subject to tax, you can reduce the impact by structuring withdrawals to stay within lower tax brackets and utilising capital gains tax exclusions.

d) Endowment policies

- If you are in a high-income tax bracket, endowment policies can be tax-efficient investment vehicles. The tax within the policy is levied at a flat rate of 30% on interest income and 12% on capital gains, which may be lower than your marginal tax rate.
- Endowment policies also benefit from protecting your investment from creditors and estate duty, making them suitable for legacy planning.

4. Strategies for minimising tax on RA withdrawals and subsequent investments

Strategy 1: Partial lump sum withdrawal

- Withdraw only R550 000 as a lump sum to maximise the tax-free portion.
- Purchase a living annuity with the remaining funds to benefit from tax-free growth within the annuity and control your income drawdown.

Strategy 2: Living annuity with a low drawdown rate

- Choosing a living annuity with a low drawdown rate (e.g. 2.5%) minimises the taxable income while allowing your funds to grow within the annuity tax-free.

Strategy 3: Reinvestment into a TFSA and balanced fund

- Use the lump sum (up to R550 000) to maximise your annual TFSA contributions.
- Invest any additional lump sum in a balanced fund within a discretionary account, taking advantage of the annual capital gains tax exclusion (R40 000 per year as of 2024)

5. Example scenario: Applying the strategy

Let’s assume your total RA value is R2 million at retirement.

1. *Take R550 000 as a tax-free lump sum:* You can take R550 000 tax-free, leaving you with R1.45 million to invest in a living annuity.
2. *Invest the R550 000 in a TFSA and balanced fund:* Contribute R36 000 to a TFSA. Invest the remaining R514 000 in a balanced fund, generating growth with potential tax efficiency.
3. *Purchase a living annuity with R1.45 million:* Set the drawdown rate at a conservative 3% (R43 500 annually), which may fall within a lower tax bracket, reducing the overall tax burden.

4. *Manage withdrawals for tax efficiency:* Use TFSA withdrawals for tax-free income and draw only the minimum required amount from the living annuity to keep your taxable income low.

6. Conclusion: Choosing the right strategy

While there are no utterly tax-free investment options when drawing from an RA at retirement, you can use a combination of strategies to minimise your overall tax burden:

- Maximise the R550 000 tax-free lump sum and reinvest it in a TFSA and other tax-efficient vehicles.
- Use a living annuity to benefit from tax-free growth on the remaining retirement savings and control your taxable income through a low drawdown rate.
- Consider discretionary investments or endowment policies for additional growth while maintaining flexibility and tax efficiency.

Implementing these strategies can reduce your tax liability and optimise the post-retirement growth of your savings. Consult a qualified financial planner to ensure your plan is implemented as intended.

Moneyweb | 6 November 2024

A new dawn for legacy retirement annuities: Reduced penalties … should you move?

While the reduction of penalties is a positive development, it is essential to carefully consider a few factors before deciding. Legacy retirement annuities (RAs) are retirement annuities that were issued before 2005. These older RAs often come with certain restrictions and penalties that can hinder investment growth and flexibility. Investors were "forced" to remain invested in these products because of the high penalties imposed.

The good news: Reduced penalties and enhanced flexibility

A significant change in South Africa's retirement landscape has opened up new possibilities for investors with legacy RAs. These amendments have resulted in a decrease in penalties associated with premature transfer-outs or discontinuation of regular contributions. This means that investors can now move their legacy RA funds to more modern and potentially higher-performing investment portfolios with greater ease. The previously allowed penalty was up to a maximum of 30%. Now, it has been reduced to 10% and will be further reduced to 5%. There will be a 1% reduction per annum until 2028.In addition to the reduced penalties, the new regulations under the two-pot system also offer enhanced flexibility for investors. For example, you may now be able to access a portion of your RA funds earlier than previously allowed, subject to certain conditions. This can be particularly beneficial if you experience financial hardship or have unexpected expenses. Over the years, the process of transferring RAs has been simplified. This means that you can more easily take advantage of the benefits of modern RAs, such as lower fees, a wider range of investment options, and improved performance.

Why consider a transfer?

- **Enhanced investment flexibility:** Modern RAs offer a wider range of investment funds, allowing you to tailor your portfolio within the rules of Regulation 28. Regular contributions can also be stopped and implemented without incurring any penalties.
- **Lower costs:** Newer RAs often have lower fees, which can significantly impact your long-term returns.
- **Improved performance:** By transferring to a better-performing, more flexible RA, you can potentially increase your retirement savings over time.

Key considerations before transferring:

While the reduction of penalties is a positive development, it is essential to carefully consider the following before deciding:

- **Consult a financial advisor:** Seek professional advice to assess your specific circumstances and determine the most suitable course of action.
- **Understand the fees and charges:** Compare the fees of your current RA with those of potential new providers to ensure you are making a cost-effective decision, taking into account the still remaining penalties that apply.
- **Consider the tax implications:** Transferring an existing RA to a new platform does not have any tax implications – it is a tax-neutral transfer.

Seizing the opportunity

The reduction of penalties for legacy RAs presents a valuable opportunity to optimise your retirement savings. By carefully considering your options and seeking professional advice, you can make informed decisions to secure a more prosperous future.

Moneyweb | 4 November 2024

Mid-term budget: Godongwana introduces early retirement plan

The treasury said on Wednesday that it is re-introducing an early retirement programme to reduce government employment costs. It will cost R11 billion and this amount will be allocated over the next two fiscal years, with details to be set out in the 2025 budget review in February. Public servants aged 55 to 59 will be able to apply for early retirement, without a reduction of pension benefits. Tabling his 2024 medium-term budget policy statement (MTBPS) on Wednesday, Finance Minister Enoch Godongwana said this move will cut government spending on salaries and promote the entry of younger talent into the civil service. This is not a new initiative; it was initially implemented from 1 April 2019 to 30 September 2019. In a question and answer session with the media, the treasury said it was targeting a 30 000 uptake, which will result in a R2 billion cost saving a year because people in higher income bands will be replaced by those earning less. Government employment takes up 18% of total employment in the country, which was 16.7 million in the second quarter of 2024, according to Statistics South Africa. The treasury said early retirement was a voluntary project but added that it would be up to executive authorities and accounting officers to approve applications so that highly skilled people would be retained. “We are implementing initiatives like early retirement not to merely reduce the size of the workforce, but also to introduce younger talent to the public service. This is part of building a capable, ethical and developmental government,” Godongwana said in his speech. The public sector wage bill has weighed heavily on the fiscus for years with attempts of reigning it in proving largely unsuccessful. In 2019, former finance minister Tito Mboweni introduced a public sector salary freeze for three years in an effort to control the ballooning wages. But, in the 2023-24 financial year, public service wages increased.

Over the past 30 years the public service wage bill has increased as a share of South Africa’s GDP from 5.6% in 1994-95 to 10.4% in 2023. This is a result of the fast-growing average remuneration Of public service employees over the past three decades. On Wednesday the treasury said that as the demand for services such as healthcare, education and security increased, it put pressure on the limited number of public service workers. This meant the government needed to attract and retain skilled professionals in the public sector by way of higher wages, benefits and allowances. “Public service remuneration requires a delicate balance between attracting and retaining skilled personnel, ensuring fiscal sustainability and promoting economic growth,” the treasury said. “It will be essential to implement reforms that align public service compensation with broader economic growth while addressing the pressing issue of growing public service employment.”

Mail & Guardian | 30 October 2024

UK pensioners who haven't touched their pension pot warned over 'deadline'

Pensioners have been told to watch for an inheritance tax deadline in 2027, which may force OAPs to reconsider their pension pots in the wake of the Labour Party Budget. State pensioners have been issued a stark warning to remain vigilant over a crucial inheritance tax deadline approaching in 2027. Pensioners and OAPs may need to overhaul their pension strategies as experts delve into who must act and precisely when in the wake of the Labour Party's Budget. Felicia Hjertman, CEO of investment platform TILLIT, described the freeze on National Insurance pension contribution changes as a "welcome relief" and a "reassuring step forward."

However, she highlighted that an alarming eight out of ten households are at risk of undershooting the mark for a comfortable retirement. Post-April 2027, any portion of pension pots left untouched will once again become subject to Inheritance Tax—a policy that was standard before 2015. Hjertman remarked: "the Government continues to face a significant challenge: creating stronger incentives for both employees and employers to prioritise private pension savings." Echoing the sentiment post-Rachel Reeves' address, David Piltz, CEO of Gallagher Benefits Services, said: "We hope that the final position does not result in a wider impact on this valuable aspect of pension saving with a knock-on erosion of confidence in retirement planning.", reports

With the Chancellor's recent Budget declaration, inheritance tax will come back into play for private pension wealth from April 2027, a move set to predominantly affect the heirs of former private sector workers, according to specialists. Pensions consultants and wealth managers have voiced concerns that recent changes will exacerbate the disparity between "gold-plated" public sector pensions and the more common defined contribution (DC) schemes in the private sector. Ian Cook of Quilter commented: "Rachel Reeves has spared the public sector and widened the gulf between DB and DC pensions." He added, "Some families of private sector workers will find themselves on the sharp end of an unexpected tax bill, whereas public sector workers can continue to provide for their spouses in the event of their passing." Cook further explained: "If a beneficiary of a DB pension who is not a spouse or civil partner inherits an estate that is above the inheritance tax threshold and a lump sum death benefit is paid out, then this benefit will be subject to inheritance tax. This is almost the only scenario in which DB pensioners will be affected."

Edinburghlive | 4 November 2024

FSCA fines 2 pension fund bosses R30 million each, debars them for 30 years

N-e-FG allegedly lost R470 million of pension fund members' funds after not investing the money according to clients' mandates, the FSCA says.

The Financial Sector Conduct Authority (FSCA) has fined two executives from a Vanderbijlpark pension fund administrator, N-e-FG, R30 million each and debarred them for 30 years. Another executive was fined R8 million and was debarred for 20 years and another was debarred for 10 years. The FSCA, says after an extensive investigation and sanctions process it decided to impose an administrative penalty of R30 million each on the funder of N-e-FG, Corne Jansen van Rensburg (54) and the managing director, Erick du Preez (45) and debar them for 30 years. In addition, the FSCA imposed an administrative penalty of R8 million on Steyn Jansen van Rensburg (51), debarred him for 20 years, and debarred Elia Jansen van Rensburg (75) for 10 years. The hefty fines and debarments came after the FSCA investigated Phahamisa Administrators (previously N-e-FG Administrators), N-e-FG Fund Management, The Wealth Strategist and the key executives.

Members' money not invested according to mandates

The FSCA says in a statement that the findings of its investigation include that clients' funds were invested without the requisite mandate and in entities not regulated by the FSCA. In addition, the FSCA found that some of the key executives had an interest in the entities where they invested clients' funds. The authority says the investigated parties contravened provisions of the Financial Sector Regulation Act, Financial Advisory and Intermediaries Services Act, the General Code of Conduct for Authorised Financial Services Providers and Representatives, Financial Institutions (Protection of Funds) Act and the Determination of Fit and Proper Requirements for Financial Services Providers. The FSCA says before taking this action, it handed its investigation report over to the National Prosecution Authority and is aware that some of the complainants also opened criminal cases. The FSCA will actively assist the NPA if requested.

R470 million in client funds missing – statutory manager

According to a statement from the FSCA issued in February last year, the statutory manager appointed by the FSCA found that R470 million of clients' funds were missing from N-e-FG, which invested pension funds. Jansen van Rensburg founded N-e-FG, which stands for New-e-conomy Financial Group, in 1999. N-e-FG sold itself to investors as a transparent firm with "responsible reporting' and said it takes full responsibility for its investment decisions. N-e-FG went into business rescue by the end of 2021 and shortly after the FSCA withdrew its licence to operate as a financial services provider before appointing the statutory manager in May 2022 to oversee how N-e-FG managed pension funds because it failed to responsibly manage the funds under its administration. According to the report of the statutory manager, Krishen Sukdev, the company did not stick to the investment mandates signed with clients and put the funds into high-risk stocks, while the executives "continuously misled" members about the value and whereabouts of their investments. N-e-FG mainly dealt with pension funds for miners and employees in the security industry.

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Switchboard : 011 450 1670 / 081 445 8722
Fax : 011 450 1579
Email : reception@irfa.org.za
Website : www.irf.org.za

3 William Road
Bedfordview
Johannesburg 2008