

# Pensions World<sup>®</sup>

## SOUTH AFRICA

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### PROVIDENT FUND ANNUITISATION RULES ARE HERE - SO WHAT NOW?

Mark Swanepoel explains what trustees and management committees should be dealing with in terms of the changes to retirement benefits from 1 March 2021.

### SHOULD CRYPTO- CURRENCIES BE TREATED AS AN ASSET CLASS IN A DIVERSIFIED PORTFOLIO

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## Editor's Comment

David Weil, CEO ICTS Group of Companies



2020 was undoubtedly a difficult year for investors, advisers and service providers ... in fact, for the whole industry. But one outcome of 2020 that deserves celebration is the resilience demonstrated by the retirements industry as a whole. Before we all knew it, we were absolutely comfortable with managing our various deliverables from home and running client meetings effortlessly on the various online platforms that we had once found completely daunting. If you had secretly hoped that 2021 would be different, by now you're probably disappointed to realise that online meetings and virtual seminars will be with us for some time to come – even possibly *forever*.

Whilst editing this latest issue of Pensions World, I was struck by how we each seem to come at the same topic from very unique and different angles. This got me thinking about how, in this new online world of work, it is becoming rather easy to simply fall into an “everybody thinks like I do” mindset – supported by algorithms which ensure that social media and Netflix feeds us things that appeal to us based on our interests and past online behavior. And so, as we embrace this electronically connected world, it is important to appreciate that lines of communication have become more complex and be mindful of the downsides of online interaction.

We all know that communication is made up of both verbal and non-verbal cues. In fact, some have said that non-verbal expressions have up to 93% more influence than only text. Digital body language is becoming a thing! The next time you're engaging with colleagues on a team Whatsapp group, you might pause to think how your words might be interpreted (or misinterpreted).

Then there are the unconscious biases, the underlying attitudes and stereotypes, which we all bring with us into our interactions and affect how we understand and engage with each other. If we are to truly embrace diversity and value the differences in perspective, we need to give each other space for differences in personality, communication styles and opinions. When you catch yourself attaching meaning to the photographs on a colleague's wall in the background or the curious children popping into your meeting, stop yourself and examine why you're interpreting this in the way that you do, and challenge your underlying assumptions and beliefs.

2020 taught us that if we are to succeed in this “new normal” we need to learn new skills and habits. Effective communication and embracing diversity are key skills required to understand and collaborate with each other for the benefit of all involved in our industry. In Pensions World we seek to continuously provide the different perspectives on trends and legislative developments to foster richer conversations between industry role players.

I trust you find this issue interesting (and challenging!) reading, until the next time, keep safe.

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# Provident fund annuitisation rules are here – so what now?



Mark Swanepoel, Senior Associate, Axiomatic

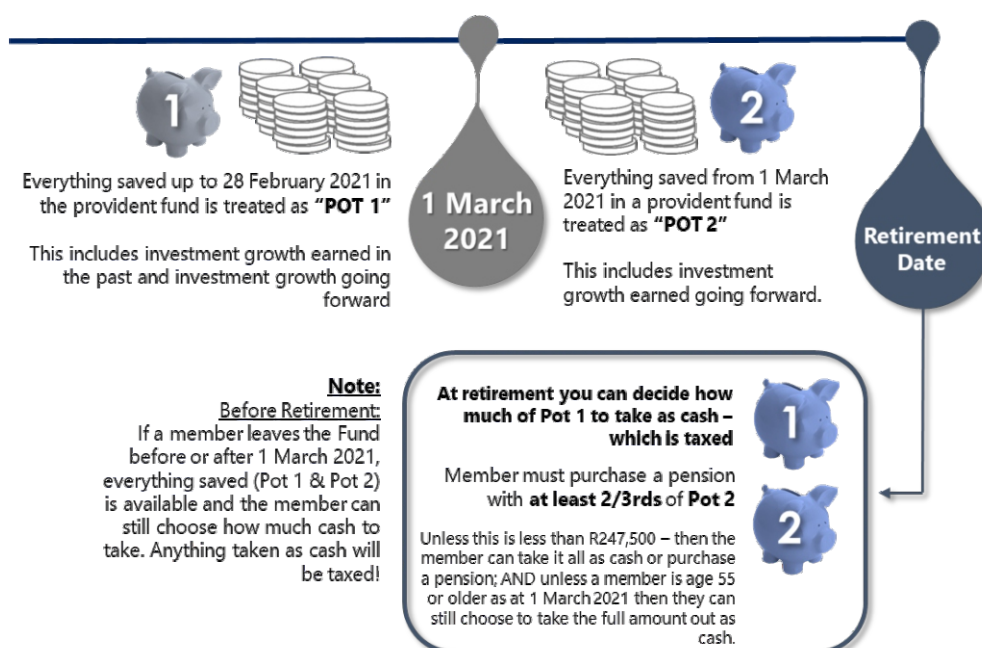
As a provident fund member, it is now more important than ever before to be proactive in your engagement with the growth of your fund benefits.

As members should all know (but most do not!), the fundamental difference between provident funds and pension funds in the past was how you were able to receive your retirement benefit. With a pension fund, you can only take one third of the capital in cash and the balance must be paid as a monthly income (provided the gross benefit is more than R247,500), whereas with a provident fund, a retiring member could get the full amount as a lump sum irrespective of the value of the benefit.

Prior to March 2016, the tax relief was more favourable to pension funds in respect of monthly contributions; however, the intention was to treat both pension and provident funds the same after March 2016. The tax treatment was then made consistent and, from 1 March 2021, the retirement benefit for future accruals will also be consistent.

Members closer to retirement (over age 55 on 1 March 2021) must understand that this change will not affect them whatsoever as long as they stay in the same provident or provident preservation fund. However, for those younger than 55 at the time the change is implemented, these members will have to purchase a pension with at least 2/3<sup>rd</sup> of their retirement savings accumulated after 1 March 2021 and may take 1/3<sup>rd</sup> as cash provided the gross benefit exceeds R247,500.

Below is an illustration of how this will work in practice.





## Provident fund annuitisation rules are here – so what now?

These changes have a couple of notable consequences for provident fund trustees.

Firstly, members of provident funds must be adequately informed to ensure that they fully grasp the consequences of the change, particularly that this is a change that (1) affects them only at retirement and (2) that this is not a retrospective change. It is important to ensure that there is no misconception of the impact of the changes and thus no cause for panic or concern leading to cash outs, which we saw happen in 2016.

Secondly, it is absolutely vital that the Section 13B administrators ensure that their systems and processes are correctly configured for the 2 separate pots of savings to be managed properly. The correct division will have a significant effect (especially for members far from retirement, but who have also accumulated a large savings pot by 1 March 2021) on the possible options and treatment at retirement.

It is vital that accurate, informative and knowledgeable information is provided through the Retirement Benefit Counselling process. Where funds use counsellors to contact and provide information to members, these counsellors must be properly trained and be fully conversant with the implications on retirement for provident fund members to avoid any misinformation which results in incorrect or inappropriate decisions being made. Default annuity strategies may also need to be relooked at and communicated appropriately with this change in mind.

I believe that it is now more important than ever that members are engaged through the various channels available to them to get information about their benefits; especially for peace of mind to ensure that their 2 separate pots of savings are being looked after correctly. In addition, it is also now more important than ever for trustees, management committees, employers, and independent consultants to review and scrutinise the processes in place and communication issued by the administrator to ensure that no misleading, confusing or incorrect information is given to members.

This is a change in process which should not be hugely complicated, but many administrators continue to fall short when implementing process changes. The hope is that this will not be the case here and, in the long term, the change ultimately benefits retirees with improving the longevity of their income in retirement – which is really the purpose of the change.

Of course for this to be the case, it is implied that we have solved the problem of high cash-out withdrawal statistics which is far more complicated and impossible for the retirement fund industry to do on its own.

# Split-service or integrated solutions?



Over the years, debates have continued on whether split-service or integrated solutions with a one-stop service provider are better in the delivering of employee benefits.

*Belinda Sullivan, Principal Consultant, Alexander Forbes Financial Services*

The most appropriate approach relies on the correct focus on what the objectives should be in managing the retirement fund and associated group risk benefits. This entails ensuring that suitable solutions are in place throughout the member or employee's lifetime to provide for:

- a reasonable income replacement throughout their retirement
- access to education around money and debt management
- access to financial planning advice and counselling
- protection of their accumulated wealth in the event of disability or death

To properly address the integrated solution approach, one needs to review the retirement fund in the context of South African legislation and the regulatory environment within which it operates. We have seen significant change in the past few years on this front with more focus on more robust regulation to protect the interests of members. We also know that the Covid-19 pandemic has resulted in significant health and economic challenges, affecting the provision and design of benefit offerings.

With this, the integrated approach has made advice, solutions and support easily accessible to trustees, employers and members, especially at this time of financial distress. Providing adaptable solutions through a central point has proven successful, covering all aspects of the fund and the employer's benefit programme.

In light of the changes in the environment, trustees and employers need to constantly re-evaluate the benefit design of their employee benefit arrangements and review:

- whether member needs are being met, and
- evaluate how any shortfalls can be addressed

We have seen the integrated approach evolve and ultimately improve long term outcomes for members through holistic advice and sourcing best solutions for members, considering TCF and the default regulations.

Here are the advantages of using an integrated approach with one service provider:

## 1. Is convenient and easily accessible

We live in a world where time is really a commodity. The convenience of the key relationship manager facilitating interaction across all spheres of the retirement fund and associated group benefits helps trustees and employers focus on other important aspects in managing the fund or on their core business.

## 2. Delivers packaged solutions

Packaged solutions include consulting, investment, communication, administration and individual advice and counselling aspects. The ability to tailor the advice and source alternative solutions through the integrated approach has truly been tested during the pandemic, where decisive action was taken, and solutions implemented to support clients in distress and manage expectations.

In a split-service environment, every solution is a tailored solution, resulting in higher costs, inferior solutions or both.



## Split-service or integrated solutions?

### 3. Reduces risks and is accountable

Integration requires teams to collaborate within the service provider, encouraging greater oversight through peer reviews. Understanding each area's level of expertise, and working together, promotes a beneficial environment for managing the retirement fund.

An integrated approach also enables the fund information officer to have more oversight and control of the data and reporting due to accessibility and management through one provider.

Splitting the components of the solution between several different providers increases the number of providers that clients need to deal with. This introduces a major risk of accountability for clients. A single provider provides ultimate accountability for services provided.

### 4. Is efficient and saves costs

In a retirement fund, the ability of one service provider to deliver is often dependent on receiving information from others. An integrated provider can be significantly more efficient because consultants and administrators are much more familiar with each other's processes and systems.

The issue of costs is subjective. Ultimately, it is expected that having a single service provider can introduce economies of scale and cost savings. Processes, advice and solutions can be standardised to some extent.

### 5. Spends on research and development

Any innovation that takes place in any industry will take place because the innovators are motivated by the long term payoff on their investment in research. The pursuit to provide an offering that will improve member outcomes and the client experience throughout their journey continues to drive innovation and service excellence. Separate service providers may be less inclined to spend on research and development, or being spread across too many service providers means the fund or client may miss out on innovation.

### 6. Reduces gaps in service delivery

Trustees have increased responsibility to ensure that there are no gaps in the services provided, and this is exacerbated by even greater governance requirements. An integrated approach limits this exposure for trustees and the employer.

The advantages of an integrated single service provider far outweighs any negatives. That is largely because single service providers offer many day-to-day administrative advantages. There are several significant, practical advantages to using single service providers as highlighted. It is far easier to build integrated solutions where some overlap of services does exist.

Integrating the delivery of information, counselling, advice and providing the appropriate solutions at the right time through the group arrangements has improved financial well-being for individuals. Ultimately, clients' interests must come first.



# Retirement savers still free to sabotage themselves



*Mica Townsend Business Development Manager and Employee Benefits Consultant, 10X Investments*

**Almost 10 years after National Treasury embarked on its mission to strengthen South African retirement savings, the final reforms are scheduled to come into effect on 1 March 2021<sup>1</sup> but, unfortunately, fund members will still be free to sabotage their own retirement.**

As pertinent as some of these reforms are, they are unlikely to achieve the overarching objective, to “improve preservation ... and ensure higher levels of income in retirement”.

The reforms do not adequately incentivise, or enforce, appropriate behaviour. This means that fund members are likely to continue to make poor investment decisions and cash in their savings early, a very common course of action that tends to have a crippling effect on a retirement saver's final outcome.

In its initial discussion paper in 2012, “Strengthening retirement savings”, Treasury argued that the complexity of the existing tax laws – the arbitrary differences in tax deductions, access rules and annuitisation requirements across fund types – discouraged saving and added unnecessary costs.

It has, therefore, acted to harmonise these rules. Since 1 March 2015, the maximum annual tax deductible contribution to pension and provident funds and retirement annuities have been standardised as 27.5% of gross remuneration or taxable income (with a cap of R350 000).

<sup>1</sup> According to the Taxation Laws Amendment Bill of 2020, the compulsory annuitisation of provident fund benefits will be implemented with effect from 1 March 2021.

## Retirement savers still free to sabotage themselves

In the final aspect of these reforms, which come in effect on 1 March 2021, provident fund members must use at least two-thirds of their savings to buy an annuity that will pay them an income in retirement (as pension fund and RA fund members are already obliged to do).

In principle, this is a good thing. For the great majority of people, purchasing an annuity is the most sensible and tax effective way to manage their retirement savings. It is sensible because the legal draw-down limits will enhance the longevity of those savings, and tax effective because it lowers the average rate at which those savings are taxed.

Those entering the workforce after this reform has been enacted will find a far simpler system. They will see no difference between pension and provident funds; only Retirement Annuity (RA) funds will stand out, and only because there is no option to cash out savings in an RA fund when changing jobs; as these funds are not connected to an employer.

Current provident fund members who are younger than 55 when this reform is enacted will have to contend with a complex blend of the old system and the new one. The new rules will apply only to contributions (and returns made thereon) after the reform is enacted. So-called vested rights (the provident fund balance on the day before the reform is enacted and subsequent returns thereon) may be still claimed under the old rules (in other words, as a lump sum) at retirement.

Fund administrators will have to separate these balances, possibly for the next 40 or 50 years still.

If nothing else, this separation will underline the importance of preserving even seemingly small amounts. To illustrate, in the context of a 40-year savings plan, the vested balance after just 10 years (plus subsequent returns) will make up some 45% of the final savings balance.

Even those who had been saving for just five years on the scheduled enactment day of 1 March 2021 would have 30% of their fund balance subject to the old provident fund rules. Add in the one-third lump sum portion available from the non-vested portion, and these savers would still be able to cash in more than half their savings in 2055. The potential for significant lump sum leakage at retirement will thus be with us for decades to come.

But even doing away with vested rights would not stop it all. There is just no point locking the stable door after dark when it stands open all day. Without mandatory preservation before retirement, those who are determined to avoid an annuity will simply exit their fund before retirement. The lump sum tax penalty will not dissuade them, just as it doesn't dissuade most people today.

So, unfortunately, by protecting vested rights and avoiding compulsory preservation, the mandatory annuitisation of provident funds may do little to raise income levels in retirement. That outcome will still be largely down to individual behaviour, meaning most fund members will continue to focus on their short term needs at the cost of their retirement lifestyle.

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# Beneficiary funds – some top-of-mind questions



The COVID-19 pandemic has led to severe economic hardship for millions of South Africans. During these difficult times, there is no doubt that beneficiary funds have come to the fore. Stats SA figures released in early October 2020 showed that more than 2 million jobs were lost in the second quarter of 2020.

*Olefile Moea, Chairperson, Fairheads Umbrella Beneficiary Fund*

The economically vulnerable have been particularly hard hit. Those who have lost a breadwinner are relying on grants and, if they are fortunate, on the steady income provided by a well-managed beneficiary fund. This can make all the difference to a family, helping to boost household income and keeping a roof over the family, thereby benefitting the minor who may be the beneficiary fund member.

At a recent industry webinar on beneficiary funds, a panel of beneficiary fund trustees answered a range of questions from retirement fund trustees, consultants and other stakeholders. Following below are a selection of questions asked during the webinar which give an indication of what is on peoples' minds in the current climate.

**Q: How do you track whether the guardian is in fact taking care of the beneficiaries, particularly where the children are under 10 - is there a way to "police" this?**

In addition to an annual Home Affairs check, most beneficiary fund processes stipulate that every guardian or caregiver must provide a Proof of Existence (POE) each year. This is either completed in interview format with the beneficiary fund, or by sworn statement. The process involves confirming that the guardian or caregiver is alive, the beneficiary is alive and that the beneficiary remains in the care of the guardian or caregiver. In addition, the beneficiary fund service provider should collect information to do with the child's progress through school as well as their general well-being.

This information is matched against the information the beneficiary fund has about the beneficiary, and any discrepancies are investigated through a fraud and forensics process.



## Beneficiary funds – some top-of-mind questions

**Q: What systems are in place to prevent guardians from misusing beneficiaries' money, especially in the case where the guardian might have other children to take care of?**

There is indeed a risk that some guardians may abuse funds and this is why best practice is for the beneficiary fund to limit the amount of money paid out as income to the guardian or caregiver on a monthly basis. The majority of assistance that the beneficiary fund provides is paid out as capital assistance. Every capital request is assessed by the beneficiary fund. Safeguards in place should include:

- Capital is restricted to an annual budget.
- Supporting evidence is required for all payments.
- Payment is made directly to the service provider (school or uniform provider).

Regular communication with the family is the most important point in combatting fraud. Information from every interaction with guardians and members should be used to test for compliance and inconsistency.

Ultimately, where the beneficiary fund has any indication that money is being abused (and this includes their “gut feel”), steps should be taken to investigate and rectify the situation.

**Q: If the beneficiary passes away, am I right in thinking that beneficiary funds are excluded from the estate, as it is an approved fund?**

Yes, death benefits stemming from retirement funds are excluded from the estate of the late member. The trustees of the retirement fund will apply section 37C of the Pension Funds Act to these benefits.

**Q: Will the benefits in the beneficiary fund (for beneficiaries) also be exempt from estate duty tax in the hands of the beneficiaries?**

Yes, beneficiary funds are tax exempt pension fund organisations.

**Q: When you stop payments for beneficiaries who have not been in contact with the fund for over a year, do you inform them first before stopping payments or do you stop payments and expect them to contact the fund?**

Best practice is to communicate extensively with guardians and caregivers prior to suspending income. Usually, following the income suspension, the guardian or caregiver contacts the service provider immediately, who would then reinstate the income (including back paying of any months which have been missed).

**Q: With the age of majority being 18, and members often being still at school at that age and not yet financially sophisticated, how does the beneficiary fund respond regarding payment of a lumpsum when the member turns 18?**

The short answer is that once a member reaches the age of majority, they have a legal right to the money held in the beneficiary fund for them.

The slightly longer answer however is that the trustees of the beneficiary fund must exercise their discretion as to whether it is in the best interest of the beneficiary to pay out the benefit. They cannot simply adopt a standard position on this, but must exercise their discretion with due care.

This discretion sits with both the transferring fund trustees when considering the mode of payment for a major dependent, as well as the beneficiary fund trustees when considering the termination of a beneficiary upon reaching the age of majority.

## Beneficiary funds – some top-of-mind questions

**Q: How do you set up a beneficiary fund for mentally incapacitated individuals, which could include older people, not just minors?**

There are many cases of major members who are suffering under some legal disability. It is firstly important for the beneficiary fund to understand the extent of the disability so that they can customise the approach.

For example, some disabled members are able to operate a bank account for day to day expenses but are unable to deal with larger financial decisions.

Service providers will work with social workers, the family, government institutions and NGO's to find a way to meet the member's needs. The trustees will assess each case and approve claims as and when required.

**Q: What is the process in respect of unallocated funds?**

Beneficiary funds applying best practice should have a robust procedure when dealing with unallocated funds which is monitored daily with swift turnaround times for the establishment of a member sub-account.

As soon as a deposit is made to the beneficiary fund's bank account, it is matched against the member application received. Where a member application has not been received, a process should be followed to identify the source of deposit and contacting them. If no progress is made on allocating the deposit (for example, after three months) the funds are returned to the source.

The industry is becoming increasingly concerned about the length of time it takes for money to reach dependants following the death of a loved one. In fact, analysis on the time between the death of the retirement fund member and the establishment of the member sub-account in the beneficiary fund has revealed some alarming statistics – some funds take on average three years to complete their investigation and distribute the benefits, which is well in excess of the 12 months prescribed period.

**Q: How do you deal with a beneficiary that is now housed at an NGO Care Centre due to circumstances, but the guardian is still receiving the income?**

Where the beneficiary fund trustees become aware the member is no longer in the care of the guardian, they engage with them to understand what the child's circumstances are. In some cases, it remains appropriate to continue to pay the guardian the monthly income as they may be looking after the day to day needs of the child. In other cases, it is more appropriate to suspend the income payment and deal directly with the NGO to pay any amounts that are due.





# The Trustee Toolkit lays a solid foundation for being fit and proper

By now, all retirement fund trustees in South Africa should have completed the FSCA's online Trustee Toolkit. I wonder if you have done it yet?

*Nicola Burger, Head Trainer, Investment Consulting & Trustee Services*



This legislative requirement came into effect on 10 July 2020 through the FSCA's Conduct Standard 4 of 2020 (RF), which provides for the “*Minimum skills and training requirements for board members of pension funds*”. Effectively this Conduct Standard gave all board members six months in which to have completed the online assessment with the deadline date being 10 January 2021. It then requires all new board members to have completed the assessment within 6 months from their date of appointment to the board.

So, does this now mean that all trustees are suddenly “fit and proper”, have full knowledge of everything about retirement funds and are able to appropriately manage their retirement funds? If faced with complicated investment questions around the strike price of a derivative would they be able to answer? Somehow, I doubt it. In fact, if asked the difference between a retirement fund and a retirement annuity I can honestly tell you that I doubt many board members, even those who have completed the Trustee Toolkit, could adequately answer. The question is then: what is the toolkit achieving and where do board members go from there?

I often tell board members that their educational journey as a board member is a bit like building a house - and that even once the building is complete, maintenance continues - in fact, it never ends. Board members, when elected or appointed, do not somehow instantly know everything retirement fund related - in fact, most often their term of office expires just as he/she is starting to feel familiar with the issues at hand. So, how do we build that house as quickly as possible without cutting corners and having it all fall down, like the foolish man who built his house upon the sand?

As like any house, the key to a solid understanding is the foundation. Build a strong foundation, like the wise man who built his house upon the rocks, and the rest will follow. I believe that this foundation is through trustee training. Training provides a platform for engaging, the sharing of knowledge and experience, as well addressing the key areas that concern trustees. It is always amusing to see just how interesting trustees find learning about divorce and its potential impact on their retirement fund! There is no greater feeling for a trainer than seeing the “lights go on” and delving into a discussion and/or debate with trustees.

The Trustee Toolkit is a part of your foundation. While it does not examine technical details and fund finances, it does focus on key governance principles, looking to ensure that board members do things right because it is the right thing to do. The Toolkit goes further to ensure that trustees are aware of the broad and onerous fiduciary responsibilities they have. Certainly, in a world constantly rocked by stories of governance failures, it is critical that these values are instilled in trustees at all time.

Once that foundation is set, and the board members understand the why, what and how's about their fund the rest of the house can be built. This takes time. Advanced training, specialist courses and practical and in-depth insight follows.



## The Trustee Toolkit lays a solid foundation for being fit and proper

The Conduct of Financial Institutions Bill, when promulgated, will make it mandatory that trustees meet fit and proper standards. Whilst these requirements are yet to be revealed, it is confirmed that trustee training will be a formalised requirement for trustees. This is to be welcomed by trustees because, after all, trustees make decisions about other peoples' money.

2020 brought significant challenges to the way in which we all operate. Suddenly we were unable to meet face-to-face and have had to adapt. Board meetings moved online and so did training. Change is difficult, but as I often say to board members about this time, "it is what it is, so let's get on with it and learn".

Change also brings opportunities and many have taken this time of uncertainty to relook at the way things are done - trustee training included. It may look and feel different to the past, but the end goal remains the same. Build that house trustees - get the foundation right and go forward - be the wise man who built a house upon the rocks.





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# Covid-19 vaccine included as a prescribed minimum benefit

Despite the recent announcement by the Council for Medical Schemes (CMS) that Covid-19 vaccines will be included as a prescribed minimum benefit (PMB), the procurement and distribution of vaccines do not fall within the ambit of medical schemes.

Clayton Samsodien, CEO, Phoenix Healthcare Consultants (PHC) - a subsidiary of Phoenix FSG.



Government will be the sole purchaser of vaccines before allocation to regional authorities and the private sector. The first doses of the vaccines are expected to arrive at the end of January 2021 and the government has an ambitious goal of vaccinating 31 000 citizens a day. This is according to Phoenix Healthcare Consultants (PHC) - a subsidiary of Phoenix FSG – managed by CEO Clayton Samsodien.

*“It is laudable for the CMS to announce that Covid-19 vaccines will be included as a PMB. However, we need to remain cognisant that although the National Treasury will fund the majority of the cost, government will look to medical insurance providers to contribute. This means that medical insurers could contribute to the insured and the uninsured, a solidarity principle in action,”* says Samsodien.

PMB treatment is covered in full by medical schemes meaning that no member co-payment is necessary. The majority of medical schemes already have partnerships with pharmaceutical companies to deliver various forms of wellness initiatives such as screening, preventative tests and flu vaccinations. It is expected that schemes will build on these partnerships to deliver vaccines to members when available.

The CMS has always argued for medical schemes to ensure 25 percent solvency to fund future material healthcare expenses such as pandemics. Schemes themselves countered this argument indicating that the high level of solvency was not required and could rather be used to reduce the rising cost of healthcare. Currently, schemes are sitting with an estimated R66 billion in reserves that could help all South Africans with access to vaccines and not just those that are members of medical schemes.

Says Samsodien, *“The percentage of reserve funding of a medical scheme will have an impact with the other demographics of the risk pool like average age and pensioner*

*ratio of members. The higher the average age of members, the more the likelihood of members with comorbidities who will need to be vaccinated earlier in the vaccination drive.”*

Government has indicated that it will follow international standards and practice in terms of the vaccine rollout once secured. Front line health care workers will be vaccinated first, then essential workers, persons in congregate settings, persons over 60 years, persons over 18 years with comorbidities followed by other persons over 18 years and then the general public. However, there remain numerous factors at play delaying the procurement and delivery of vaccines locally.

South Africa is a party to the World Health Organisation (WHO) COVAX facility. Health Minister Zweli Mkhize indicated that South Africa will be receiving vaccines from the following manufacturers:

- 5% from Moderna
- 5% from Pfizer
- 70% from AstraZeneca
- 20% from Johnson & Johnson

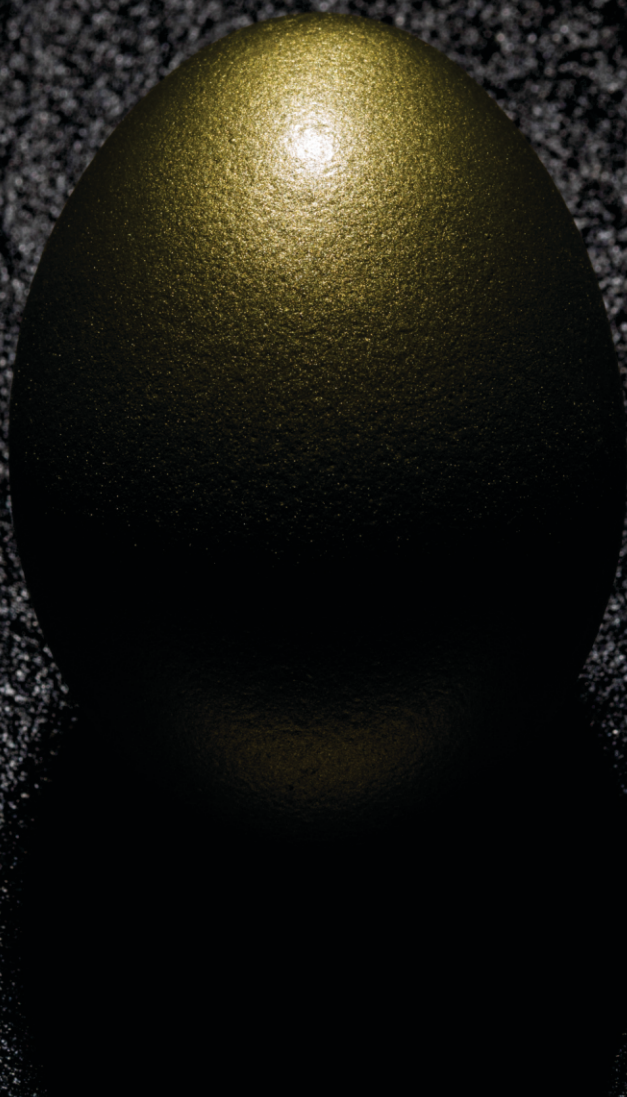
It is reported that approximately 34,5 million doses of Covid-19 vaccines have been secured. Approximately 40 million people need to be vaccinated to achieve herd immunity. Important to note is that vaccination is not compulsory.

Government has also indicated that it is developing an electronic vaccination data system in partnership with leading multinational technology firms. This will include a national register of all vaccinated citizens, each of whom will be provided with a vaccination card.

*“Looking at the proposed National Health Insurance (NHI), what the pandemic has done is to push the project even further down the road. It appears that NHI cannot be implemented by 2025 given the current economic climate,”* concludes Samsodien.



# INVESTMENTS



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# A thriving South Africa will take alternative thinking by pension funds



*Adam Bennot, Senior Associate, Alternative Investment Services at RisCura*

**There is much focus in the retirement industry on improving retirement outcomes for South Africans. But there is little point in retiring with a decent pension if the society and environment you retire into is undesirable or unliveable.**

Nor will you actually have a decent pension if the retirement industry doesn't make sustainable investments with positive social and environmental impacts. The two are inextricably linked.

From a public policy perspective, many stakeholders believe that impact investing can deliver a public good, particularly in areas where the government lacks the resources. For pension fund trustees, the argument may be around why capital should be used to finance projects that should have been funded by government expenditure. The answer is quite simple. In South Africa, we have reached a point that if we don't act now and make sustainable investments with positive social and environmental impacts, we are unlikely to generate stable, long term returns.

The Covid-19 pandemic has harshly reminded us of the acute issues around health and how closely health outcomes are related to poverty, lack of adequate education, human rights, the environment and racial, gender and income inequality.

For long term investors, of which pension funds are the quintessential example, sustainability should be an important concern. An unhealthy, unstable and unsustainable economy cannot serve investors who have a multi-decade investment horizon, and who are concerned about the livelihoods of the next generation and beyond.

Fortunately, there has been a significant shift globally over the last decade in the way many investors are thinking about the utility of their investments. Conventionally, the focus was on risk and return with less concern for sustainability or the impact on people or the planet. Increasingly, investors are concerned with the effects their investments have. "Knowing what you own" has become a motto for impact investors.

According to Schroders Institutional Investor Study 2020, 67% of institutional investors believe the role of sustainable investing will become more important over the next five years.



## A thriving South Africa will take alternative thinking by pension funds

Impact investing has transformed from a mere concept a decade ago, to a formalised investment strategy and mandate throughout the investment industry and according to the Global Impact Investing Network (GIIN), has a current estimated market size of USD715 billion.

The Covid-19 pandemic is having a profound and lasting impact on the South African economy and we were already in a recession before it began. Our unemployment rate hit a new high of 30.1% in the first three months of 2020, even before Covid-19 related job losses were accounted for, and recent estimates forecast around an 8% contraction in South Africa's growth for the year. Without a thriving, inclusive economy, investors and asset owners will struggle to reach the required investment returns to successfully reach the "golden years".

The medium term budget made it clear that the government faces some tough decisions as the country teeters on a fiscal cliff. Debt servicing is likely to be nearly 16% of government expenditure, the single largest component and far weightier than allocations to health, education and social assistance.

A paradigm-shift in the way we save and invest is needed if we are going to build a sustainable and inclusive economy. It's time to think out of the box and consider alternative investment strategies.

South African investors have experienced a persistently low return environment for the past five years. There is unquestionably a need to invigorate returns to ensure we can leave a legacy for tomorrow.

We believe that investing for developmental impact can drive sustainable returns and help tackle the imbalances that characterise our country. And impact investing does not mean forfeiting attractive returns.

An impact investing strategy offers a potentially powerful lever for retirement funds to diversify, spread their risk and enhance returns all in a way that positively contributes to our struggling economy. Importantly, we can take advantage of the full mandate of Regulation 28 of the Pension Funds Act which allows up to 35% of assets under management to be allocated to alternatives, unlisted debt, unlisted equity and unlisted property.

Not only will moving even a small portion of institutional capital in South Africa have a ground breaking effect on driving the United Nation's Sustainable Development Goals (SDGs), National Development Plan (NDP) and the recently published Economic Recovery Plan, but it will also catalyse the impact investment industry. It could be the spark that launches South Africa as a leading global player in the impact space. Just as in the past when we implemented substantial enabling policies like the Code for Responsible Investing in South Africa (CRISA) and amendments to Regulation 28 to facilitate greater consideration of ESG factors, South Africa can become a global impact industry leader.



# Should cryptocurrencies be treated as an asset class in a diversified portfolio intended for retirement savings?



*Nic du Toit, Regional Head: Investment Consulting, Simeka Consultants and Actuaries*

In 2020, the value of Bitcoin increased from just under USD9,000 to around USD40,000. This occurred amid record low real interest rates and continued accommodative monetary policies.

Given this rife environment for speculative investments, it is not surprising that investors are grappling with the question whether cryptocurrencies should find their way into retirement fund portfolios.

In 2008, an online posting of a pseudonymous white paper envisioned a new way to transfer value over the internet in an instant and a transparent way, without using the banking system. This peer-to-peer electronic payment system, explained by a “Satoshi Nakamoto” (who is yet to be identified), set the scene for Bitcoin to lead the way for cryptocurrencies to be a worldwide accepted medium of transacting. The payment system was made possible through an encryption methodology known as blockchain. Now, 13 years later, at the start of 2021, a single Bitcoin had a market value of around USD40,000 (roughly R600 000) and according to the initial white paper there will be no more than 21 million Bitcoins in circulation. Of these, an estimated 19 million have already been made available for trade after being “mined”. At today's market value, the 21 million coins represent a total market cap potential of USD0.84 trillion (R12.6 trillion), which is more than double the South African GDP of roughly USD0.35 trillion (R5.2 trillion).

The question remains, though: Does Bitcoin, or any other cryptocurrency, have a place in a well-diversified portfolio and can it be considered a sustainable asset class?

In 1997, Robert J. Greer published an article in the Journal of Portfolio Management where he identified the following three criteria to be used to specify asset classes for the purpose of asset allocation:

1. Assets within an asset class should be relatively homogeneous or similar – the assets that make up an asset class should exhibit similar characteristics.
2. Asset classes should be mutually exclusive – an asset should only be able to be categorised into one asset class (in other words, there should be no overlap between asset classes).
3. Asset classes should be diversifying – have a low correlation to other asset classes.

In order to make sense of these asset classes within portfolio theory, asset classes can then be categorised as either being local or offshore, public or private, as well as traditional or alternative in nature. While classifying asset classes into either local or offshore, public or private markets may be easier to comprehend, the other asset classifications are more elaborate. In layman's terms, alternative assets represent real assets which are more sensitive to inflation and can represent a store of value, whereas traditional assets like equities and fixed income securities are more sensitive to market conditions

## Should cryptocurrencies be treated as an asset class in a diversified portfolio intended for retirement savings?

Let's see how Bitcoin fits into these criteria:

### 1. Homogenous attributes?

Deemed a cryptocurrency, Bitcoin paved the way for various other cryptocurrencies to follow in its wake, such as Ethereum, Ripple and Litecoin. Although these competing currencies differ somewhat in purpose and construction, they all use blockchain encryption as a method of transacting or storing value. Therefore, cryptocurrencies can be considered a homogenous asset class.

### 2. Are cryptocurrencies mutually exclusive?

Considering Bitcoin and other crypto assets we can argue that they are more closely aligned to alternative assets, in the form of real assets rather than traditional assets. A cryptocurrency is perhaps the most comparable to investments in commodities or hard currencies, as it serves as a means of payment or to preserve purchasing power of money. However, unlike commodities, cryptocurrencies do not offer any value derived from an underlying tangible asset whatsoever, as they don't offer returns in the form of utility, dividends or interest payments. The only available return is derived from the fluctuation of the capital value per unit once realised. Although Bitcoin has been themed a currency it also has no link to any jurisdiction or authority, and therefore does not offer any protection from a legislative perspective. Cryptocurrencies' value drivers are somewhat unclear and more aligned to sentiment and the intentions of their accountholders. Whether this asset class is therefore mutually exclusive remains to be seen, especially when compared to other commodities like gold.

### 3. Are Bitcoin and cryptocurrencies diversifying?

In a CFA Research Institute paper issued by Matt Hougan and David Lawant in January 2021, they point out that Bitcoin's historical performance characteristics exhibit three main attributes which prove, at least for now, it exhibits diversification benefits: high returns, high volatility and low correlations with traditional assets. The research indicates the cryptocurrency was the best performing investment of the past decade, although it had a bumpy ride. Over this period, Bitcoin underwent six different peak-to-trough drawdowns of more than 70%. Lastly, although Bitcoin did indicate low correlations to traditional asset classes, this might be temporary as Bitcoin remains an early stage investment opportunity.

It therefore seems one could qualify cryptocurrencies as an asset class given some leeway in its interpretation of being mutually exclusive and assuming the current diversifying benefits will remain, but would it be prudent to invest in such an option when considering retirement savings?

It is imperative to understand that, when investing into such an asset class, there are other factors to consider, including:

- applicable legislative environment;
- tax considerations (applicable to taxable entities);
- selecting the appropriate investment vehicle;
- valuations and marketability;
- operational liquidity issues; and
- expense and fee considerations.

After considering the factors listed above, it becomes clear that cryptocurrencies do not yet qualify as sustainable investments for institutional investors. At this stage, the cryptocurrency market is not sufficiently developed and regulated for this asset class to be seriously considered by institutional investors. To address this concern in South Africa, the Financial Sector Conduct Authority (FSCA) recently published a draft declaration of crypto assets as a financial product under the Financial Advisory and Intermediary Services Act (FAIS) which is a step in the right direction to protect vulnerable investors in the interim. The selection of the investment vehicle is also an issue, as it enabled the rise of unscrupulous market participants as evidenced by recent cryptocurrency fraud. There are examples of investors who invested in Bitcoin early, only to find a hacker managed to get hold of their valuable information to enrich themselves, which reflects positively on the asset but not the intended investor. Furthermore, valuing these assets is one of the most complex, challenging and disagreed-on aspects of the crypto market. Regarding liquidity, another big concern is that research showed about 2% of the anonymous Bitcoin ownership accounts that can be tracked on the crypto-currency's blockchain control 95% of this digital asset. This can significantly distort prior statistical findings since correlations to traditional asset classes could therefore simply be spurious, or worse, market manipulation. When liquidity becomes a concern transaction costs can be high, eroding value.

We canvassed a number of asset managers to get their view on investing in cryptocurrencies. Many asset managers agree on the importance of monitoring developments in this space but agree that the market is not mature enough to consider allocating assets into a retirement fund portfolio.

In summary, the cryptocurrency environment is still new and evolving with a somewhat uncertain future. The rise of cryptocurrencies can pave the way for technological improvements due to the underlying blockchain encryption it uses, and its applications in the financial industry. However, as with any new technology, early-stage adopters could make a handsome profit but must be aware that substantial losses are also possible. When saving for retirement such risks are not prudent to accept.



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# Investors able to generate positive returns whilst making a positive difference



*Johan Marnewick, Head of STANLIB Credit Alternatives*

**Attractive yields are available to institutional investors willing to look beyond traditional markets in developed economies. Some of the most attractive high-yield opportunities at present can be found in private or unlisted credit on offer in South Africa.**

Private assets also present real opportunities for investors to be effective in raising environmental, social and governance (ESG) standards in developing economies and being the catalyst to making a positive difference in communities.

## Investing for good

The idea that returns can be measured, not just by profit, but the upliftment of people, communities, taking care of the environment and society at large, is a compelling notion for a holistic approach to wealth creation and preservation, and is not new.

In the South African context, where economic reform and structural investments are sorely needed, the opportunities to combine impact with profit are immeasurable, especially when viewed through the lens of the United Nations Sustainable Development Goals (UN SDGs). The COVID-19 crisis has further emphasised the need to combine social sustainability and strong governance with key investment outcomes for investors.

## Some key themes

Many stakeholders believe that private debt capital can make an enormous contribution to ESG investment propositions and many investors are motivated to do just that. There is a need to drive economic inclusion and help South Africa to develop, while giving investors measurable and predictable outcomes that reward them for the risks taken.

Some key themes stand out in the quest to maximise impact and investment outcomes.

The first theme is infrastructure, which is dissected into social and economic sub-categories. Social infrastructure activities focus on helping build and develop sustainable communities - by investing into areas of affordable housing, education and healthcare, fulfilling SDG 3 (Good Health and Well-Being) and SDG 11 (Sustainable Cities and Communities).

Economic infrastructure projects focus on creating jobs, new business growth opportunities and economies of scale in telecommunications, utilities, transportation, as well as state owned enterprises and municipalities.

In line with the UN SDGs and South Africa's efforts, the pursuit of sustainable and clean energy solutions present opportunities, especially in line with SDG 7 (Affordable Clean Energy) and SDG 13 (Climate Action).



## Investors able to generate positive returns whilst making a positive difference



The second theme is financial inclusion, where the key objective is to increase the penetration rate of financial services usage. The aim is to lower the economic barriers to entrepreneurship, increase financial literacy and access to financial services, which will collectively lead to greater economic activity. To influence positive change, the focus should be on wholesale financing into the micro loans, SMEs, BEE and Payment and Remittances sectors, covering a wide range of SDGs, from SDG 1 (No Poverty) to SDG 8 (Decent Work) to SDG 10 (Reduced Inequalities).

The final theme is agriculture, which is critical to food security in the country. Agriculture within an African and South African context is a key impact theme, informing various SDG outcomes including SDG 2 (Zero Hunger), SDG 3 (Responsible Consumption and Production) and of course climate change as encapsulated by SDG 13.

Impact investing efforts that aim to support local agriculture to ensure access to land through informed redress as well as support sustainable practices, are likely to lead to greater food security and access to wholesome nutrition.

## Overcoming the hurdles to ESG investing

It is well known that there are several difficulties in constructing ESG-focused investment portfolios in the short term. These include the complexities of quantifying ESG risks, which entails a level of expertise, and the current inconsistency of disclosures, which makes it difficult to compare entities within a peer group. The United Nations Principles for Responsible Investment (UNPRI) and the Task Force on Climate-related Financial Disclosures (TCFD) framework are helping to set high standards and consistency in the way ESG is assessed however more is needed and professional investor bodies can help shape these outcomes.

Two other impediments are that ESG risks in general do not appear to be currently priced into loans, so borrowers with higher ESG risks pay the same risk premium as those with lower risk. There is also a general lack of oversight and regulation of ESG which also contributes to the inconsistency of disclosure. In time, it is hoped that investors will better differentiate on the basis of ESG features and that it will be reflected in the access to and price of capital.

## Achieving wider objectives by investing in private credit

Private credit offers a solution to achieving the twin objectives of financial returns and impact outcomes. In addition to more attractive yields and being able to better achieve ESG outcomes, private credit also offers very particular other advantages - it is uncorrelated to traditional asset classes, can be counter-cyclical, and able to deliver stable, predictable returns. Private credit is appropriate for investors with long term investment horizons or those with liability-driven objectives, as it is less volatile than traditional fixed income assets and is therefore ideal as a liability matching tool.

Private credit can be issued by corporates or the public sector, and is well suited to infrastructure rollout, impact and ESG investing. We expect the global private credit market will top US\$1 trillion during 2020/21 as more investors allocate funds to private credit offerings.

As investment managers, we see big possibilities for South Africa when combining private credit with impact investing, with many opportunities that are yet to be realised. Although the South African market for impact investing is lagging many other parts of the world, we have the benefit of learning from global best practice, especially when it comes to assessing whether the funds deployed are achieving real, sustainable impacts.

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# A year to forget that will never be forgotten

*Jonathan Wernick, Equity Analyst, Sasfin Wealth*

**As we consider the final quarter of 2020 investors will probably be left with mixed feelings oscillating between a sense of relief and uncertainty (more so than usual).**

Positive news surrounding COVID-19 vaccines, the eventual approval of the US stimulus package and low interest rates continue to drive global markets higher as the MSCI All Country World Index ended the quarter up 14%. All the while, equity valuations are now higher than a year ago, there has been a significant contraction in economies across the globe, unemployment has increased, there has been a general decline in corporate profits and many nations are experiencing a new wave of the virus.

The general increase in equity prices reflects a more optimistic outlook for economic growth and corporate profits in 2021 supported by approvals and rollouts of various vaccines. During December 2020 multiple vaccines received regulatory approvals and became available to the public. As we close out the year, 29 countries had administered over 10 million doses of the various vaccines, the vast majority of which attributable to China and the US with other European and North American nations making up the remainder of the recipients. The US Food and Drug Administration (FDA) has approved the use of both the Pfizer-BioNTech and Moderna vaccines and as we start the new year over 3 million US citizens had received doses of the vaccines, approximately 1% of the population. With the exception of Israel, who has managed to vaccinate approximately one tenth of its population, the remaining nations that received a vaccine have only managed to administer vaccines to slightly less than 1% of their population. Unlike the gains we saw earlier in the year which were predominantly supported by the pandemic beneficiaries,

specifically “big tech” stocks (Alphabet, Amazon, Apple, Facebook and Microsoft), this time market gains were predominantly driven by stocks that fall into the “return to normality” bucket as well as those that were left behind during the pandemic. Stocks that fall into this category include cyclicals (stocks whose items or services are strongly correlated to the economy namely industrials and banks as well as stocks that were at the epicentre of the COVID storm such as hotels, restaurants, airlines and cruise ships), energy stocks (oil and natural gas), small cap stocks (specifically those situated in the US) and emerging markets.

In the US, the S&P 500 Index, a broad market index for US stocks ended the quarter 12% higher supported by progress on stimulus talks as well as the approval of and administering of vaccines. Just in time for Christmas, an agreement was reached between Democrats and Republicans for a \$900 billion stimulus package. Under the new package households earning less than \$75,000 will receive \$600 for each adult and \$600 for each dependant, somewhat lower than the respective \$1,200 and \$500 that were disbursed in the first round. In addition, unemployment insurance will be topped up by an additional \$300 per week which will persist through to mid-March 2021. In what will be one of his last acts as President, Mr Trump had initially labelled the heavily negotiated package as a “disgrace” and threatened not to support it. There was however not to be a repeat of the Grinch stealing Christmas as his threats were short lived and he eventually signed the package into law.

## A year to forget that will never be forgotten

This package is somewhat smaller than the \$3 trillion stimulus that was provided earlier in the year but the trillions of dollar spent by the US government as well as the anticipation of more stimulus to come in 2021 has led many to question the longer term strength of the US dollar. The greenback has underperformed other currencies since introducing such extreme stimulus measures and this led many wary investors to turn to gold as a safe haven. This saw the yellow metal breach the \$2,000/ozt level earlier in the year but it has since fallen back below this key point and during the quarter the price remained relatively flat ending December at \$1,893/ozt.

As an alternative to gold some have turned to Bitcoin. The cryptocurrency experienced a meteoric rise during the final quarter of 2020 climbing 167% to end the year just shy of the \$30,000 level (which it subsequently breached in the new year). For some, the rapid rise in the digital currency has created a bubble which is bound to pop as it did previously in late 2017. Those on the sceptical side of the coin believe that the rise in bitcoin is based on pure speculation without any fundamental support. Flip the coin over and you will find a growing number who have warmed up to bitcoin and interestingly, support has broadened to now include backing from institutional investors such as Paul Tudor Jones and Stanley Druckenmiller. Even corporations such as PayPal, Square and Robinhood have made it easier for users to buy and sell such digital assets.

Though not quite as pronounced as the rise in digital currencies, physical commodity prices rose sharply during the quarter following positive news on the vaccine front. The S&P GSCI Industrial Metals Index rose 14% and the combination of logistical bottlenecks and stockpiling led to a 21% increase in the S&P GSCI Agriculture index. Over the quarter the price of Brent crude climbed above \$50 a barrel but remains precariously positioned. The global rollout of vaccines has supported the rise in oil prices but ongoing tensions between OPEC nations Saudi Arabia and Russia over oil production as well as the renewal of lockdowns, which will dampen economic activity, continue to create fragility in the market.

While the US was greeted with a stimulus package for Christmas, Europe was served its own turkey of sorts as Britain and the European Union ("EU") finally struck a trade deal after nine months of arduous negotiations. The deal however is far from all encompassing. Britons have now lost the right to live and work in 27 countries. This may be especially painful for professional service providers such as doctors, vets and engineers who will need to ensure that their qualifications are recognised in each EU member state where they want to work. The current deal does not cover financial services, roughly 80% of Britain's economy and by far its biggest export. Other negatives that Britons will now face include the prospect of cheap mobile roaming across the continent no longer being

guaranteed, increased waiting times can be expected at airports as Britons will be required to queue with other non-EU citizens and there will be no more pet passports. On the positive front, at this stage both sides have agreed there will be no tariffs or quotas on trade but companies can expect delays at the borders. The deal leaves both parties with a rather unsteady foundation and we can expect years of tweaks and adjustments to the relationship, much like what has occurred between Switzerland and the EU. UK equities appeared to react positively to the agreement and despite a renewal of lockdowns compounded by the discovery of a new potentially even more threatening strain of the COVID virus, over the quarter the FTSE 100, a broad market index for UK equities, gained 10%.

The stellar performance of big tech stocks during 2020, both in the US and China, has led to unwanted attention from governments looking to regulate sprawling operations of these behemoths. Alphabet, the parent company of Google, faces an antitrust lawsuit in the US where it stands accused of holding a monopoly over internet search which it has achieved through anticompetitive contracts and conduct. Facebook has been sued in an antitrust case that accuses the social media giant of choking out competition through the acquisition of and freezing out of smaller competitors. In Europe, the EU intends to launch a digital services act which will provide a framework to regulate big tech companies. The EU has also slapped Amazon with antitrust charges over the treatment of European merchants that sell their goods over the e-commerce giant's platform. Amazon is accused of gathering non-public data of merchants' sales to boost its own-label products. In addition, Amazon is accused of giving preferential treatment on its site to its own products at the expense of competing merchant products.

China has taken a much firmer stance against the power garnered by its tech giants with Alibaba and its CEO Jack Ma feeling the full force of the ruling party's power. The 5<sup>th</sup> of November was expected to be a landmark date for the e-commerce tycoon with the listing of Alibaba's associate, the Ant Group, holding company of Alipay. However, on the eve of the listing, Chinese regulators stated there had been a "significant change" in the regulatory environment which saw the IPO suspended. This was merely a sign of things to come for Mr Ma.

Instead of dining on turkey like Boris Johnson and Ursula von der Leyen, Jack Ma was left with a lump of coal in his stocking as Chinese regulators began to take action against the billionaire's empire. Beijing's market regulator, the State Administration for Market Regulation, announced that it had launched an antitrust investigation into Alibaba. The antimonopoly regulator said that it would investigate reports which had suggested that Alibaba pressures merchants who sell goods on



## A year to forget that will never be forgotten

its platform not to sell on competitor's platforms such as JD.com and Pinduoduo, both backed by another Chinese tech giant, Tencent. In addition, China's central bank and regulatory agencies responsible for securities, banking and insurance announced that they would urge the Ant Group to implement financial regulations and rules. Regulators are concerned with the Ant Group's unsecured online-lending model which could potentially represent a "systematic risk" for the Chinese financial system. The Chinese central bank has stated that it would prefer to see the Ant Group "return to its origins" as a payment services provider as well as "rectify" its credit lending and wealth operations.

The listing of the Ant Group would have been the largest IPO in history at \$34 billion. Even without this mega listing, 2020 has seen the most money raised through equity listings in over a decade. Globally, companies raised close to \$300 billion with more than half raised on US stock exchanges. The recent listings of DoorDash, a US-based meal delivery company (think Mr. Delivery or Uber Eats) and Airbnb, a vacation rental online marketplace, caused many investors to experience flashbacks of the dotcom mania in the late 1990's. Both DoorDash and Airbnb experienced massive "pops" on the days that their shares started trading with the pair closing 86% and 113% higher respectively. DoorDash now has a market cap that exceeds Yum Brands, the company that owns KFC, Pizza Hut and Taco Bell. Airbnb is now worth more than the combined value of Marriot International, Hilton Worldwide Holdings and Hyatt Hotels.

The South African rand has experienced a roller coaster year. After nearly reaching R20 to the dollar earlier in the year the rand closed out 2020 at R14.65 to the dollar. With South Africa currently experiencing its second wave of the virus and a recommencement of a stricter lockdown many may be wondering what is spurring the appreciation in the local currency. One factor would be the dollar weakness as discussed previously. Investors are also attracted to the higher interest rates offered by South Africa. Interest rates are at close to zero or even negative in developed markets and after subtracting inflation South Africa offers an attractive real interest rate compared to other emerging markets. As mentioned, one of the categories of stocks that has been powering the gains seen in global equities has been emerging markets. The local South African market has been a beneficiary of this trend with the JSE All Share Index closing 9% higher over the quarter. Keeping with this change in trend, South African cyclical had strong gains over the quarter with the JSE Banks Index, General Retailers Index and Industrials Index up 26%, 22% and 19% respectively. Weighing down on the performance of the local market were gold miners that declined due to the stronger rand and flat gold price leading to the JSE Gold Mining Index declining 25% over the quarter. The Chinese antitrust probe into its tech sector has also weighed on Tencent which in turn has flowed through to both Prosus and Naspers. The SA-listed tech counters ended the final quarter in positive territory though events surrounding the

antitrust investigation led to a sharp pull back in their respective share prices resulting in both underperforming the overall JSE.



As we begin 2021, the 20<sup>th</sup> of January will mark the first major event of the calendar year, that being the inauguration of president-elect Joe Biden as the 46<sup>th</sup> president of the United States of America. In the lead up to his inauguration there was a small matter of two run-off elections that took place in Georgia. Neither Democrat nor Republican senate candidates were able to obtain 50% of the votes during the election held in November and now Georgian voters must return to the polls to once again decide. At stake were two seats for the US senate. Both Democratic candidates were victorious in a close fought election. The chamber now has a 50-50 split with the incoming vice-president, Kamala Harris, having the tiebreaking vote meaning that the Democrats will now control the US senate. Democrats now control both houses, those being the Senate and the House of Representatives, as well as the Presidency which will provide Mr. Biden with a better chance of implementing his agenda regarding climate change and infrastructure spend.

I think most will agree that 2020 was an awful year and sadly it will forever be etched into our minds, never to be forgotten. Though equity markets have recovered (for the most part) ending the year on a positive note and the rollout of the vaccine will instil a sense of hope into investors, unfortunately, as we close out the final chapter of the year we find ourselves once again hunkered down at home under harsher lockdown conditions. In what would normally be a festive period I believe the words from Taylor Swift's new chart-topping album say it best: *'tis the damn season*.

# Prepare. Diversify. Multi Manage.



*Riccardo Fontanella, Head of Technical Marketing, Alexander Forbes Investments*

**There are two words that were overused last year with, unfortunately, good reason – 'unprecedented' and 'uncertainty'.**

We were all forced to come to grips with a way of life never faced before; something that made us stop in our tracks and put everything on hold. The global pandemic brought on by COVID-19 has most of us still feeling confused and unsettled.

While the events that unfolded last year were certainly nothing anyone could ever have expected, the seismic impact experienced in capital markets was not unnatural. All generations of investors have been through a severe market downturn at some point along their investment journey. For some investors, 2020 presented them with their first financial market squeeze. It is important to remember that last year's market shock was not the first rodeo for investors. We have been here before. It was just a different bull we were faced with.

At the point of impact, it was hard for investors to rationalise what would happen to their hard earned savings. However, it is in the aftermath that a moment of reflection ensues. The calm after the storm provides some breathing space to formulate a defined and thoughtful response to future uncertainties. To paraphrase Howard Marks, we cannot predict what will happen, but we can prepare.

Last year's downturn was no different to any other downturn investors have experienced in the past. In fact, we have seen numerous financial crises unfold over the last 40 years and, before that, a longer list still. Those who took the time to reflect and heed the lessons from past experiences know that peace of mind in a world of uncertainty comes from preparation.

The standstill – to which the world was (and continues to be in other countries) subjected to – had forcefully ring-fenced breathing space for so many people. The lockdowns have decelerated so many aspects of our lives. All noise and clutter seemed to dissolve away and, in the calmness, many of us noticed and appreciated the things taken for granted during times of normalcy.

While the impact of COVID-19 and its foreseeable knock-on effects are not lost on us, it did surface a stark reminder of the merits of multi-management.



## Prepare. Diversify. Multi Manage.

### Purposeful diversification

Investing has no guarantees. Diversification – investing in different types of investments such as equities, property and cash, across different sectors, currencies and regions – can help reduce the overall investment risk of a portfolio and help smooth short term market volatility. As the adage goes, diversification is an investor's only free lunch.

Multi-management is an investment approach premised around diversification. Purposefully combining several complementary asset managers, across different markets, investment types, investment philosophies and styles of money management to enhance meaningful diversification and optimise investment returns. Other than the unattainable shield of perfect hindsight, the value of diversification embedded in a multi-management investment approach becomes particularly obvious in markets such as these. It is an insistent lesson from most market downturns in our history.

### Adaptation is the rule of existence, not the exception

We had to dig deep into ourselves to endure last year, finding the resiliency to overcome the challenges sprung upon us and the adaptability to pivot around the unanticipated shifts in our lives and environments.

In much the same way, investment portfolios have had to navigate turbulent and shifting markets. The resiliency and adaptability of a multi-management investment approach would have been good levers to have on the side of your savings and investments. This should not come as a surprise as diversified portfolios are better positioned to respond strongly enough to participate in market opportunities or protect during extreme conditions.

Whilst many other market-linked portfolios may find themselves anchored in the eye of a storm, multi-management provides a portfolio management crew who can access the levers required to deploy different asset classes, investment strategies and asset managers at different times and depending on their views. This ability is fundamental in striking the right balance between protecting against inherent risks and quickly modifying investments to take advantage of growth opportunities, where appropriate, on behalf of investors.

Once again, in the calm following a storm, I am reminded of the value of a multi-management investment approach. It is an insistent lesson I have certainly come to appreciate and remember when it comes to tackling market turbulence and preserving long term promises to investors, now and into the future.



# The COVID-19 pandemic exposes home truths about the critical need for responsible investment



*Khaya Gobodo, Managing Director, Old Mutual Investments*

Asset managers are in the unique position to make decisions that influence the economy, the environment and society as a whole. As an industry, we direct a material portion of capital flows in the economy and so have a genuine interest in ensuring that the economy sustains itself. Critical in this work is an appreciation of the interconnected nature of the economy, society and the environment.

The continuing COVID-19 pandemic has heightened this awareness and laid bare the vulnerability of the economy to outside biophysical system shocks. A measure of this vulnerability is the scale of fiscal stimulus presently being rolled out around the globe. It's an amount that far outstrips the stimulus packages post the 2008 Global Financial Crisis. There are questions to be asked around how this capital will be deployed. Will it be directed to enable more of the same kind of economic growth and its attendant social and environmental system risk? Or will it be used to build back better and be directed in a manner that drives socially inclusive, low carbon and resource efficient growth?

Another distinct capability of the industry is the capacity to enable a growth path that best sustains the long term health of the economy, society and the environment. Asset managers will have to choose which side of the fence they sit on in respect of this issue. The side they choose could well define their future prospects. This is all while focusing on the

fiduciary responsibility to act in the best interest of clients and deliver investment outcomes that meet or exceed their expectations.

## Partnership across the value chain will be key

Capturing the green growth and build-back-better opportunity will require collective action by asset managers, asset owners and asset consults. As industry partners, we have the responsibility to understand the impact of our investment and stewardship decisions on society and the environment. A critical element of this will be formulating long term partnerships based on measurable sustainability outcomes. Asset managers will not only need to engage proactively with investee companies on sustainability issues, but will similarly need to engage asset owners on their views.





## The COVID-19 pandemic exposes home truths about the critical need for responsible investment

Seeking alignment on these issues, through solutions that deliver appropriate risk adjusted returns and impact, will remain at the forefront of innovation in the asset management industry for the foreseeable future. Long term partnerships will be a key to success here, as will be the ability of managers to collect and report on ESG impact metrics. For asset managers, it is clear that it's no longer enough to only focus on providing appropriate risk adjusted returns, excellent client servicing and competitive fees. The type and scale of impact will rightfully also become an important consideration when selecting a long term partner.

### Aligning impact outcomes across asset classes

The SA government has made a commitment that our recovery plan will be infrastructure-led, with a focus on energy; water and sanitation; public transport, roads and bridges; human settlements, health and education; digital infrastructure and public transport. All these areas present great opportunities for long term investors to align capital with green economy outcomes.

It is expected that the bulk of these opportunities will be best accessed via long-dated debt and private equity investments. Presently unlisted investments provide the most direct opportunities to contribute to green growth through themes like renewables energy, schools and housing. The economic

structure of the SA listed markets means that opportunities to play the green growth theme are somewhat limited. However, investors shouldn't forget the opportunity to drive impact through the listed market. This can be done by investing in ESG indices in addition to the growing ranges of active investment solutions that leverage and integrate ESG data and insights.

Another important opportunity to drive impact in the listed markets is through active stewardship. We expect large scale asset owners, with long term time horizons, to start exercising their fiduciary right in a more coordinated fashion. We see this as a material opportunity to drive market transformation while, at the same time, reducing long term systemic risk.

There are a diverse set of return, risk and ESG impact outcomes that can be achieved across the various asset classes in SA and globally. Having products and service that deliver measurable impact outcomes across asset classes will be a key competency for asset manager competitiveness going forward.

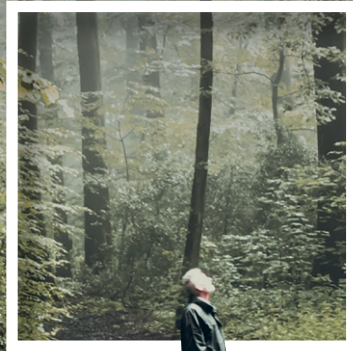
While we cannot possibly anticipate all the factors impacting the asset management industry going forward, we can be sure that the COVID-19 pandemic has strengthened and hastened the pre-existing trend of responsible investment and green growth.





# HOW DO WE CREATE A FUTURE THAT REALLY MATTERS?

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**To answer more of your investment-related questions or queries, visit [www.oldmutualinvest.com](http://www.oldmutualinvest.com) or email [futurematters@oldmutualinvest.com](mailto:futurematters@oldmutualinvest.com)**



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# Exactly how do Emerging Asset Managers fit into my investment strategy?



*Tshepo Pule, Research and Portfolio Solutions, Motswedi Emerging Manager Strategists*

The concept of investing with emerging asset managers (EAM) in the South African context has been gaining momentum over recent years. Lending support to this is the fact that many of the EAMs happen to be >51% Black owned small and medium sized businesses – which we all know to be the growth engine of employment in our economy.

These EAMs play a critical role in building and growing relevant investment experience and skills, and promote inclusion of young professionals into the financial services industry. The most important contribution of these EAMs is to the diversity of thinking in the industry. We have seen many new ideas and innovations seeded in these small and medium sized businesses, which have the potential to take on the traditional established investment houses.

Let's look at some of the typical conversations trustees are having around the table on EAMs.

## Will the manager be around next year?

Let's be clear, risk exists in every organisation. The difference between the EAM and the traditional manager is where these risks exist and how these risks are managed. Organisational risk in large firms tends to be ignored due to the assumption that there is no risk attached to established businesses - something which has been exposed as not true numerous times over the past few years (think Steinhoff, McKinsey, Tongaat-Hulett, KPMG etc). EAMs are generally small to medium sized investment firms which tend to have entrepreneurial founders and leaders, who have a deep knowledge of the industry and well established networks, and have chosen to challenge the status quo. In these firms there is usually a clear alignment of personal, professional and economic interest with the interests of the investor.

## Performance advantage

EAMs provide an opportunity to early stage investors to access differentiated return profiles. Global research has shown that younger smaller funds outperform older larger funds. In South Africa which has a smaller number of stocks for asset managers to choose from, EAMs have a trading and liquidity advantage, which allows for meaningful positions, particularly in the small and mid-cap stock space while at the same time having less market impact. The trick most investors find difficult is to identify EAMs which are truly differentiated in order to realise this advantage. Hence investors tend to stick with the established names they are used to.

## So how many managers are we talking about here?

There are more than 40 EAMs which have Black ownership greater than 51%. Other aspects taken into account when identifying managers who have taken transformation seriously, is the representation of Black individuals with decision making power at Board of Director and senior management level. This measure gives an indication of the asset manager's commitment to transformation and the direction the firm may be expected to take into the future.

In the asset management industry, we also look at the representation of Black individuals at portfolio management level, in other words the investment decision makes, or “trigger-pullers”. This gives investors a truer picture of the willingness of asset managers to truly transform in a South African context.

## Exactly how do Emerging Asset Managers fit into my investment strategy?

### Are there too many managers to choose from?

A clear theme we have identified from the investors we talk to is that there are too many asset managers to choose from. Research has shown that too many options lead to low action by participants, which in our observation translates into the exclusion of transformed and EAMs. One solution is the use of a specialist in the area of EAM research to assist with the understanding of transformation initiatives within asset managers.

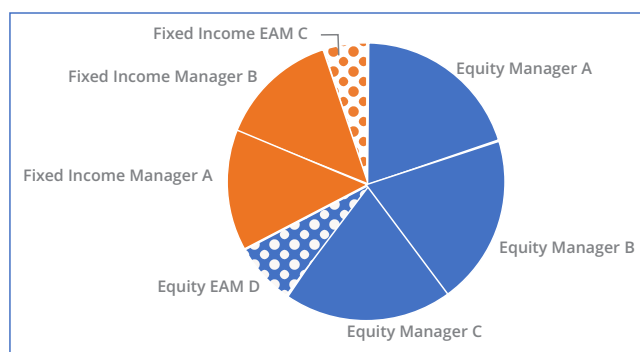
A specialist multi-manager is able to carefully choose suitable asset managers for the different solutions investors seek. The multi-manager approach uses a process of manager research, selection, blending and monitoring to reach favourable outcomes. The multi-manager will need to demonstrate their value-add showing that this process is not only about deploying assets to emerging managers but also providing necessary tools to reach desirable levels of sustainability.

### How do we put EAMs into our strategy?

Several approaches exist as to how an investor can efficiently introduce EAMs into their long term investment strategy. One strategy we have observed is the “part of total allocation” strategy. In this approach, investors simply include good EAMs into their strategy in a like for like swap or in a reduction of assets allocated to incumbent traditional managers.

#### “Part of Total Allocation” strategy

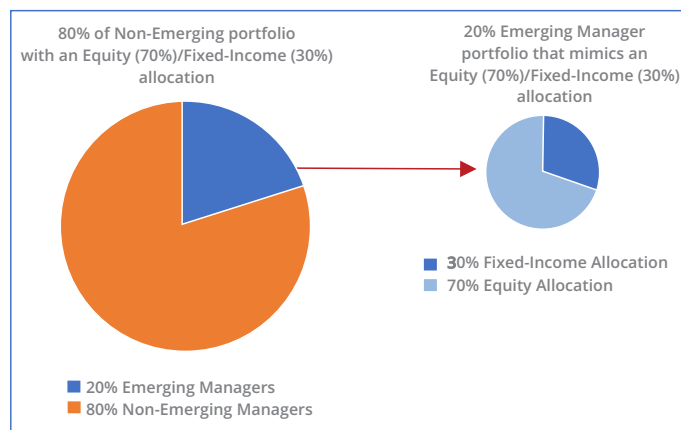
We have observed that most investors have taken a “dip-your-toes-in-the-water” approach - very few have jumped in the deep end with significant allocations. In circumstances where investors have been guided by a transformation policy or score card, they have made major strides in increasing allocations to good EAMs.



Source: Motswedi Research

#### “Separate Allocation” strategy

The second approach to including EAMs into a portfolio is the “separate allocation strategy” where EAMs are introduced as a discrete portfolio designed to mimic the asset allocation of the overall strategy. The aim is that, over time, the EAM will graduate into the mainstream strategy and the fund would eventually have a single strategy with all managers delivering according to mandate. Our research shows that this approach is not popular in South Africa.



Source: Motswedi Research

### Performance first then transformation

But can we not do both at the same time? Yes, we can! There are a multitude of publicly available surveys and data sources showing the universe of majority Black owned and managed asset managers which have delivered consistent competitive performance. Thereby debunking the myth that performance is sacrificed for transformation. However, we know that performance alone cannot change investors' buying behaviour to move from the “safe as houses” traditional managers towards the many new-kids-on-the-block majority Black owned and managed asset managers. Attitudes about skill and ability have to be modified, together with a dose of gut instinct on up-and-coming EAMs. Encouragingly we are already seeing more investors looking outside of their comfort zones and implementing new innovative thinking. Transformation in asset management means different things to different people. A question I often ask is: “What is the spirit of transformation which permeates within an organisation which has achieved a good employment equity certification?” Are we entertaining the proverbial tick-box exercise to show that we are on board with transformation or are we truly embracing transformation as a valuable tool of growth and expansion of the South African asset management industry?





# Catalysts of the new wave of emerging asset managers

Now is the time to partner with Motswedi to identify and invest with the new wave of emerging and transformed asset managers. We provide independent asset manager research, strategic consulting services and empowered multi-manager solutions.

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# Getting to grips with green bonds

Santhuri Thaver -  
Head of Credit Risk  
at Ashburton Investments



As we continue to grapple with the impacts of the current pandemic, we shouldn't steer attention away from another critical and immediate challenge: climate change. Response to climate challenges is no longer the right thing to do but rather an imperative in order to create a sustainable future.

Enhanced investor focus on environmental, social and governance (ESG) factors, increased stakeholder activism and the need to remain competitive with peers who are leading the pack continues to create momentum for investments that can achieve both the necessary returns and a positive tangible impact. One such financing mechanism dedicated to funding climate positive/friendly investments and gaining traction in the South African landscape is the issuance of green bonds. At the recent Sustainable Infrastructure Development Symposium, Government made mention of the issuance of green infrastructure bonds to finance much needed infrastructure projects that are key to revitalising the South African economy. Below we explore this financing instrument and some investor questions around aspects of green bonds.

## What are green bonds?

A green bond is a fixed income instrument issued on either a listed or unlisted basis, the proceeds of which are specifically earmarked to address climate related challenges. It is important to stress that green bond proceeds are not available for general corporate purposes. Green bonds can be used to fund both new or existing operations with issuance not only limited to greenfield project finance transactions. A green bond issuance by an existing corporate could seek to improve their environmental impact by utilising proceeds to reduce greenhouse gas emissions, water pollution or improve energy efficiencies.

## Is investing in a green bond riskier?

Our view is that participation in listed green bonds does not bring about additional credit risk. Where the bonds are unlisted, investors should be compensated for illiquidity through an upward adjustment in the margin. There is, however, added operational complexity and costs borne by the issuer in respect of reporting requirements but assessment of the risks and returns remain the same as with traditional bonds. In fact, one could argue that there is a slight decrease in the credit risk due to the improved sustainability of the issuer's operations as a result of the use of bond proceeds.

## Do green bonds price differently to traditional bonds?

The City of Johannesburg was the first to pioneer the issuance of green bonds in 2014. More recently, we have seen issuances from South African financial institutions.

In 2019, Nedbank led the South African banks with two issuances. A R1.7 billion first issuance in April and a second R1 billion issuance in October were both oversubscribed by 3x and 4x respectively. The proceeds from both issuances were used to fund solar and wind energy projects. The below table compares Nedbank's green bond issuance spreads to other big four South African bank issuances in the same month.

April 2019	Quantum (R'm)	Spread at issuance	Other Senior Unsecured Bank issuances			Green Bond Margin Improvement
			Bank	Quantum (R'm)	Spread at issuance	
3 year	616	114bps	ABSA	600	115bps	1bps
5 year	715	130bps	No comparable issuance, cleared at lower end of guidance			
7 Year	331	141bps	No comparable issuance, cleared at lower end of guidance			

Source: Nedbank CIB Fixed Income DCM Trends Publication April – 09 May 2019



## Getting to grips with green bonds

October 2019	Quantum (R'm)	Spread at issuance	Other Senior Unsecured Bank Issuances			Green Bond Margin Improvement
			Bank	Quantum (R'm)	Spread at issuance	
3 year	495	110bps	FirstRand	1 316	111bps	1bps
5 year	505	123bps	FirstRand	1 009	125bps	2bps

Source: Nedbank CIB Fixed Income DCM Weekly Issuances -29 October 2019

From the above, it can be seen that Nedbank's green bond saw a marginal improvement in spreads. This could be driven by various investor bid considerations, however, it is unlikely that a lower return will be accepted for the same counterparty's green vs traditional bond unless there is a specific mandate target for sustainable investments.

### Why should an investor consider green bonds if a traditional bond provides similar returns?

Investor mandates and the increased appetite for socially responsible investing will drive demand for green bonds over conventional fixed income bonds as they place a specific requirement on the issuer in terms of the use of the proceeds, reporting principles and audit requirements. Earlier this year, Standard Bank issued its maiden USD200 million listed ten-year green bond. The entire issuance was taken up on a private placement basis by the International Finance Corporation (IFC). The proceeds of the bond would be applied towards financing of eligible green assets including renewable energy, green buildings, water and energy efficient projects<sup>1</sup>.

In July 2020, African Development Bank invested R2bn in Nedbank's ten-year non call five Tier 2 Sustainable Development Goals linked bond. The investment is expected to create more than 6 000 new jobs in South Africa and promote financial inclusion through the provision of 20 000 Small Medium Enterprise loans, as well as catalyse further investment in renewable energy. The facility is aligned with the African Development Bank's ten year strategy emphasising green and inclusive growth<sup>2</sup>.

September 2020 saw FirstRand secure USD225m from the IFC to facilitate financing of green projects and assist with the country's de-carbonisation journey. The quantum of these issuances evidences both lenders and investors commitment towards sustainable financing.

Through a green bond, investors will be able to access projects or investments that will unlock specific environmental and economic benefits.

### Given limitations on use of proceeds and increased reporting requirements, how does an issuer benefit from issuing a green bond?

Green bonds enable an issuer to broaden its funding base by attracting capital from a diverse and/or new funding base seeking to address climate challenges. It also enables the issuer to meet their sustainability objectives and provides brand or marketing equity, enhancing its reputation as a responsible corporate citizen not generally arising with raising of conventional debt.

Investors should, however, ensure that they are comfortable with the reporting principles or framework and the third-party verification so that the intended consequences of the financing are achieved.

Transparency with regards to selection of projects, use of proceeds and reporting will set further appetite for future green bond issuances.

### What are typical green bond tenors?

Tenors vary, with green bonds being largely medium term in nature and can match those of traditional bonds but are dependent on the underlying project or activity being funded. Longer dated tenors provide a risk adjusted return for investors looking to match long term liabilities with an added impact benefit.

### Are green bonds suitable for retail investors?

This is really dependent on the green bond reporting framework. While retail appetite may be present, a retail investors' ability to assess the credibility of the reporting and impact assessment may require a further measure of oversight.

### Outlook

The pandemic has seen companies in survival mode with a focus on raising debt to manage operations and/or create liquidity buffers. In the medium to long term, we expect increased appetite for green funding driven by ESG factors, the need for more sustainable operations and particularly Government's infrastructure rollout. To assure investors that the proceeds are being used as intended, transparency and requisite reporting is key.

<sup>1</sup> <https://www.bloomberg.com/news/articles/2020-03-02/standard-bank-sells-200-million-10-year-green-bond>

<sup>2</sup> <https://www.afdb.org/en/news-and-events/press-releases/african-development-bank-concludes-r2billion-investment-nedbank-sdg-linked-bonds-37612>



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# Six degrees of separation

*Mike Adsetts, Deputy Chief Investment Officer, Momentum Investments*

**"Six degrees of separation is the idea that all people on average are six, or fewer, social connections away from each other.... As a result, a chain of "a friend of a friend" statements can be made to connect any two people in a maximum of six steps.... It is sometimes generalized to the average social distance being logarithmic in the size of the population<sup>1</sup>." (Frigyes Karinthy)**

If we ever needed a real life demonstration of the interconnectedness of all of us, the events unfolding in 2020 showed us that we are part of a highly unified global family. The other feature of 2020 was how timelines shortened, be it the speed with which information is carried around the world, the speed of the market crash in March followed by an equally rapid market recovery and the record breaking speed in development of numerous vaccines.

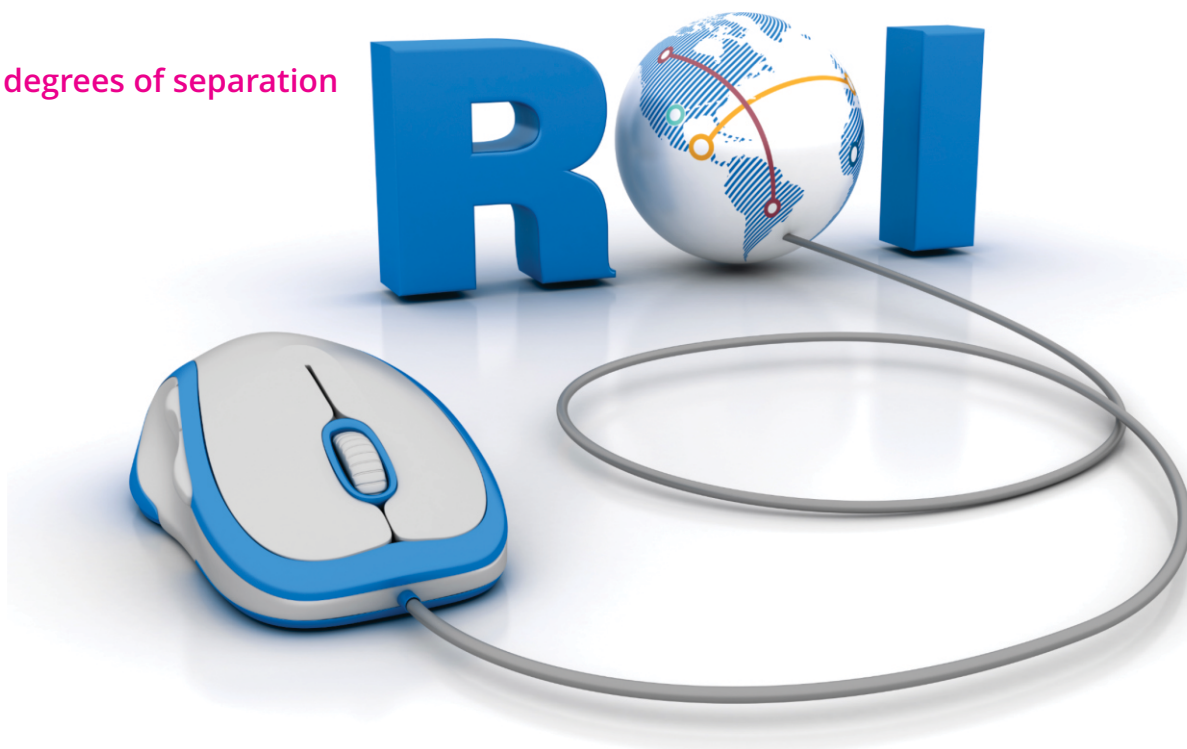
In the context of 2020, it is no surprise that investors increasingly start to question the effect of their investments beyond just return. 'Capital with purpose' is a good descriptor of this shift in mindset. Responsible investing and environmental, social and governance (ESG) risk factors received unprecedented attention and the importance of each of the three ESG factors in sound and sustainable investment decision making became more evident.

The high temperature in the aptly named 'Death Valley' in California of 54,4°C on 16 August 2020, with the public outcry on the effect of global warming that followed, was a good example of how environmental issues are going to become increasingly important when considering energy (and renewable energy) investments in the future. As with all investments, there are threats as well as opportunities, and renewable energy is a perfect example of an investment opportunity that arose in response for more considered approaches to energy security.

A robust approach to try and remedy climate change is the obvious driver of interest in renewable energy, with the added dimension locally of the failure of Eskom to provide an adequate energy supply. In one of those cruel twists of fate, the constraints on the local economy, as a result of the COVID-19 lockdowns, limited load shedding in the last year. As the

<sup>1</sup> Wikipedia

## Six degrees of separation



economy opens up, there is going to be increasing pressure on energy availability, and addressing this constraint is a non-negotiable for any efforts to get South Africa back onto a sustainable growth path. While the principle of collaboration between government and the private sector is clear, the devil is most definitely in the detail. As we seem to work together in formulating a new social compact, the goal posts keep shifting and we need policy certainty and to re-establish a level of trust between labour, government and business. Unfortunately, the apparent tone deafness of government in rolling out restrictions has resulted in significant stress in the system and needs to be addressed.

The societal effect of COVID-19 and the need for re-invigorating the economy after South Africa endured one of the hardest lockdowns globally is evident. Investments in infrastructure have been flagged as one mechanism for reigniting economic growth. There are good and bad infrastructure investments but undoubtedly this will warrant a lot of focus in South Africa in the next few years. Here again we will not be able to forge forward without a consensus between role players.

There are many different perspectives on infrastructure investments. Taking into account the noise around prescription or compulsory investment by retirement funds, you can easily conclude that these investments are a bad idea. The reality, as always, is far more nuanced. In May 2020, government announced that it is in the process of fast tracking R350 billion of infrastructure projects.

This is part of government's overall COVID-19 response to restart the economy and crucially requires private sector investment. The project pipeline yields a mixed bag that has vastly different levels of attractiveness, from a return


perspective and an ESG perspective. The full pipeline is unlikely to excite all private investors but the focus on critical water and energy as well as transport infrastructure is a bright spot.

The Zondo Commission brought governance failures and the destruction of capital into sharp focus. In 2021 the revelations of failures in governance and state capture will continue to capture headlines. As shocking and upsetting as all these revelations are, worse would be for these issues to no longer be brought out into the open. The silver lining, albeit a painful one, is that there is more evidence that wrongdoers will be held to account and increasingly those being brought to book are prominent and powerful government and business figures. We must continue to support these processes of accountability.

Responsible investing has come into the mainstream in the mind of investors and rightly so. As we increasingly question not just the return on our investments but the effect and purpose thereof, there is a real opportunity not only to achieve healthy returns but also to have an effect on the health of the interconnected world.

Responsible investing practices resonate with an outcomes based investing philosophy and the alignment of investors' long term goals to positively influence the world they will retire into. Responsible investing can help to create investments that are not only good for investors, but also sustainable for the world we live in.





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# momentum

## investments

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# 危机

Responding to the real needs  
of clients during a crisis -  
what the pandemic has  
taught us



*Natalie Phillips, Deputy Managing Director, Africa Client Group, Ninety One*

**The unprecedented global crisis that we have witnessed unfolding since January 2020 has created unique challenges for us all - both as people and as professionals in the investment industry.**

As custodians of our clients' capital, the first and most critical step in responding to the challenge posed by COVID-19 is to ensure that we put our clients first. During the COVID-19 pandemic, companies that lead with empathy and genuinely address their clients' needs will strengthen their most important relationships. Now, more than ever, it is incumbent on us to remain calm and focused to navigate these markets and position investment portfolios in the very best way to benefit from whatever recovery may come.

As investment managers, the starting point when a crisis breaks and the resulting market volatility impacts clients, is to ensure that we continue to engage and support them. By its very nature, the investment industry is driven by a high degree of uncertainty and markets are a complex adaptive system. In addition, we were managing the risks associated with a market crisis due to a black swan event. The level of uncertainty we were working with was magnified, with no understanding of what the final outcome would be. In times like these, chasing the best performing manager falls by the wayside. John F. Kennedy had a great quote in dealing with crises: "When written in Chinese, the word crisis is composed of two characters – one represents danger, and the other represents opportunity".

## A crisis beyond the market

The unique challenge of the recent crisis was that it affected us personally – the impact was not only felt in performance and portfolios.

With the benefit of hindsight, we appreciate that it was important very early on in the crisis to recognise that we would not be able to tackle this challenge – and maintain the vital link between ourselves and our clients – if we didn't take care of our employees and their families. Investment management is a human capital business.

The crisis forced the entire industry to adapt quickly: to effectively switch to working from home without a glitch and support our clients in embracing new communication initiatives, such as investment webinars. Investment managers also had to ensure that we were on the front foot and agile in responding to real time questions and fears (including the issue of prescribed assets) and how to stay the course with a particular investment strategy despite significant drawdowns.



## Responding to the real needs of clients during a crisis - what the pandemic has taught us

The industry had to be quick to understand the importance of keeping staff working efficiently and motivating them. We learnt that consistent and regular communication from leadership is vital.

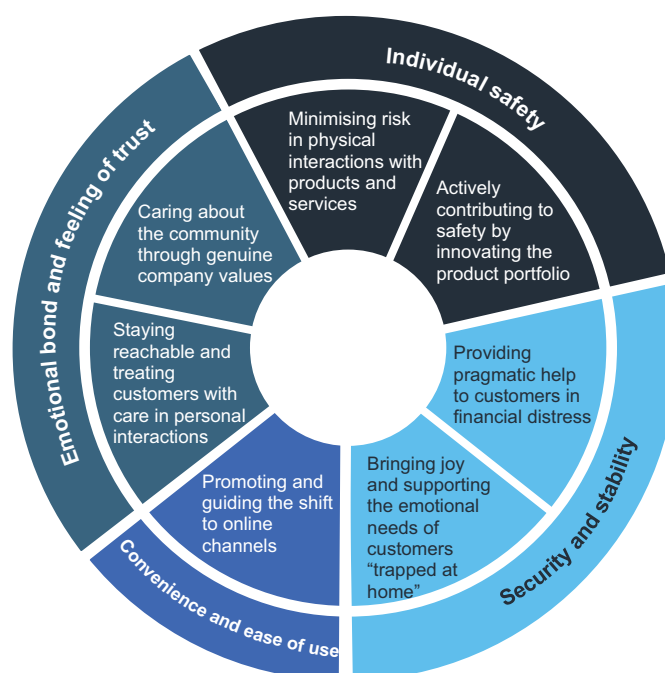
### What were the real client needs?

The real needs of our clients during the crisis became clear in that they wanted ongoing communication, and far quicker response times in dealing with their queries. The entire industry had to adapt to online client meetings and report backs – those that had these tools available first benefitted greatly.

What has also made this crisis different is that we have seen client needs shift to more essential concerns. Many clients are really suffering financially and supporting industry wide initiatives is key to assist those individuals who were, and remain, at risk of losing their jobs. To this end, investment managers and advisory teams helped lobby the SA government to temporarily allow living annuitants to draw less than 2.5% (if they were concerned about locking in losses as they have to sell units as per a pre-determined income level percentage) and to draw more than 17.5% (if, for example, the impact of the pandemic put a strain on their cash flow).

A recent McKinsey survey of US consumers found that 64% of respondents have felt depressed and anxious as the crisis continues and 39% have stated that they would be unable to pay their bills. The numbers for SA are likely to be far worse. McKinsey & Company provide an excellent visual of how companies can connect with their clients during times of crisis. An example is in providing pragmatic assistance as an industry in times of financial distress.

### Companies can consider seven actions to emotionally connect with customers



Source: McKinsey & Company, 15 April 2020

### Why honesty matters

Ultimately, working in collaboration with clients in finding solutions to manage the crisis has proven to be a successful strategy. This is achieved by honest conversations with clients and ensuring that there is a shared understanding of the uncertainties and difficulties faced as a consequence of the crisis and the resultant impact on their portfolios. Give clients some steer about the future and the impact of the crisis on their investment strategy.

Navigating through a crisis can be a true test of any firm's culture on many fronts: are they genuinely true to their vision and do they really care about their clients? The pandemic and its aftershocks will be with us for many years to come. Those firms that stay close to their clients, listen and engage, respond to their needs while fulfilling their fiduciary duty as custodians of their investments, and play an active role in supporting their communities, will ultimately emerge the winners once we can put COVID-19 behind us.



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# [STOCK - TAKE]



# A revival in the life insurance sector: Growth potential at MMH undervalued



Nicholas Stein, Portfolio Manager,  
Coronation Fund Managers

Coronation owns stakes in both Sanlam and Momentum Metropolitan Holdings (MMH) on behalf of clients. Sanlam has long been a share we wanted to own, but its persistent premium to embedded value (a measure of a life company's intrinsic value) left little margin of safety.



The Covid-19-induced selloff in March 2020 hit high quality and low quality businesses indiscriminately and provided us with a good entry point to acquire shares in Sanlam below its embedded value. We suspect, however, that readers will find our Sanlam purchase uncontroversial and may be more interested in the thought process behind our MMH stake.

## Life company attributes

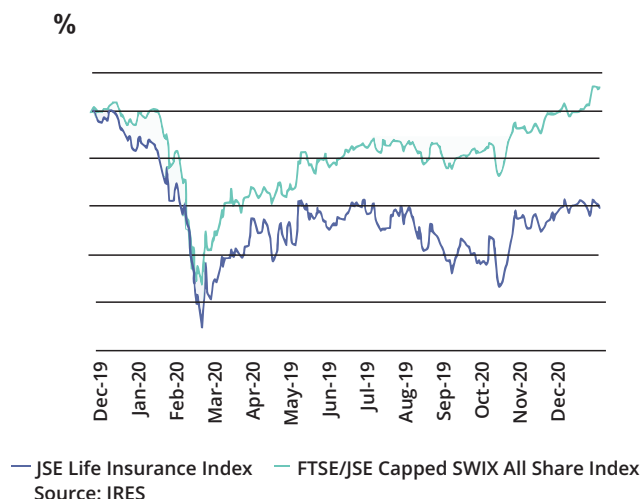
Life companies may be considered mature and boring, but they have attributes that contribute to their desirability:

- Extensive distribution networks of advisers that are complex to manage and costly to replicate.
- A number of companies faced existential threats from Covid-19, for example, restaurants and landlords. Life companies have large in-force books of business that generate ongoing fees, often based on asset levels (which are driven by stock market levels). This makes them a bit more defensive.
- Tied to this, we believe the JSE offers compelling value at the moment. A strong stock market lifts the asset levels on which fees are earned.
- Above-average returns on equity through the cycle.
- Very strong capital positions designed to withstand 1-in-200-year stress tests. Companies that are inadequately capitalised are often forced into sub-optimal decisions at wrong points in the cycle.

And yet, while the share prices of many domestic shares have recovered meaningfully from their March 2020 lows, most life insurers are not trading far off them (see figure 1). We suspect there are two main reasons for this:

- Life companies' earnings (and to some extent embedded values) were hit very hard in 2020.
- A dividend mainstay as life companies ceased dividend payments.

Figure 1  
LIFE INSURANCE INDEX VERSUS BROADER  
MARKET INDEX FROM COVID-19 ONSET TO PRESENT





## A revival in the life insurance sector: Growth potential at MMH undervalued

Yet these reasons are short term. When the life insurance companies reported their June 2020 results, markets had not fully recovered. Credit spreads also widened materially. Both factors impact earnings meaningfully (negatively to June), but then started reversing. Perhaps more importantly, life companies 'front-end loaded' the earnings pain caused by Covid-19 by raising provisions for the expected financial impact and expensing them through their income statements. For example, MMH assumed its share of 40 000 Covid-19-related deaths and expensed this. The company also assumed that 50% of policyholders requesting premium holidays would lapse, and up to 10% of all other policyholders, too. MMH also expensed this. This resulted in a R1.3 billion knock to embedded value and a R1 billion knock to reported earnings. However, by taking the pain upfront, life companies should see 2021 earnings rebound quicker than the typical company.

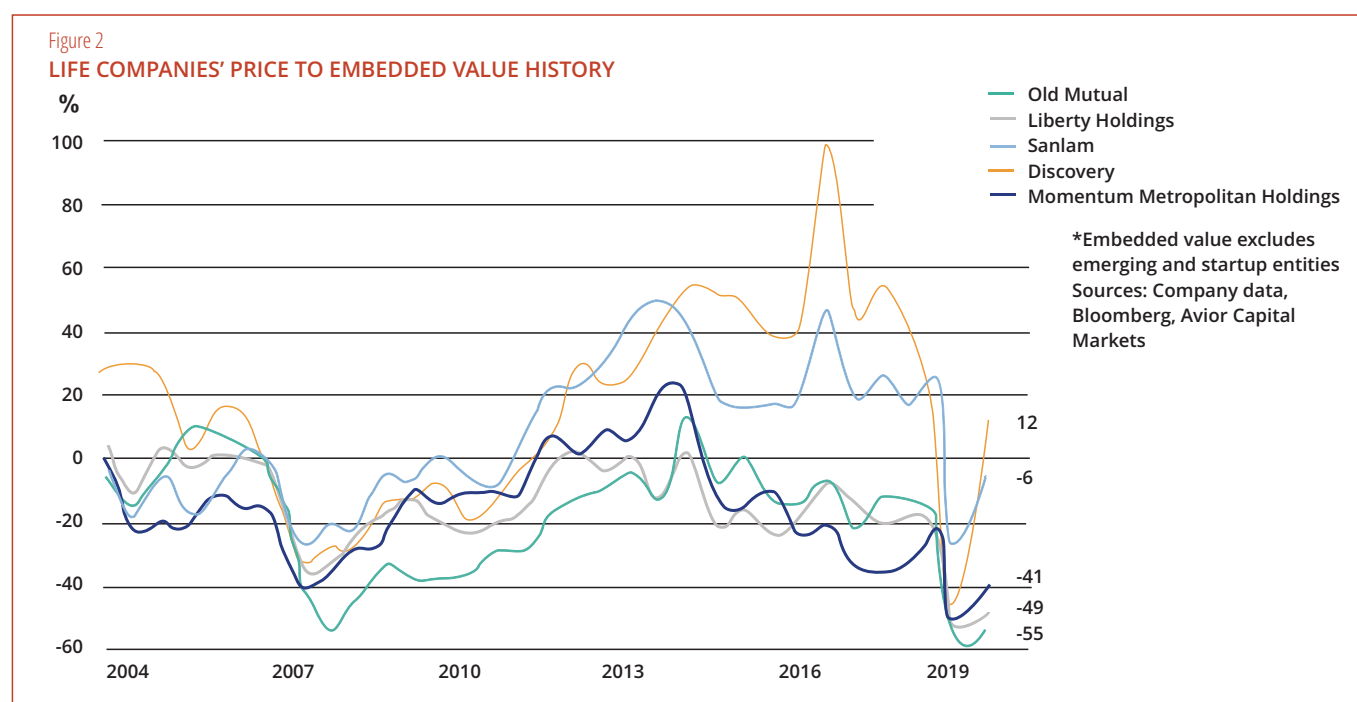
We would also expect most companies in this sector to resume dividend payments when they report in February and March 2021.

### Momentum Metropolitan Holdings (MMH)

MMH trades at a record 40% discount to embedded value (see figure 2). We find this surprising for three reasons:

- The Covid-19 provision has resulted in a more conservatively stated embedded value.
- Over the last few years, management has made the life and non-life valuations within the embedded value more conservative (effectively using a lower price earnings/discounted cash flow to value their own business).
- The new management team under Hillie Meyer, Jeanette Marais and Risto Ketola has done a good job in turning around the operating performance of the group.

As such, the 40% discount to embedded value is even starker than it first appears, given that the embedded value is far more credible and conservative than it was previously, and the company's business prospects are brighter.



### New broom underestimated

The last points on the new management team and the operational turnaround warrants further discussion. New management has been in place since early 2018. In our view, the market is not recognising the turnaround currently under way and is adopting a wait-and-see approach. Turnarounds often take time to fully manifest in reported numbers but we believe there are some very encouraging signs that the market isn't attaching sufficient weight to.

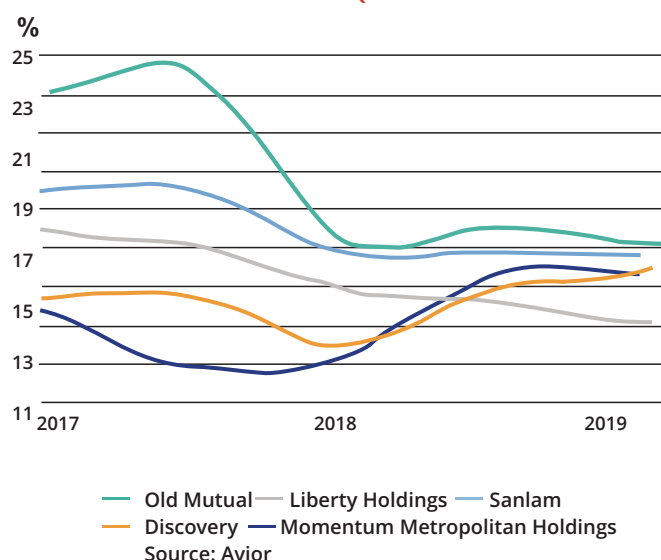
## A revival in the life insurance sector: Growth potential at MMH undervalued

Some divisions within MMH, such as Employee Benefits and Guardrisk, have historically performed well versus their peers. However, there are also signs that previously lagging divisions are turning around. A driving force behind these improvements is the reintroduction of divisional profit and loss statements, which has boosted divisional management accountability.

- Both Metropolitan and Momentum have been growing their tied agency forces ahead of the broader market, suggesting life insurance agents are starting to view them as attractive places to work. Improved product offerings and service levels to agents support this.
- Metropolitan Life was seen as a likely victim of Old Mutual's dominance in the entry-level market, as well as Capitec's entry into funeral product sales. Yet the number of policies that Metropolitan's advisers sell per week has never been higher – an impressive peak given that this includes the Covid-19 operating environment. Metropolitan's earnings have remained resilient.
- Momentum Investments has languished relative to its peers, with its platform shunned. A concerted effort to improve service levels and re-engage with the independent financial adviser community has seen a big pickup in platform net flows and a trend of market share losses being reversed.
- Five years ago, MMH had the weakest franchise of the four mature life insurers. We don't think it's a stretch to say that the company is now on its way to the number 2 spot (after Sanlam).

Figure 3

### LIFE COMPANIES' RETURN ON EQUITY

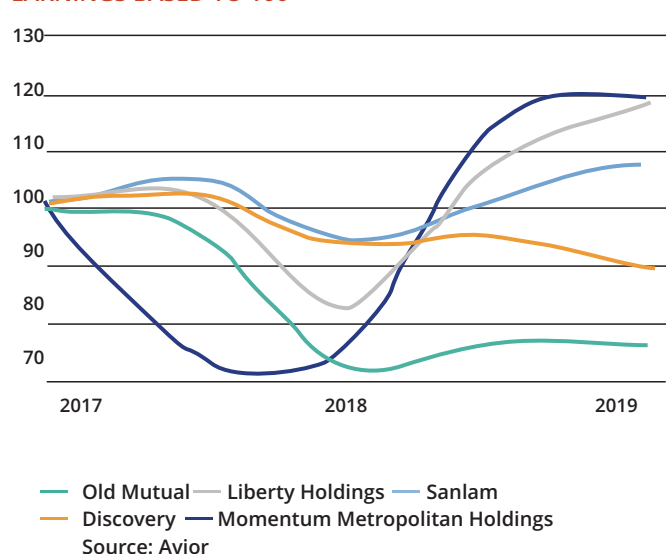


Returns on equity and earnings have started picking up nicely off a low base (figures 3 and 4). We think this trend can continue as the divisional operational improvements continue, given that Covid-19 provisions are now in the base and as loss-making divisions become profitable (if MMH's new Indian Healthcare Insurance joint venture reaches breakeven, it would result in a R300 million earnings improvement alone).

If management's internal profit expectations are realised, MMH trades on about six times two-years-out earnings. We think this is a compelling multiple and provides a large margin of safety.

Figure 4

### EARNINGS BASED TO 100





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# Hybrid annuities: truly the best of both worlds?



*Michael de Villiers (left) and Henre Prinsloo (right), members of the Retirement Matters Committee of the Actuarial Society*

Over the last decade much has been said, analysed, argued and debated on the choice retirees face between living annuities and life annuities.

Historically, this debate has centred around the polarised view that retirees are essentially faced with a binary choice of two annuity options at retirement: purchasing either a living annuity or a life annuity.

Much research has been conducted on how retirees ought to make this decision; and considerations for changing between the two at certain times in order to achieve optimal outcomes (for the retiree) has not escaped the analysis or debate.

But is there a different solution - a solution that looks to combine the best of both products in one wrapper? As a starting point to address this question, it is important that a clear understanding of terminology is set out.

## What is an annuity?

An annuity is a financial product that pays you a regular income at retirement.

With this understanding, it is now possible to lay out the definitions of (and the differences between) a living annuity and a life annuity.

## Living annuity

Following the investment of a capital lump sum, a living annuity allows an investor to select an annual income drawdown percentage of between 2.5% and 17.5% per annum. The investor can select an income frequency of monthly, bi-annually, quarterly or an annual payment. This income percentage can be changed – but only once a year on the

anniversary date of the investment. Throughout the life of this product, the investor carries the risk of maintaining sufficient capital in the annuity to meet their future drawdown needs, or they risk outliving their money!

The often quoted advantages of this type of annuity is the flexibility available and the ability to draw a higher income if needed, as well as the bequeath capacity where, on death, the remaining capital value in the living annuity will be paid to nominated beneficiaries.

## Life annuity

A life annuity secures a pre-determined monthly income for the rest of the investor's life. This product is provided by a life insurance company, where the capital sum (of the retirement saving) is paid to the insurance company who then takes on the obligation to pay an income for the rest of the investor's life. The income may be a fixed rand amount or it might be linked to inflation. In addition, a spouse's benefit or a guaranteed payment term can be added.

While this type of annuity has the advantage of the income being guaranteed for life, upon death any remaining capital reverts to the life insurance company unless the contract includes a guaranteed period or a spouse's benefit.

Given the debate between these two types of annuities, the ever evolving needs of investors as well as the desire of life insurers for increased profitability and market share, it was not unexpected that some form or combination living/life annuity was introduced - the hybrid annuity.

## Hybrid annuities: truly the best of both worlds?

### What is a hybrid annuity?

As the name implies, hybrid annuities are simply a combination of two or more basic types of annuity contracts. Most products combine a fixed (for example, life annuity where a life insurance company takes most of the risks) and a variable (for example, living annuity where the investor takes most of the risks) annuity contract that are housed inside the same product. Those that have a variable annuity in one segment are designed to allow a portion of the investor's money to grow in a sub-account of the contract, while providing guaranteed income that the investor cannot outlive on the fixed side.

Hybrids can be made up of inflation, fixed or with profit annuities. Other types of hybrid contracts pair a fixed annuity with an indexed product in order to provide a complete guarantee of principal in both segments. Like all other types of annuities, they can be either immediate or deferred, with fixed or flexible premiums.

### Are hybrid annuities the one size fits all solution?

Although there are no absolute criteria of who should utilise a hybrid annuity, they are generally most appropriate for retirement investors who are seeking a combination of growth and income. In addition, investors who are more oriented towards getting a stream of income that will keep pace with inflation over time may also find hybrid annuities attractive. The amount of risk that they are willing to take on the growth side will determine whether they should use a product with a variable or indexed segment.

Contra considerations may apply to investors who are well into their retirement years. Investors in this category may not be suitable candidates for hybrid annuities as they are not likely to get the chance to profit adequately from the growth portion. For these investors, a simple immediate annuity contract may provide a better income profile with little to no risk to the capital. However, investors who are more sophisticated and understand how annuities work may be a good fit regardless of age, although the same restrictions may apply to them as well.

### Key benefits of hybrid annuities

Hybrid annuities offer a couple of key benefits to investors in addition to the standard features found in other types of annuities. Their dual nature can provide guaranteed increasing income to investors because the growth portion provides a hedge against inflation - the market risks of this notwithstanding. Contracts that combine a fixed (life) and a variable (living) annuity can also provide clients with a lower level of downside risk than a variable annuity by itself, because the fixed portion will continue to pay out, regardless of the performance of the variable sub-accounts.

### The downside of hybrid annuities - over-designed and too expensive?

While hybrid annuity pundits may claim they are a one-size-fits-all solution that can do almost everything, many critics feel that they are overdesigned and too expensive. The dual type model makes these products especially complicated and many investors are not capable of understanding all the technical features or limitations.

Many hybrid products also come with extremely high fees and back end surrender charges that investors may not see clearly at the time of purchase. They also often pay inordinately high commissions to intermediaries, which can easily sway advisers to show clients these products in lieu of something else that may be a better fit.

A further criticism of these products is simply that they are not really what they claim to be. Any type of annuity can provide both growth and income in some fashion, as virtually all variable and indexed annuity products today come with guaranteed income riders and other features that allow investors to lock in a stream of guaranteed income and still enjoy some form of upside potential.

Nevertheless, hybrid annuities are still able to package two complete annuity contracts into a single product that can essentially perform two different functions at the same time.

### Can hybrid annuities be used as a default annuity strategy in retirement funds?

Regulation 39 of the Pension Funds Act provides for the inclusion of living annuities as part of a fund's annuity strategy. It also provides that living annuities must comply with regulation 37. Regulation 37(2)(g) provides that Boards of funds must ensure and be able to demonstrate to the Authority that:

*"Where member investment choice is provided in the rules, members may, at least once every twelve months, instruct the fund to transfer their retirement savings from their default investment portfolio into any other investment portfolios offered in terms of investment policy statement, in respect of which transfer the fund may deduct reasonable costs."*

As discussed above, since hybrid annuities offer a combination of a living and guaranteed life annuity in a single product solution, while the Financial Services Conduct Authority (FSCA) has no objection to funds including hybrid annuities in their annuity strategy, the Authority is of the view that hybrid annuities included in an annuity strategy require an exemption from the FSCA.



## Hybrid annuities: truly the best of both worlds?



The necessity for an exemption derives from the wording of the regulation (Regulation 37(2)(g)). The Authority points out that:

*"A life annuity has no viable surrender value. It would not be in the interests of members to be allowed to transfer out of a life annuity portfolio at least once every twelve months because the surrender value will be significantly less than the interest held in a life annuity."*

In order to work around this, funds who offer hybrid (or life) annuities in their annuity strategy must apply for an exemption from regulation 37(2)(g).

### The bottom line

Although hybrid annuities represent the fastest growing segment of the annuity industry in recent times, their true value remains unproven to many sceptics. Their ability to combine two complete products into one vehicle is their greatest selling point, but the jury is still out on whether they are genuinely able to provide a level of benefits (and at a competitive cost) that cannot be matched by their traditional cousins.

# Lessons from Covid-19 to boost your budget

*Brett Mackay, Investment Consultant at 10X Investments*

If there was one constant in life that we all encountered this past year, it was change. Who could have predicted that social distancing, beach closures and lockdown would be the new norm?



But it has not been all bad. Perhaps a few of the adjustments we were forced to make in our attempts to survive last year could be incorporated into our efforts to thrive this year.

Here are some thoughts on five lessons delivered to many people this past year:

## 1. Preparation is key

It may sound simple but what budgeting is about at its very core is planning. Although the last year was challenging to say the least, some of the financial issues we lost sleep over might have been avoided if we had prepared better.

Some think budgeting is only for people who are concerned about running out of money but the reality is that everyone can benefit from a budget. Irrespective of your circumstances or goals, whether you want to pay off your short term debt or to retire early, a proper budget enables you to understand your current situation in the context of where you want to be.

Spontaneity can be exciting, but your finances and life will eventually suffer if you let your money control you instead of you controlling it. Start by optimising your objectives, create a plan around your spending and refine this into a strategy that empowers you to reach your goals.



## Lessons from Covid-19 to boost your budget

You might feel the urge to rush into your new approach, but give yourself the time to ease into it. Make sure you set realistic goals, especially when it comes to saving. As Aesop's fable, The Tortoise and the Hare, taught us, you are more likely to be successful by doing things slowly and steadily than by acting quickly and carelessly.

### 2. Flexibility is important

While preparation is key, it's not until we face abrupt or significant change, as we did during the pandemic, that we realise that even the best of plans can benefit from some flexibility. If there is a pivotal lesson many of us have learned this past year, it is the importance of being able to adapt to changing circumstances.

Think of your future goal as a destination and your finances as a vehicle to help you get there. Sure, there will be some stops along the way (a few of them unexpected) and possibly a couple of detours. You might even realise that some parts need replacing, but how you navigate the journey ultimately determines where you end up.

Make the time to review your budget regularly. Ask yourself if your spending aligns with what you need at this point in your journey.

It may be time to cut back on expenses you once thought were essential, so that you can divert some extra cash into your retirement savings fund if you see that you are not exactly on track to the dream retirement you are after. Whatever it is, you should be willing to adapt and change to keep moving towards your desired destination.

### 3. Think about the little things that add up

With the sudden change in so many of our daily routines we have had more time to reflect on our normal spending habits. Perhaps, in all those months of missing out on your daily takeaway coffee and lunch purchases, you became more conscious about just how much those little things were costing. While most of us do thorough research and give much thought before making bigger purchases, like a car or a large household appliance, we tend to pay less attention to the small, inexpensive items that we purchase often, sometimes every day. As an example, if you had spent about R25 on a coffee as you headed to the office every day, you would have spent around R500 every month on takeaway coffee – money you could have invested or saved for a rainy day.

Being conscious about where we're spending our money helps us to identify changes we can make to improve our financial situation. In fact, it's the seemingly small changes applied consistently, that end up making a big difference over time.

### 4. Long term goals should be prioritised

It's no secret that we often live day-to-day, focusing on our immediate needs, from food to school fees and rent/bond payments. It is worth remembering that the urgency of our short term needs is probably diverting attention from something equally important.

Although some may think of retirement as a goal that's too far down the timeline to prioritise right now, being financially vulnerable at a time when financial security is needed most is a reality that defines the retirement crisis in South Africa today.

So, while it's fair that your budget accounts for short term goals, such as a vacation, it's also important that you prioritise your long term objectives as well. Think of this as a down payment on your future, an investment you will definitely thank yourself for later when you'll need it most.

If you don't already have a retirement plan you should create one. There are online tools available that allow you to define your goals according to your age and current earnings and track your progress against them. It is simple and free, and there is no obligation to buy anything; what have you got to lose?

### 5. Be ready for those rainy days

One lesson to be learned from the crash-course in real life that was 2020, is that rainy days can hit us when we least expect it. To help you prepare for unanticipated storms that could potentially strain your finances it is best to have an emergency fund in place. This is not an investment but more of a savings plan. Investing will build your wealth, saving will secure it.

There is no age limit on who should have an emergency fund. Emergencies can happen to anyone at any time.

An emergency fund can be a lifesaver if your income is interrupted as it will ensure that you can still pay the bills. Building up an emergency fund will teach you the discipline of putting money away ... and will also help you sleep at night. It is advisable to save at least three months of your take home pay in a low fee money market fund or income fund for this purpose.

We don't know when the pandemic will be truly behind us but it is clear that applying the valuable lessons we are learning from it will set us up for success, whatever the post-pandemic 'new normal' is like.

# [INDUSTRY UPDATE]





# in the NEWS



## IRFA APPOINTS NEW BOARD

In January this year we welcomed our new Board of Directors. On Friday 26 January 2021 the Board had its first meeting and in line with our Memorandum of Incorporation (MOI) and our established practice, a new President and Vice-President was elected. The election turned out to be a first for the IRFA, and is supportive of the gender equality practices the IRFA promotes. Both our new President and Vice-President are women. Geraldine Fowler has been elected as President and Amanda Khoza as Vice-President.

As is the custom the ceremonial handover by the immediate Past President, Enos Ngutshane, will take place at our annual conference in September 2021. In the interim the immediate past and current presidents will be working closely together to ensure continuity.

The new executive committee was also established and again following past practices and our MOI, the executive committee members are firstly the new President and Vice-President, the immediate Past President and a board member, Nancy Andrews.

We wish the new President and Vice-President and new established executive committee every success. We would also like to acknowledge and thank our immediate Past President Enos Ngutshane for his courageous leadership and guidance during his term.



Enos Ngutshane  
EXECUTIVE COMMITTEE MEMBER



Geraldine Fowler  
PRESIDENT



Amanda Khoza  
VICE-PRESIDENT



Nancy Andrews  
EXECUTIVE COMMITTEE MEMBER

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*in the NEWS*

**UPDATE**



**Contact:**

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## MOMENTUM GLOBAL INVESTMENT MANAGEMENT APPOINTS NEW INVESTMENT DIRECTOR



Momentum Global Investment Management (MGIM), Momentum Investments' international investment management division, has appointed Andrew Hardy as Director of Investment Management as the business positions itself for further growth in the UK. Effective immediately, Hardy will assume full oversight of MGIM's UK Investment Team and will be responsible for managing relationships with key clients and partners.

Hardy is a long-standing member of MGIM's London-based investment team, having been with the company since 2005. He has been co-Head of Research for the last five years and a Portfolio Manager for over 10 years, leading the management of the Harmony Portfolio multi-asset range and global developed and emerging market equity funds, with combined assets under management of around £2.2 billion. During his time at the company he has also played an important role in developing MGIM's investment philosophy and process while supporting business strategy and development.

According to Ferdi van Heerden, Chief Executive at MGIM, "Andrew's appointment as Investment Director is testament to the talent and depth of our investment team. He has made a huge contribution to the business during the past 15 years and his experience and understanding of our culture and values made him the ideal choice for this leadership role. The decision to promote from within ensures that there will be no disruption at this important time for the business, and we are confident that Andrew will continue to deliver exceptional outcomes for our clients and partners in his new position."

Established in the UK in 1998 the MGIM works closely institutional and adviser partners in the UK and Europe, Asia and the Middle East, South America and South Africa to design, build and manage outcomes-based investment solutions,

delivered through global multi-asset portfolios and tailored client solutions. The appointment comes as MGIM is poised to further develop its UK presence following the acquisition of Seneca Investment Managers in October 2020, giving the combined business over £4.5 billion in assets under management.

Sonja Saunderson, Chief Investment Officer at Momentum Investments says, "Andrew brings experience through various market cycles that is invaluable to our global portfolio management insight and decision making. His depth in research and detailed understanding of market behavior in an investment leadership role will help us navigate tough environments and further strengthen the decision making in our global portfolios."

Saunderson adds that as exchange controls in South Africa relaxed over time, the business increasingly realised the importance of the integration between local and global portfolios playing a critical role in the outcome of client portfolios. "We therefore invested in a dedicated team of specialist portfolio managers for our global efforts. Andrew's promotion into this role speaks of the importance of promoting and growing from within and recognizing leadership skills in our staff."

"I am delighted to be taking on the role of Investment Director at MGIM. During my time at the company I have been immensely proud of how the business has grown and evolved. We have an outstanding team and a long track record of success across our global client base, and multi-asset solutions like ours are becoming increasingly popular with both retail and institutional investors.

"This is an exciting time for MGIM and in my new role I look forward to continuing to drive the company's overall ambition to be the gold standard for multi-asset investment among financial advisers and intermediaries," concludes Andrew Hardy, Investment Director at MGIM.





Financial Planning  
Institute of Southern Africa

**THE PROFESSIONAL STANDARD**



# Gearing up for 2021

INDUSTRY UPDATE

*Lelané Bezuidenhout CFP®, CEO of the Financial Planning Institute.*

Welcome to 2021, and I hope you are all healthy and rested! While the new year may not have started exactly as we'd hoped, at least we all know more or less what to expect from the pandemic this time around.

## Necessity is the mother of all invention

Merely surviving 2020 was an achievement. But at the FPI, we were fortunate that the dark cloud did have a few silver linings. Not least the fact that our digital infrastructure has advanced by leaps and bounds thanks to the pandemic.

Early in the first lockdown, we took the brave decision to move all of our events (including our flagship Professionals' Convention), training sessions and exams online. This didn't only allow us to continue to serve our community through a terribly challenging year; it also had a few unexpected benefits. Not least the fact that it was much easier for people in remote locations to attend events / sit exams. Another bonus of online events and training sessions is that you can attend them in your own time, long after the live event. In fact, you can still benefit from the wisdom (and CPD hours!) imparted at our 2020 FPI Professionals' Convention. Simply visit [www.fpi.co.za](http://www.fpi.co.za) or contact [events@fpi.co.za](mailto:events@fpi.co.za).

## Focus areas for 2021

**Improving Diversity and Inclusion** must be a continual work in progress for everyone in the financial planning profession (and beyond). To ensure that these words translate into actions, the FPI's Human Capital Committee revised our D&I strategy late last year. We will kick off 2021 by constituting a brand new D&I committee (watch this space). They will soon be rolling their sleeves up and getting to work.

**Continuing to provide robust feedback on draft regulations** remains a key focus for the FPI. Currently out for public comment include: amended Fit and Proper requirements, the General Code of Conduct and the draft declaration of Crypto Assets as a Financial Product, to mention a few. The FPI will also be meeting with the National Treasury later this month to provide feedback on the 2020 version of the COFI Bill.

**Embracing Financial Planning technology (FPtech)** within Practice Standards is another must. FPtech is here to stay, so why not go with the flow and use it to your advantage? Clever use of technology can greatly improve efficiency (and thus profitability) in your practice. It can also give you the edge when trying to appeal to the increasing number of millennials and Gen Zs who are creating and inheriting wealth.

**Increased consumer awareness** of the Financial Planning profession is key to South Africa's future success. With this in mind, the FPI has already taken key education programmes (such as FPI MONEY123™) online onto our social media platforms. The latest series is entitled "Wills and Estates – Mistakes made by the Rich and Famous". We will also be launching a revamped consumer education website later this year.

Gearing up for 2021

## Dates to diarise

- The FPI's membership renewal window will remain open until the end of March 2021. And remember, you can pay by monthly debit orders.
- In the next couple of months, we'll have webinars on Technical Content (Investments, Retirement Planning, Risk Planning, Tax Planning and Estate Planning) as well as General Topics that covers Skills and Abilities needed to remain a competent professional member of FPI and last but not least, webinars on Ethics and Practice Standards. Webinars are free for FPI professional members (RFP, FSA and CFP) as if forms part of your membership benefits.
- This year's FPI Professionals Convention will take place on 25 and 26 October 2021. If regulations allow it will be a hybrid (in-person and digital) event.

## One more thing before I go...

As a member of the pensions community, you are probably very aware of the retirement crisis facing South Africa. Tackling this problem is a massive challenge for our profession, our government and, frankly, our citizens.

Towards the end of last year, Treasury issued an exchange control circular that announced the reclassification of inward listed debt and derivative instruments as well as exchange-traded funds referencing foreign assets. This created widespread confusion as some FSP's assumed that this "changed" Regulation 28. Shortly after this, the circular was withdrawn. It is important to note that the circular issued (and then withdrawn) could never have determined Financial Sector Regulation without proper consultation with the FSCA and other bodies. What this whole incident highlighted, however, is that Regulation 28 is indeed in need of an urgent review.

## Onwards and upwards

On that note, I will leave you to get on with your year. I wish you strength, insight and energy in tackling the challenges and opportunities which 2021 presents you with. If you are not already a member of the FPI, I do encourage you to join. Being part of a community of like-minded professionals who understand your challenges inside out makes everything so much easier.



*Enos Ngutshane, Past President of the Institute of Retirement Funds Africa (IRFA)*



#### **Background to the conference**

The Institute of Retirement Funds Africa's (IRFA) virtual conference held in November 2020 was well received, reinforcing the retirement

sector's role in shaping the future. The IRFA is confident that the sector will continue to play a major role in defining the future through change, resilience and in rethinking traditional boundaries. Certainly, this was a major discussion point at the conference.

The IRFA believes that leaders and expert speakers at this leading industry conference built the case for change and transformation in the financial sector, as well as for the benefits of leveraging technology for the greater good.

#### **Vital role played by the retirement sector**

We are adamant that the retirement sector has a vital role to play as the economy gears up for recovery in the wake of the Covid-19 pandemic and consequential lockdowns around the world. Events such as IRFA's annual conference are crucial to the "harnessing of a multiplicity of ideas" that are crucial to change, growth and transformation in our sector.

The conference, held for the first time on a virtual platform, provided ample opportunity for the exchange of ideas in terms of the provision of platforms for networking and interaction, in addition to the substantial line up of speakers.

Siegel took delegates through the history and features of defined benefit funds, and the thinking behind why these have been replaced to a large extent by the defined contribution model - which has been implemented internationally with a large measure of success.

Siegel however cautioned that the avoidable pitfalls of the defined contribution fund included underfunding, liability growth due to falling interest rates and most importantly decumulation, which directly impacts the retirement security of members.

# Reflections on the 2020 IRFA Conference

INDUSTRY UPDATE

#### **Handholding through decumulation**

Handholding is an important factor in realising the benefits of defined contribution in retirement funds. Delegates at our conference learned the intricacies of this from US based speaker, Lawrence B Siegal. Siegal is the Research Director of the CFA Research Foundation who, in addition to having served as a Director of the Ford Foundation, has over 30 years' experience in investment management and financial consulting.

## Reflections on the 2020 IRFA Conference

Siegel however cautioned that the avoidable pitfalls of the defined contribution fund included underfunding, liability growth due to falling interest rates and most importantly decumulation, which directly impacts the retirement security of members.

Siegel emphasizes that “for a defined contribution fund to succeed, we need good asset liability management, protection against inflation and handholding of the member through the decumulation phase.”

According to Siegel this “handholding” is vital to ensuring the member has sufficient funds to last through retirement and in many cases this support and guidance is shared with insurance companies through products like retirement annuities. He argues that this sharing alleviates the risk.

Siegel is also an acclaimed author in the field. His first book “Fewer, Richer, Greener” published in 2009 examines the environmental and social impacts of investment.

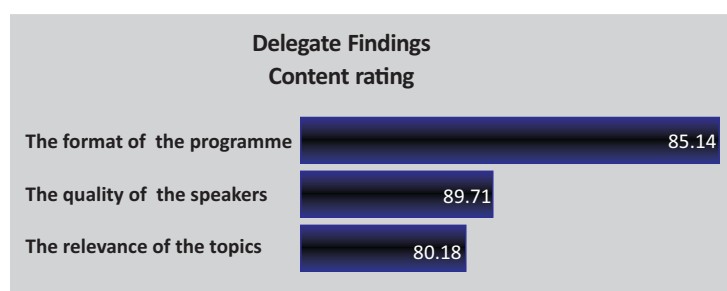
### Topical issues highlighted

Topics covered included the impact of Covid-19 on the investment market, the importance of resilience and innovation to the sector, a look at the alternative investment approach as well as its importance to socio-economic development, and key pointers for the ongoing sustainability of the sector.

Built into the programme was a series of master classes featuring pointers from the Acting Commissioner of the Financial Services Conduct Authority (FSCA) as well as expert presenters covering subjects such as “Investment fundamentals and data science” and “Innovative solutions for the retirement industry and the South African Economy.”

The content was rated highly by attendees as relevant, topical and educational as evidenced by post conference feedback obtained in an electronic survey. In addition to the findings below, delegates rated the learning experience at 77%.

### Content rating by the delegates



We are convinced that the November 2020 conference certainly delivered on its member and industry mandate. On the back of this success and positive feedback, the Institute is planning a high level Thought Leadership Imbizo for 16 March 2021.

### IRFA announces incoming Management Board

Following the virtual conference, the IRFA started the process of electing the a new Management Board. The process started with the nominations managed through ElectionWorx, a tool that is operated by AgendaWorxs. A former Director of the IRFA, Ms Fiona Rollasson, was appointed as the Election Officer.

The election process for the new Board of Directors was held during November and December 2020. The term of office of the current IRFA Board of Directors expired on 15 January 2021 and the Institute has announced the names of the incoming Board elected by its membership base.

As the IRFA, we would like to extend our gratitude to the outgoing Board for their commitment and contribution during their term of office. Our thanks goes out to: Enos Ngutshane (President), Anthony Williams (Vice-President), Geraldine Fowler, Thomas Mketelwa, Vusi Mashile, Amanda Khoza, Fiona Rollason, Pieter Cronje, Johannes (Voet) du Plessis and Wayne Hiller van Rensburg.

The members of the incoming Management Board who will serve a three year term of office are the following:

- Enos Ngutshane
- Geraldine Fowler
- Amanda Khoza
- Mandla Nkosi
- Voet du Plessis
- Nancy Andrews
- Mkuseli Mvombu
- Cheryl Ward

The IRFA will be introducing you to the Board shortly and give you an opportunity to engage with them. Please look out for our invitation. Lastly, don't forget to follow us and register as we take you towards the Thought Leadership Imbizo on 16 March 2021.



# Adjudicator rules employer is entitled to pension deduction after double salary payments



*Advocate Matome Thulare, Deputy Pension Funds Adjudicator*

**The Deputy Pension Funds Adjudicator, Advocate Matome Thulare, has ruled that an employer was entitled to claim a deduction for double salary payments made to the complainant for over two years.**

Advocate Thulare dismissed the complaint by a member against his pension fund's decision to withhold his withdrawal benefit.

The complainant commenced his employment with Nedbank from 1 February 2017 until 13 September 2019. He was a member of the Old Mutual Superfund Pension Fund.

Prior to being a permanent employee, the complainant had been employed by Nedbank for two consecutive periods on fixed term contracts during the period June 2016 to December 2016.

During the period of the fixed term contracts, the complainant was remunerated at the rate of R500 per hour. Upon becoming a permanent employee, the complainant's remuneration changed to R414 per hour capped at 158 hours per month/R785 644 per annum.

The complainant admitted that he noted discrepancies in his salary after becoming a permanent employee. He said that he initially assumed that this was because of the transition from fixed term employee to permanent and that these discrepancies would resolve over time. When the discrepancies persisted, he assumed that the employer "had in fact not prejudiced him, by reducing his pay scale so drastically". The complainant said that his IRP5 documents corresponded with his pay slips.

After an investigation by Nedbank, it was discovered that the complainant was receiving a second salary as a result of a processing error whereby he was not removed from the temporary payroll. This resulted in the complainant receiving almost double his salary for a period of just over two years.

Despite admitting knowledge of the discrepancy, he never brought it to the attention of Nedbank.

In a written statement made to Nedbank after the investigation, the complainant admitted his liability to Nedbank and undertook to repay the money. The complainant was subsequently dismissed for misconduct relating to dishonesty and criminal charges were laid against him for fraud. The complainant referred the matter to the CCMA but abandoned the arbitration after conciliation failed.

## Adjudicator rules employer is entitled to pension deduction after double salary payments

The complainant tried to access his pension fund after his dismissal and was informed that it was being withheld because of the employer's claim against him and pending the outcome of legal proceedings against him. After failing through his legal representative to get the fund to change its decision, the complainant decided to lodge a complaint with the Pension Funds Adjudicator.

Advocate Thulare found that the complainant had admitted his liability in writing to the employer and that the basis for such liability was his misconduct relating to dishonesty, as per the findings of the disciplinary enquiry.

The Deputy Adjudicator did not accept the reason for the complainant abandoning the CCMA arbitration as being due to a lack of funds for legal representation and held that legal representation at the CCMA for unfair dismissals was not an automatic right. Furthermore, that the CCMA processes were designed to assist lay persons and that if the complainant desired legal representation, then he could have approached the Legal Aid Board.

The Deputy Adjudicator also rejected the complainant's argument that he should be found negligent instead of dishonest.

"These payments persisted for a long time and the complainant had sufficient opportunity to query same with the third respondent. He failed to do so.

"As an employee and in terms of the employment contract entered with the third respondent, the complainant stood in a position of confidence which involved a duty to protect the interests of his employer. Accordingly, the complainant owed a fiduciary duty towards the third respondent which he failed to fulfil," Advocate Thulare said in his determination.

The Deputy Adjudicator held that payments of almost double his expected salary should have raised alarm bells and the complainant ought to have queried same. Instead, he chose to stay silent. He also knew that he did not work for the hours that he was being paid for.

"The inescapable conclusion is that the complainant, who conceded that he became aware of the discrepancies in his salary from the outset of his permanent employment, did not bring it to the attention of the third respondent (employer Nedbank) because it benefited him and because he assumed that the double salary payments would go unnoticed due to the scale of the third respondent's operations."

The Deputy Adjudicator found that there was a duty to speak on the part of the complainant and that his failure to do so constituted dishonesty.

The Deputy Adjudicator stated that in several recent determinations, the requirements that must be met in order to justify the withholding of a benefit were set out. One of the main requirements for withholding a benefit is applying the principles of natural justice. However, it was important to appreciate that there is a distinction to be drawn between the "withholding" of a benefit and the "deduction" of compensation due to an employer on the grounds of fraud, theft, dishonesty or misconduct.

The Deputy Adjudicator held that in circumstances where there is no dispute that the member admitted liability in writing, and such liability arises from dishonest conduct, a deduction can be made without awaiting the outcome of civil or criminal proceedings. There is simply no point in the fund continuing to withhold the complainant's benefit, he said.

The employer was entitled to a deduction and it follows that the complaint could not succeed because it would deprive Nedbank of the relief that it is lawfully entitled to. The complaint was dismissed.



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# LEGAL ROUND UP





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- Independent board or principal officer positions

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## Legal Update, Qtr 1, 2021

Leanne van Wyk, Director  
ICTS Legal Services (Pty) Ltd



# Explaining compulsory annuitisation

**Compulsory annuitisation of provident funds will go forward on 1 March 2021. (The amendment to the legislation allowing for this change is now an Act.)**

The idea is to further align pension and provident funds – this time regarding how much a member may take in cash on *retirement* from a provident fund.

The differing interpretations of the wording of the legislation remains an issue for implementation and what follows are my views.

### The basic idea going forward for provident funds

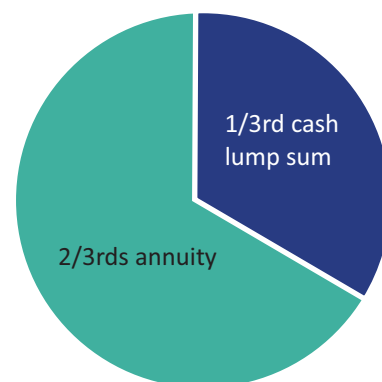
The change affects retirement benefits only, not withdrawal benefits.

The basic idea is that provident funds from 1 March 2021 will pay out retirement benefits in the form of an annuity, with only one-third of the retirement benefit available to be taken as cash.

### Other amounts will also continue to be allowed to be taken in cash

As a way of phasing-in this change, Government wanted to continue to allow more of a provident fund member's retirement benefit to be taken in cash. Some of what had already been built up in provident funds and some of what will still be built up going forward will also be allowed to be taken as a cash lump sum on retirement. These amounts are different for older and younger members.

Those amounts that will still be able to be taken as cash on retirement (in addition to the one-third already allowed) are referred to as “vested benefits”. Other terms like “vested rights” or “protected benefits/right” have also been used. You won't find these terms in the legislation – they are simply terms used and understood by the industry.



#### “Vested benefit”

A part of a retirement benefit that the member does not have to take as an annuity and may choose to take as a cash lump sum (in addition to the usual one-third) when retiring from his retirement fund.



There are different vested benefits for older and younger members – the simplified version:

## What makes up vested benefits?

### "Vested benefit"

#### A. For all members of a provident fund

- Contributions to provident fund before 1 March 2021
- Plus all fund return on this



#### B. For members of a provident fund who are 55 or older on 1 March 2021

- Contributions on 1 March and after as long as you were a member of the provident fund on 1 March 2021
- Plus all fund return on this

### The retirement benefit



Vested amount -  
may take as cash



"Vested benefit" = a part of retirement benefit that the member does not have to annuitise on retirement and may take as a cash lump sum (in addition to the normal one third)



'Non vested'  
amount - may take  
one-third as cash,  
rest as annuity



#### Exception:

if 'non vested' pot is R247 500 or less then can take it as cash

**Non vested benefit** = a part of a retirement benefit that the member must annuitise on retirement and may not take as a cash lump sum

## Legal Update, Qtr 1, 2021

### What makes up non vested benefits?

- All members:** contributions to a fund other than a provident fund
- Members younger than 55:** contributions to a provident fund on 1 March 2021 and after, and fund return on this
- Members 55 and older:** contributions to a provident fund from 1 March 2021 and after if they were not a member of that fund on 1 March 2021

### Amounts that a member may still take in cash on retirement

A member may take as cash on retirement:

- (a) All vested benefits, plus
- (b) One-third of non-vested benefits.

And if the value of the member's 'non vested' pot is R247 500 or less then the member can take the whole retirement benefit as cash.

#### "Vested benefit"

##### A. For all members of a provident fund

- Contributions to provident fund before 1 March 2021
- Plus all fund return on this



##### B. For members of a provident fund who are 55 or older on 1 March 2021

- Contributions on 1 March and after as long as you were a member of the provident fund on 1 March 2021
- Plus all fund return on this

#### The retirement benefit

Vested amount - may take as cash



"Vested benefit" = a part of retirement benefit that the member does not have to annuitise on retirement and may take as a cash lump sum (in addition to the normal one third)



'Non vested' amount - may take one-third as cash, rest as annuity



##### Exception:

if 'non vested' pot is R247 500 or less then can take it as cash

**Non vested benefit** = a part of a retirement benefit that the member must annuitise on retirement and may not take as a cash lump sum



## What are vested benefits? The longer story

It is worth mentioning that the above explanation of vested benefits is the simplified version that is usually included in publications and training. The legislation is more complex than that and also includes certain “amounts credited” to fund credits as vested benefits, for example in certain circumstances this may include surplus amounts credited to members and other amounts. Thus, I have set out the fuller account of vested benefits below, for your information.



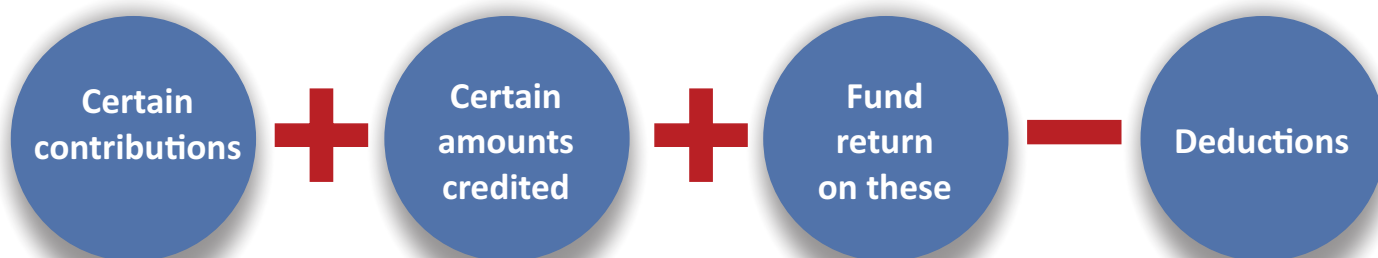
### All members of a provident fund younger than 55 on 1 March 2021

1. Any amount contributed to a provident fund prior to 1 March 2021
2. Plus any other amounts credited to the member's individual account/ minimum individual reserve prior to, on or after 1 March 2021 as a result of the value of the member's individual account/minimum individual reserve on 1 March 2021; and
3. Any fund return, as defined in the Pension Funds Act, in relation to the contributions contemplated in 1 or amounts credited contemplated in 2
4. Reduced by any amounts permitted in terms of any law to be deducted from the member's individual account/minimum individual reserve of the provident fund



### Member of a provident fund who is 55 years or older on 1 March 2021

1. Any amount contributed to a provident fund of which that person is a member on 1 March 2021
2. With addition of any other amounts credited to the member's individual account/minimum individual reserve of the provident fund prior to, on or after 1 March 2021; and
3. The fund return, as defined in the Pension Funds Act, in relation to the contributions contemplated in 1 or amounts credited contemplated in 2
4. Reduced by any amounts permitted in terms of any law to be deducted from the member's individual account/minimum individual reserve of the provident fund



## Deductions

Deductions, such as pension interest on divorce, maintenance orders, housing loans and other permitted by law, such as the Pension Funds Act, will reduce the vested and non-vested part of a fund credit proportionately. Note this is a proportional reduction and not an equal reduction.

The legislation does not cover once off withdrawals from preservation funds. Thus, it remains unclear whether a once off withdrawal from a preservation fund reduces the vested or non-vested part of the fund credit or whether the intention is that the vested and non-vested part of the fund credit should be reduced proportionately. The Income Tax Act needs to be amended to clarify this uncertainty and we may see an amendment mooted during the National Budget process.

The SARS Business Requirement Specifications (BRS) for annuitisation (and other aspects of the amendments to the Income Tax Act) has not yet been finalised at the time of writing this article.

# TRUSTEE TUTOR

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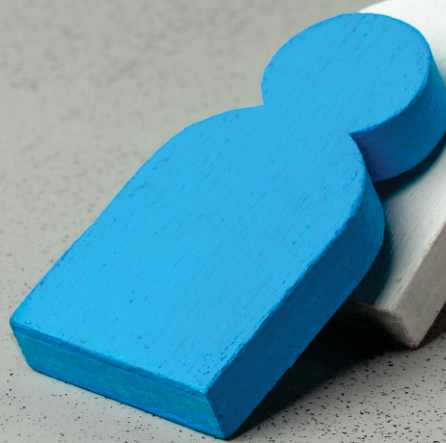






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# Trustee Tutor: Issue 5

## Categories of retirement funds



As the T-Day reforms provided for in the Taxation Laws Amendment Act take effect on 1 March 2021, it is worthwhile to look at the different types of retirement funds and how these have changed over time.

## CATEGORIES OF RETIREMENT FUNDS

There are two broad categories of retirement funds:

### 1. Occupational funds



Occupational funds are, historically, those retirement funds that members belong to by virtue of their employment with a specific employer. For example, to be a competitive and sought after employer, ABC (Pty) Ltd promises certain benefits for their employees in their contracts of employment. The most cost and tax effective way to provide for some of these benefits is through an occupational retirement fund (pension fund or provident fund). In terms of the tax laws, when an employee joins ABC (Pty) Ltd, it is compulsory that they join the employer's retirement fund, in other words, eligible employees don't have a choice but to join the fund.

For completeness of this discussion, an employer can choose to set up their own retirement fund or they could choose to participate in an umbrella fund.

### 2. Retail funds



Retail retirement funds are those funds that an individual **chooses** to use to save for their retirement, in other words, membership of the fund is not compulsory, but rather discretionary. Individuals choose these types of savings vehicles for the tax benefits they offer, as well as their competitive fees (when compared to other types of discretionary savings options). Examples of retail funds are retirement annuity funds and preservation funds.

## The impact of Default Regulations on these two categories ...

After the default regulations on preservation came into effect on 1 March 2019, you may find members who leave their employer but choose to keep their savings in their occupational funds (preserve in the fund) – meaning that an occupational fund may now have a combination of members who belong to the fund due to their employment with the employer and members who have chosen to remain in the fund as individual investors after their employment with the employer has come to an end.



The Taxation Laws Amendment Act introduced a number of key changes on 1 March 2016 (tax deductibility of contributions) and then again on 1 March 2021 (payment of benefits on retirement) to align the different types of retirement funds. These changes were done to ensure fairness to members through consistency of tax treatment and to compel members to preserve (or save) their money on retirement.

Therefore, to understand the evolution of the different types of retirement funds, one needs to look specifically at the tax deductibility of the contributions paid into the fund and the way in which retirement benefits may be taken when a member retires. We also look at the changes to transfers between funds to demonstrate further how alignment has been implemented.

## WHAT IS A PENSION FUND?

A pension fund is a retirement fund set up by an employer to support employees in providing financially for their retirement and to provide benefits to their families should the employee (member) pass away.

 <p>Tax deductibility of contributions paid into the fund – before <b>1 March 2016</b></p>	<p>Member contributions: up to 7,5% of approved remuneration Employer contributions: up to 20% of approved remuneration</p> <p>(Fringe benefit tax on employer contributions was not payable in the hands of the member)</p>
 <p>Tax deductibility of contributions paid into the fund – after <b>1 March 2016</b></p>	<p>A total of 27,5% of the greater of remuneration or taxable income.</p> <p>The overall tax deductible limit is R350 000 each year. Contributions over this limit are allowed, but will not qualify for a tax deduction.</p> <p>(Contributions made by the employer is taxed as a fringe benefit in the hands of the member)</p>
 <p>How the retirement benefit is paid out – before <b>1 March 2021</b></p>	<p>A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity).</p> <p>If the member's accumulated balance was less than R75 000, the full amount could be taken in cash on retirement.</p>
 <p>How the retirement benefit is paid out – after <b>1 March 2021</b></p>	<p>A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity).</p> <p>If the member's accumulated balance is less than R247 500, the full amount may be taken in cash on retirement.</p>
 <p>Transfers – before <b>1 March 2016</b></p>	<p>Transfer tax free to a pension fund, pension preservation fund or RA fund.</p>
 <p>Transfers – after <b>1 March 2016</b></p>	<p>Transfer tax free to a pension fund, pension preservation fund or RA fund.</p>
 <p>Withdrawal benefit (no changes)</p>	<p>Members may take a cash lump sum on withdrawal.</p>

# WHAT IS A PROVIDENT FUND?

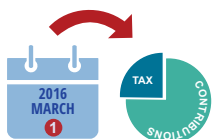
A provident fund is a retirement fund set up by an employer to support employees in providing financially for their retirement and to provide benefits to their families should the employee (member) pass away.



Tax deductibility of contributions paid into the fund – before **1 March 2016**

Member contributions: not tax deductible  
Employer contributions: up to 20% of approved remuneration

(Fringe benefit tax on employer contributions was not payable in the hands of the member)

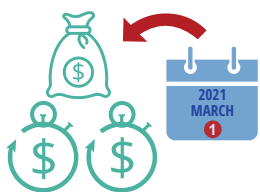


Tax deductibility of contributions paid into the fund – after **1 March 2016**

A total of 27,5% of the greater of remuneration or taxable income.

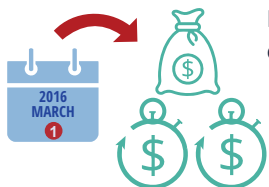
The overall tax deductible limit is R350 000 each year. Contributions over this limit are allowed, but will not qualify for a tax deduction.

(Contributions made by the employer is taxed as a fringe benefit in the hands of the member)



How the retirement benefit is paid out – before **1 March 2021**

A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity).



How the retirement benefit is paid out – after **1 March 2021**

A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity).<sup>(1)</sup>

If the member's accumulated balance is less than R247 500, the full amount may be taken in cash on retirement.



Transfers – before **1 March 2016**

Transfer tax free to a pension or provident fund, a pension or provident preservation fund, or to an RA fund.



Transfers – after **1 March 2016**

Transfer tax free to a pension or provident fund, a pension or provident preservation fund, or to an RA fund.



Withdrawal benefit (**no changes**)

Members may take a cash lump sum on withdrawal.

<sup>(1)</sup> It is very important to note that this applies only to contributions made after 1 March 2021 by members younger than 55 years old. All balances saved up to 28 February 2021 are still able to be taken as a full cash lump sum at retirement. And members over 55 are still able to take their whole accumulated balance in cash on retirement (provided they don't change funds). (There is more detail on how accumulated balances as at 28 February 2021 will be treated on retirement in this issue's Legal Update – explaining compulsory annuitisation.)



# WHAT IS A RETIREMENT ANNUITY (RA) FUND?

A retirement annuity fund is a retail fund that an individual chooses to invest in to make financial provision for their retirement. It is a tax effective way for an individual to save for retirement – either if they are self-employed and therefore do not have an employer fund, or if they wish to save more outside their employer's fund by making additional contributions to maximise the 27,5% allowable deduction.

 <p>Tax deductibility of contributions paid into the fund – before <b>1 March 2016</b></p>	<p>A maximum of 15% of non-taxable income</p>
 <p>Tax deductibility of contributions paid into the fund – after <b>1 March 2016</b></p>	<p>A total of 27,5% of the greater of remuneration or taxable income.</p> <p>The overall tax deductible limit is R350 000 each year. Contributions over this limit are allowed, but will not qualify for a tax deduction.</p>
 <p>How the retirement benefit is paid out – before <b>1 March 2021</b></p>	<p>A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity).</p> <p>If the member's accumulated balance was less than R75 000, the full amount could be taken in cash on retirement.</p>
 <p>How the retirement benefit is paid out – after <b>1 March 2021</b></p>	<p>A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity).</p> <p>If the member's accumulated balance is less than R247 500, the full amount may be taken in cash on retirement.</p>
 <p>Transfers – before <b>1 March 2016</b></p>	<p>Members may transfer to another RA fund only and this transfer is tax free.</p>
 <p>Transfers – after <b>1 March 2016</b></p>	<p>Members may transfer to another RA fund only and this transfer is tax free.</p>
 <p>Withdrawal benefit (no changes)</p>	<p>Members may not withdraw from an RA fund before age 55 (whereupon they would take a retirement benefit).</p>

One last important comment on contributions: the 27,5% tax allowable contribution is aggregated across pension, provident and RA funds, meaning an individual may claim a tax deduction on a total maximum contribution of 27,5% to any (or all 3) of these funds.

## So what's the bottom line?

In essence, from 1 March 2021, there will be no differences between pension funds and provident funds. In fact, new impending legislation will simply refer to them as retirement funds. This will be the completion of the alignment of these funds to ensure fairness and consistency, and encourages individuals to save more for retirement.

You can also see that the (now aligned) rules around how a retirement benefit may be taken, compels members to preserve their savings for longer into their retirement years.

But there are also funds that don't receive regular contributions but rather once off lump sum payments ...



## What is a preservation fund?

If a member leaves their employer and decides to take his withdrawal benefit in cash from their employer's retirement fund, they would pay tax on any cash amounts taken over R25 000 (according to the current tax tables). A member could avoid this tax by:

- Preserving their benefit in their employer's fund, or
- Transferring their benefit to a preservation fund.

The following are some of the features of a preservation fund:

### Tax deductibility of contributions paid into the fund

Members do not make contributions to preservation funds

### Withdrawal benefits

Members are able to make a once off withdrawal from their preservation fund (up to the full balance in the fund) before they reach retirement age (normally set at age 55).

### Retirement benefit

A member may take a maximum of 1/3 of their accumulated balance in the fund in cash, and the remaining 2/3rds must be used to buy a pension (or annuity).

*(Similar to pension and provident funds above, retirement benefits from preservation pension and preservation provident funds were aligned on 1 March 2021.)*

If the member's accumulated balance is less than R247 500, the full amount may be taken in cash on retirement.

Although the default regulations introduced in 2019 allows members to preserve their withdrawal benefits in their previous employer's fund (thereby avoiding tax), there are still a couple of reasons why a member may choose to transfer to a preservation fund:

- A preservation fund offers a once off withdrawal of your savings before retirement age.
- The preservation fund may offer choice of a more attractive range of investment portfolios than the occupational retirement fund.

Retirement and investment funds operate in a framework of complicated legislation and in a market of seemingly never ending choices. For this reason, the Financial Advisory and Intermediary Services Act regulates who can advise the public on these financial products. Advisers need to remain fit and proper, behave with honesty and integrity, and give their clients the most appropriate financial planning advice to meet the client's identified financial needs. This is why non-accredited people, like trustees, management committee members, human resources staff, amongst others, should not be offering members any form of advice on their retirement fund options or investments.



## What is an unclaimed benefit fund?

Historically, an unclaimed benefit is a benefit that had not been paid to or claimed by a member within 24 months from when it became due for payment. These benefits were due to members of a retirement fund who did not claim their benefit when their employment ended, or their beneficiaries who did not provide the necessary information to enable the fund to pay their allocated benefits.

Once a member's benefit became unclaimed, in other words after 24 months, the retirement fund could transfer this benefit to an unclaimed benefit fund. An unclaimed benefit fund is thus a fund set up to specifically receive and deal with unclaimed benefits.

However, on 1 March 2019 the default regulations brought into effect in-fund preservation. Regulation 38 provides that when an employee leaves an employer before retirement date, the employee must be made paid-up until the fund receives an instruction in writing. In other words, these members can no longer be regarded as unclaimed after 24 months.

Thus, after 1 March 2019 the need for unclaimed benefit funds diminished significantly – with the only possible future use being for those beneficiaries who are due death benefits but do not submit the necessary information to enable the fund to pay these benefits.







## What is a beneficiary fund?

A beneficiary fund is a uniquely South African retirement fund designed to receive benefits allocated to beneficiaries of deceased members of retirement funds, where these beneficiaries may not be suited to receiving their benefits in a cash lump sum.

Section 37C of the Pension Funds Act governs the payment of death benefits from retirement funds – pension, provident, RA and preservation funds. In terms of this legislation, death benefits payable from a retirement fund do not form part of the deceased member's estate and are thus not subject to the deceased member's will. The retirement fund trustees have the duty and discretion to distribute the benefit to the deceased member's dependants in a fair and equitable manner taking into account the extent of their financial dependency.

It sometimes happens that the intended recipients of these benefits may not be suited or equipped to manage these often large lump sums, for example a minor child without a clear guardian or a mentally incapacitated adult dependant. In these instances, the trustees of the retirement fund may pay the benefit into a beneficiary fund to be managed carefully by the beneficiary fund's trustees on behalf of that beneficiary. The beneficiary fund will prudently invest the

benefit to pay regular amounts in respect of the beneficiary's expenses for things like education, medical needs and general upkeep. When the minor child beneficiary reaches the age of 18 any balance left over in the beneficiary fund will become payable as a cash lump sum.

These are all the types of retirement funds in the South African context. Although they are all designed to meet a different need, they do share some similarities. All of these funds are legal entities separate from the employer or the fund sponsor and are managed by a board of trustees. Trustee Tutor 1 in the Q1 2020 issue of Pensions World looked at the duties and responsibilities of trustees when managing retirement funds. And secondly all of these funds invest in appropriate investments to meet the needs of their different members, in fact many offer members a wide choice of where to invest their retirement savings.

This issue of Trustee Tutor has looked into the various types of retirement funds, and shared the changes that have supported the government's stated aim to align the different types of funds into a simpler and fairer system, that encourages members to save for their retirement while working and into their retirement years.



# Trustee Tutor: Issue 5

## Categories of retirement funds

For an on-line version of the required reading material as well as electronic CPD Submission form, go to <https://www.pensionsworldsa.co.za> or <https://www.ebnet.co.za>

### How to?

Answer all the questions by inserting the correct answer(s) into the block provided next to each question, scan the pages and email to Toni Cantin at ICTS, using [cpd@icts.co.za](mailto:cpd@icts.co.za)

#### 1. Choose the most correct answer: An occupational retirement fund is:

- a. A discretionary savings fund to which all employees in a particular occupation contribute.
- b. A discretionary savings fund to which all employees at a particular employer contribute.
- c. A compulsory savings fund to which all employees in a particular occupation contribute.
- d. A compulsory savings fund to which all employees at a particular employer contribute.

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#### 2. One of the consequences of the default regulations on preservation is that you might find members who were previously considered retail members, in traditionally considered occupational retirement funds.

- a. True
- b. False

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#### 3. An example of a retail retirement fund is:

- a. A preservation pension fund.
- b. A preservation provident fund.
- c. A retirement annuity fund.
- d. All of the above.

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#### 4. On 1 March 2016, the following changes to tax legislation were made:

- a. Members were allowed to contribute a maximum of 27,5% of the greater of remuneration or taxable income on a tax deductible basis to a retirement annuity fund.
- b. Members were allowed to contribute a maximum of 27,5% of approved remuneration to a pension fund.
- c. All members could contribute R350 000 per year on a tax deductible basis to a provident fund.
- d. A loophole was created whereby members were able to contribute more than 27,5% of the greater of remuneration or taxable income on a tax deductible basis, if they contributed to more than one retirement fund.

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#### 5. From 1 March 2021:

- a. A member who resigns can take his full accumulated fund balance in cash from a pension fund.
- b. A member who resigns can take his full accumulated fund balance in cash from a provident fund.
- c. A member who resigns can take his full accumulated fund balance in cash from a retirement annuity fund.
- d. a and b only.

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**Trustee Tutor: Issue 5 - Categories of retirement funds****6. Which piece of South African legislation governs who may give advice on financial products?**

- a. The Retirement Funds Act
- b. The Conduct of Financial Advisors Bill
- c. The Financial Advisory and Intermediary Services Act
- d. The Financial Crimes Control Act

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**7. Which of the following statements is incorrect.**

- a. Member contributions to a retirement annuity fund are tax free to certain maximums.
- b. Member contributions to a preservation pension fund are tax free to certain maximums.
- c. Member contributions to a provident fund are tax free to certain maximums.
- d. Member contributions to a pension fund are tax free to certain maximums.

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**8. In some instances, members of provident funds, pension funds and retirement annuity funds are able to take their full retirement benefit as a cash lump sum.**

- a. True
- b. False

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**9. Choose the most correct answer: An unclaimed benefit fund:**

- a. Is used for those members who don't wish to belong to their employer's fund.
- b. Is used for those beneficiaries who don't wish to receive their benefits in cash.
- c. Is no longer required in the retirement funds industry.
- d. Is used for those beneficiaries who don't provide their payment details to the fund.

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**10. Retirement funds in South Africa have the following in common:**

- a. They are managed by a board of trustees.
- b. The need to comply with Regulation 28 to the Pension Funds Act.
- c. The need to comply with the requirements of the Treating Customers Fairly framework.
- d. All of the above.

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Publication of FSCA Conduct Standard 4 of 2020 (RF) - Minimum skills and training requirements for board members of Pension Funds.

In accordance with the FSCA Conduct Standard 4 of 2020 (RF) - effective 10 July 2020, a board member contemplated in section 7A(3)(a) of the Act must attain the certification of the Trustee Training Toolkit within a period of 6 months from date of appointment to the board. A board member appointed prior to this date must complete the Trustee Training Toolkit within 6 months of the effective date.



Stay updated and in the know about who is moving up the corporate ladder in the pension fund industry.



**Ashley Singh**  
CIO Sanlam Corporate

Ashley Singh joined Sanlam in June 2020 where he took on the role of CIO at Sanlam Corporate. Ashley brings with him extensive exposure to technology enablement, having successfully developed and executed IT strategies across a number of industry sectors. Ashley believes that technology plays a key role in helping members of retirement funds to take control of their financial future.



**Ntombizethu Sibisi**  
Business Development Manager,  
Fairheads Benefit Services

Ntombizethu has been appointed to BDM within the fast-growing consultancy team at Fairheads Benefit Services. Based in Sandton, Gauteng, Ntombizethu will take responsibility for growing clientele, communication and reporting to retirement fund clients across sectors. She joined Fairheads in 2020 following 22 years in both the public and private sectors.



**Miranda Mkhumbuzi-Rasehala**  
Senior Associate , Soonder Associates Inc

Miranda is a Pensions lawyer with 9 years career experience. She is Senior Associate at Soonder Inc., a law firm that provides legal advice tailored to the Pensions Industry, and a Director at Legaltech, a consultancy that offers Retirement Fund Legal And Technical Expertise.



**Carolyn Weil**  
Senior Investment Consultant, Mentenova

Since starting her career at Alexander Forbes in 2016, Carolyn has gained experience as a financial market analyst as well as a client relationship manager. Carolyn obtained her CFA charter in 2019 and recently joined Mentenova as a Senior Investment Consultant. She is responsible for consulting to corporate and institutional clients and brings her experience in financial markets and economic analysis to the broader Mentenova client base.

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# Introducing the Sanlam With-Profit Annuity

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The **Sanlam With-Profit Annuity** is a new addition to the Sanlam annuities product range, launched to enhance the range and quality of retirement solutions available to pensioners. It provides a guaranteed income for life, offers pension increases linked to market performance and a generous starting pension.

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