OCTOBER / DECEMBER 2017 VOL 20 No 4

Pensions World

SOUTH AFRICA

- Our current concepts of retirement and employee benefits are under fire
- Beware! The FSB can replace the board of your pension fund!
- What difference does a quarter of a percent interest rate change make?
- Information analysis and the future of investing
- What do foreigners see that local investors don't?

www.lexisnexis.co.za

LexisNexis®

PENSIONS WORLD SOUTH AFRICA
OCTOBER/DECEMBER 2017 Vol 20 No 4

PENSIONS WORLD SA

December 2017

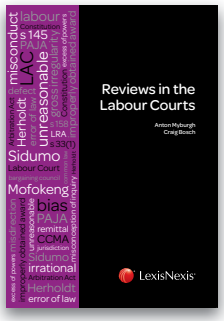
CONTENTS

Labour Law Essentials

Social Media in the Workplace

Authors: R Davey and L Dahms-Jansen

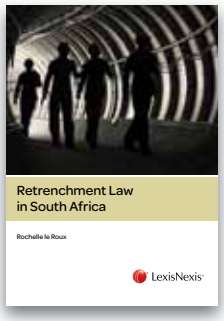
Social Media in the Workplace provides legal advice and training on the proper use of social media. The book considers the legal implications of social media use, in order to identify some of the risks that modern day businesses face and articulate ways in which the risks can be managed and mitigated.



Reviews in the Labour Courts

Authors: A Myburgh and C Bosch

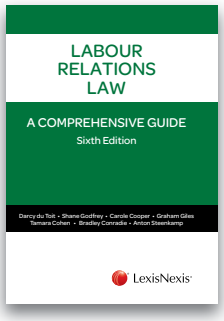
Reviews in the Labour Courts provides invaluable guidance for practitioners bringing and defending review applications in the Labour Courts. It is also essential for those who handle disputes in the CCMA and bargaining councils. This critical read is a necessary addition to the bookshelves of all practising lawyers. It is a seminal commentary work that covers the principles of judicial review in South African labour law, assisting those bringing and defending review applications.



Retrenchment Law in South Africa

Author: R le Roux

Retrenchment Law in South Africa is a detailed and comprehensive analysis of retrenchment law in South Africa. It provides new insights into the interplay between case law and legislative developments. This publication is aimed at legal practitioners and specialists in labour law. An analysis of a "fair reason" to retrench is examined. Complex concepts such as bumping and notice requirements in large scale retrenchments are also covered.



Labour Relations Law: A Comprehensive Guide Sixth Edition

Authors: D du Toit, S Godfrey, C Cooper, G Giles, T Cohen, B Conradie and A Steenkamp

Labour Relations Law: A Comprehensive Guide is an authoritative commentary that covers the main South African labour statutes, namely the Labour Relations Act, Basic Conditions of Employment Act and the Employment Equity Act. It provides a comprehensive overview of statutory labour law and case law with detailed coverage of critical issues, providing you with greater understanding of the debate within, as well as the socio-historical context of, South African labour law. The 6th edition represents a major update of the previous edition. It is a comprehensive, detailed and in-depth publication that can be used by students and seasoned practitioners alike.

Labour Law Through the Cases

Authors: D du Toit, T Cohen, W Everett, M Fouche, G Giles, S Godfrey, A Steenkamp, M Taylor and P van Staden

Labour Law Through the Cases is a detailed and comprehensive guide to the application of South African labour law. It offers extensive commentary which examines each principal labour statute section by section in light of judgments handed down in the South African labour courts. Each statutory provision interpreted by the courts and arbitrators is subjected to detailed analysis and comment. Specific issues dealt with in each judgment and award are identified, enabling you to distinguish quickly between rulings that were followed, and thus remain authoritative, and rulings that were rejected. The authors' extensive exposition and analysis, together with their authoritative opinions as to which are the better judgments, will alert you to problem areas and help you identify judgments that are more likely to be followed.

LexisNexis®

Order Now

0860 765 432 orders@lexisnexis.co.za

Managing Editor David Weil
Editor Nicole Smith
Designer Lulu Pillay

Advertising enquiries:
Michelle Baker (031) 764 6725 (tel)
073 137 1231 (cell)
086 620 6768 (fax)
michelle.baker@mediamarx.co.za
www.mediamarx.co.za

Editorial enquiries:
Nicole Smith (031) 268 3205
nicole.smith@lexisnexis.co.za

ISSN: 0409070637
Printed by C P W Printers

Subscriptions:
Customer Services 0860 765 432

(1) Ordinary rate – 4 issues R395.00
(excluding VAT & handling)

(2) For bulk copies contact:
Customer Services 0860 765 432

Pensions World South Africa is published quarterly and distributed as an independent journal.

LexisNexis®

Comment

David Weil
Managing Director
Investment Consulting and Trustee Services

"Change is the only constant" is a well-known quote by *Heraclitus* that many of us have heard countless times. But it appears to never have been more appropriate than in these current economic and political times that we find ourselves in. How do we cope in an environment that is constantly changing? This quandary is magnified when dealing as a fiduciary or advisor looking after other peoples' money. One thing is certain, you cannot stand still and expect to remain relevant.

As the seasons change from winter into spring, perhaps so too should our perspectives and thoughts around retirement and other employee benefit provisions for employees. *Anne Cabot-Alletzhauser* challenges us to think about what employees actually want from these arrangements and come up with innovative solutions to meet these needs. And if you think your retirement fund board of trustees may never change, think again! *Rebecca Jansch* warns that, in certain situations the Financial Services Board may step in and appoint trustees.

The investment landscape is constantly dynamic – a continuous ebb and flow of ups and downs. *Guy Fletcher* elaborates on what the ups and downs in interest rates mean for investors. And in this time of change, investment professionals need to find different ways of providing returns to their investors. *John Gilchrist* and *Grant Watson* introduce "quant investing" the hottest new international trend in investments. And sometimes all we need to change is our perspective! *Melville du Plessis* points out that it is clear that foreign investors still see value in our bond market. Lastly, when it comes to investments in this issue, *Jason Swartz* elaborates on what's changed in the Satrix style tracker over Q2.

Your personal financial situation changes as your life changes. *Gavin Smith* gives the five questions you should raise with your financial planner to understand how these changes affect your personal investment and insurance portfolio. *Samantha Jagdessi* takes the insured benefits discussion a step further by unpacking how your group insurance benefits may not be giving you the coverage you need. And *Sonja Visser* explains how to choose the correct funeral plan. *Nigel Green* shares his opinions on the unfairness of possible taxing of South Africans abroad.

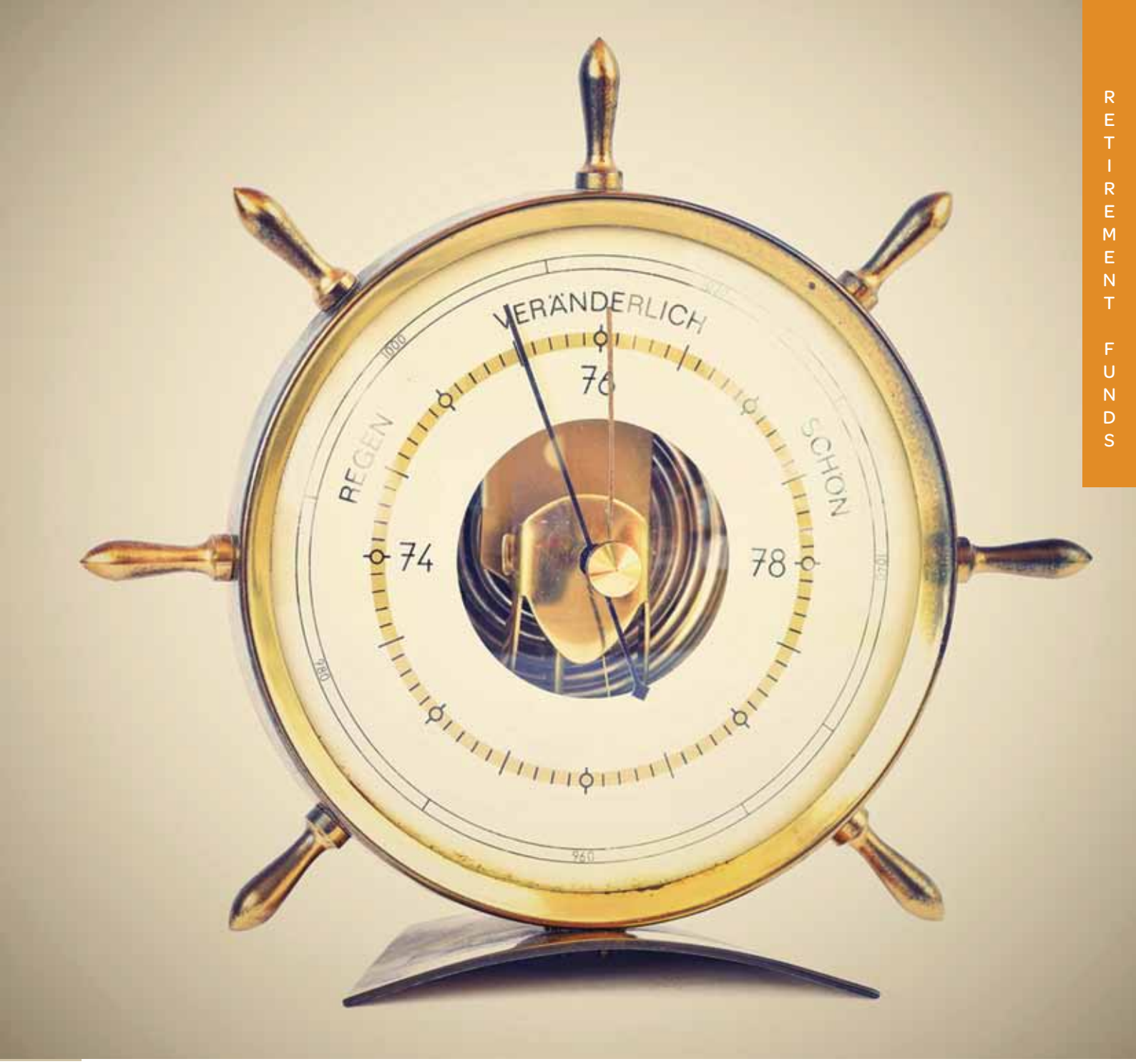
As the weather changes, so too does the legal environment. *Nancy Andrews* sets out the latest legislative developments in our industry.

It was *Charles Darwin* who said, "*It is not the strongest of the species that survives, nor the most intelligent. It is the one that is most adaptable to change*". In the new world of rapidly changing political beliefs, changing technology and even changing weather, the most successful will be those who adjust their sails and find creative ways of solving unprecedented problems. I trust this issue sparks your creativity. ❐

Our current concepts of retirement and employee benefits are under fire. The 2017 edition of Benefits Barometer highlights the issues and poses the answers

This year marks the fifth edition of Alexander Forbes' thought leadership publication, *Benefits Barometer*. Each year we seem to travel that little bit further away from our starting topic – Pension Funds. But because of the unique challenges that South Africa faces, the journey is a necessary one. Today we stand at a sort of crossroads. Pension reform has hit a wall of resistance. Unions and workers raise valid issues around whether it's feasible to mandate such issues as preservation or annuitisation if we haven't created an effective social security net for individuals. But it's more than that. How do we expect to facilitate asset ownership and social mobility for several generations of South Africans who have been denied such access if savings can only be really applied to retirement, income protection and medical aid?

Anne Cabot-Alletzhauser
Head
Alexander Forbes Research Institute

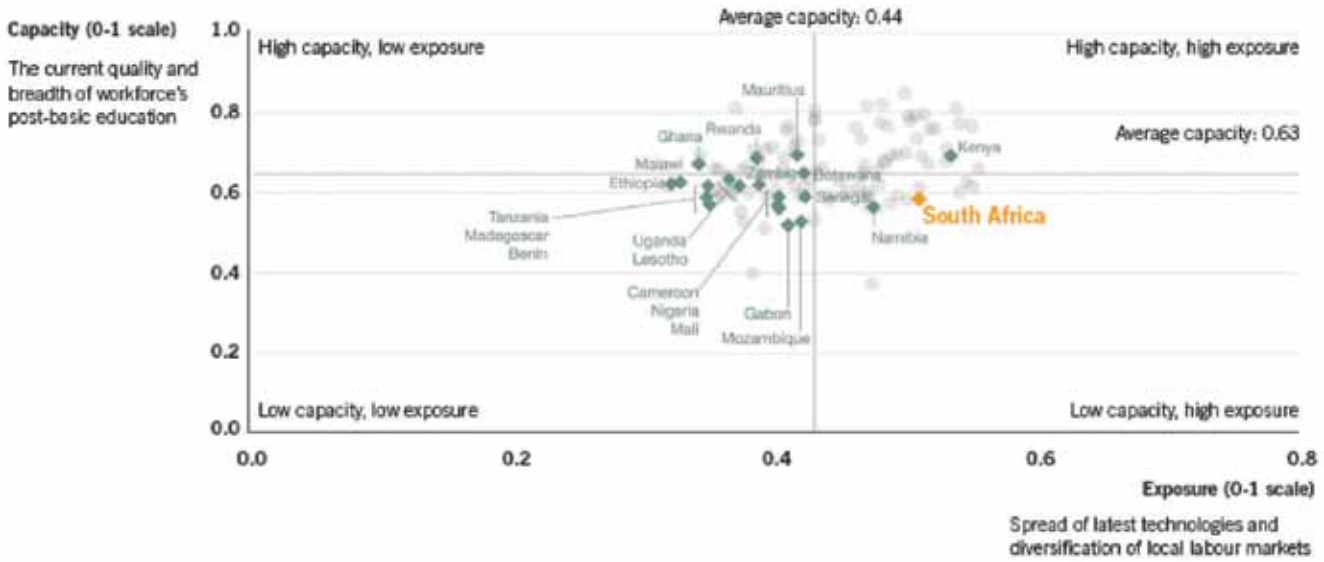


In last year's Benefits Barometer we raised the fairly provocative question of whether compulsory savings might be more palpable to employees if they could apply it not just to retirement savings, but to achieving such critical building blocks for social mobility as housing and education, or such family stabilisers as an emergency savings fund. We went into great detail about the Singapore model as an example of a state-sponsored savings fund whose design was specifically targeted at ensuring that employees were able to both meet their basic living needs and develop financial capability skills.

This year, *Benefits Barometer 2017* raised a new challenge that should give us even further pause for thought about the future or pension funds, or, more specifically, employee benefits.

Whether we like it or not, the South African workplace will be directly (and indirectly) influenced by the disruptions that are occurring as a result of the Fourth Industrial Revolution. This is the next phase of technological development that is currently introducing such challenges as automation and robotics, artificial intelligence, machine learning and the type of biotechnological advances that will be increasing the longevity of our work lives. As the graph below from the World Economic Forum highlights, South Africa is in a particularly unenviable position when compared to other African nations. Because we are a relatively evolved economy, we are likely to have one of the highest exposure to these global technological trends. But because of our second-to-last position on the continent in terms the quality of our education and the level of our unemployment, South Africa is poorly positioned to meet

Figure 7: Africa's capacity to adapt and exposure to the future of jobs



these global challenges. The World Economic Forum has estimated, for example, that as many as 77% of our current jobs stand to be impacted by these changes. A critical question will be, how ready will our workplaces be for such destabilising influences?

It's not just the issue of job skills required for this future world of work that will be problematic. Concepts such as the rise of the gig economy (where employees elect to hold multiple jobs or jump from one job to the next), the emergence of the sharing/collaborative economy (where the whole value chain of production is likely to be disrupted) and the emerging reality that workers are still highly productive long after they have reached their mandated retirement dates, all point to a world where "retirement benefits" and "employer/employee relations" will need to be completely reconceptualised.

This is the detailed discussion that *Benefits Barometer* takes the reader through. At first consideration, this discussion might seem better suited to C-Suite executives, or to HR departments. But in truth, the real *agents of change* are likely to be trustees of pension funds or management committee members. They will be the receiving end of employee disengagement with their employee benefits or their pension funds. As the ambit of responsibility for trustees increasingly extends to meeting the needs of members, it will become increasingly apparent that employers can do so much more for employees than what is currently on offer in the form of retirement savings, risk coverage and medical benefits. Indeed, a more carefully conceptualised employee benefit programme can make a significant impact on helping employees achieve real financial security and viability – something that should be of particular interest to employers.

And therein is the message: Exactly why do we have "employee benefits"? Is it really for the benefit of employees (who tend to consider retirement savings, risk benefits, and medical aid schemes as grudge purchases) or perhaps it's more for the benefit of policymakers, who see these benefits as proving the key to keeping employees from becoming a ward of the state?

We believe that in this dramatically changing world of work, there is so much more that can be done under the ambit of "employee benefits" that actually speaks to what matters most to both employees and employers. What's needed is a framework that addresses the issues of effective financial decision-making not just in retirement, but throughout an individual's lifetime financial journey. Help members save for the travails of that journey, and this in turn helps sort out the issues around retirement, income protection and health.

To facilitate this change in the structure of employee benefits, *Benefits Barometer 2017* sets out the basic building blocks that trustees or management committee members could begin engaging with:

1. The first is for trustees and employers to start employing HR data more effectively. What more can we learn about the needs of employees and the challenges they would like to see addressed?

2. The second building block is derived from this data analysis: How could the employer structure a customisable employee benefits platform that creates no additional cost to the employer, but more clearly targets what matters most to the member? Shouldn't a customisable benefits platform help members with such issues as:

- Access to low cost savings vehicles to solve both short term problems (emergency savings, school funding, vehicle financing) and longer term acquisition targets: (housing, post-retirement frail care health needs).
- An advice framework around housing: rent/build or buy?
- Financial well-being and coaching programme to target debt and aspirational needs
- Health and Wellness benefits with on-site programmes
- Second life benefits that help individuals' re-skill themselves or launch their second or third careers.
- Education programmes – both from a funding perspective and from an on-site early childhood development perspective.
- Cost effective family and personal protections
- And finally HR policies to address such issues as multi-month compassionate care leave, bereavement leave, parenting leave, and flexible work schedules.

3. The third building block is a financial coaching programme (after all, employees will need help in determining which of these benefit options will give their families the greatest bang for their buck).

4. The final building block is a completely new skills development platform that completely changes the way members can learn, not just about their benefits, or financial well-being, or their specific job, – but the implication here is to help them significantly evolve their personal skill set, to ensure that their own human capital development is on a continuous upward trajectory.

Taken altogether, we emphatically feel that this array of building blocks will ready the South African world of work for the challenges of the Fourth Industrial Revolution in ways that the current model of employee benefits could never possibly achieve. It's in our hands, now, to consider how we could use this rapidly changing world to rebalance opportunities and outcomes across our diverse population. ❐

Beware!

The FSB can replace the board of your pension fund!

Rebecca Jansch
Partner in the Pensions and Employee Benefits team
Shepstone and Wylie

In certain circumstances, the Registrar of Pension Funds can deconstruct the board of a pension fund and appoint a new interim board. It's happening with increasing frequency and this more intrusive approach of the regulator is in keeping with Twin Peaks and the intention to advance a safer financial services sector.

The Financial Services Appeal Board recently made a far-reaching ruling on the powers of the Registrar of Pension Funds to appoint 'interim boards' in terms of Section 26(2) of the Pension Funds Act 24 of 1956 ("PFA").

In the matter before the Financial Services Appeal Board, a properly constituted board was in place until the member elected trustees were dismissed from employment. The Fund could not conduct member elections within the prescribed 90 day period allowed in the Act. For this reason, the Registrar appointed an entirely new interim board. The Fund argued that, on a proper reading of Section 26(2) of the PFA, the Registrar could appoint so many Section 26 trustees as may be necessary to fill the vacancies, but could not remove existing trustees who had been lawfully appointed and replace them with a new interim board of the Registrar's choosing.

The Appeal Board disagreed with the Fund and upheld the views of the Registrar, stating that the Fund had made the mistake of treating the board as if it was divisible; a fund cannot have a board of which half is properly constituted and half is not. The Appeal Board confirmed that once any part of the board is not properly constituted, the Registrar may appoint as many persons as he/she considers appropriate – either to make up the full complement or only the number of people required to make up the quorum of the board.

The Appeal Board confirmed that the Register has the power to appoint as many persons as he/she considers appropriate when one of three jurisdictional facts are present:

1. Where a fund does not have a properly constituted board as contemplated in Section 7A and has failed to constitute a board after 90 days. Section 7A requires that members of the fund are entitled to elect at least 50% of the board, so the loss of even one member elected trustee can render the entire board invalid, unless there is an alternate trustee to fill the vacancy automatically or the Fund is able to secure a replacement within 90 days. The expiry of an exemption from the 50% member elected requirement, as is held by many umbrella funds, would also be problematic.

2. Where a fund cannot constitute a board properly.

3. Where a board fails to comply with any requirements prescribed by the Registrar in terms of Section 7A(3) of the Act (a provision that is not yet in effect).

The Appeal Board confirmed, that in making the appointments, the Registrar acts 'notwithstanding the rules of the fund' and therefore, in appointing the interim members, the Registrar does not attempt to create a board that fulfils the requirements of Section 7A or a board as set out in the rules of the fund in question.

Considering this decision, it may be prudent for funds to consider what measures can be put in place to avoid the Registrar deconstructing the board and appointing a new interim board. Possible solutions include rule amendments or the adoption of advance directives/policies/delegations to avoid the extended hand of the Registrar in the appointment of Section 26(2) boards. ❐

What difference does a quarter of a percent interest rate change make?

So there you were, going about business as usual, when unexpectedly you hear the murmurs – the Monetary Policy Committee (MPC) could cut interest rates today! Suited men nod sagely while CNBC Africa invites experts to share their knowledge. Friends tell you how successful they've been at investing while you are struck by a dawning sense of FOMO – what should you do and why? Guy Fletcher, Head of Research and Client Solutions at Sanlam Investments unpacks the knock-on effect of even a small percentage change in interest rate on investments.

Guy Fletcher
Head of Research and Client Solutions
Sanlam Investments

Economists, media commentators and investment professionals alike spend multiple hours observing the nuances of central bank policy announcements, the way that the committee members voted and what their expectations are. However, interest rate policy is acknowledged to be a fairly blunt instrument in supporting economic growth and managing inflation risk, often with (at best) an impact that takes many months to take effect.

So why should we concern ourselves?

Interest rates are considered to be important since they underpin the very foundation of asset pricing – in simple terms, the price of an asset is considered to be the present value of all the future payments that asset will make, whether in the form of dividends from equities or coupons from bonds. Higher interest rates imply lower present values and vice versa.

Two observations must be made:

(a) the impact that a change in short-term interest rates has on asset price formation is thus increasingly a function of the persistence of that change, and

(b) the sustainable impact of these changes on real long-term interest rates is, perhaps, at odds with standard monetary theory that argues that the markets will ultimately dominate central bank interventions.

So far, so good, but who sets interest rates?

Historic monetary policy

The South African Reserve Bank currently has full operational autonomy – the Monetary Policy Committee (MPC) sets the levels of interest rates (commonly known as the repo rate or the rate at which commercial banks borrow rands from the Reserve Bank) within an inflation-targeting framework.

However, monetary policy has evolved over the previous decades with the Governors since 1990 as follows:

Dr CL Stals	:	8 August 1989 to 7 August 1999
Mr TT Mboweni	:	8 August 1999 to 8 November 2009
Ms G Marcus	:	9 November 2009 to 8 November 2014
Mr L Kganyago	:	9 November 2014 to date

South Africa introduced inflation targeting in February 2000 after a proposal to adopt the framework in August 1999. Prior to adopting this, the Reserve Bank had followed policies including: (*Source*: *SARB*)

- exchange-rate targeting
- discretionary monetary policy
- monetary-aggregate targeting
- an eclectic approach (multi-method)

"*The SARB acknowledges that monetary policy cannot directly contribute to economic growth and employment creation in the long run. However, by creating a stable financial environment, monetary policy fulfils an important pre-condition for the attainment of economic development*".

This clearly has implications regarding the analysis of interest rate policy since the Reserve Bank was executing interest rate changes for different reasons and under different economic conditions (witness Governor Stals' attempt to shore up the rand during the 1997/8 Korean crisis). Thus, any direct inferences must be tempered with a healthy respect for prevailing policy implications.

And, similarly, it makes you wonder what was on the Public Protector's mind when she challenged the SARB's mandate!

The data

Let's have a look at the historical evidence within the South African markets to see whether interest rate changes have a direct and sustainable impact on asset price formation. In doing so, we will break the information into two sets: pre- and post-inflation targeting, the former commencing in December 1995 (after the new regime had settled down), and the latter commencing in February 2000. Please note that the numbers presented (in the table on the next page) are in REAL terms.

Our first observation is that there would definitely appear to be a difference between pre- and post-inflation targeting, despite the low reduction in overall inflation of 0.7% p.a. The most obvious other ones are:

- The significant change in the annualised real exchange rate (as a consequence of stable policy).
- The massive jump in property returns, mostly due to rental growth and reductions in vacancies.

- The significant reduction in returns for both nominal bonds and cash – this can be directly attributable to inflation-targeting yielding a far more stable environment.

- The significant upward move in gold (notwithstanding its benefit from a declining rand exchange rate).

It is also notable that most of the real return numbers indicated since March 2000 are somewhat higher than those put into long term strategic asset allocation models. The justification for the lower numbers is largely based on more recent experiences, where real returns (last 7 years) are anywhere from 1% to 3% lower p.a. (cash, bonds, gold, ILB's and equity) to 8% less p.a. (property) than indicated in the table.

This is all very interesting, but what has this got to do with the MPC announcements?

Well, let's break down each period between the times when interest rates are increasing and the times when they are decreasing. We do this in a simple fashion. Interest rates are presumed to increase until the end of the first month, during which interest rates were cut and vice versa. In this way, there are only two regimes (up and down) and there is no foresight (a regime only changes after a physical announcement). Results are enlightening: (as per table on the next page).

It is notable that CPI is far higher in regimes where interest rates are increasing as opposed to decreasing – even post 2000 (since the introduction of inflation-targeting), the difference is almost 2.5% p.a. making this a far harder threshold to overcome in a real return environment.

Secondly, the interest rate UP regime can be redefined as risk-off and characterised as a defensive environment where one should elevate the interest-bearing elements of one's portfolio. The opposite also holds true. The interest rate DOWN environment is risk-on, where a portfolio should be biased towards growth assets. The difference for equities is marked while the change for gold is most likely the consequence of its relationship with the exchange rate.

These are not guarantees, but merely observations. One refrain that is dutifully trotted out by market practitioners is that "it is different this time". However, it is also realistic

Data	OVERALL Dec 1995 to Jul 2017		PRE Inflation-targeting Dec 1995 to Feb 2000		POST Inflation-targeting Mar 2000 to Jul 2017	
	Annualised Real return	Annualised Real Stdev	Annualised Real return	Annualised Real Stdev	Annualised Real return	Annualised Real Stdev
Equities	9.1%	17.8%	7.0%	25.9%	9.6%	15.5%
• Rating	1.7%	21.7%	-1.4%	28.5%	2.4%	19.8%
• Earnings	7.3%	13.2%	8.4%	12.1%	7.1%	13.5%
Listed Property	14.2%	16.6%	-0.2%	20.6%	18.0%	15.5%
• Rating	2.5%	35.8%	3.5%	40.3%	2.2%	34.8%
• Earnings	11.5%	33.5%	-3.6%	26.0%	15.4%	35.1%
Gold ETFs	5.4%	19.4%	-0.1%	15.6%	6.7%	20.5%
Nominal Bonds	5.4%	8.7%	9.3%	13.1%	4.5%	7.5%
Inflation-linked Bonds *	4.9%	5.2%	2.4%	6.4%	5.5%	4.8%
Cash	3.4%	1.8%	8.5%	1.6%	2.2%	1.7%
USDZAR **	3.1%	16.2%	9.7%	11.6%	0.6%	16.8%
Inflation (CPI)	6.0%	1.6%	6.6%	1.8%	5.9%	1.6%

Source: IRESS, Sanlam Investments, August 2017

* The ILB numbers pre-2000 have been estimated from post-2000 relationships for the sake of completeness
** Note that the USDZAR real return is the change in the exchange rate adjusted by the difference between the SA and US CPI rates

to state that it is always different, yet the results speak for themselves.

Conclusion

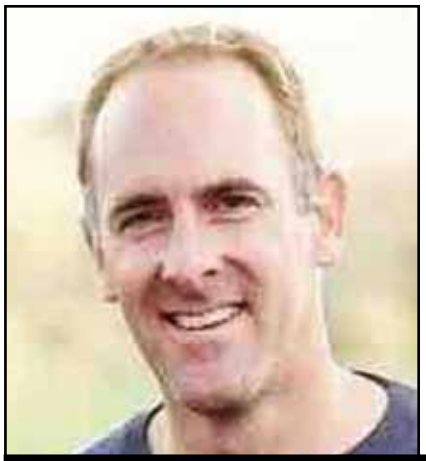
The marked difference in the real performance of assets between the two interest rate regimes underpins the critical nature of the MPC's policy on interest rates. The magnitude of the change is often less important than the direction. Portfolio managers are acutely aware of this and implement their decisions accordingly.

So where are we now? Well, on 20 July the MPC cut the repo rate somewhat unexpectedly by 25 basis points, signalling the end of a 42 month UP (risk-off) environment. If we're now entering an interest rate (DOWN) environment, should portfolios be biased once again towards growth assets? ❐

Average annualised Real returns	Equities	Listed Property	Gold ETF	Nominal Bonds	ILB's	Cash	USDZAR	CPI
Pre-Inflation targeting	7.0%	-0.2%	-0.1%	9.3%	2.4%	8.5%	9.7%	6.6%
IR Up	-9.7%	-20.8%	-9.0%	4.0%	6.7%	6.4%	4.4%	10.0%
IR Down	22.2%	19.6%	7.6%	13.7%	-0.8%	10.2%	14.0%	4.0%
Post inflation-targeting	9.6%	18.0%	6.7%	4.5%	5.5%	2.2%	0.6%	5.9%
IR Up	-1.4%	14.6%	0.4%	4.4%	3.8%	1.6%	-4.9%	7.2%
IR Down	18.6%	20.6%	11.7%	4.5%	6.7%	2.7%	4.9%	4.9%

Source: IRESS, Sanlam Investments: August 2017

Information analysis and the future of investing



John Gilchrist and **Grant Watson**
Joint Heads
Old Mutual Investment Group's Customised Solutions boutique

Michael Lewis's 2003 best-seller, *Moneyball*: *The Art of Winning an Unfair Game*, tells the true story of how the Oakland Athletics baseball team's general manager, Billy Beane, was able to turn the team's fortunes around through the use of data analysis. Beane was able to exploit inefficiencies in the market for baseball talent through a statistical/data driven approach, rather than the gut instinct-based scouting approach prevalent at the time. This approach allowed his low-budget team to triumph over other highly funded competitors. This same approach can be applied to investing – using data analysis to identify and exploit market pricing inefficiencies.

Although this quantitative approach can trace its roots back to the 1930s, the growth in assets managed quantitatively has been relatively slow – at least until recently. Much has been made of the rise of passive investing and smart beta in recent years, but the hottest investment trend globally right now is quantitative (quant) investing. Quant hedge funds have had eight consecutive years of inflows and, with assets approaching $1 trillion, account for nearly one-third of total global hedge fund assets.

These strong flows into quant funds have been driven by both better performance and lower risk, with quant funds generally delivering more consistent returns with low correlations to their fundamental investing peers.

Quant funds are constantly looking for unique methodologies, data sets and trading strategies that can identify proprietary alpha-generating ideas. They are being helped in this quest by the rise of big data, machine learning and artificial intelligence (AI), combined with superfast computers. For quant analysts, these developments represent incredibly fertile ground – the opportunities are almost unlimited.

In Deloitte's *Investment Management Outlook 2017*, big data, AI and machine learning were identified as a major trend likely to gain momentum this year. Deloitte foresees developments both in alpha generation and in cost improvement.

Even fundamental managers are starting to embrace quantitative investing. After laying off 15% of the employees at Tudor Investment Corporation following poor returns and withdrawals, legendary hedge fund manager, Paul Tudor-Jones has made organisational changes to focus more on technologically driven and big-data trading approaches. According to the Wall Street Journal, he told the employees that "No man is better than a machine. And no machine is better than a man with a machine".

The lines between quantitative and fundamental investing do indeed appear to be blurring. It is important to distinguish between *quantitative trading*, which includes high frequency trading and algorithmic trading, and *quantitative investing*, which generally involves building outperforming portfolios in a risk-controlled manner.

It is also important to follow a disciplined quantitative approach to avoid behavioural bias pitfalls and to consider numerous fundamental factors (including financial statements and macroeconomic, sector and local and global market sensitivity based factors) where a number of factors that correlate with either out- (or under-) performance may be identified.

The fundamental factors driving the market at any point in time tend to trend, and investment managers should adjust their portfolio dynamically to ensure they are best positioned to benefit from whatever the market is rewarding at a given time.

The adoption of quantitative investing has generally been relatively muted in South Africa but the trend towards quantitative investing being seen globally is likely to increase locally over the next three to five years. We also believe that, as computing power and data availability grow exponentially, quantitative investing will become increasingly more popular.

With the simultaneous rise of passive investing, smart beta and quantitative investing, fundamental managers may be feeling under threat. However, as their portion of the investing universe shrinks, the opportunities for them to add alpha through detailed research and stock selection should grow.

Ultimately, all these developments should benefit the investor in terms of both higher returns and overall lower fees for their entire portfolio of assets, and that can only be a positive development, long term, for the industry as a whole. ❐

What do foreigners see that local investors don't?

Melville du Plessis
Portfolio Manager
Sanlam Investments

Since Nenegate South Africans have had to digest a series of rather unpalatable political events. This year alone there has been the surprise Cabinet reshuffle, the so-called continued 'state capture' and the release of a Mining Charter draft so punitive and unreasonable that it's highly unlikely to ever be implemented in its current format.

In addition, there's the economy's entry into a so-called 'technical' recession, an unemployment rate of close to 28%, more downgrades looming and little on the horizon to signal an economic lift-off and an improvement in the fiscal budget anytime soon. So, it's not surprising that SA investors have a gloomy view of local assets, including SA bonds and cash. Cash is currently giving you just under 6% and historically has given returns between 5% and 12%. SA equity has offered investors a wide range of returns between a staggering -38% and 70%.

Local investors' perception of SA assets stands in sharp contrast to foreign sentiment: despite all the uncertainty facing South Africa, foreign investors are grabbing the yields on offer from SA fixed income assets with both hands. According to the Institute of International Finance, foreign inflows into emerging debt markets surpassed $100bn in the first half of 2017 and according to Deutsche Bank have reached an all-time high of $700bn. SA received its fair share – inflows totalled R30bn in the second quarter of 2017 and almost R45bn to date!

What do foreigners see that local investors don't? Melville du Plessis confirms that, despite the uncertainty in South Africa – or perhaps *because* of it – his team sees value in local fixed interest and credit markets.

The hunt for value offshore

For disgruntled South Africans the only way out appears to be offshore – for any spare capital they may have. But one of the principles of value investing is to buy low and sell high – or if you have to invest now and can't find

assets at a discount, at least don't pay a premium. This begs the question, where would SA investors currently find fair value offshore?

Most developed market cash accounts now offer between 0% and 1% – hardly the type of returns that create long-term wealth. On the equity side, the majority of global equity indices have hit record highs in the past quarter and according to some investment managers' calculations, US markets have only been more expensive during the internet bubble of the 90's and the run-up to the US stock market crash of 1929.

It is normally towards income-yielding portfolios that more conservative investors turn and here the picture is not very promising either. Nearly a decade of quantitative easing and asset purchase programmes have sent global bond yields to all-time lows (and consequently developed market bond prices sky high). It's most likely there's only one way global bond prices could go from here.

Says du Plessis, "The fiscal and monetary policy responses to the 2007/8 global financial crisis were on an unprecedented scale, with fiscal stimulus and budget deficits leading to an increase in debt levels worldwide. Interest rates are still at their lowest levels in history and quantitative easing has led to massive expansions of central bank balance sheets."

The central bank 'bubble' appears to have spilled over to other assets, leading to record-high asset prices across most asset classes in developed markets. Undervalued assets offshore have become a scarce commodity.

Exactly how big is the central bank bubble?

The world's largest central bank, the US Fed, currently has more than $4.5 trillion on its balance sheet, composed primarily of bonds that it purchased in response to the great financial crisis. The programme, also known as quantitative easing, was pursued to inject money into the economy and encourage risk-taking. As a result, the Fed's balance sheet is now big enough to buy the 10 largest companies on the S&P 500, including Amazon, Apple and Exxon.

It's not only the absolute size of these debt numbers but also the rise in negative-yielding debt that is noteworthy. Says Du Plessis, "We have reached a point in history where some debt instruments even carry negative interest rates. You actually have to pay someone to lend them money! During the last few years the amount of negative yielding debt increased significantly with the total amount peaking at around $13 trillion during the second half of 2016. It is a staggering amount".

It is clear that the debt dynamics in the world are not on a sustainable path, but how will central banks shrink their balance sheets and what will be the consequences?

How to shrink the world's largest balance sheet

The Fed has already started raising interest rates, but it has not yet started the second part of the journey: unloading its balance sheet. The Fed has two choices: it can simply allow the bonds to run off naturally when they mature, or it can actively sell them back into the market before maturity. If the Fed gets its tapering process wrong, possible consequences include a sharp decline in equity and other asset prices.

In comparison, SA bonds look attractive

The good news is that unlike the US and the rest of the developed world, South Africa hasn't seen yields moving lower. In spite of the economic and political uncertainty, South Africa still offers good quality credit plus a margin of safety. Investors are actually being compensated with a healthy premium for the level of risk taken (currently around an 8.5-9% nominal yield for SA 10-year bonds).

The type of yields on fixed interest and credit assets that we currently see in South Africa are actually quite rare in the global context.

In fact, SA long bonds are still offering among the highest local currency real yields in emerging markets. "Even if inflation settles at the top end of the 3% to 6% inflation target, a real return of 3% is still on offer from vanilla government bonds, and that's before one starts investing across high quality companies and credits where you get an additional 1.5% to 2% above that", says Du Plessis. This is particularly attractive given the low real returns available in global bond and equity markets.

In addition, SA inflation is currently trending downwards, while inflation in developed market countries are picking up. South Africans could therefore see more rate cuts over the next year, which would be a boost to SA bond prices.

What happens to SA bonds if they're downgraded further?

If or when SA debt will be downgraded further should not be the main focus point. At the moment SA's credit default swap spread is already similar to non-investment grade countries and a large and sustained drop in asset prices is not necessarily expected, and very dependent on the global backdrop and specific local factors at play should further downgrades transpire. The SA government should theoretically always be able to service its own currency debt (as it's in control of the money printing press). But there are risks. The mismanagement of an economy can manifest itself in rising inflation, which could halt the decreasing interest rate cycle that the Reserve Bank signalled recently with its first interest rate cut in five years during July this year.

Du Plessis, however, expects inflation to trend lower and trough below 5% by the end of 2017 before picking up again. Upside risks stem from the potential for higher electricity tariffs next year, as well as unfavourable political outcomes, which could lead to a weaker rand.

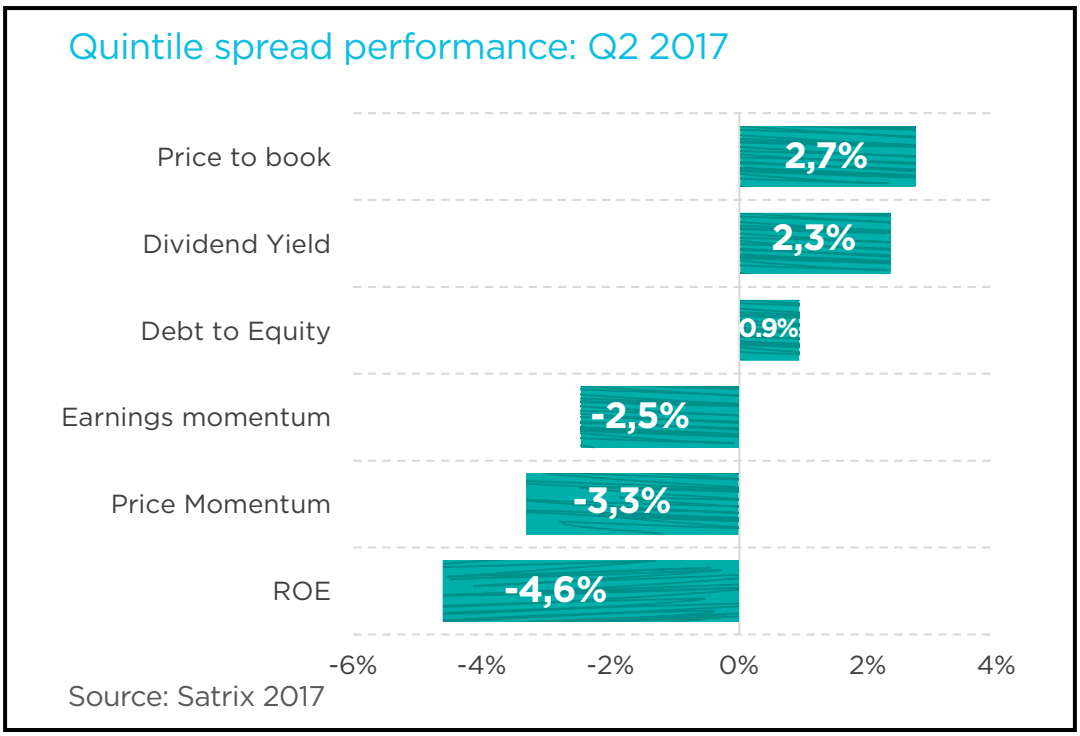
Fixed income performs an important role in helping investors preserve capital and generate a more stable level of income. Du Plessis concludes, "We believe SA fixed income assets are still attractive within the global context of a low-yielding environment. Locally, we see real yields of between 2% and 3% on offer against a backdrop of declining inflation". ❐

Satrix quarterly style tracker: Q2 snapshot

Who were the stand-out performers in Q2?

At a glance, Price to Book and Dividend Yield were the best performing factors during the second quarter with returns of 2.7% and 2.3% respectively, while ROE (the best performing factor in the previous quarter) and Price Momentum struggled over the same period. Earnings Momentum ended the quarter down 2.5%, as company earnings revisions from the resources sector weighed heavily.

Jason Swartz
Head of Portfolio Solutions
SATRIX Managers

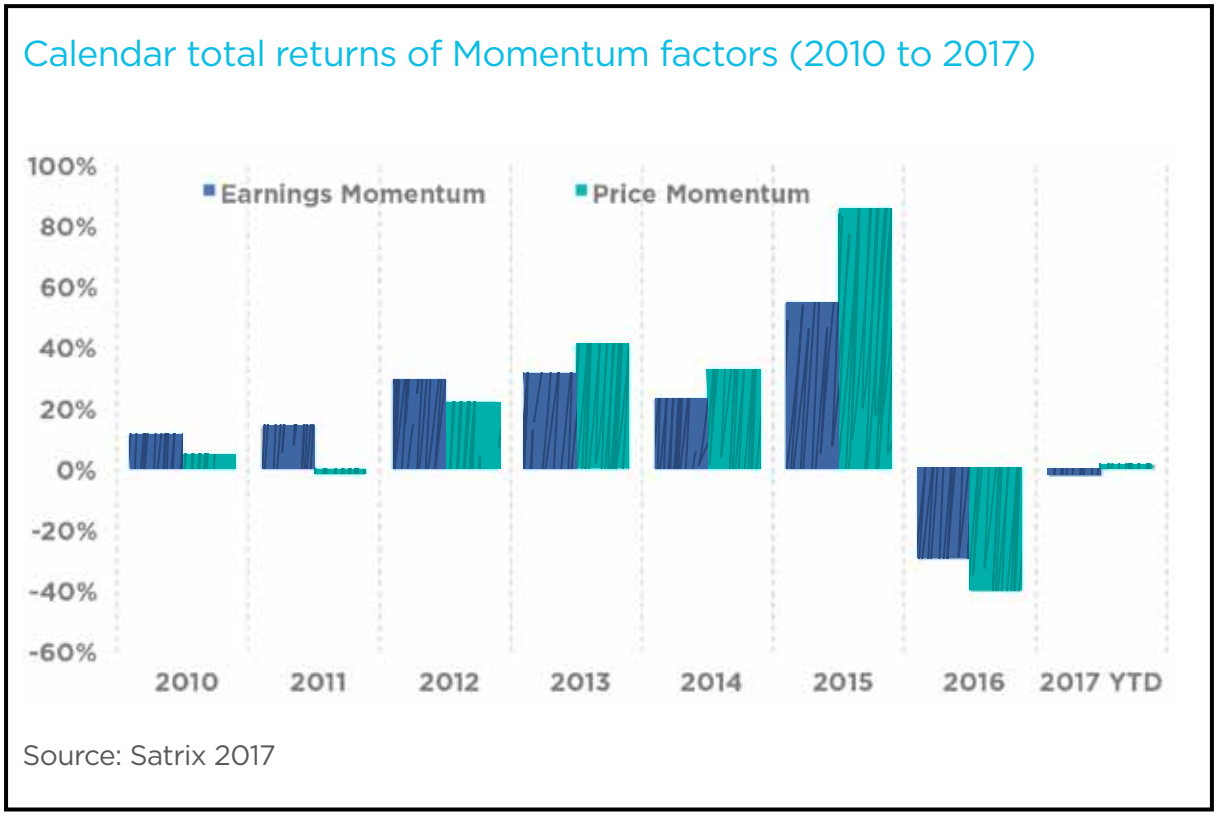


What impacted performance in Q2?

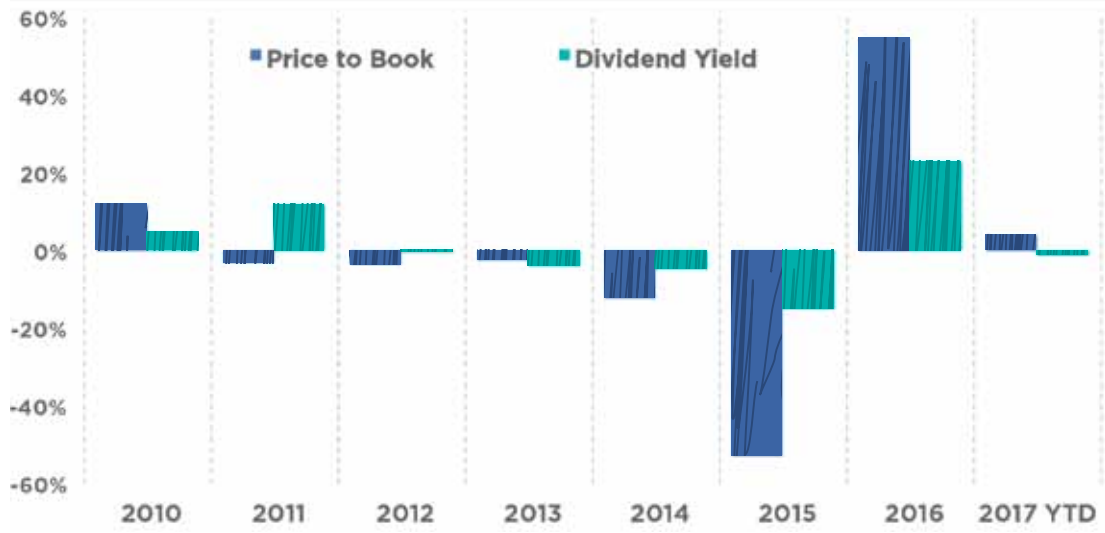
Q2 was characterised by continued high levels of economic and policy uncertainty as well as weak consumer sentiment. Moody's cut SA's currency ratings and kept the outlook at negative due to political infighting and a weaker growth outlook, as our domestic economy saw a 0.7% quarter on quarter GDP contraction in the first quarter of 2017. Equity markets were largely flat but saw divergent performances from industrials (+2.2%) and resources (-7.0%).

Momentum

While Q1 showed a moderate recovery in Price Momentum's performance, the memories of 2016



Calendar total returns of Value factors (2010 to 2017)

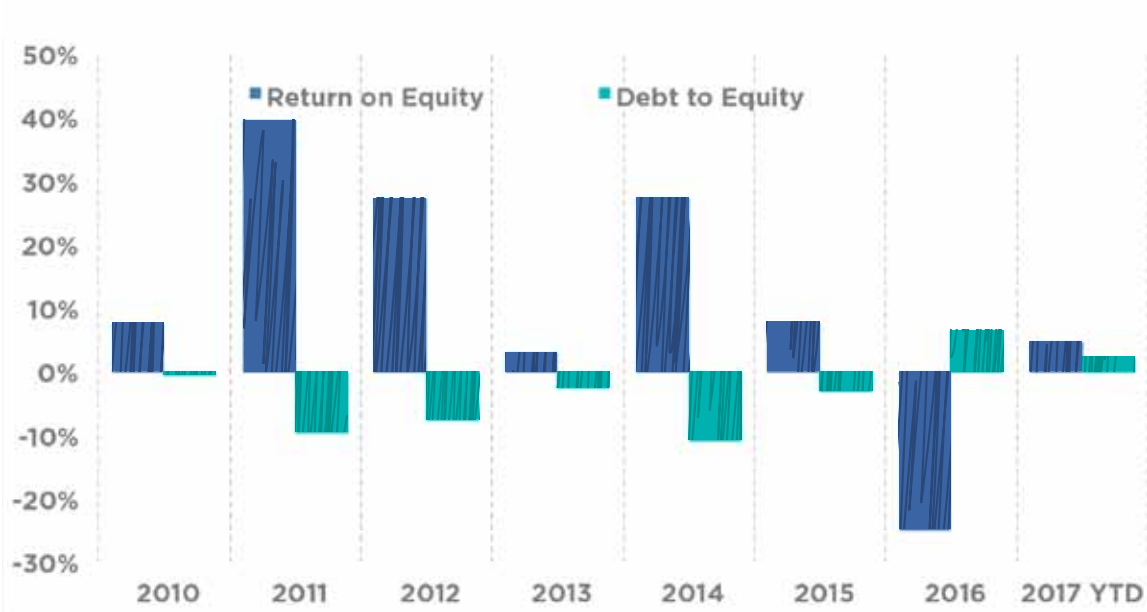


Source: Satrix 2017

continue to haunt this factor in Q2. Continued macro volatility and a protracted domestic economic recovery remains a challenging environment for this factor, as equity price reversals have prohibited this factor from entrenching a firm trend.

Earnings Momentum's experience has been marginally worse than Price Momentum, with year-to-date performance down 4.7%. Aggregate consensus earnings continue to be revised lower, with downgrades led by resources and industrials.

Calendar total returns of Quality factors (2010 to 2017)



Source: Satrix 2017

Value

Price to Book continues to shine so far in 2017 after a fantastic performance in 2016, as extraordinary levels of economic and policy uncertainty created a fertile environment for this factor.

Dividend Yield similarly did well in 2016, shedding a forgettable value cycle since 2012. With a sluggish SA economy struggling to recover, investors have redirected their attention away from 'growth' orientated shares, and instead to counters that offer higher margins of safety (from a valuation perspective) as well as a strong component of income.

Quality

The Return on Equity factor experienced an astounding reversal in Q2. After being the best factor in Q1, it fell back into its '2016-like' performance during the second quarter. We maintain that this factor still has some overhang from a moderately crowded position in 2015, based on valuation measures. After some further normalisation, the factor's long-term premium should become more accessible.

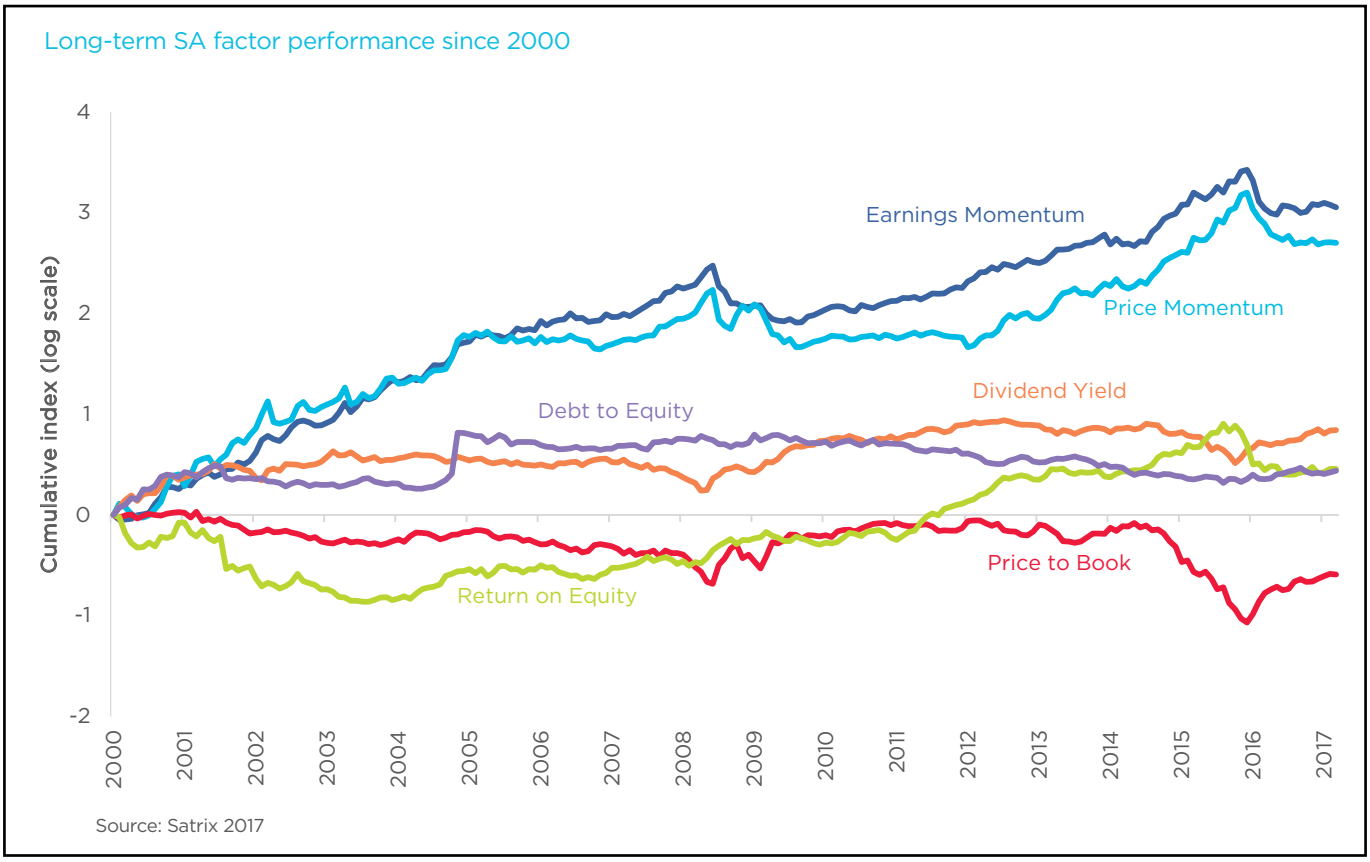
Debt to Equity continues to deliver positively year to date, after an improved 2016, where this factor showed sporadic bursts corresponding with periods of extreme market stress, reminding us of its defensive attributes. As uncertainty unwound so did the return premium.

How we measured this

The strategies shown in this article are factors we believe are the most significant in our domestic market. The universe we use is the All Share universe excluding property and small cap shares. We rank the stocks from highest to lowest for each factor and divide the universe into quintiles (subsets or groups of 5). We then calculate the quintile spread by taking the top quintile's return experience less that of the bottom quintile. Rebalancing and performance calculations are conducted each month. The performance results do not reflect transaction costs, tax withholdings or any investment/advisory fees. The results of these quantitative factor strategies are significantly less diversified, and, as such, their performance is more exposed to specific stock or sector results. Past performance should not and cannot be viewed as an indicator of future performance.

International experience

If you consider the MSCI World as your universe, Growth, Quality and Price Momentum have been the clear outperformers since the start of the year. Despite the latter half of 2016 seeing the 'reflation trade' firmly in place, we have seen a marked reversal in 2017 with the year-to-date Value factor underperforming Growth significantly, due to the global economic recovery tracking well, strong corporate earnings and fading policy uncertainty. ❐



The 5 questions you should be asking your financial advisor

Financial advisors are there to help you make the correct financial decisions. Yet, many people find it difficult to ask them questions as they are often not familiar with financial jargon and their advisors present them with a wad of documents they don't fully understand.

Gavin Smith
Head of Africa
deVere Acuma

Here are five questions you should be asking your financial advisor.

1. How am I doing financially and should I be worried?

The primary role of a financial advisor is to make sure your money is preserved (at the very least) and that it grows in line with your financial, saving and investment plans.

The first thing your financial advisor needs to show you is whether this has happened. You should ask to see a detailed account not only of the total investments and savings amounts, but also how each element of your portfolio has performed. In addition, they should be able to evaluate all of your other financial policies, such as your life insurance that you may have in place.

You should be able to see whether your cash, shares, property or retirement annuities have performed well relative to your expectations and to peer averages and need to question why there is under-performance (if there is) and how this will be rectified. You should also be able to get a better understanding whether you are fully protected in the event that something unexpected happens.

"Most of all, you need to know if all of this means you should be worried – about whether you are still on track to meet your financial goals and objectives or whether you need to adjust your expectations or change your plans", says Gavin Smith, head of Africa at financial advisory group deVere Acuma.

2. What risks am I taking?

You and your advisor would have initiated your relationship based on an understanding of your risk appetite, which would be factored into your plan.

This needs to be constantly re-examined and it is up to your financial advisor to spot any new or increased risks in your life that could impact your financial plans, investments and policies in place.

For example, says Smith, a rand hedge biased portfolio may have been considered low risk some two years ago, but the rand's recent strength was an unexpected risk and you have been taking on a risk that you did not sign up for. Equally, if you are invested in a particular region which was considered a safe bet but is now fraught with issues, your low risk option has become high risk. If your investment has done well or you have come into some additional funds, you may feel you are in a position to take on more risk than before.

3. How have you adapted your financial strategy to react to external changes?

"If your advisor tells you this is a long-term game and nothing has changed or needs to change, it may be time to ask the hard questions about whether they are fully taking into account the short-, medium-, and long-term risks that could have an impact on all of your investments and financial policies in place", says Smith.

While it has been proven that a long term strategy works, and that making impulsive changes in reaction to current events is generally not a good idea, it is critical that your investment advisor explains what recent global and local events mean for your financial planning, and whether these events have been carefully considered in relation to your investments and policies in place.

Your advisor needs to explain what a Donald Trump presidency, Brexit, low South African economic growth rate, possible ratings downgrade or rising or falling commodity prices mean for your savings and investments and how these uncertainties are factored into their strategy, and whether any of these events require a reaction.

Obviously you cannot expect them to accurately predict the future, but you can expect them to have done some scenario planning and worked this into their financial strategy.

"At the very least, if you are a low risk investor they need to show you how your portfolio offers you the maximum protection against volatility. If you have a greater risk tolerance, your advisor should show you how your portfolio is structured to take advantage of the volatility".

4. What are you doing to take my personal needs into account?

Financial advisors may be quick to sell you a plan that works for the majority of their clients. The whole point of enlisting an advisor, however, is to get advice that is specific to you.

Has your advisor asked you if anything in your life has changed or is expected to change?

"Getting married or divorced, changing or losing your job or having to step into care for a family member will significantly alter your financial situation and future needs and resources", says Smith.

If you lay out your priorities, your advisor needs to fine tune your financial portfolio as those priorities change, whether it is changing your investments, increasing your life cover, or even taking out an education policy for a little one on the way.

5. What changes do we need to make right now?

Financial planning may be a continuous and long term process, but if there are any new changes in your circumstances, these may require immediate adjustments to your financial portfolio and your advisor should act rather than advise you to carry on as before.

Similarly, if there are any external changes which may affect your savings and investments, these should also be accommodated immediately. If, for example, you have investments in countries or in asset classes whose risk profiles have changed, you need to adjust your strategy or your expectations and your advisor must alert you to the changes you should be making.

If your advisor indicates that no changes are required despite these new circumstances, you need to be assured that you are correct in sticking to your guns. ❐

The primary role of a financial advisor is to make sure your money is preserved (at the very least) and that it grows in line with your financial, saving and investment plans.

Outside lane

Inside lane

There's a time to be bold and a time to be cautious.

Knowing when to make a split-second decision takes experience and strategy. But it's a bold move that can make all the difference. The Sanlam Investment Management Top Choice Equity Fund offers investors an aggressive fund with a 10-year track record of consistently high returns above the market. By skillfully uncovering gems within the listed universe of stocks, the Sanlam Investment Management Top Choice Equity Fund helps navigate stock market volatility for consistent, superior results. Which is why when it comes to managing investment risk for growth, our expertise is hard to match.

Our expertise includes:

Active | Index Tracking | Alternatives | Offshore | Multi-Manager

Investments

www.boldorcautious.com

Sanlam Wealthsmiths™

Sanlam Collective Investments (RF) (Pty) Ltd is a registered and approved Manager in terms of the Collective Investment Schemes Control Act. A schedule of fees can be obtained from the Manager. This is a high conviction, pure equity fund. The fund is exposed to equities, which means the prices will go up and down. Sanlam Investment Management Top Choice Equity Fund aims to deliver above average growth of capital over the medium to long term. The fund may display high volatility in the short to medium term and is suitable for the sophisticated investor with an aggressive risk profile. The Retail class is the most expensive class offered by the Manager. Maximum fund charges include (incl VAT): Initial advice fee, 3.30%. Initial manager fee, 0.00%. Annual advice fee, 1.14%. Annual manager fee, 1.02%. Total expense ratio (TER), 1.19%. SIM refers to Sanlam Investment Management.

Don't be left underinsured on your group risk benefits

Starting a new job can be overwhelming! Amid learning the ropes, onboarding also requires making important decisions like deciding what percentage of your salary to put towards your retirement savings each month. Over time, things change and you settle in. After each promotion, you increase your retirement contributions; as your family grows, you remember to update your beneficiaries included in your death cover. But have you ever considered updating your disability cover to reflect your current lifestyle needs?

This is a question posed by Samantha Jagdessi, Head of Benefits Consulting at Old Mutual Corporate Consultants, who says many employees neglect to double check that their risk cover is in line with their changing occupational needs. "An injury can significantly impact your ability to earn an income", says Jagdessi. "Time passes and life happens. With age, your health and financial requirements change and the disability cover provided by your employer may not meet your financial needs or the physical demands of your lifestyle".

Samantha Jagdessi
Head of Benefits Consulting
Old Mutual Corporate Consultants

Despite the fact that most large companies provide their employees with group cover benefits, a study by the Association for Savings and Investment South Africa (ASISA) last year showed that, for an average family to maintain its standards of living after a disability event, households would require insurance cover of around R28.9 trillion.

However, the extent of actual cover in force amounts to only R13 trillion, leaving a disability insurance gap of around R16 trillion. For the average individual income earner, this represents a life cover shortfall of more than R900 000 and a disability cover shortfall of over R1.1 million. This means that even if you have group life cover in place, it may be insufficient to adequately address your needs.

"Employers generally offer a standard level of disability cover linked to your pensionable salary. However, disability cover is not a one size fits all approach. If you decide on a lower pensionable salary you will probably have a lower benefit payable on disability. When considering the rising cost of living however, very few can afford to live on their pensionable salary alone".

Each employee will have different needs and will require a different level of insurance explains Jagdessi. "Employers are not in the financial or practical position to always provide satisfactory risk benefits and members could easily find themselves underinsured. It's the responsibility of the employee, not the employer, to ensure that the cover meets their needs and that they're not left underinsured".

"It's also critical that members understand the legal terms of their insurance contract, especially how their policy defines 'permanent disability'".

She uses an example of a skilled surgeon unable to earn an income due to a motor car accident. "If the policy provides for a temporary income benefit if he or she, for a short period of time, is unable to perform 'his own occupation with his own or another employer' due to a hand injury, then he'll receive an income benefit on a month to month basis".

However, if the surgeon insists that his disability is permanent, the policy's definition of disability is a lot stricter. "If the policy reads 'a member is unable to perform his own or similar occupation', the onus will fall on the surgeon to prove he's unable to perform another job in his field", says Jagdessi. "In other words, he'll need to prove in this example that he's unable to lecture medical students, or manage the hospital, or the like".

If the wording of the disability insurance reads 'a member is unable to perform any occupation for any employer', the surgeon would be considered 'disabled' only if it was impossible to perform any of his previous duties or any other occupation. "He would need to prove he's unemployable, in this example he would have to sustain a very serious injury, for example a brain injury, to qualify".

"Generally the rule suggests that the more permanent the disability, the stricter the definition. Lump sum benefits are typically only paid out when you are permanently disabled, whereas income benefits can provide for both temporary and permanent disability", says Jagdessi. "The broader the definition of disability, generally the lower the cost of the policy. While it's important to balance what you can afford to pay each month and having adequate cover, you never want to be left vulnerable when you need protection the most".

Apart from ensuring that you're not underinsured, Jagdessi suggests the following to members:

- **Have your personal details been uploaded correctly and do they need to be updated?** You may have moved house or changed cell phone numbers. Your policy documents and updates may be posted to the wrong address. If, at claims stage, your policy is found to have changed significantly, you may find that the insurer did try to notify you but was unable to do so because your contact details were out of date.

- **Is there a waiting period on your policy?** This could mean two things. In the first case, the waiting period could mean that after you first take out the policy, there is a waiting period of one to two years before any claims will be recognised. In the second case, there might be a waiting period following an accident and before your benefit is paid out, for example, six months. This waiting period is usually to ensure that any disability is a permanent injury and will permanently impact your ability to earn an income. If there is a waiting period, are you aware of the employer remuneration policy for the first few months when the insurer is not paying any benefit, and you are unable to work?

- **Have your income levels changed beyond inflationary rates and do these details need to be updated on your policy?** Again, your income details on your disability insurance policy would need to be updated.

- **Have you fully disclosed all details of any pre-existing health conditions or ailments to your insurer?** The recent annual report for the Long-term Insurance Ombudsman shows that 50% of complaints related to disability insurance, had to do with insurance claims that were declined due to the client not disclosing information properly. In at least two of these complaints, the members had not fully disclosed material changes in their income, or details regarding similar policies with other insurers. Some policies do not require disclosure but, at claim stage, a claim may be declined if a pre-existing condition exists.

- **What are the exclusions on your policy?** For example, if you suffered from asthma as a child, this condition might be excluded from your policy. This means any complication resulting from asthma would not be covered by the policy. Also, as medicine progresses and new conditions are diagnosed, some insurers update their policies to include new exclusions. ❐

How to choose the right funeral plan

News that the Financial Services Board (FSB) is probing 13 funeral schemes, highlights the need to make sure that consumers pick the right product and insurance services provider for their funeral cover. According to the FSB, the schemes under investigation did not confirm that their policies are underwritten by a registered long-term insurance company before the FSB's stipulated deadline. This is in breach of the Long-Term Insurance Act and is seen as running an unregistered insurance business.

Sonja Visser
Chief Executive Officer
African Unity Life

For many South Africans, choosing a funeral policy is the first experience they have with insurance products. It is important that the industry does what it can to ensure that funeral plans are exactly what they should be – safe and reliable.

> "A positive experience with funeral schemes can encourage consumer confidence in the insurance industry" says Sonja Visser, CEO of African Unity Life, a registered insurer that underwrites a large selection of well-known funeral schemes. "It is potentially disastrous if the policyholder discovers that there is no financial or institutional support to pay out claims to beneficiaries of the insured".

Acquiring a funeral policy is the first step people take to ensure that they and their families can afford a dignified funeral.

> "Choosing the right funeral policy can prove a challenge as there are many options and providers – and not all of them are reliable", Visser says. "It is crucial that consumers are sure that the policy they purchase is with a registered and trustworthy service provider".

When choosing a policy, consumers need to carefully consider their family's needs. The chosen cover should include the appropriate range of benefits needed, such as the required casket, transport services for family and friends to the funeral, a grocery benefit (to support the family for a short while), airtime to contact relatives and friends, and even – in some cases – education fees for the children of a deceased breadwinner. Benefits will vary according to the funeral plan and level of cover chosen.

> "It is important to note that there are no medical examinations when taking out a funeral policy", says Visser. "However, there is usually a waiting period, generally of about six months".

It is of utmost importance to confirm that the person who is selling the policy has a license from the FSB (or works with a credible Financial Services Provider), which must be presented upon request. Additionally, funeral policies are often administered and sold by third party funeral administrators so it is important to know who the insurer is that underwrites the risk.

The following practical checklist provides guidance when taking out a funeral policy:

- Confirm the details of the intermediary and their relationship with the insurer. Intermediaries must be mandated by insurers to sell their products.
- Always complete a policy proposal form yourself.
- Give complete and accurate information. If in doubt, disclose information.
- Always read any document thoroughly before signing it.
- You have a 30 day grace period to cancel a policy or make amendments - enquire about this cooling-off period.
- Make sure the policy contract matches what you understood it should be.
- Check the terms and conditions, benefits, premiums and exclusions.
- Ask what the implications are of replacing one policy with another.
- Keep written proof of your correspondence and dealings with the insurer and intermediary.

Visser adds that once a policy is in place, there are still a few things to be aware of regarding the actual claims process:

- Most insurers will pay out within 48 hours if the correct documentation is submitted. You will need a death certificate, proof of banking and the applicable claim forms.
- Remember, the insurer cannot stipulate what the claim payout is used for.
- You do not get any money out if you cancel the policy. It is a pure risk insurance product, which means that the premium you are paying is being used to cover the risk of your passing away. The moment you cancel the policy or it lapses (if premiums are not paid) your cover will be forfeited and no claim will be paid.
- Ask for a written explanation for repudiation or non-payment of claims.
- An insurer must always advise the holder of a policy when the policy is being cancelled. ❐

It is of utmost importance to confirm that the person who is selling the policy has a license from the FSB (or works with a credible Financial Services Provider), which must be presented upon request.

Scrapping SA expats' tax exemption is unjust, discriminatory and regressive

South Africa's move to scrap the tax exemption for South Africans abroad has been slammed as "totally unjust", "highly discriminatory" and "achingly regressive" by Nigel Green, founder and CEO of deVere Group. Green is speaking out as plans are put forward by the country's Revenue Services (SARS) to domestically tax those who earn overseas - even though they would still be taxed on their income abroad too.

Nigel Green
Founder and CEO
deVere Group

Presently, those working in another country for more than 183 days each year do not pay tax on income from overseas.

Mr Green comments: "The plans by SARS to drop this exemption is going to hit the many hundreds of thousands of South Africans who choose to live and work outside South Africa".

"The move is totally unjust and breaks the cornerstone principal of taxation: that the taxpayer receives government services for their taxes, such as healthcare, education, roads and police services".

He continues: "These plans are highly discriminatory. It is simply unfair to tax someone because of their citizenship. Indeed, residence and/or territoriality are the only criteria upon which a fair income tax system should be based".

"This draconian move to double tax South African expats effectively shackles them to South Africa and they would no longer enjoy the same freedoms as almost everyone else in the world".

"Under these proposals, they would be persecuted for living abroad".

"Yet South Africans living abroad should be celebrated and championed. They are among the most important ambassadors the country has globally. They play a significant role in defining the international view of South Africa and its core values".

Mr Green goes on to say: "There are only two other countries in the world that maintain this outdated, misguided and wrong citizen-based taxation (CBT) regime: The U.S. and Eritrea".

"There is a growing campaign for the U.S. to change from this system to residence-based taxation enjoyed by the rest of the planet. It is achingly regressive for South Africa to be looking to adopt CBT and to do so would put the country on the wrong side of history".

The deVere CEO concludes: "The Draft Rates and Monetary Amounts and Amendment of Revenues Laws Bill is open for public comment until 18 August. I would urge all South Africans at home and overseas who care about freedom and prosperity to make their opinions heard".

"This move to scrap the tax exemption for South Africans who live and work overseas is not the way forward for a modern, democratic nation". ❐

Legal Update

The impact of final 'default' regulations to the Pension Funds Act and the draft Taxation Laws Amendment Bill, 2017 on retirement funds

Nancy Andrews
Senior Legal Advisor
Alexander Forbes

Final 'default' regulations to the Pension Funds Act

On 25 August 2017, the Minister of Finance issued the final 'default' regulations to the Pension Funds Act ('regulations'). The regulations have three components: a default preservation strategy, a default investment strategy and a fund annuity strategy (which is not a default as such).

These 'default' regulations are meant to improve the outcomes for members by ensuring that they get good value for their savings and retire comfortably. The regulations require boards to offer:

- a default in-fund preservation arrangement to members who leave the service of the participating employer before retirement;
- a default investment portfolio for contributing members who do not exercise any choice regarding how their savings should be invested; and
- an annuity strategy with annuity options, either in-fund or out-of-fund, for retiring members.

Member defaults should be relatively simple, cost-effective and transparent. The regulations will require that boards assist members during the accumulation and retirement phases.

Importantly, all new default arrangements that come into operation on or after 1 September 2017 must comply with the requirements set out in the regulations. Furthermore, it is clear from the Gazette, that existing default arrangements will be expected to be fully aligned within 18 (eighteen) months of the effective date (1 September 2017), that is by 1 March 2019.

The implementation date proved problematic for existing retirement funds and through industry forums representations were made to National Treasury and the Financial Services Board ('FSB'). The FSB issued an exemption on 30 August 2017 in Notice 3 of 2017 to clarify that all funds registered before 1 March 2018 will have until 1 March 2019 to comply with the regulations.

National Treasury will monitor, assess and review the implementation and effectiveness of the regulations, to ensure members are protected against excessive fees, complex and obscure products and bad practices.

The draft Taxation Laws Amendment Bill, 2017

Comments on the latest proposed tax law amendments in the Taxation Laws Amendment Bill, 2017 ('TLAB') have been submitted to National Treasury and we can expect a second draft of the TLAB later this year.

The TLAB aims to give effect to the tax changes announced in the 2017 National Budget. The following retirement issues are included in the Bill:

- The annuitisation requirements for provident funds will be postponed to 1 March 2019. In 2015, amendments were made to the Income Tax Act (ITA) regarding the tax treatment of provident funds. The aim of these changes was to promote the preservation of the retirement fund interest on retirement. These changes would have had the effect of ensuring that provident funds would be treated like pension and retirement annuity funds inasmuch as retiring members of provident funds would be required to annuitise a portion of their retirement benefits accruing after the implementation date. In February 2016, the annuitisation requirements for provident funds **were postponed for two years until 1 March 2018**. The postponement was done in order to provide sufficient time for the Minister of Finance to consult with interested parties, including NEDLAC, after the publication of the comprehensive policy document on Social Security. The Minister of Finance was asked to report back to Parliament on the outcome of the consultations by no later than 31 August 2017. The discussions on the comprehensive paper on social security are still underway in NEDLAC.

- Retiring members of occupational funds, will now be given the option of preserving their retirement benefits in a retirement annuity fund after reaching normal retirement age. Transfers to preservation funds are not currently included in the proposal. (Allowing retired members the option to transfer their benefits to a preservation fund would create a situation where members of pension funds can transfer their benefits into preservation funds and withdraw the entire benefit in a lump sum withdrawal, thereby going against the policy of preservation).

- The Second Schedule of the ITA, currently allows for the determination of amounts to be included in gross income for lump sum amounts arising from public sector funds in terms of the prescribed formula.

  It further allows for the tax free withdrawal of pre-March 1998 benefits:

  - when they are withdrawn from a public sector fund, and
  - when they are withdrawn from the fund to which they were transferred, that is, the pre-March 1998 benefits that were transferred from the public sector fund to a private sector fund.

Where employers decide to merge or consolidate with other employers forming new funds, the exemption applying to pre-March 1998 benefits no longer applies.

From 1 March 2018, it is proposed that changes be made to the Second Schedule to allow for the exemption, in respect of pre-March 1998 benefits, to apply in cases where one additional transfer to a different fund of benefits originally coming out of a public sector fund. This change is aimed at addressing the issue of unfairness.

- To encourage employees to contribute towards their retirement and remove practical difficulties, it is proposed that from 1 March 2018 the current limit of a 12 month period be removed so that employees are allowed to join a newly established pension or provident fund at any time, subject to the rules of the fund.

- As part of the wider retirement reform objectives, the tax deductibility of contributions to retirement funds was harmonised across all retirement funds through the replacement of Section 11(*k*) from 1 March 2016, where the same deduction now applies to both employer and employee contributions to pension funds, provident funds and retirement annuity funds. The inclusion of the deduction in Section 11(*k*) has created technical complications. The opening proviso states that deductions under Section 11 relate to taxable income derived from the carrying on of a trade. However, not all allowable contributions to retirement funds relate only to income generated from the carrying on of a trade. Before 1 March 2016 the ITA contained a specific exemption for retirement annuity funds under 11(*n*)(i)(*ff*), seeing that contributions to retirement annuity funds did not relate to income that is generated from carrying on a trade. The provision dealing with deductions for contributions to retirement funds under Section 11(*k*) has created some anomalies such as generating an assessed loss from contributions to retirement funds that are above the allowable limit when taxable capital gains are a part of the higher limit. To remove the inconsistences and anomalies created by the provisions in the ITA that allow for a limited deduction for retirement fund contributions under Section 11(*k*), it is proposed that a new Section 11F is inserted to effect this deduction. These proposed amendments will be deemed to have come into effect on 1 March 2016.

- From 1 March 2001 South Africa moved to a residence based system of taxation (previously source based). This means that South African tax residents are subject to tax on their worldwide income. In section 10(1)(*o*) of the Act exemption was extended to include South African residents who are rendering services outside South Africa for a period which, in aggregate, exceeds 183 full calendar days during any period of 12 months commencing or ending during a year of assessment. The exemption does not apply in respect of remuneration derived from services rendered outside South Africa if the taxpayer's employer is the government or any public or municipal entity or the taxpayer holds a public office position. South Africa has concluded double taxation agreements ('DTAs') with many countries. The main purpose of a DTA is to eliminate double taxation of the same income, by allocating taxing rights between the source state and the residence state. When the Section 10(1)(*o*)(ii) exemption was introduced in 2001, the main purpose of this exemption was to prevent double taxation of the same employment income between South Africa and the foreign country. The current exemption creates opportunities for double non-taxation in cases where the foreign country does not impose income tax on the employment income or taxes on employment income are imposed at a reduced rate. It is proposed that the current Section 10(1)(*o*)(ii) exemption be repealed from 1 March 2019 and will apply to all years of assessment on or after that date. This will result in all South African tax residents being subject to tax on foreign employment income earned in respect of services rendered outside South Africa with relief from foreign taxes paid on the income under a different section of the ITA. ❐

ACTUARIES & CONSULTANTS

ARGEN

ACTUARIAL SOLUTIONS

Independent actuarial, consulting and enterprise risk management services

Hyde Park:
tel (011) 441 2700
jhb@argen.solutions

Kroonstad:
tel 080 ACTUARY
(080 22 88 279)
krd@argen.solutions

Centurion:
tel (012) 643 0222
cent@argen.solutions

www.argen.solutions

Registered Financial Services Provider • FSP Number 38235

where precision | meets innovation

ACTUARIES & CONSULTANTS

NOVARE®

has a proud 17-year track record of innovation and performance excellence. We are an independent advisory business providing investment consulting services to institutional clients throughout Southern Africa. Our implemented investment consulting solution provides the most up-to-date, world-class systems; paired with a dedicated consulting service team that guarantees the most innovative and appropriate execution of asset management and portfolio construction techniques and solutions.

Modibedi Selepeng
Head of Fund Consulting
(011) 447 9605
modibedi@novare.com
www.novare.com

Licensed as a 13B administrator in terms of the Pension Funds Act. Authorised licensed financial services provider.

Cadiant Partners
Consultants & Actuaries

A firm of independent professionals, advising on Retirement Benefits, Healthcare and Investments.

Telephone: (011) 783 1620
Fax: (011) 783 1694

Postal Address: Private Bag X24, Sandton 2146

Contact: Virgilio da Silva
Email: virgiliod@cadiant.co.za

OLD MUTUAL CORPORATE CONSULTANTS

To help your members reach their retirement financial goals, you need an experienced, insightful and committed actuarial and consulting partner.

Speak to Old Mutual Corporate Consultants for leading general and employee benefit, actuarial, and investment consulting services.

For more information contact Samantha Jagdessi on 011 217 1105, email SJagdessi@oldmutual.com or visit www.oldmutual.co.za/omcc

DO GREAT THINGS | OLDMUTUAL CORPORATE

Old Mutual is a Licensed Financial Services Provider

INDEPENDENT ACTUARIES AND CONSULTANTS

Do you need ***independent*** actuarial & investment advisory services that is understandable and provided by a skilled, professional & experienced team?

To find out more about the impartial, customised ***actuarial & investment*** advice that we can offer you, please contact us:

Cape Town
Tel: +27 21 422 4373
Asim Gani (MD)

Gauteng
Tel: +27 11 656 4170
Email: asim@iac.co.za

Website: www.iac.co.za

Robson • Savage

"Integrity, Credibility, Passion"
Experienced, wholly independent consulting and actuarial services as part of quality fund administration.

Tel: (011) 643 4520
Fax: (011) 643 4535

2 Hermitage Terrace, Richmond 2092
PO Box 3041, Houghton, South Africa, 2041

Email: home@robsav.com
Website: www.robsav.com

AUDIT

Cape Town
PO Box 4609
Cape Town, 8000
Tel: (021) 408 7000
www.kpmg.com

Contact: Tareq Carrim
tareq.carrim@kpmg.co.za
Tel: +27 83 255 3777

Johannesburg
KPMG Crescent
85 Empire Road
Parktown, 2193

Contact: Leon Grobler
leon.grobler@kpmg.co.za
Tel: +27 82 714 8699

EMPLOYEE BENEFIT ADMINISTRATION

OLD MUTUAL SUPERFUND

Put South Africa's largest umbrella retirement fund – by assets, members and participating employers – to work for you and your staff.

Choose from three affordable, customisable, expertly administered fund options that include free financial education. All are designed with a singular objective – to deliver the best possible retirement outcome for every South African employee.

For more information contact Samantha Jagdessi on 011 217 1105, email SJagdessi@oldmutual.com or visit www.oldmutual.co.za/omcc

DO GREAT THINGS

Old Mutual is a Licensed Financial Services Provider

COMMUNICATIONS & TRAINING

Market leaders in:

- Trustee and member education
- Independent trustee services
- Death benefit consulting
- Specialist communication
- Tracing services

TEL: +2711 656 1160/087 702 3800

FAX: +2711 656 1165

ADDRESS: Unit 21A, The Woodlands, 20 Woodlands Drive, Woodmead 2191

EMAIL: weild@icts.co.za
www.icts.co.za

Robson • Savage

"Integrity, Credibility, Passion"
Experienced, wholly independent consulting and actuarial services as part of quality fund administration.

Tel: (011) 643 4520
Fax: (011) 643 4535

2 Hermitage Terrace, Richmond 2092
PO Box 3041, Houghton, South Africa, 2041

Email: home@robsav.com
Website: www.robsav.com

EMPLOYEE BENEFIT CONSULTING

Death Benefit Consulting Services

- Outsourced death benefit consulting
- Unique technology solution
- Full resolution of the death benefit process in terms of Section 37C of the Pension Funds Act

TEL: +2711 656 1160/087 702 3800

FAX: +2711 656 1165

ADDRESS: Unit 21A, The Woodlands, 20 Woodlands Drive, Woodmead 2191

EMAIL: weild@icts.co.za
www.icts.co.za

EMPLOYEE BENEFIT CONSULTING

Robson • Savage

"Integrity, Credibility, Passion"
Experienced, wholly independent consulting and actuarial services as part of quality fund administration.

Tel: (011) 643 4520
Fax: (011) 643 4535

2 Hermitage Terrace, Richmond 2092
PO Box 3041, Houghton, South Africa, 2041

Email: home@robsav.com
Website: www.robsav.com

ESTATE PLANNING & FIDUCIARY

Fiduciary Services

At Sanlam our reputation is built on a devoted, vigilant and caring approach. We look at the world of beneficiary support differently. We assess each beneficiary's unique needs and ensure that we build and preserve their income to maintain an appropriate lifestyle.

Our Beneficiary Fund offers:

- Personalised support team for each beneficiary
- Low fees
- Free Dial-A-Teacher homework and project support in language of choice
- Food and clothing subsidies at leading retailers

With high PO and guardian satisfaction levels, our credential as market-leading wealth protectors are well-founded.

Contact

Bongani Khumalo on T +27 11 778 6478 or
C +27 76 965 3863 or E bongani.khumalo@sanlam.co.za

Madi Carstens on T +27 11 778 6487 or
E madi.carstens@sanlam.co.za

Sanlam is a Licensed Financial Services Provider.

SPF014 02/2017

INVESTMENT CONSULTING

INDEPENDENT ACTUARIES AND CONSULTANTS

Do you need ***independent*** actuarial & investment advisory services that is understandable and provided by a skilled, professional & experienced team?

To find out more about the impartial, customised ***actuarial & investment*** advice that we can offer you, please contact us:

Cape Town
Tel: +27 21 422 4373
Asim Gani (MD)

Gauteng
Tel: +27 11 656 4170
Email: asim@iac.co.za

Website: www.iac.co.za

FINANCIAL PLANNING

Robson • Savage

"Integrity, Credibility, Passion"
Experienced, wholly independent consulting and actuarial services as part of quality fund administration.

Tel: (011) 643 4520
Fax: (011) 643 4535

2 Hermitage Terrace, Richmond 2092
PO Box 3041, Houghton, South Africa, 2041

Email: home@robsav.com
Website: www.robsav.com

INVESTMENT MANAGEMENT

Prescient Investment Management (Pty) Ltd is a leading independent investment manager. Our core investment philosophy is directed around capital preservation and the management of downside risk. Our objective is to perform in line with the relevant benchmarks on the upside, while focusing on strategies to protect the fund against downside volatility i.e. limiting the losses that any downward movements in the market may have on the portfolio.

Contact: Monei Pudumo-Roos, Institutional Business Development
Postal address: PO Box 31142, Tokai, 7966
Telephone: +27 21 700 3600
Fax: +27 21 700 3700
Email: monei@prescient.co.za
Website: www.prescient.co.za

Authorised Financial Services Provider (FSP 612)

Edge Capital's funds cover the full spectrum of fixed interest, equity centric and risk-profiled multi-strategy fund of hedge funds.

PO Box 4188, Tyger Valley, 7536

Tel: +27 21 976 1012
Fax: +27 21 976 1096

Contact: Pieter Davis, CEO
Email: pdavis@edge.co.za

Website: www.edge.co.za

SOFTWARE & SYSTEMS

- Information portal for the retirement industry
- Electronic boardpack technology
- News, surveys, research and calculators
- Company and professionals directory

TEL: +2711 656 1160

FAX: +2711 656 1165

ADDRESS: Unit 21A, The Woodlands, 20 Woodlands Drive, Woodmead 2191

EMAIL: britsc@ebnet.co.za
www.ebnet.co.za

TRACING SERVICE PROVIDERS

Setting us apart in the industry:

- Various levels of tracing
- Document collection services
- Investigative tracing services

TEL: +2711 656 1160/087 702 3800

FAX: +2711 656 1165

ADDRESS: Unit 21A, The Woodlands, 20 Woodlands Drive, Woodmead 2191

EMAIL: weild@icts.co.za
www.ictstracing.co.za