INVESTMENT REPORT

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HOW TO RESCUE YOUR RETIREMENT

By **Magnus Heystek** | Director and Investment Strategist, Brenthurst Wealth

Magnus Heystek, founder of award-winning Brenthurst Wealth Management, has been educating South African investors on the perils of investing in South African vehicles to fund retirement. In this article, the former personal finance editor unpicks the problems in Retirement Annuities (RAs), which have been promoted heavily as a tax-efficient savings option for the long term. This article is essential reading for anyone wondering what to do with money that's tied up in a poorly performing RA – and a salutary lesson to plan money moves very, very carefully, with an uncertain future in mind. – Jackie Cameron BizNews

IN THIS ISSUE

RESCUE YOUR RETIREMENT

- **> Access your tax-free portion as soon as possible.**
- **> Transfer the remainder of your funds to a more cost-effective platform.**
- **> Gain exposure to world-beating global funds with a cost structure over 50% cheaper than your current one.**

BREAK THE CHAINS OF REGULATION 28 AND PROSPER!

It's rather ironic that I started my career in financial journalism more than 35 years ago at The Star newspaper, writing and warning about retirement annuities that were all the rage at the time. This was in the days when the investment industry was dominated by the three big insurance companies—Sanlam, Old Mutual and Liberty Life—who employed thousands of brokers to sell these products to self-employed businesspeople and professionals.

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Today's article recommends that, should you have money invested in one or more of these products, you should consider maturing them immediately, provided you are older than 55 years.

With the help of some very attractive tax benefits from Treasury, legions of advisors and brokers spread throughout the industry, targeting high earners who were not members of compulsory pension funds. These high earners were typically doctors, lawyers, dentists and virtually anyone else who was self employed.

At first glance, these products appeared very attractive and were sold on the basis of "reducing tax," which they did, or rather, taxation was delayed until a later stage. However, upon closer examination, a much darker side emerged, which didn't feature prominently in the marketing material. It's important to remember that this was in the days before the internet, and obtaining a full breakdown of costs and fees required making several phone calls to get hold of a hard copy of the product rules. I recall an insurance company refusing to provide me with a copy of the rules, which left me sitting in a cramped office to read them. The reason for this was their fear that their "trade secrets" would fall into the wrong hands.

Here's where it gets interesting: these retirement annuities (RAs) were long-dated insurance contracts, often challenging to unravel and involving multiple layers of costs. The fact that RAs could only be accessed after the age of 55 years, made them an attractive product for large life insurance companies. Once the money was paid into these RAs, it had to remain there for 10, 20 or even 30 years. Transferring your money from one service provider to another, if you were dissatisfied with returns and service, was quite challenging, and this restriction led to the accumulation of substantial fortunes. Moreover, every increase in contributions, often solicited in a feverish rush just before the end of the tax year, resulted in the creation of a new RA instead of merely an addition, with a fresh set of costs for marketing, commissions and other expenses.

What made these products so disheartening, was that the upfront costs were determined by the size of the premium and the investment term. Many investors found themselves lured into a financial trap they couldn't escape. Salespeople had an added incentive to ensure the maximum term, often up to 28 years, to maximize their commissions and the profits for the insurance companies.

Each product or contract began with a loan against it, which, for the first several years, had to be paid off through ongoing contributions. Typically, it would take between 5-7 years for any of these products to start accumulating a positive balance. Breaking the contract after the age of 55 would still entail early termination penalties, which remain in place today.

After writing a series of columns in the Money section of The Star, I was invited for a "cup of coffee" by a PR representative from Liberty Life who wanted to chat. I accepted and, dressed in my best tie and jacket, made my way to Braamfontein, all in the spirit of fostering good relationships, given our dealings with a major advertiser.

The fact that RAs could only be accessed after the age of 55 made it such a wonderful product and, in my view, was the bread and butter of large life companies, as once the money was paid across it had to remain there for 10, 20 or even 30 years. It was also very difficult to move your money from one service provider to another if you were unhappy with the returns and service.

I was escorted into a boardroom and when the doors opened, was faced with an assembly of actuaries, consultants and general managers, all seated on one side of an expansive boardroom table, with me alone on the other side. It became clear that I had unwittingly walked into a trap, and the entire purpose of the meeting was to "educate" me about the virtues on these long-dated RAs (retirement annuities) and what exceptional products they were.

As I remained unconvinced, I expressed my doubts, incurring the lasting disapproval of the life insurance industry. Years later, thanks to the exceptional reporting by the formidable Bruce Cameron, who succeeded me as editor of the Money section (then called Personal Finance), the life insurance industry and Treasury, under the watchful eye of the (then) Finance Minister Trevor Manuel, acknowledged certain flaws in these products. This resulted in an industry-wide mea-culpa, and approximately R3 billion was added to these existing products as a form of compensation.

Today, the terms and conditions of these insurance-based RAs have improved significantly. However, I cannot personally vouch for them, as I have never marketed these products. Nevertheless, early termination penalties have yet to be removed.

Over 30 years ago, I voiced my dissatisfaction with these products, finding them deeply flawed, almost bordering on the criminal. On one occasion, I attempted to explain the workings of these products to an American investment consultant who was shocked that the South African authorities allowed such a product to be marketed. I strongly preferred unit trust-based RAs, which were more cost-effective and did not carry the substantial penalties associated with the other products.

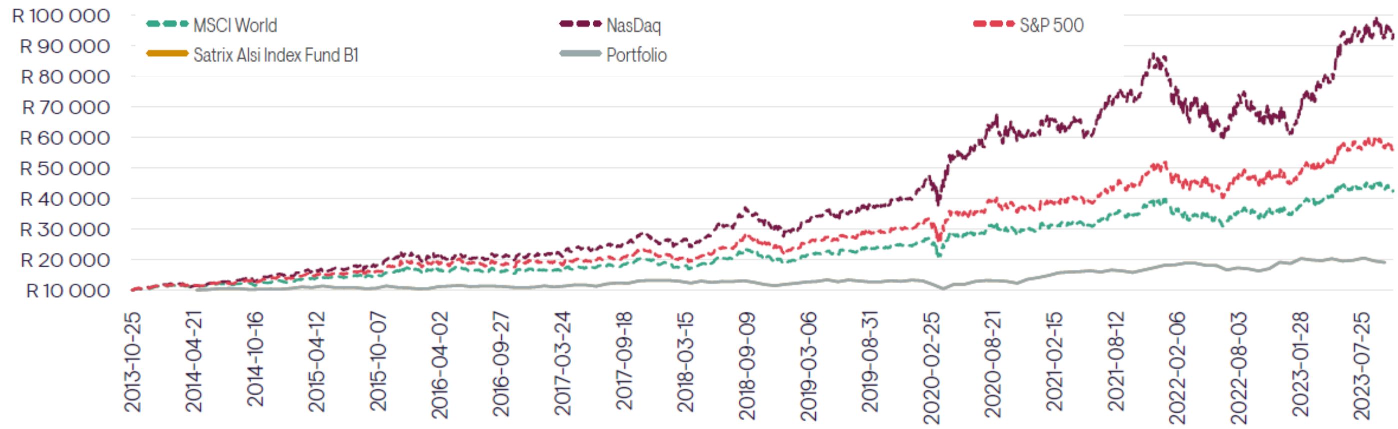
HOW REGULATION 28 IS CHOKING YOUR RETIREMENT

Fast forward to today. I've encountered challenges in obtaining industry-wide numbers and have been redirected from one source to another, but the best estimate I can provide is that there's likely close to R100 billion invested in these products across the many life insurance companies in South Africa. Most of these long-dated RAs were adversely affected by the fee structure, and since 2011, the investment guidelines mandated by Regulation 28 of the Pension Fund Act have added an additional constraint on their growth.

Before 2011, RAs could be invested 100% in offshore funds, making these products incredibly valuable for investors who maintained them. On the Liberty website, I found an offshore RA fund where the returns have averaged approximately 15% per annum over the past decade or more. My recommendation to withdraw does not apply to those fortunate individuals who stuck with their offshore RAs.

RAs ARE CURRENTLY RESTRICTED TO INVESTING ONLY 30% OF THE TOTAL ASSET BASE IN OFFSHORE ASSETS. While this allocation used to be determined at the fund level, it is now calculated at product level. Today, many investors have only a limited awareness of the underperformance of the local market. They are, however, astonished by how poorly the JSE has fared in comparison to global markets over the past decade.

JSE AGAINST THE WORLD | FUND PERFORMANCE GRAPH (ZAR)



Regulation 28, which is shaped by the country's economic policies and constraints on foreign exchange, essentially compels retirement fund managers to allocate the majority of funds to a consistently underperforming market. The investment industry often attempts to downplay this as a contributing factor, but such a response may be expected, isn't it?

The other day I attended a webinar hosted by Allan Gray, where the presenter, in a somewhat feeble attempt, relied on 100-year return figures of the JSE to justify the 30% limitation on foreign exposure. This argument is, by the way, not very convincing. Investment returns are primarily influenced by the present economic cycles, rather than events that occurred many decades ago.

The JSE increasingly resembles a stagnant stock exchange, and foreign investors have rapidly been withdrawing from this market for more than five years. Keith McClachlan, a small-cap expert and fund manager, recently published an article on his website, suggesting that all the foreign investments made over the past 30 years have effectively left our market since 2015. That's quite significant.

As a result, very few retirement annuities (RAs) and preservation funds have managed to outpace the inflation rate over the past 5-7 years, when you factor in total costs and fees. Incidentally, the same holds true for the country's pension funds.

While options for contributing members of a pension fund are limited, aside from requesting a full cash portfolio, persons aged 55 years and older should strongly consider withdrawing their funds from retirement annuities (RAs) and preservation funds, without delay. This recommendation applies to all RAs, not just those offered by life insurance companies.

Once you reach age 55, even if you have no immediate retirement plans, you should contemplate withdrawing one third of your funds (cash free up to R550,000 and taxed according to a sliding scale thereafter) and reinvest the remaining two thirds into a low-cost living annuity through an investment platform that provides 100% exposure to foreign funds. The two thirds portion must be used to purchase an annuity, either a life annuity (which is not typically recommended at the age of 55) or a living annuity, which is advisable.

By transitioning your retirement funds to this option, you can invest 100% in FAANG funds, for example, which yielded returns of 80% and more, over last twelve months. Alternatively, you can consider biotechnology, technology, healthcare, or even gold funds, depending on your risk tolerance.

I personally matured two of my own retirement annuities that were sold to me many years before I became a finance reporter. For years I witnessed their slow growth. While the amount involved wasn't substantial, I considered it a valuable tool to test my recommendations. I consolidated two RAs, one from Sanlam and one from Old Mutual, into a single living annuity on the Ninety One platform (formerly known as Investec Asset Management). The net average return since inception is now 20% per annum, and last year the portfolio delivered a remarkable 52% return. In comparison, traditional RAs have yielded only 2-4% per annum over the past 5 years and beyond. The only minor drawback is that you must draw an income withdrawal of between 2.5% and 17.5% per annum, subject to full taxation.

Occasionally I encounter snide remarks from other advisors and spokespersons in the investment industry regarding this advice. However, I can't find a single valid reason to stick with a plan that hasn't produced substantial returns for over five years, soon to be seven years.

The South African investment industry, which is rapidly contracting, appears to put up a half-hearted defense of the JSE's poor returns. Still, in private, many seem to concur with my assessment.

So, why wouldn't you **(a) access your tax-free portion as soon as possible,** considering the time value of money**, (b) transfer the remainder of your funds to a more cost-effective platform,** and **(c) gain exposure to world-beating global funds with a cost structure over 50% cheaper than your current one?** If the JSE begins to outperform again, perhaps due to a commodity boom, you can always move your funds back whenever it suits you.

Allow me to reiterate: If you have any money invested in RAs, pension preservation funds or provident preservation funds, it's crucial to act on this advice promptly. If your funds continue to underperform going forward, the responsibility falls on your shoulders.

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Magnus Heystek is a co-founder, director and investment strategist at Brenthurst Wealth Management. The company was established in 2004 and manages more than R18bn on behalf of its clients. It has nine offices across Gauteng and the Western Cape in South Africa and an office in Mauritius. Heystek is the author of several books on investing, retirement and personal finance and an established public speaker regarding money and investment-related topics.

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