BENCHMARK SURVEY **2016**

Rethinking retirement through a new dimension

Research Insights Report

Insurance | Financial Planning | Retirement | Investments | Wealth

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foreword

The application of systems thinking in a world of transition

Dawie de Villiers
Chief Executive Officer:
Sanlam Employee Benefits

Over the years I have witnessed numerous changes in the financial services sector, none quite as profound as the changes brought about by technology. Klaus Schwab, founder and executive chairman of the World Economic Forum (WEF), recently published a book, The Fourth Industrial Revolution (2015), which formed the backdrop for discussions at the WEF annual meeting held in Davos in January this year. The Oxford dictionary defines a revolution as a forcible overthrow of a government or social order in favour of a new system. Schwab argues that we are at the beginning of a technological revolution that 'is fundamentally changing the way we live, work, and relate to one another'.

According to Schwab 'there has never been a time of greater promise, or greater peril. Business models and labour markets will be affected'.

I am proud to present the results of the 2016 Sanlam BENCHMARK™ Survey. In it my team has applied a 'systems thinking' approach to unpack the research insights. Systems thinking asserts that every individual element is interlinked and interdependent on one another for the entire system to function optimally as an integrated whole. This is a fitting approach for the retirement industry which, in itself, is at the heart of a technology revolution and impacted at every touch point. This ranges from investment administration platforms to the way funds and employers engage with members through the use of retirement fund web portals and mobile applications (apps).

Remaining future-fit

What if employee benefits become less of a leverage and are no longer a competitive advantage in the war on talent?

What if the employee benefits, which constitute a salary, medical, risk and retirement benefits in the current structure, cease to exist in the format that we have come to understand?

What if the new labour market entrants are no longer motivated by monetary incentives in exchange for their 20 to 30 years of employment, with the aim of accumulating capital from which to draw an income during retirement?

As we contemplate the potential impact of the longer term trends on the retirement fund industry, we are mindful of the infrastructural challenges such as the unemployment rate of 25% and the issues within our educational system. The South African retirement fund system is challenged by members not reaching their desired retirement outcomes. We're seeing relatively low contribution levels, lack of preservation and investment strategies that are not aligned with the targeted level of income replacement at retirement. South Africa is also ambivalent about creating a culture of entrepreneurs, which is possibly the best solution to addressing rising unemployment levels.

Demand for innovation

Despite our local challenges, younger generations are entering corporate South Africa and are demanding a more innovative culture. Up until now our research has provided evidence of a workforce that is totally disengaged from the retirement fund industry. My team has approached these challenges from a fresh perspective by looking at employer offerings on a more holistic basis, considering the interconnectedness of all the moving parts that make up the intricate, complex retirement system.

We have refreshed the www.sanlambenchmark.co.za research portal. You are now able to access the interactive research tool as well as all reference material in one easy place.

I trust that this edition of the Sanlam BENCHMARK Insights Summary Report is as insightful and valuable as it has been in the past, and that you will benefit from the multi-dimensional lens through which we articulate our findings and views.

My gratitude is extended to all who made this work possible.

Dawie de Villiers
CEO Sanlam Employee Benefits

Executive summary Rethinking retirement in the new dimension

This year we applied a 'systems thinking' approach to unpacking our research insights. The retirement fund industry is at the heart of a technology revolution, which has an impact at every touch point. Our lives are governed by the digital evolution which provides us with 24/7 access to every and anything.

by

Wagieda Suliman
Market Insights
Sanlam Employee Benefits

We've considered the retirement fund space in its entirety and how mobile technologies, robo-advice and web portals have brought prolific changes in the way an industry communicates with its key stakeholder, the retirement fund member. More importantly, we've tested what fund or employer responses as well as communication mediums were seen as most appropriate.

The annual research programme constituted a mix of qualitative discussions with members and financial advisers. As in the past, we've conducted quantitative studies with pensioners, principal officers of stand-alone funds, and representatives of participating employers in commercial umbrella funds. This Research Insights Summary report is based on the team's collective analysis and insights of more than 400 interviews and discussions, which took place amongst the key respondent target groups.

At Sanlam Employee Benefits, we often challenge ourselves and debate internally whether we are sufficiently controversial. We are driven by our need to understand and unpack the drivers of consumer behaviours, which lead to members not achieving their desired financial outcomes in retirement. We appreciate the financial challenges that South Africans face at their various life stages, and dare to challenge each other. At the same time, there are times when we are more than willing to disagree with conventional wisdom. **Dawie de Villiers** has put forward a number of provocative and stimulating questions about the trends that will effectively transform our industry.

One of the most respected individuals in the retirement fund industry, **Elias Masilela**, Executive Chairman: DNA Economics and National Planning Committee Commissioner, recently alluded to the fact that in South Africa an individual graduating from a local tertiary institution only has 18 active years of contribution to the economy. He points out that it takes a graduate on average three to five years to find gainful employment. This is indeed a dilemma which faces the economically active youth in this country, and also a large contributing factor to our unemployment rate.

For the past nine years we've highlighted a number of trends which we believe have an impact on the nature of retirement provision, and which impact members' ability to achieve adequate retirement outcomes. Notwithstanding the structural economic challenges as cited by Masilela, there are many levers which affect behaviours and poor decision-making. The Sanlam BENCHMARK team has tackled this year's research with a fresh approach. Inside this research report you will find views that are perhaps contentious, somewhat polarised but decidedly contemplative. Each of the following levers are instrumental in getting members to arrive at their desired financial destinations in retirement.

Through the lens of 'systems thinking'

Systems thinking is an approach to problem solving that contextualises challenges within a system of integrated linkages and influences. It acknowledges that outcomes are the result of a complex, inter-connected set of mechanisms and moves us beyond a narrow cause and effect mentality. This approach allows users to take intelligent views of the broader picture in order to appropriately identify key leverage points as well as downstream effects of interventions. Viresh Maharaj points out that a systems view helps to prevent the unanticipated consequences.

The challenges facing South Africa's working class

We believe that these views may not have been emphatically addressed in previous research. This view suggests that the impact of adequate retirement provision could potentially extend beyond the needs of the retiree, but also to the family unit as whole. Phillip Mjoli asserts that union retirement funds now have an even more critical role to play in furthering economic and social advancement. He points out that union retirement fund membership represents thousands of families having access to sizeable financial resources in the future. Mjoli cautions that contribution levels have to be at an optimum level while, at the same time, taking into consideration members' financial realities and unique circumstances.

Beyond wellness

The traditional view of defining wellness, primarily in relation to health, has resulted in a lack of attention being paid to a critical area that impacts significantly on the psychological wellbeing of employees, their families and the economic wellbeing of employers – that of employee financial wellness. **Jocelyn Hathaway** deliberates whether this is the critical disconnect the industry needs to address. Hathaway believes that this is an area that warrants greater attention, as financial stressors potentially play a far greater role in influencing employee psychological health and stress levels than the actual health stressors themselves, which are the traditional targets for employee wellness programmes.

Members are doomed, or are they?

Representatives of the retirement funds that members belong to reckon that about 20% have sufficient savings to maintain their current standard of living in retirement, says **Willem le Roux**. It seems as if the ideal contribution to retirement savings is elusive – even when these contributions are high, the target seems to be still higher. Le Roux purports that a more practical approach is required to significantly change the status quo and to address the imbalances within the system. One scenario could be to challenge the level and timing of member retirement fund contributions.

Because South Africans are not wired to save

We will never have more leverage to change behaviour and teach new habits than in the first week or two of new employment. This is the introduction to the assessment of this year's research results by **Kobus Hanekom**. Of the few retirees interviewed on the advice they would give to younger people, almost all of them said, "Save / start planning / invest from a younger age". When we asked a focus group of young South Africans about their saving habits, they indicated that they tended to react to a specific development in their lives and did not follow a clear plan. Financial advisers know this behaviour only too well. "We do some initial planning in terms of a retirement annuity, but our clients can't afford to pay whatever they need to pay because there is always something that tends to get more attention, like small children, house, car, the good things in life that they want to buy and benefit from first, and only then they look at retirement. When you look at 55, then they all of a sudden want to contribute more in the last 10 years of their life and that is too late."

Ensuring better outcomes for members

Adequate retirement savings are not only important for the individual (the member) retiring. This also has a significant impact on the family or community who may need to support them should their savings not be adequate. Equally so, the economy as the bigger system is impacted as savings are essential for sustainable capital investment. As much as technology can enable members to engage better and more frequently with their retirement decisions and understand the implications of certain decisions more clearly, this will not solve all the current shortcomings. **Mayuri Reddy** is adamant that just as drivers are responsible for ensuring their car is serviced and maintained, this should not imply that they need to know every detail involved. Drivers cannot be expected to have the same level of understanding of their car as a mechanic does. Similarly, in the retirement process, members cannot be expected to know everything.

Retirement behaviour during tough economic times

It goes without saying that starting to save from an early age is an excellent springboard for a better retirement. **Jaco-Chris Koorts and Jayesh Kassen** reaffirm that year on year, the message remains consistent: that it is of paramount importance to start your retirement planning as early as possible. In conjunction with contributions towards a pension or provident fund, 63% of affluent pensioners indicated that they made additional contributions to a retirement annuity. This highlights the importance of making additional retirement contributions, even if you are part of an employer's retirement fund.

Defaults and a dummy's guide to product choice

As the current system provides no protection for members at retirement, individuals have been left to their own devices to make one of the most important financial decisions of their lives. Too many people, retirement funds, and financial advisers have focused on building wealth before retirement, while paying little or no attention to what should happen at and during retirement. **Karen Wentzel** asserts that in fact, year on year we've seen that 76% of Trustees do not want further involvement with members after retirement at all. All retirement funds should have an active responsibility to assist exiting members, many of whom are at their most vulnerable when they retire, with little or no financial advice provided. There are several reasons why people may choose not to make a choice. They might lack sufficient information or could be overwhelmed by too much information.

Whose fault is it anyway?

It is interesting, says **Danie van Zyl**, to read the original Sanlam BENCHMARK Surveys of the 1980s, where these surveys rarely considered member options and decision-making. Back then, the fund's actuaries worked out how much should be contributed, and the investment consultants advised Trustees on the investment strategy. Then there was a focus on the long-term sustainability of the fund as a whole.

In the 1990s, everything changed with the introduction of defined contribution funds. Beyond the 2000s, further developments such as member investment choice affected members' retirement provisions. Today, members find themselves in an environment of lifestage investments and default strategies and choices that are impossible to comprehend and navigate.

Umbrella summary

We have witnessed the continued migration of employers towards umbrella fund structures. **Irlon Terblanche and Shakeel Singh** provides an overview and synopsis of the umbrella funds market and a summary of the research with participating employers. They are particularly pleased to note that, after three years of being constant, there has been a slight decrease in the average cost of administration as a percentage of salary. Coupled with the increase in total contributions, this has resulted in an increase in the total provision for retirement. What stood out in this year's survey is that ease of administration has been pointed out as the number one reason for employers moving to umbrella funds, displacing cost savings, which was last year's primary catalyst.

And that succinctly captures our collective views and opinions on some of the key trends shaping the industry. We profoundly believe that all the moving parts are interconnected and that we are approaching an entirely new dimension of the retirement system. We affirm that the whole is greater than the sum of its parts, not just within our team but also across the entire retirement funding system, and its sub-systems.

We have merely highlighted a handful of the inserts which the team analysed, discussed and debated. At times we have even challenged each other's insights. I invite you to contemplate the views expressed thoughout these pages and encourage you to debate our opinions further with your peers, and other industry stakeholders. As always, the team is always available and willing to engage with you on these research insights.

Through the lens of systems thinking

by

Viresh Maharaj
Chief Marketing Actuary
Sanlam Employee Benefits

The Sanlam BENCHMARK research survey is a diagnostic tool that helps us to understand the retirement funding system in its totality, while the Sanlam BENCHMARK Symposium is our platform to influence real change so that we can collectively help members reach better retirement outcomes. This article unpacks the core of Sanlam's BENCHMARK research and highlights the key issues uncovered.

Systems thinking is an approach to problem solving that contextualises challenges within a system of integrated linkages and influences. It acknowledges that outcomes are the result of a complex set of mechanisms and moves us beyond a narrow cause and effect mentality. This approach allows users to take intelligent views of the broader picture in order to appropriately identify key leverage points as well as downstream effects of interventions. A systems view helps to prevent the unanticipated consequences that we have all been subjected to by stakeholders who take an inappropriately simplistic view of challenges. The things that really matter form part of the bigger system.

Retirement funding is a complex system and, if we want to move more members to better retirement outcomes, we need to understand the system drivers in order to influence it. Systems nested within systems all affect each other dynamically. The BENCHMARK research is a decisive diagnostic tool that enables us to identify where components, processes and linkages are failing.

Stated targeted income

Our research found that only half of the standalone funds and a third of participating employers in umbrella funds actually had a destination in mind, defined as a stated minimum targeted income for members in retirement.

We believe that a foundational principle of the role of consultants and trustees should be to have this **stated target income in mind and articulated at the outset, and then to structure various strategies** accordingly. This would include contributions, investments, lifestaging, risk and annuitisation to best achieve this goal. For instance, of those who have a target in mind, 60.4% of funds do not have contribution strategies that align with this target.

Defaults: can they deliver?

The minimum targeted income and the aligned strategies to enable the achievement of this income need to be in place to empower stakeholders to make appropriate decisions. Just over half the funds believe investing in the default options will achieve the targeted income over the long term. This is a concern given that more than 80% of assets sit within these types of portfolios. The investment default is a component of the bigger system in which many other decisions are made.

In a very real sense, all other decisions at board level can then be held up to this goal with a simple question - **will the combination of the various defaults in place achieve our targets?**

Financial jargon adds complexity

As an additional layer of complexity, 85% of those funds that have a targeted income express this as a percentage of pensionable earnings (PEAR), industry jargon that the average member does not understand. The member who is on track for a 75% net replacement ratio (NRR) does not realise that it is in fact only 75% of 80% i.e. 60% of cost to company (CTC). This makes a material difference when planning.

Have we reached a tipping point?

The research indicates that we are very far off the point where all decisions and strategies are weighed against a practical target. We believe a radical shift is necessary, potentially driven by regulatory intervention, to move the industry to apply this dimension of best practice. The purpose of our engagement regarding the proposed default regulations has been to **ensure that the defaults move members towards a targeted point.**

Which fund structure is most suitable?

The Board of Trustees running a standalone fund has a high degree of control and takes accountability for all decisions. They need to be educated, trained and capable of making the right decisions. This takes time, effort and is costly.

On an umbrella fund, control is outsourced to the fund's board of trustees. There are pros and cons to either approach. **There are segments where stand-alone funds makes sense, while there are others where umbrella funds make sense.** Neither structure acts as a silver bullet.

43% of standalone funds have considered moving into an umbrella fund with lower fees, better efficiencies and the reputation of the sponsor cited as the key criteria for choosing a provider.

Worryingly, only one respondent indicated that service to members or communications with members were considerations. This contrasts with 79% of the same sample set who considered it very important that members actually understand their benefits. It alludes to the set of top of mind criteria typically considered by Boards and our contention is that this scorecard needs to be balanced to ensure that the right outcomes are achieved.

Balancing the scorecards: umbrella funds vs stand-alones

For those who had joined umbrella funds, ease of administration and lower costs were the key reasons for doing so.

The main reason for respondents electing not to go into umbrella funds is a loss of control over decision making. This reflects an implicit line of thinking that the existing board is able to make better decisions for its employees than the umbrella fund board. Typically, 38% of participating employers have an independent principal officer, professional principal officer or independent trustees represented on the board of their umbrella fund. If experts are utilised, our argument is that more trustees would be comfortable to outsource control.

The umbrella choice is not just one for standalone funds; 74% of participating employers have never moved from the first umbrella fund they entered, with 78% never even considering moving to another umbrella fund. This is not reflective of a mature rebroking market, however, as there are material differences between providers across various dimensions. The decision by an employer to outsource the fund to an umbrella fund cannot be a once-off decision. Regular rebroking needs to be implemented so that employers can actively consider their options to ensure that their employees' retirement funding is optimised.

For instance, of the 22% that have considered moving, cost savings, better investment returns and poor service were cited as the three key reasons for doing so. Employers certainly cannot afford to be complacent after they have chosen their initial umbrella fund.

To the same point, 51% of participating employers indicated that insurance was only offered via the umbrella fund sponsor or a related entity. Under such structures, it is very difficult to know whether the group insurance purchased was secured at competitive rates. Employers should preferably seek umbrellas where it is possible to compare costs.

The role of technology

Technology has a key role to play in enabling better outcomes at lower costs.

Robo-advice is very much in its infancy in South Africa, with the term being applied to anything from a digitised risk profiler that places you into a certain risk class for investment purposes (this has been around for decades) to sophisticated counsellor type models that integrate living persons into the advice process. Given that only one in three funds currently provides access to advice, such models should be considered as a means to moving more members more efficiently to better outcomes through better advice processes. Progressively, we have formed the view that a well-structured default combined with modern member communication and member services can systematically move members toward achieving better outcomes.

Member communication

Member communication acts as the set of signals that help members to make better decisions in order to get them from **Day One of employment to Day One of retirement.**

The most popular forms of member interaction are roadshows (34%) and member Q&A's (33%) while wellness days (2.5%) and web-based communications (5%) were the least popular, with a spread of other interventions in between.

A gap in the system is the feedback loop to understanding whether the range of communication provided has resulted in better decisions being taken.

This loop is important as member surveys and focus groups have consistently indicated that they do not engage with this type of communication, claiming that it is not effective.

The feedback loop enables stakeholders to identify better means of communication and the actual impact on members' understanding. This is where traditional methods like roadshows or passive communication are not effective, as they do not readily provide such a loop. More contemporary methods, such as apps and gamification, enable more targeted member communication based on an individual's particular context. Each individual is on a unique journey and it is therefore important to obtain real time feedback on the effectiveness of the communication.

New technologies enable communication of this dimension in a more effective manner and are also low in cost due to the efficiencies of scale through modern platforms.

There are very low levels of awareness of risk benefits amongst members who needlessly purchase additional cover with often quite high premiums that could have been used more efficiently to defray debt or build wealth.

Again, technology can play a key role in keeping members up to speed with their risk benefits so that they are able to achieve better outcomes.

The advantage of guidance and financial advice

Financial advice is the navigation system that guides members in reaching their desired retirement outcomes. There are crucial turning points where individuals have the opportunity to leverage advice to their ultimate benefit, or face the prospect of making the wrong decision.

Members appreciate financial advice and have recognised the need for guidance given their lack of understanding. 48% of the funds stated that they have a formalised strategy in place to render

financial advice to active members. However, and this is very important, 35% of the funds that do have a strategy in place, merely consider offering factual information as their formalised strategy. This does not qualify as financial advice and is not as effective as the proper advice process. When looking closer, only 29% of stand-alone funds have a formalised strategy regarding advice that actually involves providing financial advice. This is potentially one of the key contributing factors to the poor retirement outcomes experienced, as high quality financial advice is shown to make a material difference to retirement outcomes.

The conflict at hand here is the value of advice relative to the cost of providing such advice.

The implementation of a Risk Benefits Consultant will go a long way towards helping the situation, while holistic member services can act as a means to provide scalable, high quality advice across an employer base.

“A real advice gap exists as pensioners indicated that nearly three quarters only first received advice within 10 years of retirement.”

The lack of awareness around preservation

More than two thirds of pensioners indicated that they did not preserve their savings when changing jobs. Popular uses of the cash were to settle short term debt, pay for living expenses between jobs, or to finance home improvements. Many pensioners indicated that they did not understand the tax implications of not preserving (cashing in) their retirement savings and the negative effect on their overall retirement funding nest egg.

This lack of awareness is one of the main factors that drive poor decision making. In order to encourage preservation, 77% of funds provide information, 24% have forms designed to channel decisions towards preservation, 23% have a financial advisor ready to counsel the member at the withdrawal stage, and 15% have a default preservation strategy in place.

It is concerning that 9% do nothing at all to encourage preservation of withdrawal benefits. It is widely accepted that a lack of preservation is the key cause of poor retirement outcomes. Unless there are very compelling reasons for those participating employers who do nothing to encourage awareness around preservation, this could be considered gross negligence.

Conclusion

Defaults need to be appropriately structured while managing the right risks at the right time.

Member empowerment needs to be driven to enable members to succeed and to prevent them from actively failing. This can be achieved through a combination of technology and traditional advice channels.

Retirement funds need to apply serious introspection and summon the courage to change what needs to be changed in order to move their members towards better outcomes.

Union Insights

Putting the plight of the working class into context

by

Phillip Mjoli
Segment Head Institutional Business
Sanlam Investments

Our research amongst trade union funds is gaining traction, with this being the fourth consecutive year of participation in the BENCHMARK Survey.

We have again successfully completed interviews with principal officers of 11 defined contribution union funds who are collectively responsible for R58.5 billion assets under management. I am exceptionally pleased with the 80% year-on-year participation amongst this research segment which makes the data statistically relevant and allows us to draw meaningful inferences on the broader union funds population. More importantly, I am sincerely grateful for the research respondents. Without your dedication we would not be in a position to make this valuable contribution to the retirement fund industry.

Union retirement funds are by their very nature unique to other stand-alone funds in that their decision-making processes are governed by a few additional considerations and principles. One such principle is the choice of remaining in a stand-alone fund structure as opposed to migrating to an umbrella arrangement.

Loss of control was the primary reason cited by 90% of the respondents for not migrating from a stand-alone fund structure.

Having said that, over the last four years, at least one or two union funds have contemplated migrating their fund administration to a commercial umbrella fund.

An opportunity to make a significant impact on the next generation

Our nation is challenged economically and socially by our inability to create employment and provide an education system that fosters a culture of entrepreneurship. Principal officers of union funds believe that 17.45% of retirees are able to maintain their standard of living post retirement. This is a slight improvement from 17.33% cited in 2014.

Union retirement funds have an even more critical role to play in furthering economic and social advancement. Adequate retirement provision presents the opportunity not just to change the lives of each individual fund member, but can have a huge impact on the entire family structure. It is comforting to observe from our research that half of the funds surveyed have memberships in excess of 10 000 employed individuals. I prefer to see this as thousands of families having access to sizeable financial resources in the future. This could potentially change the outcomes for, and significantly influence, the options available to the next generation, by enabling members to reach their desired financial outcomes at retirement.

Trailing contribution levels

The table below is from this year's BENCHMARK Survey and we observe that both member and employer contributions have declined year on year. National Treasury has amended the legislation governing tax treatment of contributions to allow up to a maximum of 27.5% of the member's salary for their retirement provisions. To quote one of my younger colleagues: "The thought of saving one quarter of my income for retirement savings is not practical. , How do we then manage our day-to-day living expenses, as well as short-term savings goals?".

In its simplest form, this comment is exceptionally profound. Our younger members do not have the leeway in their income to significantly increase their retirement fund contributions, regardless of the inherent tax benefits. At the same time, we need to consider the power of compounding and the financial impact of saving even an additional 1% per month.

	2016 Average	2015 Average	2014 Average	2013 Average	Average over last 4 years
Employer contributions	9.60%	10.89%	7.55%	7.36%	8.85%
Employee contributions	6.32%	6.66%	5.93%	6.94%	6.46%
Total contributions	15.92%	17.55%	13.48%	14.30%	15.31%

	2016 Average union funds	2016 Average
Total contributions	15.92%	17.63%
Deduction for life cover	-1.81%	-1.38%
Deduction of disability cover	-1.00%	-1.06%
Deduction for administration costs	-0.62%	-1.19%
Total provision for retirement	12.49%	14.0%

We observe that 80% of union funds do allow members to make additional voluntary contributions (AVC's). The additional contribution levels range between 0.1% and 5%, averaging at an additional 2.13%, which is a substantial increase from the 1.44% recorded in 2015. For some people this may not seem significant at all, but we need to factor in the impact that just 1% reduction in disposable income will have on an entire household dependent on a single income. Our communications around increasing contributions need to be positive and persuasive (showing the advantages) and also empathetic (respectfully taking into consideration) the current strain on household disposable incomes.

I would caution against any blanket communication that suggests members should increase their contribution levels, as this is perhaps not realistic in most instances. Individual circumstances need to be taken into account.

Risk benefits

There appears to have been a slight reduction in the multiple of Group Life Assurance (GLA) cover, from 3.5 times annual salary (2015) to 2.69 times annual salary this year. This relates to lump sum death benefits provided by the fund.

More than half the funds provide a permanent income disability (PHI) for members who are incapacitated.

Selecting a risk benefits provider was strongly influenced by the following three attributes, which have increased significantly year on year from 2015:

- Price (90.0%), increased from (60.0%)
- Confidence that valid claims will be paid (81.8%), increased from (60.0%)
- Service levels (63.6%), increased from (50%).

Lower contribution levels and the cost of risk benefits have a significant impact on the net provisions for retirement funding.

Distribution of death benefits in accordance with Section 37C of the Pensions Funds Act is an exceptionally difficult and contentious process for Boards of Trustees. Often the death benefit distribution process is fraught with unintended delays. In most instances, this is extremely burdensome on the deceased member's spouse and family. The reasons cited for these delays are ascribed to:

- Lack of identification of dependants as defined (100%)
- Family disputes (81.8%)
- Traditional practices versus legislative requirements (45.5%)
- Lack of a valid will (18.2%)
- Trustees' level of confidence in awarding benefits (27.3%).

We know that 80% of Trustees are applying their minds rather than being led by administrators' recommendations on how death benefits ought to be distributed. Section 37C allows for a portion of the benefit to be withheld so that any delays do not adversely affect beneficiaries who have already been qualified as valid financial dependants of the deceased. Just on half (54.5%) have a beneficiary fund in place to manage the assets of minors receiving death benefits from approved funds. This is an especially sensitive matter for Boards of Trustees, members and beneficiaries. Perhaps this is deserving of greater focus in member communication so that families have a clear understanding of the requirements needed to expedite the claims process.

Responsible investing

The majority of union funds (63.6%) believe that there is a cost (or other) benefit associated with responsible investing, but appreciate that social good outweighs the cost. Half are of the view that the shares selected during this process will provide a higher value to members over time.

Union funds provide members with an average of five investment options. From the fund's perspective it is important to offer cost-conscious investment options (81.8%), socially responsible investments (54.5%) and age-appropriate investments (54.5%).

Investment performance is a critical driver in the selection of investment managers. The majority of union funds will assess an investment manager's performance over a three-year period before deciding to fire or replace the existing provider.

Key take-outs

Currently the retirement fund industry is in a precariously volatile state, with much uncertainty around the recent regulatory reforms. The unintended consequence of regulation, which was supposed to improve financial retirement outcomes for members, has conversely resulted in many members contemplating resigning from their employers to gain access to their retirement benefits. The dire consequence is that in most instances members will have to re-apply for their jobs without any certainty of such application being successful.

Now is the time to encourage our members to remain calm, and stay invested in their employer funds, as resigning from jobs without provocation will have dire financial consequence in the long term. We believe that retirement fund vehicles remain the most cost-effective alternative to the many retail options available in the market.

Stand-alone

Contributions
The negative impact of poor administration efficiency

by

Danie van Zyl
Head: Guaranteed Investments
Sanlam Employee Benefits

With the renewed focus on administration efficiency, this year we introduced a new question to gauge what a reasonable delay would be between when members pay their contributions into the fund's bank account and when the money is actually invested. Two thirds of the funds surveyed believe that a five-day delay was acceptable, while surprisingly, two retirement funds indicated that they considered a delay of more than 15 days reasonable.

The impact of the latter is that members lose out on nearly half a month's investment returns on new contributions.

Of the funds surveyed, 47% indicated that the employer paid a fixed contribution per member, as well as the fund administration and risk benefit costs, compared to 42% of employers who only pay a fixed contribution.

The average contribution rate (employer and employee) is broadly in line with those of the 2015 BENCHMARK Survey and continue to be significantly higher than those in previous years, likely due to an increase in the number of large funds in the survey sample since 2015. Comparisons to contribution rates pre-2015 should therefore be made with caution.

Employer contributions

The average employer contribution, as a percentage of salary, amounts to 10.36%, which is below last year's result of 11.09%. Similarly, average employer contributions for union funds amounted to 9.6% of salary, significantly down from 10.89% in the 2015 survey.

25% of employers allowed members to vary their employer contributions in terms of a package restructure arrangement, in line with 23% of employers in the 2011 survey.

Employee contributions

In contrast to the lower employer contribution rate, the average employee contribution rate increased to 7.27% of salary, compared to 6.46% of salary in 2015. Average employee contributions for union funds amounted to 6.32% (2015: 6.66%, 2014: 5.93%).

26% of funds allow their members to choose their own employee contribution levels, broadly in line with the 2013 survey result when 29% of funds allowed this.

87% of funds allow members to make additional voluntary contributions, up from 69.5% in 2011. The average additional voluntary contribution for these funds (as a percentage of salary) is 1.65%.

Deductions

Most funds express their administration expenses as a percentage of a member's salary (46% of funds), while a further 41% express this cost as a fixed rand amount per member per month. Only 6% of funds expressed their administration expenses as a percentage of the fund's assets.

The average percentage of member's salary that is deducted for fund administration is 1.19%, while the average fixed fee per member for standard members has increased R54.04 a month.

As in previous years, members of very large funds (more than 10 000 members) benefit from economies of scale and pay a much lower administration fee (0.48%) compared to members of smaller funds (less than 500 members) who pay on average 1.85%. Expressed as a fixed fee per member, this varies from R33.36 a month for very large funds to R113.04 a month for smaller funds.

The average deductions to cover the cost of life cover in the fund have decreased to 1.38%, while the cost of disability cover has remained fairly steady at 1.06% of salary.

	2016 Average	2016 Funds with 10 000 + members	2016 Funds with less than 500 members	2015 Average	Average over last 5 years
Employer contributions	10.36%	10.21%	10.32%	11.09%	**10.22%**
Employee contributions	7.27%	6.44%	6.85%	6.46%	**6.40%**
Deduction for life cover	-1.38%	-1.25%	-1.16%	- 1.54%	**-1.55%**
Deduction of disability cover	-1.06%	-0.38%**	-1.15%	- 1.00%	**-1.06%**
Deduction for administration costs	-1.19%	-0.48%	-1.85%	- 1.00%	**-1.02%**
Total provision for retirement	14.00%	14.54%	13.01%	14.01%	**12.99%**

* The average contribution rate (employer and employee) is broadly in line with that of the 2015 BENCHMARK Survey and continues to be significantly higher than in previous years. This is likely due to an increase in the number of large funds in the survey sample since 2015. Comparisons with contribution rates pre-2015 should therefore be made with caution.

** The level of cover for lump sum disability benefits for these large funds is, on average, half that of smaller funds.

Stand-alone

Risk benefit insights

by

Neil Cilliers
Actuarial Team Leader: Group Risk
Sanlam Employee Benefits

The 2016 survey indicates that 'price' is by far the biggest driver in the selection of a risk insurer. The turbulent economy has caused consumers to tighten their belts. Insurers' prices are being forced down in an effort to increase the savings component of pension fund contributions. The size and brand of the insurer becomes less important, as employers and funds simply want the confidence that their insurer will pay all valid claims and maintain a high service level.

Death

The average cost of death benefits has decreased steadily from 1.56% of salary in 2011 to 1.31% in 2016. This reflects the increase in competitive pressure experienced by the insurers in the market.

Not much has changed regarding the benefits provided to members – a majority of members still have cover of around three to four times annual salary.

There has been a marked increase in umbrella funds offering flexible death cover in the form of age-banded cover and lifestage cover. This may be an indication of funds trying to overcome general member apathy and achieve the desired outcomes for their members.

Disability

The average cost of disability income benefits has decreased steadily from 1.22% of salary in 2011 to 0.99% of salary in 2016. Again, this reflects the competitive nature of the industry in recent times. With the economic downturn having a negative influence on disability claims, we expect this trend to turn around soon.

69% of respondents are not making (or have not made) any changes to their disability income benefit structures to accommodate the tax changes. This is down from 76% last year. There has been very little consensus in the market as to the best way to address these changes. This has caused confusion among clients and might be the reason the majority have implemented no changes to their benefits – despite the tax change being an important one.

We've seen a decrease in the number of respondents who have increases of CPI on their income disability benefits, without a cap. This could suggest that insurers are trying to protect themselves against rising inflation.

There has been a slight increase in the number of respondents indicating that no lump sum disability is offered to their members – from 75% last year to 80% this year. This may reflect a measure of cost cutting by funds during these difficult economic times.

Other drivers: price, confidence and service

'Price', 'confidence that claims would be paid', and 'service levels' of the insurer were again listed as the three most important drivers in choosing a risk provider. The number of respondents selecting 'price' as the most important factor has increased from 28% last year to 42% this year. This highlights the downturn in the economy and really emphasizes the competitive environment insurers find themselves in. The number of respondents who selected "confidence that claims will be paid" has increased from 61% last year to 76% this year. Service delivery is still important, but clients are looking for the cheapest insurer who will pay out all valid claims.

The turn-around time on processing death claims has steadily decreased over last four years to 3.55 months. This is an indication of how insurers are improving their customer service in an attempt to retain clients in a very competitive market. While price and paying out valid claims are the two most important factors for clients, customer service remains a very close third.

95% of respondents indicated that one of the key reason for delays in payment of claims was a lack of identification of dependents. Again, this indicates that insurers are ramping up their customer service and most of the delays that come through are not insurer based, but rather due to external factors.

Stand-alone

Are we passively accepting sub-optimal investment solutions?

by

Rhoderic Nel
CEO: Investments
Sanlam Employee Benefits

Passive investments are by no means the new kid on the block, but have continued to receive much airtime, given National Treasury's guidance on low-cost investment portfolios. The draft guidelines on default investment portfolios specifically mandate that Trustees should consider passive investments when determining the fund's default investment portfolio.

The push for passive: cost

Two strong motivations are often put forward for going the passive route – lower fees and the ability of active managers to add value above an index. Cost was by far the most cited reason for investing in passive by trustees who have chosen a default that is either fully passive, or a combination of both active and passive management (55% of stand-alone fund trustees and 45% of participating employers in umbrella funds). Interesting though, when asked to give an idea of exactly what a "reasonable" cost for a passive investment portfolio might be, 71 of the 89 respondents using passive solutions could not, or would not, provide an estimate.

The results for those 18 who were willing to provide an estimate were quite surprising. Despite this being a small sample, and therefore any implications should be deduced with caution, the average reasonable investment fee was estimated at 0.56% (56 basis points) by stand-alone fund Trustees and 0.61% (61 basis points) by participating employers of umbrella funds. Aggregating these two sets of respondents, the average reasonable cost that those already using passive investments were willing to pay was 0.58% (58 basis points), with half saying they would be prepared to pay more than 30 basis points. To put this in context, the average investment fee on an active multi-asset pooled portfolio, for investments under R50 million, was 0.68%*.

What constitutes reasonable tracking error?

More interesting results came from considering the investment management fees that respondents were willing to accept, compared with the tracking error they felt was reasonable. Tracking error is the measure of the difference in returns from the passive investment and the return achieved on the index being tracked. The difference between these two returns is due to the methodology used by the passive manager to track the index, as well as trading costs and timing differences. In essence, a higher tracking error is an underperformance of the benchmark and results in lower net returns.

It is important to note, however, that some tracking error on passive investments is unavoidable as the investment manager is highly unlikely to be able to hold all components of the index they are tracking in exactly the same proportion as that held in the index.

The "reasonable" tracking error – as estimated by the one in five trustees using passive investments that were comfortable to respond – was on average 0.78% (78 basis points). Stand-alone Trustees were less accepting of tracking error (on average, they stated that 0.36% was a reasonable amount) than their umbrella fund counterparts (1.19%). In fact, umbrella fund participating employers were, on average, willing to pay way more of their returns in tracking error than in investment management fees.

When we combine the investment fee and tracking error, the result is that the overall return that Trustees would be happy with a passive investment, is the index being tracked less 1.22% (stand-alone funds Trustees) to 1.8% (umbrella participating employers). Only 35% of stand-alone Trustees and 14% of umbrella fund participating employers considered tracking error when choosing to invest in passive portfolios. 25% of stand-alone Trustees and 16% of umbrella fund participating employers had considered the risk that the fees charged on the portfolio may lead to under-performance, and roughly a third did not consider any of the risks associated with passive investments at all.

With fairly substantial "reasonable" reduction in returns currently expected by respondents, it is concerning that more decision makers aren't factoring this into their considerations.

It is not surprising then that more than half of stand-alone Trustees using passive investment strategies did not know the exact strategy or methodology used in managing the passive portfolio, and a much higher 82% of participating employers in umbrella funds said the same. The strategy used is important as it may have a large impact on the tracking error experiences and the fees incurred, and therefore a considerable impact on the net returns from such portfolios.

It seems then that as much as funds want to make use of passive investments for cost reduction, there is still some way to go in evaluating the various passive options available to them and how to make use of these options. Only 5% of respondents said they preferred to be exclusively invested in passive in the future. A third indicated that they wanted an equal split between active and passive, or a combination of active and passive but with a larger proportion in passive. The rest still relied heavily on actively managed portfolios.

*Alexander Forbes Manager Watch™ Survey of Retirement Fund Investment Managers; December 2015

Stand-alone

Lifestage is about making the most of the risks you face

Risk is a word with such a broad meaning. There are probably as many definitions of risk as there are websites on the internet. Retirement saving is prone to much risk and, in fact, to a whole range of different risks. Some of these risks are opposing.

by

Willem le Roux
Head: Investment Consulting & Actuary
Simeka

and

Avishal Seeth
Branch Head: Gauteng
Simeka

Inflation risk

If you put your retirement savings in the bank account, you would not easily lose it (or any part of it) over any period. However, at retirement in 40 years' time, it would not have grown or kept up with inflation – in fact it would probably not be able to buy you the same "goods" as it could when you first saved it, as its value will have been eroded by inflation. In effect, it was very simply delayed expenditure, with no additional benefit. While the risk of losing capital was addressed, in the process, the risk of having accumulated no returns above inflation (or even having gone backward after inflation) was neglected.

Market risk

Conversely, if you put retirement savings in the stock market (shares or equities), by the end of the month it could potentially be worth half what you put in, due to short-term market volatility. However, 40 years later at retirement, the chances are very good that your initial investment would have grown significantly, even after taking inflation into account. A back-of-the-matchbox calculation would say that the final value could be about 20 times what it was worth up front. As an example, if you had invested R10 000, it would be worth R200 000 to you at retirement, after inflation. Here the potential short-term risk of losing money was mitigated by the significant benefit of sufficient long-term returns that equities bring.

The bond-like qualities of the future salary stream

There is literature by David Blake, Douglas Wright and Yumeng Zhang (2011) which builds on the notion of seeing your future salary as an asset alongside retirement savings. The nature of your future salary stream has very similar characteristics to something like an inflation-linked government bond – it is reasonably predictable and can therefore be seen as a conservative or "safe" asset. For a big part of your working career, this "safe" asset makes up a meaningful part of your wealth. In order to have a balanced investment strategy, you should look to invest as much as 100% of your retirement savings in shares (equities). This will give a good blend of "risky" (shares) and "safe" (future salary) assets.

The research shows that the average person's future salary income assets start shrinking in comparison to retirement savings between 45 and 50, which is when Blake, Wright and Zhang advocate that we begin converting shares to bond assets. At retirement, an additional "asset class" becomes available – insured (or life) annuities.

Income for life

Insured annuities guarantee you an income for the rest of your life. So you need not worry about how to sustain your income needs should you be blessed with a long life. The writers advocate that the full bond exposure at retirement should be converted to an insured pension. Depending on how conservative your risk profile is, you could retain between 20% and 50% of your retirement assets in shares.

Please note: This article does not cover the full array of strategies mentioned in the paper referred to above. The study may not be 100% implementable in the South African context either, considering the regulatory limits of a retirement fund's investment strategy (Regulation 28), the need for education among members and the difficulty of bringing about such change. However, we can note one or two learnings (or reinforce current strategies).

Balancing the risks

- Lifestage strategies should be about optimising the timing of taking different risks for the benefit of members. This strategy therefore advocates investing aggressively (i.e. into shares or equities) for young members.
- Lifestage strategies should protect members appropriately in the period leading up to retirement.
- Members should ideally have access to "super-aggressive" portfolios in the early years of saving for retirement.
- An insured pension is a very important building block in a good retirement plan, although it need not be the only form of pension used in retirement.

11% (31%) of respondents to the 2016 Sanlam BENCHMARK Survey for stand-alone funds (umbrella funds) indicated that they do not make use of an aggressive solution (lifestage or balanced) as the trustee portfolio or default. Of those that make use of a lifestage solution, only 31% (46%) have aligned the lifestage solution with the annuity strategy.

Clearly there are products available that cater for the correct principles and benefit members greatly. However, there does seem to be room for improvement when one interrogates the numbers.

Stand-alone

Beyond wellness

by

Jocelyn Hathaway
Chief Operating Officer
Sanlam Employee Benefits

The traditional definition of wellness is an organised, employer-sponsored programme that is designed to support employees (and, sometimes, their families) as they adopt and sustain behaviours that reduce health risks, improve quality of life, enhance personal effectiveness, and benefit the organisation's bottom line.

As a concept, employee wellness has become part of the organisational lexicon due to the acceleration of the following trends:

- The increasing costs of healthcare
- A maturing understanding of the impact that the poor health of staff can have on their ability of staff to deliver on their responsibilities
- The development of tools to evaluate lost productivity and increased absenteeism
- The increased societal pressure to live healthy lifestyles
- The emergence of the millennial employee group.

Traditional definitions of wellness are limiting

Examples of wellness interventions would include the proliferation of wellness days, testing protocols in the workplace, access to medical aid, counselling, stress management courses, etc. Given that the World Health Organisation (WHO) estimated that approximately one in four South Africans could be classified as obese, weight management, exercise and healthy eating programmes have been the popular focus areas in the recent past, as obesity has been linked to increased risk of diabetes, hypertension, heart disease, stroke and certain cancers.

However, this traditional view of defining wellness primarily in relation to health has resulted in a lack of attention paid to a critical area that impacts significantly on the psychological wellbeing of employees, their families and the economic wellbeing of employers – that of employee financial wellness. This is an area that warrants attention, as financial stressors potentially play a far greater role in influencing employee psychological health and stress levels than the actual health stressors themselves, which are the traditional targets for employee wellness programmes.

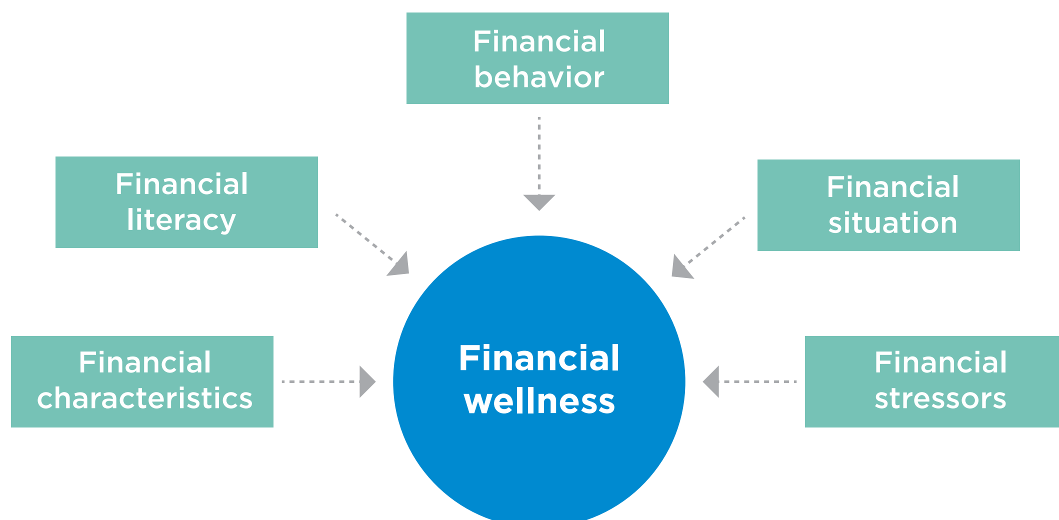
Pulling the right wellness levers

To this end, employers are actually well positioned to positively impact the financial wellness of their employees by pulling the levers that affect the financial wellness system of employees including:

- Providing appropriate funding mechanisms that enable lifetime wealth creation
- Structuring these mechanisms to channel financial behaviours towards better decision making
- Providing financial literacy and education;
- Reducing financial stressors by engaging with employees proactively regarding their financial pressure points.

The only aspect that an employer cannot directly influence in this system relates to the personal characteristics of employees themselves.

Factors influencing financial wellness



Wellness programmes are a virtuous circle

In the increasingly competitive business context, the success of companies is directly dependent on the ability of staff to deliver on their responsibilities, to innovate and to create value. Stress and ill health hamper the ability of staff to execute on their deliverables. As such, the successful implementation of wellness programmes has the potential to create a win-win situation as follows:

- Employees can lead physically, mentally and financially better lives
- Employers benefit from the economic impact through improved productivity and reduced absenteeism.

On the issue of financial wellness, employers can play a more empowered role in affecting real positive change. And not just because it's the right thing to do or because it delivers a public good to our nation, but also because it makes business sense to get more involved in employees' financial wellness. Based on the most recent BENCHMARK research, 48% of employers have a financial wellness programme in place for their staff, for an average of 3.6 years to achieve this.

PWC's 2015 Financial Wellness Survey revealed that, in the US:

- 45% of employees found their financial situations to be stressful
- 35% experienced a year on year increase in financial stress
- 20% were distracted at work due to financial stress
- 37% spent 138 hours or more per year dealing with financial stress while at work

In this context, the relevance of employee benefits programmes has never been greater, thanks to the reliance of South African employees on their retirement funds to build and create their lifetime wealth. The responsibility placed on the individual to take ownership of their funding journey by virtue of investing within a defined contribution environment is significant.

Employees still rely on their employers for retirement funding

The results of the recent Sanlam BENCHMARK research indicate that the typical South African employee is heavily reliant on their employer to provide their retirement funding mechanisms, as well as to provide guidance with respect to financial matters. The research further reveals that the typical employee prefers to be compelled to save via their employer's existing retirement fund. And, interestingly, they would not voluntarily reduce contributions to the fund if given a choice. The negotiating strength, group buying power and access to professional employee benefits consultants that employees get from participating in an institutional retirement fund, provides greater confidence than access to an alternative product at more competitive fees.

> **"The recent BENCHMARK research indicates that 87% of respondents believe that it is the employer's responsibility to enable good retirement outcomes for their employees."**

Engaged employerism

The recent BENCHMARK research indicates that 87% of respondents believe that it is the employer's responsibility to enable good retirement outcomes for their employees. More must still be done to improve their ability to influence the financial wellness of their employees. For this reason, the concept of engaged employerism is gaining rapid traction in the industry. This concept relates to employers reclaiming their critical role in nudging employees towards better financial wellness by taking advantage of the existing corporate infrastructure at their disposal, together with innovations from service providers and consultants. The aim of such initiatives is to leverage our understanding of human behaviour to influence employees to take better decisions at critical points in their careers. The HR departments within employers need to be directly engaged in the process of enabling lifetime wealth creation for employees and can assist by providing access to a range of qualified financial services that integrate with the firm's retirement fund. Additional BENCHMARK research indicates that 69% of respondents are confident that their HR departments are capable of playing such a role. In contrast, however, 92% of respondents do not measure their HR team's effectiveness in executing this critical task.

Is this the critical disconnect industry needs to address?

Stand-alone

Because South Africans are not hard-wired to save for retirement

by

Kobus Hanekom
Head: Strategy, Governance & Compliance
Simeka

We will never have more leverage to change behaviour and teach new habits than in the first week or two of new employment.

South Africans are not hard-wired to save for retirement. This is one of the many aspects highlighted by the 2016 BENCHMARK survey.

When we asked a focus group of retired people what advice they would give to younger people, almost all of them said, “Save / start planning / invest from a younger age”.

When we asked a focus group of young South Africans about their saving habits, they indicated that they tended to react to a particular development in their life and did not follow a clear plan. “For me, I think having a kid was the ultimate push to save. When you have a kid it’s like, ok I need to save. Heck this person has to grow up. That’s a big push for me.” (JNB, young, lower income)

Financial advisers know this behaviour only too well. “We do some initial planning in terms of a retirement annuity, but they (our clients) can’t afford to pay whatever they need to pay because there is always something that tends to get more attention, like small children, house, car, the good things in life that they want to buy and benefit from first, and then they look at retirement. When you look at 55, then all of a sudden they want to contribute more in the last 10 years of their life and that is too late. ”

South Africans also do not seem to have a clear idea of how much money is needed to be able to retire comfortably, and how much they need to save today to be able to achieve that. For many, the planning process is a rocky road with much tension and discomfort. A member described it like this: “You have one product but they say that’s not enough, you need this and that too. Why not make one that is enough, why split it into all these stupid little things? Oh, you need this little bumper, just that little boost, and you feel like they are just selling stuff to you. And then a year later they phone you and say, “You know, you can double your premium and still get a saving on this and that.” (JNB, young, lower income)

The Day One fund induction strategy

What we have learned from the research done in the BENCHMARK Survey over the years is this:

We will never have more leverage to change behaviour and teach new habits than in the first week or two of new employment.

If we are able to launch a member on a good retirement plan during this time, the chances are that the member will enjoy a good retirement outcome. Members who elect to contribute the minimum so that they can have more "take-home pay" or who take their benefits in a lump sum when they change jobs, never recover fully or at all.

With the Day One fund induction strategy, we break away from the conventional approach in the following ways:

Fresh message by the employer: The employer talks to new recruits in a way and in a language they understand – by way of a short audio visual. It describes and summarises the fundamentals of planning for retirement. It unpacks how much the employer is invested in ensuring a good outcome for their members, not only in the event of retirement, but also in the event of death or disability, and how important it is that the employee pays attention and takes individual control of their outcomes.

Member guided and empowered: Instead of saying "talk to your financial adviser", the employer can say, "run a calculation so that you can familiarise yourself with the likely outcome and what you can do to improve it". This step is directed at empowering the member - to help the member understand and take control of their basic retirement plan. Every member needs to know what their projected pension is and how much he or she needs to contribute if they wish to optimise the results.

HR guided and empowered: We empower the HR officer to explain the process and counsel the members. When we asked the question "who assisted you with your retirement plan in the 2016 benchmark?", just under half said they relied on the employer / HR. The HR officer is at the right place at the right time. They are generally willing to assist but tend to lack the training and the support to be able to provide assistance. With the Day One fund induction strategy, the HR officer is empowered and enabled to explain the process and support members, as was envisioned in the draft default regulations.

Robo-advice: The robo-advice approach is generally very well received. Partly because it offers just enough information at the right time. It also avoids some of the stresses and strains of a sales situation. A key differentiator, of course, is that it provides vital context and training for every member. "It's motivating you to do more. It's rewarding as well to see that you are making a difference in your own life." (JNB, young, lower income)

Serving the needs of all the members: One of the special research areas of BENCHMARK shows that those members who enjoy financial advice are much better prepared for retirement. We have to accept, however, that a large percentage of members will not enjoy advice from a personal financial planner as it may not be practical or cost effective going forward. This is primarily because, as has happened in the United Kingdom, new legislation places this service out of the reach of members in the lower income groups. As it is, research showed that few members in the lower income groups are prepared to pay for financial advice. We must therefore make sure that the fund benefit structure and the member guidance and support structures are able to guide and support these members to good retirement outcomes.

Financial literacy training

Our strategies continue to be shaped by the views and ideas of the newer generations. "I think they should do more foundation phase educational programmes in schools. Go in, make it fun, kids will come home and talk to their parents: 'Oh, I learned this today' and they will say: 'Oh, I've got this' and you interact with your kids as a family unit." (JNB, young, lower income).

Educating South Africans on financial literacy is a non-negotiable, the earlier the better. We would like to make a start where we have the most influence. The Sanlam Day One Fund Induction Strategy is inexpensive and easy to implement. Members will never be more ready to focus, pay attention and learn new habits than when they receive their first paycheck. If employers do nothing else this year, implementing this strategy will be a great start and will make a significant difference.

Stand-alone

Why are beneficiary funds important?

by

Johan Prinsloo
Retirement Fund Services
Sanlam Employee Benefits

Beneficiary funds in South Africa have a unique role to play in providing minors and widows of deceased breadwinners with some form of financial security enabling them to look after themselves despite the loss of a loved one. Given South Africa's social and demographic profile, and the country's high poverty ratio, we believe beneficiary funds play a vital role in preventing families from becoming impoverished.

Beneficiary funds started after the Fidentia debacle, effectively replacing umbrella trusts, where there was very little governance. The reason was that children's assets need to be protected and looked after better. In terms of the Pension Funds Act, beneficiary funds require proper governance and accountability.

A beneficiary fund is essentially a fund for minors of deceased members. In the event that a breadwinner passes away, the Trustees of the retirement fund must distribute the death benefits of the deceased member to his or her dependants and nominees. In many cases, the Trustees award a benefit to a dependent minor. Instead of paying the money to the minor's caregiver, the money is paid into a beneficiary fund, where it can be invested. A monthly income is then paid to the caregiver to look after the minor. The fund will also pay for other expenses such as the cost of education. The balance of the money is paid out to the beneficiary upon reaching 18 years of age. The monthly income and payment of other expenses are based on an affordability model so the payments can be sustained until the child reaches the age of majority.

As beneficiary funds fall under the Pension Funds Act, the investments are subject to the limitations of Regulation 28, requiring prudent investment by the fund. For example, in the Sanlam Legacy Beneficiary Fund, assets are invested in a mix of balanced portfolios aiming for an investment return above inflation and the provision of beneficiaries' liquidity needs.

Instead of paying a minor's death benefit allocation to a beneficiary fund, we believe that there is a high risk for caregivers who receive a lump sum directly on behalf of a minor. They may be subjected to social pressure from friends and family to spend the money. In other cases, the caregiver may be tempted to spend the money on priorities other than the care of the minor child. There are also cases where their financial literacy levels may not be adequate to manage a large sum of money. For example, if a lump sum is paid to a caregiver, it will most likely be invested in a bank account where the investment would earn negative real return and be exposed to retail costs and charges. In a beneficiary fund such as Sanlam's Legacy Beneficiary Fund, the fund aims to earn an inflation-beating return and has a corporate fee structure.

In our experience, other than the monthly income paid, a significant number of additional expense requests is related to education. This means that through the beneficiary fund, children have the opportunity to continue their education, something that may not have been the case had a lump sum been paid directly to the caregiver.

Beneficiary funds are highly tax effective. Post-tax benefits are paid into a beneficiary fund and the investment return earned thereafter is tax free. This means the monthly income is not subject to tax.

Legislation has now changed to allow not only for a fund credit or group life benefits under a retirement fund to be paid directly into a beneficiary fund, but also death benefits from group life insurance under an employer's policy. This means that a bigger chunk of money can be invested, generating a larger monthly income for minors.

This is the first year that we included a few questions in the BENCHMARK Survey on beneficiary funds. Our sample of principal officers are collectively responsible for about 900 beneficiaries with combined average assets in the order of R35 million. Out of a sample of 80 funds, at least seven indicated that each fund has more than 500 beneficiaries' benefits being administered by a beneficiary fund.

We were pleased to see that 62% of funds make use of a beneficiary fund to manage the assets of minors in receipt of approved benefits, and at least 38% from unapproved benefits.

Umbrella funds

Towards a better retirement funding industry

by

Richard Tyler
Managing Director
Simeka

"Umbrella schemes need to grow, in order to spread the largely fixed costs and investment in infrastructure. Current membership of around 786 000 needs to grow to around 1 600 000 in order to optimise the current infrastructure." ASISA National Pension Study 2009

This pivotal ASISA research finding underpins our calls for a better retirement funding industry. We've been making these calls since 2009 in our annual Sanlam Employee Benefits Benchmark Symposium.

Essentially, our long-held conviction has been that policymakers should concentrate efforts on building a more competitive umbrella fund industry, offering clients better products and better value. What is required, in our opinion, is a complete rethink of the legislative environment, moving closer to a contract-based model than a trust-based model.

The evolution of umbrella funds

Consolidation of many thousands of small retirement funds into fewer yet bigger retirement funds is the name of the game.

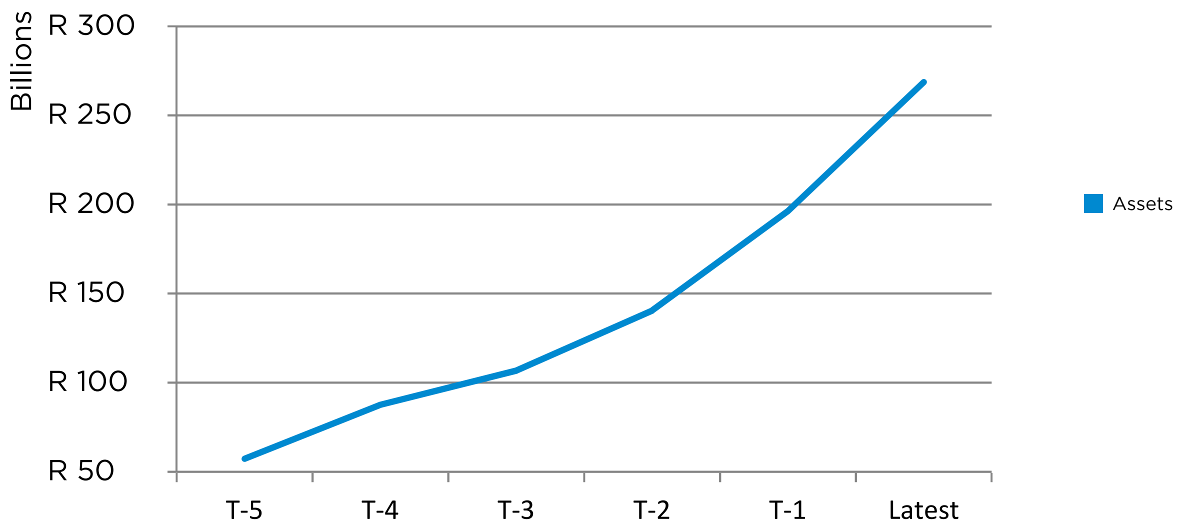
National Treasury, in an August 2015 briefing to Parliament's Standing Committee on Finance, indicated that an optimally-sized retirement fund has 50,000 members. This means that for about 10-million active fund contributors in South Africa, there should only be about 200 retirement funds.

The free market is certainly not waiting for legislation in order to start the consolidation process in a quest towards the attainment of better economies of scale and hence a better retirement funding outcome for millions of South Africans.

Since 2009, we have been tracking the growth of the commercial umbrella fund market on a consistent basis, by measuring the growth in both members and assets of the top 14 umbrella fund sponsors. This is as per the umbrella fund audited financial statements submitted to the Financial Services Board.

The latest statistics (which are approximately one year outdated) show that the 2009 target cited from the ASISA research has been achieved, with membership closing in on 1 700 000.
Even more impressive is the growth in industry assets that we estimate have grown in excess of 36% per annum, compounded over the measured period to around R269 billion about one year ago.

Assets



An analysis of the leading commercial umbrella funds makes interesting reading (see Table 2).

Quality over cost

The industry is clearly concentrated, and it would be fair to say there has been a move towards quality over the period, with clients preferring the big brand names with big balance sheets. The combined market share of the top five sponsors, as measured by assets under management, is more than 12 times that of the next five sponsors!

Top 10 commercial Umbrella fund sponsors

Based on assets under management

1. Old Mutual
2. Alexander Forbes
3. MMI
4. Liberty
5. Sanlam
6. Towers Watson
7. NMG
8. Grant Thornton
9. ABSA
10. NBC

Source: Financial Services Board data based on umbrella fund audited financial statements

Table 2

Important considerations when selecting an umbrella fund

1. Administration delivery
2. Black economic empowerment
3. Charges & costs
4. Client satisfaction / retention
5. Communication delivery
6. Experience
7. Flexibility
8. Governance infrastructure
9. Investments
10. Insured benefits
11. National footprint
12. Quality of advice
13. Preservation & annuitisation
14. Sponsor covenant
15. Track record
16. Transparency

“ The latest statistics show that the 2009 target cited from the ASISA research has been achieved, with membership closing in on 1 700 000. ”

Demand for better service

We find it very insightful that umbrella fund clients are increasingly demanding better levels of service from their umbrella funds, and though still very important, cost savings moved down this year to the second most important reason for employers joining commercial umbrella funds.

Main reasons for joining an umbrella fund

	Reason	%
1.	Ease of administration	**59%**
2.	Cost saving	**55%**
3.	Less fiduciary responsibility	**27%**
4.	Focus on core business	**21%**
5.	Investments	**21%**

Source : 2016 Sanlam Employee Benefits Benchmark Survey

Popular charging models

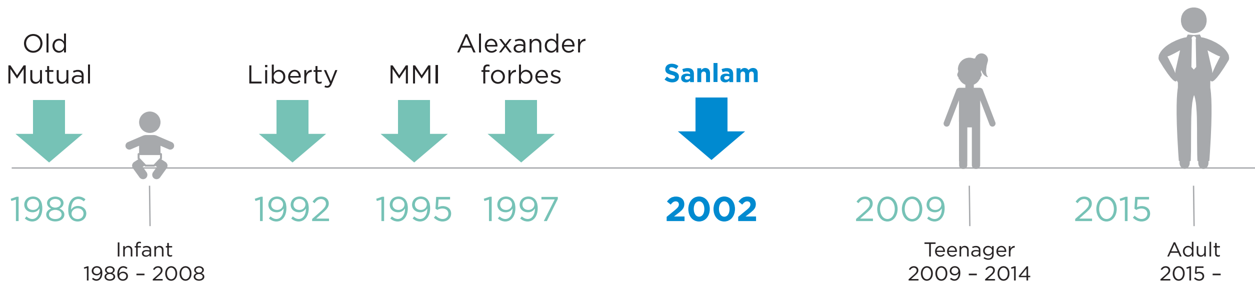
Though now long outdated, still the only thorough analysis of charges in this market was a paper that Sanlam's David Gluckman and Megan Esterhuysen presented to the Actuarial Society of South Africa in 2011 "A Critique of the Umbrella Retirement Fund Charging Model". This included a detailed critique of the Sanlam Umbrella Fund charging model in particular. Here they commented on earlier findings of high industry charge levels by the independent actuary Rob Rusconi as follows:

"the most pragmatic way to reform the industry is by means of harnessing market forces to gradually improve the situation whilst minimising any transition risks or costs. As regards systemic reform, the following measures were recommended:

- The most obvious method is via consolidation of funds so as to enhance economies of scale.
- Industry-agreed expense disclosures in the wider retirement funds industry is recommended.
- Effective competition in an environment underpinned by consumer education and awareness will result in cost reduction.
- The important point is that we need to find ways to increase consumer awareness of their rights and all costs that are paid, and to break down the information gap that exists between consumers and providers."

Our industry has come a long way since 2011, and even ASISA is now far down the line in introducing Effective Annual Cost as a new measure to allow consumers to fairly compare costs for both retail savings products and commercial umbrella funds. Once introduced, we predict this will be a watershed moment for the commercial umbrella fund market.

Evolution of Umbrella Funds



It's time for umbrella funds to leverage their scale.

Last year at the 2015 Sanlam Employee Benefits Benchmark Symposium, we made a new and very public call for the retirement funds industry to stand up and truly make a difference in improving retirement outcomes for members. This is especially important now that commercial umbrella funds have achieved significant scale, and market leaders are now in a position to leverage that scale for the benefit of members.

We also used the Benchmark Symposium platform to announce some of our thinking on how we intended to leverage our scale achieved to further enhance the Sanlam Umbrella Fund before the end of 2015 – and we highlighted planned new product features relating to default investment strategies, preservation strategies, annuitisation strategies, automated replacement ratio reporting, mini-funds governance, large funds customisation and lower charges. These have been followed up with very successful new product launches, including our industry leading, new-generation Optimal product option (which has been very well received in the market), and some exciting new developments to bring truly cost effective cradle-to-grave solutions to our membership base.

Continuing the journey

I think it is fair to say, one year later, that we have delivered on that promise to continue to innovate in an ongoing quest to serve our members better. We will use the 2016 Sanlam Employee Benefits Benchmark Symposium to demonstrate and showcase our latest thinking and innovations as we continue to deliver on our promise.

From a Sanlam Umbrella Fund perspective, we intend to continue on the journey started with our launch in 2008 and to lead the industry into a new age where providers have a clear purpose to serve members better.

Umbrella funds

Overview of umbrella funds survey

by

Irlon Terblanche
Chief Executive Officer
Sanlam Umbrella Solutions

and

Shakeel Singh
Chief Marketing Officer
Sanlam Umbrella Solutions

This is the eighth consecutive year that we have undertaken a separate study on umbrella funds and, as a result, we've now accumulated sufficient history to meaningfully analyse the emerging trends. Once again, we surveyed 100 employers that participated in umbrella funds.

The survey was once again representative of the commercial umbrella fund market as 88% of employers (in line with overall industry trends) participated in one of the "Big 5" commercial umbrella funds sponsored by Alexander Forbes, Liberty, Momentum, Old Mutual and Sanlam.

It is quite exciting to note that, after three years of being constant, there has been a slight decrease in the average cost of administration as a percentage of salary. Coupled with the increase in total contributions, this has resulted in an increase in the total provision for retirement.

From the research it can be seen that there is a definite shift toward sponsor associated investment products. This might be contributing toward the lower operating expenses that can be observed.

When it comes to active versus passive investing, employers prefer to invest in a **combination of both**. The popularity of active only and passive only investments has decreased from last year.

Participating employers in umbrella funds rarely change their asset manager, but when they do, the most prominent reasons are **performance and inconsistency** between the asset manager's investment philosophy and actual actions.

Most Trustee choice / default investment portfolios can be described as a lifestage vehicle and, on average, more than three quarters of a participating employer's assets are invested in the default investment option.

There seems to be a slight trend away from risk benefits as part of the umbrella fund package only, and risk benefits by way of a separate scheme only. Although risk benefits, as part of the umbrella fund package only, is still a very prominent feature, employers seem to be moving towards a **combination of risk benefits** that form part of the umbrella fund package, and risk benefits that form part of a separate scheme.

There seems to be shift away from just referring members to preferred financial advisers. More employers depend on their umbrella fund administrators to supply factual information about available options before members are referred to financial advisers.

From the survey results, it also seems that the recent hype around **robo-advisers** should not be over-estimated, and concomitantly, the continued role of the financial adviser should not be under-estimated.

It is very concerning that there was a significant reduction, from the employer's perspective, on members' ability to retain their current standard of living during retirement.

Following the implementation of the T-day changes, a large percentage of employers believe that umbrella funds are the best vehicle for members to use for additional retirement savings contributions, with many planning to actively encourage members to increase their contribution levels.

It is interesting to note that during this year's survey, ease of administration has been pointed out as the number one reason for employers to move to umbrella funds, displacing cost savings which was last year's primary reason. It was also interesting to note that reduced fiduciary responsibility, imposed on participating employers of an umbrella fund, was a much less prominent reason compared to last year.

When considering moving between umbrella funds, the top reasons cited were cost savings, investment performance and better communication or administration.

The survey results also indicated that a very large percentage of employers could be reached via electronic communication methods.

Contributions

Remuneration packages are based on total cost to company for 64% in 2016 (2015: 65%) where the contribution rate to a retirement fund would not affect the cost of the employee to the employer but rather affect an employee's take-home pay. The alternative would be to have the package structured as "cost plus benefits" where an employee's contribution rate (benefit) affects that employee's cost to the employer but not an employee's take-home pay. That is, 64% of the employers' remuneration packages are structured in a way that the contribution to a retirement fund is included in the salary as opposed to an add-on benefit.

Pensionable earnings (PEAR) is that portion of total remuneration which is pensionable. This is typically expressed as a ratio. 24% of sub-funds (2015: 28%) indicated that their PEAR percentage was less than 70%, with 44% of the respondents (2015: 23%) saying their fund's PEAR was more than 90%.

48% of the employers have a total monthly pensionable salary bill of between 1 and 10 million rand and 54% of the employers have a total membership ranging from 40 to 300 members.

- The average employee contribution, as a percentage of PEAR, is 7.1% (2015: 6.4%).
- The average employer contribution, as a percentage of PEAR, is 9.5 % (2015: 8.8%).

Just over a quarter, 28% of the sub-funds (2015: 51%) allowed members to select their own level of contribution, whereas only 25% (2015: 33%) permitted members to elect their employers' level of contribution.

40% of respondents (2015: 33%) indicated that the employer pays a fixed contribution only (i.e. total cost to company and no additional costs) and 50% (2015: 60%) indicated that the employer pays a fixed contribution plus the cost of administration and the cost of risk benefits. Thus we can see that expenses are having a bigger and bigger impact on provisions for retirement, as more employers move toward fixed contribution only (no additional costs).

Cost of administration

After three years of being constant at 0.8%, there has been a slight decrease in the average cost of administration as a percentage of salary, which is now at 0.7%. There is some further evidence that the model is working well for consumers as the umbrella fund industry achieves economies of scale. Similar to the BENCHMARK Surveys conducted in 2015, 2014 and 2013, this figure is lower than the comparable cost for standalone funds.

An increase in total contributions of 1.4% (2015: 1.1%) from last year and the reduction in expenses has resulted in an increase of 1.6% (2015: 1.4%) in the total provision for retirement.

> “Following the implementation of the T-day changes, a large percentage of employers believe that umbrella funds are the best vehicle for members to use for additional retirement savings contributions.”

	2016	2015	2014	2013
Employee contributions	7.1%	6.4%	5.6%	5.6%
Employer contributions	9.5%	8.8%	8.5%	8.1%
Total contributions	**16.60%**	**15.20%**	**14.10%**	**13.70%**
Death benefit premiums	(1.3%)	(1.3%)	(1.6%)	(1.6%)
Disability benefit premiums	(1.1%)	(1.2%)	(1.2%)	(0.9%)
Operating costs	(0.7%)	(0.8%)	(0.8%)	(0.8%)
Total provision for retirement	13.5%	11.9%	10.5%	10.4%

Investments

A clear majority of 76% of employers surveyed (2015: 80%) offered member-directed investment choice.

Where member-directed investment choice was made available by the umbrella fund, 10.5% of sub-funds (2015: 5%) did not offer this facility to any of their members. An average of seven investment options were offered to members, which is very much in line with previous years.

It seems that funds are automatically invested in 'in-house' investment portfolios that are associated with the sponsor for 51% of the employers (2015: 45%), whereas an estimated 11% (2015: 10%) are unsure whether this is the case.

Respondents claimed that, on average, 84% of their members (2015: 79%) were invested in the Trustee choice or default investment option.

The Trustee choice / default portfolio was classified as follows:

Trustee choice	2016	2015
Lifestage	52%	59%
Guaranteed / smoothed bonus	26%	23%
Balanced active	14%	15%
Cash / money market	4%	3%

Investment portfolios by asset managers, other than the sponsor or its associated companies, are on offer to 56% of participating employers (2015: 69%), while 28% of participating employers (2015: 19%) do not have this choice. 16% cannot confirm whether this is being offered or not.

46% of the respondents indicated that investment performance fees were charged on default and other portfolios, with 49% of participating employers indicating neither, and an additional 13% being unsure if this was the case or not.

Half the respondents (53%) indicated that they had a responsible investing policy in place, which incorporated ESG (environmental, social & corporate governance factors). 15% responded that they did not have a responsible investment policy in place.

Almost half, 47% of respondents (2015: 66%) invest in a combination of both passive and active investments, while 17% (2015: 22%) only active investments only, and 5% (2015: 7%) have passive investments only. Where passive investment choice is available, 45% of respondents (2015: 69%) indicated that cost savings was the key driver for selecting passive investments. The second most popular driver, at 12%, was cited as guidance from National Treasury. Employers seem to believe that there is value in both passive and active investing with cost savings remaining the key driver for passive investing.

"84% of their members (2015: 79%) were invested in the Trustee choice or default investment option."

Performance

The average period over which asset managers' performance is assessed, before a decision is made whether or not to replace them, is four years. A total of 22 respondents indicated that they had changed their asset manager in the past. The main reasons for the change were cited as performance (64%), inconsistency between investment philosophy and actual actions of the asset manager (23%), and fees (9%).

62% of the respondents thought that if a company was able to consistently deliver (over 5 to 10 years) on the benchmark, it could be considered a successful asset management company with a good track record.

Benchmarks used for asset manager performance	
CPI-related	28%
Peer group	25%
Indices	22%

Lifestage investing

Slightly more than half, 52% (2015: 59%) of the Trustee choice / default investment portfolio can be described as a lifestage vehicle and, on average, 80% of a participating employer's assets are invested in the default investment option. In a lifestage vehicle, members are switched to less volatile portfolios in the period prior to normal retirement age, which is commonly referred to as the phase-out period. The most common phase-out period is five years (for 50% of respondents) and six to seven years (for 13% of respondents). There has been a steady decline in the average length of this period over the last couple of years to 4.8 years (2015: 5.3 years).

Only 46% of respondents (2015: 43%) reported that their lifestage investment strategy was explicitly aligned to their annuity strategy.

The preferred type of annuities that the end-stage allows for are:

- Inflation-linked annuities:
  35% (2015: 45%)
- Living annuities:
  29% (2015: 36%).
- Guaranteed annuities (level or increasing):
  25% (2015: 39%)
- Index-linked annuity:
  10.4%

Most, 83% of employers (2015: 89%) provide members with advice when they enter the phase-out period of the life stage model. This is understandable since it is very important to ensure that the employee's phase-out period is aligned with their annuity strategy.

Insured benefits

Most employers, 55% (2015: 60%) provide risk benefits as part of the umbrella fund package only, and 24% (2015: 25%) provide risk benefits by way of a separate scheme only. Some 21% (2015: 15%) provide risk benefits both as part of the umbrella fund package and as a separate scheme.

Slightly more than half, 51% of employers (2015: 55%) selected umbrella funds whose insured benefits are automatically underwritten by an 'in- house' insurance company associated with the sponsor.

Risk benefits – umbrella funds

The most popular risk benefits provided as part of the umbrella fund package are death benefits at 97% (2015: 100%), disability benefits at 86% (2015: 84%) and funeral benefits at 62% (2015: 67%).

- The average lump sum death benefit is 3.1 times (2015: 3 times) times annual salary.
- The average lump sum disability benefit is 2.5 times (2015: 2.1 times) times annual salary.

The death benefits remained fairly constant with lump sum disability benefits, slightly up from last year.

Risk benefits – separate schemes

The most popular risk benefits provided under separate risk schemes are funeral benefits 78% (2014: 73%), disability benefits by 76% (2015: 92%) and death benefits 64% (2015: 80%),

- The average lump sum death benefit is 3.3 times (2015: 3.4 times) annual salary.
- The average lump sum disability benefit is 2.2 times (2015: 2.6 times) annual salary.

Again the death benefits remained fairly constant, however the lump sum disability benefit was slightly decreased from last year.

Advice

35% of consultants/brokers (2015: 35%) are remunerated by statutory commission and 52% (2015: 36%) negotiate a fee with the employer.

58% (2015: 69%) of sub-funds have a formalised strategy for rendering financial advice to members on exiting the fund.

When asked to describe the sub-fund's strategy for rendering financial advice to active members, 28% (2015: 62%) indicated that they referred members to preferred financial advisers, while 52% indicated that the umbrella fund administrator provided factual information about available options and only then, if members required further advice, were they referred to the fund's financial adviser.

Robo-advice

Only 9% of participating employers believed that robo-advice could be a suitable and cheaper advice channel for members. A further 28% of employers believed that robo-advice – in conjunction with human support – could represent appropriate advice for their members. The vast majority of respondents (63%) were of the view that robo-advice would not be suitable for their members.

Retirement

Respondents estimated that, on average, only 14% of their retirees (2015: 27%) would be able to retain their current standard of living in retirement.

Only 51% believed that the net replacement ratio (NRR) was a suitable measure for determining whether a member was on track for retirement. 29% of the employers believed that members did not understand this measure. Only 29% of sub-funds (2015: 45%) had a target NRR or Projected Pensions Ratio (PPR) that the Trustees actively worked towards. Of these employers, 62% (2015: 84%) indicated a default employer and employee contribution rate that was aligned with the stated target pension. 69% of these employers (2015: 76%) were targeting a replacement ratio of between 70% and 75%.

In assisting members with planning for their retirement, employers deploy the following tactics:

- 43% (2015: 51%) provide members with access to a net replacement ratio (NRR) or similar calculator
- 65% (2015: 49%) provide each member with a NRR statement each year / regularly

There seems to be less focus on providing members access to an NRR calculator and more focus on providing members with the actual NRR statement.

Employers consider the following annuities as most appropriate for an 'average' member:

	2016	2015	2014	2013
Living annuity	34%	24%	30%	30%
Inflation-linked annuity	27%	25%	19%	35%
Guaranteed annuity (level or increasing at a fixed percentage)	18%	20%	23%	15%
Combination of different annuities	12%	21%	20%	-

39% of employers (2015: 54%) stated that the Trustees of the umbrella fund had either determined an appropriate default annuity product for their members, or were in the process of putting one in place within the next 24 months. It was interesting to note that 47% (2015: 23%) believed that this was not being done.

Of the 27% (2015: 25%) who had already selected a default annuity product, 26% (2015: 8%) selected a living annuity, 22% (2015: 32%) selected the guaranteed annuity, 22% (2015: 8%) provided an inflation-linked annuity and a further 11% (2015: 28%) opted for a combination of different annuities.

Special topics

Journey towards retirement

40% of employers believe that it is the member's own responsibility to preserve their withdrawal benefit while 32% believe it is the employer's responsibility. Also, 53% of employers do not track and monitor the progress of members towards achieving their desired retirement outcomes. Yet, 62% of employers are completely or at least to a large extent interested in the financial wellbeing of their employees. It seems that taking responsibility and motivating employees to preserve and track the progress of achieving desired retirement outcomes, with the support of skilled advisors and umbrella fund sponsors, would be an easy first step in the journey towards improving the financial wellbeing of employees.

T-Day

Although the compulsory annuitisation aspects of T-Day were postponed subsequent to the survey interviews, it is nonetheless interesting to gauge participating employers' plans regarding T-Day:

- 41% of employers believe that the umbrella fund is the best vehicle for members to use for additional retirement savings contributions, and 47% of participating employers are even planning to actively encourage their members to increase contribution levels following T-Day.
- There appears to be widespread knowledge that T-Day facilitates a more flexible approach to retirement fund contributions, with no less than 60% of employers reporting awareness and 85% of employers actively planning to communicate the matter to members.
- Retirement annuities seem to be considered as savings beyond the employer's mandate and an overwhelming 80% reported no plans to encourage their members to make these savings product paid-up.
- Although there was much written in the press about members resigning from their jobs to access retirement savings in advance of T-Day, 47% of employers had not considered any view on the matter which might indicate that the trend is not as widespread as had been feared by policy-makers.

Competitiveness within the umbrella fund market

The main reasons participating employers opted for an umbrella fund are similar to last year, although there are some changes worth noting:

- Ease of administration at 59% (46% in 2015) displaced cost savings at 55% (59% in 2015) as the number one reason for joining an umbrella fund. Also interesting to note is that employers joining umbrella funds to escape fiduciary responsibility was only 27% (45% in 2015), much less prominent as a reason.
- 29% of participating employers (20% in 2015) reported that they sought comparable umbrella fund quotations in the market on an annual basis.
- 22% of participating employers (19% in 2015) reported that they had considered moving between umbrella funds.
- Cost saving at 55% (58% in 2015), investment performance at 41% (32% in 2015) and better communication or administration at 36% (37% in 2015) were the top three reasons for employers considering moving between umbrella funds.

On balance, these measures show encouraging signs that the umbrella fund market is steadily becoming more competitive, and that employers are making rational decisions regarding their choice of provider.

Communication

90% of the respondents owned a smartphone and, of these, 88% were comfortable using both apps and web browsers on it. 93% of employers had access to the internet for fulfilling their duties to the fund. These results indicated that umbrella fund administrators could reach a very large percentage of participating employers through electronic communication methods.

Members

Members are doomed! Or are they…?

by

Willem le Roux
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Simeka

The results from our annual BENCHMARK Surveys usually tend towards the general conclusion that "members are doomed".

Representatives of the retirement funds that members belong to reckon that about 20% have sufficient savings to maintain their current standard of living in retirement. The question that always arises is why members generally do not preserve their retirement savings when they change jobs, and why they appear to be doing this more and more often. It seems as if the ideal contribution to retirement savings is elusive – even when these contributions are high, the target seems to be still higher.

Consider the perspective from the eyes of a young married parent of two, which is even worse. Here essential costs pop up unannounced and the single household income is massaged carefully into the cracks of life expenses on a monthly basis.

It's not all bad news

Research by David Blake, Douglas Wright and Yumeng Zhang (2011) offers an alternative perspective and gives us some hope in terms of a different retirement savings plan.

The paper is named "Age dependent investing: Optimal funding and investment strategies in defined contribution pension plans when members are rational life cycle financial planners".

This lengthy paper is an intriguing read and the modelling is based on spreading the income that an average person earns during their working career as evenly as possible over their entire lifetime. This led researchers to understand more acutely the plight of the young parent. Earnings are still climbing rapidly compared to other periods, albeit from a low base.

Controversially, their model says the smoothest spread of income would be to refrain from saving a cent towards retirement before the age of 35. The increases above inflation from about age 35 can be used to fund retirement almost exclusively, which seems to be enough to retain one's standard of living into retirement.

From the 2016 Sanlam BENCHMARK Survey, it appears that total contributions made from the employer and member have increased compared to 2015, from 17.55% to 17.63% (15.22% to 16.61%) for stand-alone (umbrella) funds.

On the next page is a graph showing the traditional savings model, based on the average contribution rate between the stand-alone and umbrella funds mentioned above. The top line signifies someone's salary over his or her lifetime, after inflation adjustments, starting at R10 000 at age 20. The line below gives an indication of the salary after retirement savings are deducted.

Traditional savings profile

The savings profile held up as an alternative by the paper referred to is drastically different and effectively caps the individual's standard of living from age 35, but allows for no contributions before 35.

Alternative savings profile

However controversial this strategy may be, one thing is clear. At least members that are 35 years old or younger should not bury their heads in the sand, accepting that retirement won't be pleasant – in fact, the future can still be rosy!

Of course, being an actuary, I can't advocate that members save nothing before age 35, as saving is a culture and it is vastly challenging on a personal level to attempt to fix your standard of living at age 35 and save everything else. Conversely, whatever you save before 35 can give you a bit of leeway after 35 – maybe a nice trip with the family or that family car that you've always wanted. A further challenge to this model is that tax deductibility only covers contributions up to 27.5% of remuneration. Furthermore, if you are a high-income earner, it will only apply up until a rand-value cap of R350 000 per year. Of course, this position is already much better than it was before T-day, as members now have the flexibility to invest 27.5%, whether they are in a pension or provident fund (or even a retirement annuity).

We conclude that we should continue to encourage young members to contribute well to their retirement, but we could consider being a little more understanding about the level of contribution which can be afforded. Furthermore, we should spread the good news to older members that strict allocation of all increases above inflation that go towards retirement savings can have a powerful impact – particularly if you still have a good number of years to retirement.

You're only as doomed to the extent that you continue to do nothing about it – there is hope!

"At least members that are 35 years old or younger should not bury their heads in the sand, accepting that retirement won't be pleasant – in fact, the future can still be rosy!"

Members

Whose (de)fault is it anyway?

by

Danie van Zyl
Head: Guaranteed Investments
Sanlam Employee Benefits

It is interesting to read the original Sanlam BENCHMARK Surveys of the 1980s as these surveys rarely considered member options and decision making. Those were the days of defined benefit funds, when Trustees with the help of their consultants and actuaries took full ownership of a member's retirement journey.

The fund's actuaries worked out how much should be contributed, the investment consultants advised Trustees on the investment strategy and there was a focus on the long-term sustainability of the fund as a whole. A member only had to continue working to retirement and then received a pension related to his salary and years of service.

Following the trend towards defined contribution funds in the nineties, Sanlam started surveying these funds and eventually retirement fund members as well. Over numerous surveys a picture emerged of members struggling to adapt to their new responsibilities and of Trustees relinquishing the responsibility of ensuring that members secure good retirement outcomes.

This year's BENCHMARK Survey confirms a depressing trend as Trustees anticipate that only 20% of their members will be able to maintain their standard of living in retirement.

Few members are able to project how much capital they need at retirement, how much they need to contribute and how long they are likely to draw a pension. Many find the problem too complex and daunting, not even knowing where to start and respond with an all too human "Whatever – let the Trustees worry about that!" and avoid making any decisions. This disengagement can have serious repercussions, with this year's Pensioner Survey showing that 51% of pensioners only discovered what retirement benefits they had in place two years before retirement (worse 22.5% of pensioners stated that they only learnt of their retirement benefits at retirement).

Enter the age of defaults – a Trustee-approved choice for those members who are decision avoiders. Initially adopted by Trustees to deal with a specific issue – whether investment, level of life cover or contribution rates, **these default options are now taking centre stage in helping members to a better retirement outcome** by providing a holistic plan for a member's retirement journey from day one of employment to retirement.

Although members can opt out of these default options, few do as opting out requires an active decision and some form of action. Decision avoidance results in many members ending up in the default option. Often they do not move away from this default choice due to inertia.

These defaults act as powerful behavioural nudges in circumstances where:

- the needs of members or certain classes of members are fairly homogenous
- the decisions that members need to make are difficult and rare with no prompt feedback regarding their decisions available
- members have trouble translating aspects of the choice in terms that they can easily understand

The emerging trend of greater use of default options is closely tied to another trend: that of employers once more taking an active interest in their employee's financial wellbeing. 51% of principal officers indicated that their employer believes that it is largely responsible for enabling good retirement outcomes for members. Some Trustees are responding to by structure in their scheme design with the end in mind (to borrow a phrase from Stephen Covey). This implies refocusing on providing an adequate retirement income for members, more in line with the defined benefit ideals from the 1980's. The 2016 Sanlam BENCHMARK Survey shows that 48% of stand-alone funds have a stated target pension for their fund, up from 35% in 2012. But many of these funds do not stop there; 60% of them have gone further and have aligned their default contribution rate with the targeted pension. These default contribution rates set a reference point which members can use to either aim for a higher or lower target for themselves.

In addition, three quarters of such funds (75%) believe that their members can achieve their stated target pension when invested in the default investment choice, mostly a lifestage solution, over their working lifetime.

The target level of retirement income for an average fund member may well differ across retirement funds as it should take the competing needs of all fund members into account. We have seen in our 2016 survey that most of these funds target a net replacement ratio of between 70% and 75% of pensionable salary. Once a target pension has been selected, all benefit options as well as fund communication and education initiatives should ideally be designed (and framed) to align with this target. A new employee induction programme remains the ideal starting point to create awareness of the target pension.

Specific communication in this regards can include why the trustees elected this target pension and describe the characteristics of the "average" fund member who was considered when this target was decided on. The more vivid and realistic the example is, the more likely it is that fund members will resonate with this "average Joe". Additionally, this will make it easier for members with different financial circumstances to realise that the target pension may be inappropriate for them and that they may need to consult a financial adviser.

To help members track their progress towards this target over time, 59% of funds provide members with a regular net replacement ratio (or similar) statement – whether in table format or more visually, using a traffic light for example. A green light would tell a member that he/she is on track, while a red light is a clear warning that the member is likely to miss the fund's targeted pension. A further 32% of funds monitor their member's net replacement ratio and selectively intervene where necessary.

Default drawbacks:

- may be inappropriate if not aligned with the funds target pension
- difficult to apply when fund membership exhibit heterogeneity in risk preferences
- even if appropriate for the average member, may not be appropriate for certain individuals
- may be poorly understood if not communicated adequately

These selective interventions can incorporate some lessons learnt from behavioural finance to nudge those members that have opted out of the default options towards the defaults. This includes informing members with low contribution rates how much their peers are contributing or what their co-workers average projected replacement ratio is. Few members want to be worse off than their peers.

National Treasury has indicated that they want to see defaults being used to help guide members to preserve their savings when changing jobs and converting their savings into a retirement income at retirement.

To date few funds (16%) have implemented a default annuity option for members, the reluctance to do so may stem from the uncertainty regarding National Treasury's proposed regulations in this regard with funds adopting a wait-and-see attitude.

Well thought-through default options can help reduce the variability of member retirement outcomes, especially for those decision avoiders who have given up trying to understand all the complex options they are faced with. The aim is to get more members to achieve the fund's targeted income in retirement.

Members

Ensuring better outcomes for members

by

Mayuri Reddy
Market Strategist: Investments
Sanlam Employee Benefits

Year on year, our active member surveys have shown us the same trends – members are apathetic towards retirement and other employee benefit issues, members have low levels of financial knowledge, and as a result of these two factors, members are not making adequate provision for retirement. It was for this reason that our research team decided to focus on factors enabling members to achieve better retirement outcomes, as opposed to relying on the perceptions of the members alone.

A shared responsibility

Three key decision-making parties are typically involved in ensuring good outcomes for members: the member themselves, their employer and their retirement fund. The system is also influenced and supported by financial service providers, financial advisors, National Treasury and the Financial Services Board. National Treasury and the FSB set up and monitor the guidelines and structures required to be able to offer members a reliable route to good retirement outcomes. Members are responsible for the overall outcome itself – this includes monitoring measures such as net replacement ratios. Employers and funds between them need to construct specific structures and solutions appropriate to their membership.

Arguably, employers and funds have the biggest role to play in assisting members with achieving their retirement goals, given their unique position which allows for aggregation and access to a group of individuals. Indeed, the vast majority of employers feel they have responsibility to enable good retirement outcomes for members: 9.0% say they feel completely responsible, 38.5% say they feel responsible to a large extent, and 39.5% say they feel responsible to some extent. Only 39% have a financial wellness programme in place, however, and even fewer (2.5%) of employers incentivise or measure their HR departments on how they've contributed to favourable retirement outcomes for their staff.

Blurring the lines of responsibility

This means that a large part of the responsibility for good retirement outcomes falls onto the fund. Typically, this responsibility is carried out by putting in place targets and defaults. A problem does arise, however, when the areas of responsibility between employer and fund are not clearly articulated and defined. If each sees the other as being accountable for the decisions and actions required to ensure good outcomes, responsibility is diluted and neither will be effective. In such cases, the body responsible for the monitoring and governance of structures may impose more stringent or well-defined guidelines.

A good example of this is on the topic of preservation, where we saw National Treasury proposing industry-wide changes to ensure that the lack of preservation was addressed. Both employers and funds may experience secondary benefits from a member preserving their retirement savings. An employer may benefit from fewer hours of lost productivity due to financial stress close to retirement (47% of respondents said that the financial stress of their members was somewhat to highly problematic for the employer). In addition, funds may benefit from the size of their assets and individuals served, allowing them to leverage this scale to negotiate with service providers. Neither party, however, has the explicit obligation, although both feel they are in part responsible for good retirement outcomes. 77% of stand-alone funds and 68% of participating employers in umbrella funds simply provide members with information on preservation. Indeed, when we asked respondents who was responsible for encouraging members to preserve, 29% felt it was the employer's responsibility, 22% felt it was the Trustees responsibility and 37% said members should take responsibility for themselves.

The broader (social and economic) impact of saving

Adequate retirement savings are not only important for the individual retiring (the member). This also has a significant impact on the family or community who may need to support them should their savings not be adequate. Equally so, the economy as the bigger system is impacted as savings are essential for sustainable capital investment. For this reason, we should not automatically assume that the person who should take primary responsibility for retirement decisions is the person directly impacted (the member).

This is particularly true as members may not be best equipped to deal with these decisions. As an example, 69% of the pensioners we surveyed who had withdrawn from their retirement fund (and taken the benefits in cash) at some point during their working lifetime, did not understand the impact on their overall retirement outcome. 57% did not understand the tax implications of doing so.

Members must assume ultimate responsibility

As much as technology can enable members to engage better and more frequently with their retirement decisions and understand the implications of certain decisions more clearly, this will not solve all the current shortcomings. Members should still retain the ultimate responsibility for their overall retirement outcomes. Having said that, just as a driver is responsible for ensuring their car is serviced and maintained, this should not imply that they need to know every detail involved. Drivers cannot be expected to have the same level of understanding of their car as a mechanic does. Similarly so in the retirement process, members cannot be expected to know everything. This is where funds and employers still play an essential, collaborative role in ensuring good retirement outcomes for their members.

> **"Members should still retain the ultimate responsibility for their overall retirement outcomes."**

Pensioners

Defaults and a dummy's guide to product choice

by

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In the first discussion paper, "Enabling a better income in retirement" from National Treasury on 21 September 2012, the following statement was made:

"To ease the transition of most members at retirement, all retirement funds will be required to choose a single default retirement product for all their members, and to enroll members into this product."

On 22 July 2015, National Treasury published the "Draft Default Regulations" which set out detailed requirements to consider in setting up default strategies.

These long-awaited Regulations require retirement funds to establish sensible defaults for the investment strategy of defined contribution benefits and for the conversion of the member benefit into a pension at retirement.

As the current system provides no protection for members at retirement, individuals have been left on their own to make one of the most important financial decisions of their lives. Too many people, retirement funds, and financial advisers have focused on building wealth before

retirement, while paying little or no attention to what should happen at and during retirement. In fact, year on year we've seen 76% of trustees do not want further involvement with members after retirement at all. Worse, members often fall prey to unscrupulous advisers or make the wrong investment decisions.

All retirement funds should have an active responsibility to assist exiting members, many of whom are at their most vulnerable when they retire, with little or no financial advice provided. The draft regulations stipulate, therefore, that all defined contribution retirement funds, including retirement annuity funds, will be required to have a default annuity strategy in place.

There are several reasons why people may choose not to make a choice. They may feel they'll make the wrong decision. They might simply not enjoy choosing. They might be too busy. They might lack sufficient information or could be overwhelmed by too much information.

Confusion around types of annuities

Our survey results reveal that those pensioners receiving an income from an annuity product do not seem to know the format of the annuity they have. This could be problematic as the risks involved with each annuity type differ – particularly between living annuities and guaranteed annuities (sometimes described as life annuities) as living annuities do not guarantee an income for the pensioner's lifetime.

Living annuities provide pensioners with an income from their retirement savings with flexible investment choice and withdrawal rates. In exchange for this flexibility, pensioners take on the risk that they outlive their savings and the risk of poor investment returns.

38% of pensioners said they were invested in a guaranteed escalation annuity, 23% had an inflation-linked annuity, and a further 14% said they were invested in a level annuity. All these annuities provide increases that are known upfront. Only 5% said they had a living annuity and similarly 5% said they had a with-profit annuity, where pension increases couldan be highly variable. It was therefore surprising to see that almost 40% of pensioners said that they did not know what pension increases to expect. From statistics released by ASISA, of the annuities sold in 2015, 90.6% were living annuities. It seems that many pensioners may be in living annuities without realising that they are! It is for this reason, that funds are being called on to assist retiring members in converting their retirement capital to an income during retirement.

Research has shown that default rules have significant positive effects on outcomes and they tend to persist over time. The role of Trustees is therefore very important in setting up the appropriate default solution.

Default annuity options

The following options are allowed to form part of the default annuity strategy at retirement:

1. **In-fund options:**
   In-fund guaranteed pensions, in-fund living annuities, in-fund with-profits pensions
2. **Out-of-fund option:**
   Life annuities guaranteed by a life office.

Trustees will be allowed to mix different products as part of the strategy. Funds must give members access to retirement benefit counsellors on retirement to assist them with understanding the default annuity strategy. The default product options will not be compulsory and members will be allowed to opt out and buy an annuity of their own choice if they prefer.

Treasury's requirements for a fund's default annuity strategy are: good value for money, well communicated to members and transparent disclosure on all fees and charges. With only 16% of stand-alone funds and 27% of participating employers of umbrella funds having a default annuity in place, we unpack some of the requirements for a default annuity in more detail. Currently, living annuities are the most used form of annuity for the default (38% of stand-alone funds with a default annuity in place, and 26% of umbrella funds). With-profit annuities also feature strongly with stand-alone funds – 31% making use of them as a default.

Requirements for life annuities

The requirements for life annuities provided by a long-term insurer, chosen as part of the default annuity strategy, are:

1. Annuity increases must be linked to a formula which is verifiable from publically available information, produced independently of the insurance company paying the annuity.
   For example, annuity payments can increase each year by published CPI or a % of CPI or they can increase linked to the change in the FTSE ALSI Total Return Index or the ALBI Total Return Index. Policies with discretionary increases will not be allowed.
2. Direct sales commission cannot be paid out of the member's account.
3. Trustees must be satisfied with the long-term financial strength of the insurer.

The regulation leaves fund boards broad discretion in determining the types of annuity policies that they allow, but does specify some conditions that these annuities must comply with.

The regulations are currently still in draft format.

Types of (guaranteed) life annuities allowed

Currently the following annuities from life insurers will be allowed:

1. Guaranteed escalation annuity
2. Inflation-linked annuity (also referred to as a CPI annuity)
3. Index-linked annuity

In the Treasury's draft regulations, with-profit annuities are excluded from default annuities. From our 2016 BENCHMARK Survey, we saw that 21% of stand-alone funds and 27% of participating employers felt an inflation-linked annuity would be most appropriate for the "average" member in the fund. This is because an annuity income which keeps pace with inflation was believed to be the most important feature of a default annuity, with an income for life being considered the second most important feature.

Guaranteed escalation annuities

These annuities provide the annuity holder with a pension that increases at a fixed rate over the remainder of his or her life. The initial pension and future increases are guaranteed for life. These annuities will provide the highest initial pension, but pension payments will increase by a fixed percentage and may not necessarily keep up with the increase in the cost of living. This choice of annuity will solve the short-term need for more upfront cash to pensioners, but will result in an

inadequate pension within the space of a few years. Pensioners do not carry any longevity risk, as initial pensions and increases are guaranteed for life.

Inflation-linked annuities (CPI annuity)

The inflation-linked annuity provides pensioners with a guaranteed monthly pension with annual increases equal to inflation. This increase will be equal to the Consumer Price Index (CPI), lagged by four months.

Inflation-linked annuities address the need to protect the pensioner's purchasing power. Unless pensions keep up with inflation, the purchasing power of pensions decreases. By linking pension increases to increases in the CPI, a pensioner is able to maintain his/her cost of living.

By selecting an inflation-linked annuity, pensioners do not carry any longevity or investment risk, as initial pensions and increases are guaranteed for life and pensioners are guaranteed to receive annual pension increases, linked to CPI inflation. Pensioners can choose to receive between 50% and 100% of CPI inflation increases.

Index-linked annuities

A big buzz in the retirement industry centers around the exclusion of the traditional with-profit annuity and the inclusion of annuities with verifiable increases linked to indexes.

What is a traditional with-profit annuity?

A with-profit annuity provides a guaranteed income for life with some investment participation in the form of increases to the pensioner via annual bonus declarations. Bonuses are derived from returns in the underlying portfolio, typically a balanced fund, after deduction of (and allowing for) mortality, smoothing, the purchase rate and costs. Although the subjective decisions about the increases are made by experts (actuaries), the industry refers to these decisions as the "black box" decisions.

What is an index-linked annuity?

An index-linked annuity provides pensioners with a guaranteed monthly pension with annual increases linked to an index. This increase will be equal to the published index which can include for example: the ALSI Total Return Index, the ALBI Total Return Index, Short Term Fixed Interest index (STeFI). Normally an explicit, fully transparent formula is used to determine the increases which removes all subjectivity and associated conservatism.

The gross returns calculated from the indices are used in the calculation of the increases and the increases are guaranteed to be bigger than 0%.

Because the increase is guaranteed and no subjectivity is used to determine the increase to pensioner, it means that mortality is actually guaranteed without impacting future increases. In a traditional with-profit annuity, mortality experience may reduce the increase to pensioners if pensioners live longer than expected.

All subjectivity is removed and the transparency gives pensioners similar levels of security and comfort as a CPI-guaranteed annuity.

Why would a pensioner choose an index-linked annuity?

The pensioner receives a completely transparent increase based on the defined formula which is linked to published indices and guaranteed every year. Therefore there will be no holding back of future increases to restore the funding level of the scheme or reserving for a possible downturn in the market, as it is currently the case in traditional with-profit annuities. The insurance company carries all the risk of ensuring that the increases defined by the indexes are met.

In an index-linked annuity, mortality is guaranteed and where mortality experience is worse than expected, it will not be deducted from future increases. Increases are calculated by applying well-known market indices that acts as a suitable benchmark for investment returns. This is a considerable advantage in that pensioner increases cannot be adjusted in any way to ensure that the guarantees of a 0% minimum are met. The transparency in the defined increase formula means that pensioners can calculate the increases themselves, all subjectivity has thus been removed.

Concluding thought

As fiduciaries, we carry a very important responsibility and influence the destiny of those retirement fund members who ‘choose not to choose’. To ensure the best possible retirement outcomes for those members, it is important for trustees to find a solid, financially secure investment company which has:

- A product range that includes guaranteed, inflation-linked and index index-linked annuities
- Acceptable, affordable costs
- Processes and systems in place that are easy to interact with and user-friendly for members.

Indeed, many of the funds that have put a default annuity in place, have felt that members require even more assistance in converting their capital to an income. A further 70% have offered member advice prior to retirement, over and above the default annuity. Together, these factors should create a secure pension income for members for life.

“Growing old is not an option. We don’t have a choice. But we do have choices that will greatly affect our quality of life for the rest of our life.”

Pensioners

Retirement behaviour during tough economic conditions

2016 represents the fourth consecutive year that the BENCHMARK Pensioner Surveys were conducted by Sanlam. Thanks to the dedication and commitment of Sanlam's research team, we once again present the market with valuable insights facing both active members and pensioners. In addition, the results provide insights into the challenges faced by both employer funds and advisers, who aim to provide the ideal savings and support frameworks to members to help enable them to make informed decisions around planning for a successful retirement.

by

Jayesh Kassen

and

Jaco-Chris Koorts
On behalf of Glacier by Sanlam

In the past year, the retirement industry has experienced major tax changes with two legislative amendments being of particular importance. The first major change in regulation relates to the alignment of the tax handling of retirement funds, commonly referred to as "T-day", which affects provident funds, pension funds, preservation funds and retirement annuities (or RAs). Part of the regulation pertaining to the annuitisation of provident funds has been postponed for two years to 2018 following opposition by union representatives. With effect from 1 March 2016, tax deductions relating to contributions to all retirement funds were thus changed and the tax deduction is now defined as 27.5% of the greater of taxable income or remuneration, up to a cap of R350 000 per year. The biggest challenge still remains financial literacy around the handling of savings before and after "T-day".

The second major regulation change was the introduction of the tax-free saving accounts, commonly referred to as the TFSA. The industry has seen numerous providers taking up the initiative to offer TFSAs with reported uptakes being promising, especially among the younger generation, who are hopefully saving with a longer-term goal in mind. Intermediaries find this space challenging due to the limitations of fund choices and the younger generation's perception of RAs being fraught with stories of bad experiences and of their parents being "ripped off". This is important and highlights an opportunity for intermediaries and providers alike to collaborate and develop a strategy to help support the younger generation to start saving for retirement today.

Furthermore, evidence from the focus group results suggests that there is a shift in behaviour among members and advisers. Technology such as robo-advice, social media and YouTube are high on respondents' list of financial planning tools with the limitation of employee engagement and user sophistication being raised as key concerns. Other points raised were around employee wellness, default strategies and the debate around active vs. passive investment management. Many of these points have been mentioned before but the industry is facing renewed pressure to drive costs down and offer value added products so that employees maximise returns on their savings for retirement with minimal risk.

Turning to the pensioner samples, the discussion will once again be structured around the experience of two groups i.e. "core" and "booster" samples. The results of both groups are not directly comparable to previous years as the sample design has been revised by placing more emphasis on the affluent group of retirees (or the booster sample). The sample size was increased from 50 in previous years to 101 in 2016. The income threshold for inclusion in the booster sample was also increased from R25 000 per month to R39 999 per month. Inversely, the number of core group pensioners tested was reduced from 252 in 2015 to 151 in 2016. Respondents in the core group of pensioners will thus have an income level of R10 000 to R34 999 per month.

Both groups averaged 60 years when asked about the age at which they retired from formal employment. Common characteristics of the "sandwich generation" became evident, including financial stress, as well as concerns relating to their health, job, personal relationships and time. Primarily these concerns exist due to respondents not making adequate retirement provision from a young age. Major emphasis is placed on taking care of their children's university education while also providing financial support to their elderly parents. Retirees risk a shortfall in income and hence would need to supplement this by finding additional work during retirement.

65% of affluent pensioners, compared to 58% of pensioners in the core group, have other persons who are financially dependent on them. Respondents in both groups indicated that they have two dependants on average, where the definition of a dependant includes a spouse, children and other adults. In terms of capital provision for retirement, 58% of affluent pensioners believed that they have saved enough to last for the rest of their life compared to only 35% of the core group. In addition, 83% of affluent retirees were able to maintain a similar lifestyle post retirement than before retirement as opposed to only 53% of pensioners in the core group being able to do this.

The booster survey results provide further valuable insights into the behaviour of affluent pensioners:

- Both groups consistently indicated that their income was not keeping up with inflation, leading to a reduction in the buying power of retirees' post-retirement incomes
- Affluent pensioners are less likely to experience a shortfall in income due to increased living expenses compared to the core group of pensioners
- Most affluent pensioners save something at least every month
- For both groups, the largest items of expenditure were groceries (food and other household products), medical aid contributions and utility bills.

It goes without saying that starting to save from an early age is an excellent springboard for a better retirement. Year on year, the message remains consistent that it is paramount to start your retirement planning as early as possible. In conjunction with contributions towards a pension or provident fund, 63% of affluent pensioners indicated that they made additional contributions to an RA versus 42% from the core group of pensioners. This highlights the importance of making additional pension contributions, even if you are part of an employer's retirement fund.

The survey results showed furthermore that the percentage of pensioners who withdrew from their retirement fund either via resignation or retrenchment was 27% and 28% amongst the affluent and core group of pensioners respectively. Among the pensioners that withdrew their savings, over 55% from both groups did not realise the level of tax that they would have to pay on the withdrawal amount. Of those that withdrew cash, 62% of affluent pensioners regretted this decision compared to 48% of the core sample. This shows that more education should be conducted to make members aware of the consequences of not preserving your retirement benefits.

The core sample placed more emphasis on reducing long-term debt compared to 38% of the affluent sample. Affluent pensioners utilise their withdrawal to reduce short-term debt to a lesser extent (31%) but rather opt to use part of it to enhance existing assets such as improvements to their home (39%). However, topping the list was the need to cover living expenses, at 46% and 41% for the core and affluent samples respectively, which shows consistently that the cost of living is a real concern for any segment of the market. As in 2015, this is also indicative of the high levels of short-term debt that South Africans have.

Moving onto the topic of financial advice, the proportion of the core group of pensioners that received financial advice on their retirement planning prior to their retirement age was 68%

compared to 82% in the case of affluent pensioners. The affluent pensioners also received this financial advice much earlier, almost 11 years on average, prior to retirement versus only nine years in the case of the core group of pensioners.

A new question was introduced in this year's survey: "In the last five years prior to retirement, what topics did your adviser discuss with you?". High on the agenda were discussions about expected income in retirement, tax implications of different investments and cash withdrawals. Rated slightly lower was performing a needs analysis and discussing medical aid options. Affluent pensioners once again had these discussions earlier than the core group of pensioners, on average 3.5 years before retirement versus 2.8 years in the case of the core group of pensioners. Among the affluent pensioners, investment guidance on investing in a living annuity was discussed more than in the core sample of retirees. When asked how they felt about having to buy an annuity in retirement, reassuringly over 80% from both segments were happy or satisfied with the decisions that were made.

Focussing the discussion on sources of income, 48% of the core group received most of their income from a pension from the employer that they retired from, compared to 35% among the affluent pensioners. In addition, income from guaranteed annuity products and investment-linked living annuities was higher among affluent pensioners compared to the core group of pensioners at 64% and 52% respectively. The affluent pensioners often also have additional income from multiple investment sources. The types of additional sources highlighted were property investments, equity-based investments and inheritance capital. Among core pensioners, savings were often used to augment retirement income, but a high proportion indicated that they sought freelance, contract or part-time work in order to supplement their income.

At retirement, pensioners who opted for a lump sum payment are encouraged to stay within the tax-free limit. Based on the survey results, the proportion of the core group of pensioners spending their lump sum on living expenses was 27% compared to using the lump sum to reduce short-term debt such as car repayments, credit cards, and loans at 36%. If we compare this to the findings for affluent pensioners, 26% spent their lump sum on living expenses and 33% to reduce short-term debt. Fewer pensioners from the core group invested this lump sum to start their own business (12%) whereas a higher proportion of affluent pensioners utilised the lump sum to start their own business (21%). A concerning result was that 50% of pensioners in the core group indicated that they had depleted their lump sum whereas 30% of affluent pensioners had indicated the same. Retirement does not mean that saving should come to an end and it was positive to see that 62% of the core sample and 85% of the affluent sample still managed to save in retirement. However, the core sample is less likely to do so each month (16% versus 46% among the affluent sample). Investing into a TFSA is especially becoming a consideration for affluent retirees, and hopefully this trend will be seen among all of the pensioners in future.

Shifting our attention to post-retirement income products, there seems to be uncertainty about the type of product purchased by retirees to provide them with a retirement income. This is evident in that only 15% of affluent retirees and 6% of the retirees from the core group indicated that they had purchased an investment-linked living annuity (ILLA), even though the sales figures from the market would suggest otherwise. Affluent retirees stated investment and income flexibility as their main reasons for choosing the ILLA. On average, the mean income drawdown rate was 5%, with 78% of pensioners mentioning that their drawdown rate has not changed since retirement. Affluent retirees are fairly confident that they will not run out of income (79%), with 57% investing in conservative to balanced investment portfolios.

This type of investment portfolio balances risk and return by using combinations of fixed income securities and real asset classes (such as equities and property) to generate relatively steady investment growth with the aim of preserving capital, thus aiding income sustainability over the long term.

When asked how they would want to receive investment and other communications, post or personal mail remains the preferred method among both samples. The affluent segment indicated a further desire for face-to-face communication, which could be seen as a possible explanation why 73% of affluent retirees would like interactions with a financial intermediary, compared to 56% of pensioners in the core sample. Family is important and most affluent pensioners indicated that they discuss their financial situation with their spouse, children and other family members.

In conclusion, the current political and economic situation is a major concern for most pensioners as this will directly impact their future retirement years in South Africa, as well as the living conditions of their families. Maintaining a positive outlook can be a challenge, but this year's Pensioner BENCHMARK Survey highlighted that with the correct guidance, education and advice, this can be achieved. Regulatory changes around retirement provision will hopefully incentivise better retirement provision, which would ultimately increase the socio-economic welfare of all South Africans. The 2016 BENCHMARK results once again challenge leaders in the retirement space to work together in helping future retirees plan for a better tomorrow, today.

Notes

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