BENCHMARK SURVEY **2017**

hindsight / foresight

Research summary

Insurance | Financial Planning | Retirement | Investments | Wealth

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foreword

Reflections: Looking back to make looking ahead even clearer

My team and I have been debating the concept of the "evolution of employee benefits" for the past five years. I spent some time contemplating how far we have come since 2013. This is a necessary step to gaining an understanding of how the landscape is morphing. It provides critical insights into what we need to focus on to achieve our desired future state.

by

Dawie de Villiers
Chief Executive Officer:
Sanlam Employee Benefits

Despite the macro-economic challenges which South Africa faces, we have seen a marginal increase in the employed population from 14.7 million (2013) to 15.5 million (2016) adults. According to Statistics SA, the unemployment rate based on the official number has increased from 25.3% (2013) to 26.6% (2016).

These official statistics are not comforting at all. Our member studies indicate that the two primary dependencies for financial wellness is the level of education and employment status (access to financial resources).

As an industry we need to consider the longer-term economic consequences when not all employed people have access to medical aid provision or are contributing to retirement funds. The number of employed people who have access to medical aid decreased from 31.7% (2013) to 29.8% (2016) and those contributing to a retirement fund decreased from 48.5% (2013) to 46.5% (2016).

In the past, employers may have considered the impact of the financial strain on their employees' productivity. Another consequence is the effect it has on the career trajectories of those individuals. A key finding of our member studies is that financial constraints may act as a trigger for employees to search alternative employment. This is done either to access retirement benefits or to move for more competitive or a wider range of employee benefits.

5-year trends from an intermediary's perspective

Despite all the industry efforts regarding member education, the overall level of understanding around retirement benefits remains very low. Over the years we've also seen an interesting shift in demand for various types of products. Due to economic reasons it would appear that the industry is focussing on group risk benefits (funeral cover, dread disease cover and income replacement). This is a positive

trend as many members are largely under-insured. Regulatory changes are driving cost pressures which in turn are forcing the industry to reduce complexity and increase the transparency of costs. The conversion from stand-alone retirement funds to commercial umbrella funds continues unabatedly.

There also appears to be a misalignment between the employer's value proposition and the range of benefits offered.

Everything that matters to employees is entrenched in an employers' value proposition

We have consistently intimated that financial wellness as a nation and on an individual level requires a shift in thinking and behaviour. Merely being employed and/or earning an income (at any level) does not necessarily equate to positive financial outcomes. The key differentiators are behaviour and attitude towards money.

Employee value propositions are broadly defined as the full spectrum of benefits which an organisation delivers to its employees in return for the employees' time and skillset. It includes the total rewards package such as remuneration, retirement and risk benefits, flexible work arrangements and wellness programmes.

We tested the concept of an employee value proposition and whether it was aligned to the full suite of benefits offered. It was pleasing to see that 47% of stand-alone funds and 35% of participating employers in commercial umbrella funds indicated that their value propositions took a holistic view of their employees.

As a result, a wide range of financial and healthcare benefits including wellness, healthcare clinics, child care, financial assistance for children's education and financial planning are included in the total rewards offered. But only half of employed individuals enjoy these rewards for as long they are economically active.

Money conversations as a potential stimulus to bring about the change in attitude

Volumes have been written about millennials, the generation born between 1982 and 2004. Approximately one quarter (23%) of our member studies sample constitutes this generation.
We tested their attitudes on a number of issues relating to work, career and income trajectories as well as their financial wellness. What stood out for me was the candour with which young professionals speak about their career aspirations and the ability to quantify their potential future earnings.

Young professionals are indeed self-directed and want to take charge of their futures. There was little evidence to support a defined benefit mind-set. When asked about future career opportunities three key themes became apparent:

- Innovation
- Ownership and accountability
- Upskilling

Their optimism about career opportunities centres around advancements in technology across all sectors. Self-directed individuals take responsibility for personal growth and development and believe that upskilling is pivotal to their career advancement and security. However, their optimism is tempered by an overwhelming uncertainty based on a wide spectrum of macro-economic challenges.
Increasingly, open architecture with a focus on holistic benefits for members will probably be the solution for this generation. They are gearing themselves up for multiple income streams from different sources. Those with less of an entrepreneurial spirit will look to corporates to provide a wide range of benefits.

For this generation the goal is not so much about money as it is about living life on their terms. It is about having options in their careers and all other aspects of their lives.

Looking back it is apparent how much has changed in five years.

As you turn the pages of this report, you will hopefully be inspired to consider our take on what the future may hold for this industry.

I wish to extend my gratitude and heartfelt appreciation to everyone who made this research possible.

Dawie de Villiers
CEO Sanlam Employee Benefits

Executive summary

Transforming hindsight into foresight

by

Wagieda Suliman
Market Insights
Sanlam Employee Benefits

The research insights contained in this report are based on four separate studies. Each of the studies tested the following hypotheses:

Hypothesis 1: Employers in 2030 will have significantly different employee benefits structures.

Hypothesis 2: A model based on holistic financial needs will be a replacement for the current narrowly-focussed SA retirement fund industry.

Hypothesis 3: An ideal value chain for employee benefits provides flexibility, complexity, access, transparency, automation, standardisation and control.

With **hindsight**, up until now the research has largely reflected our ability to understand the retirement fund industry events after they have happened. Our **insights** have been mainly retrospective as we've analysed long-term trends and the potential impact they would have on the future of retirement funding. This is a critical path to understanding ourselves and the world in which we operate.

Foresight is the ability to predict what will happen in advance so that we can 'future proof' ourselves and the world around us to mitigate any potential (future) negative impacts.

But it is not that simple because we operate in a world where regulatory reform is accompanied by mass uncertainty. We are in the business of protecting employees' life savings and nothing should deter us from our commitment to ensuring positive retirement outcomes for these fund members.

Dawie de Villiers, CEO of Sanlam Employee Benefits, has undertaken deep reflection on how far the industry has come in the last five years, taking into account the views of employees and intermediaries. He sketches a somewhat regressive view of labour force absorption and the rate at which the unemployment levels in South Africa have increased. Moreover, he reiterates the extent to which even fewer individuals today than those employed five years ago are benefitting from access to retirement funding and medical aid provisions. His contemplation leads us down the path of the evolution of the retirement funds industry with a slight peek into what the future may hold.

One key insight which emerged in conversations with more than 1500 stakeholders was that money is a sensitive topic and must be approached with empathy, understanding and the willingness to change one's perspective. Candour and enthusiasm about future career prospects and earnings potential prevailed in discussions with young professionals.

Mxoli Sigenu shares his views on the unionised labour force and their retirement fund benefits. He draws parallels between the potential retirement outcomes for members in union funds and other stand-alone funds. Mxoli laments on the ever-important role which education plays in the retirement

funding system. He further instils a level of confidence in the efforts that have already been made to ensure that those members of the workforce which have access to retirement and medical aid benefits are equipped with the appropriate tools and the right level of knowledge to ensure that members and their beneficiaries reach satisfactory retirement outcomes.

Danie van Zyl guides us with his in-depth knowledge and detailed analysis on contribution levels. With retirement contributions at their highest levels on average over the past three years, it is comforting that at least some of the industry advice and guidance shared previously has hit home.

Michele Jennings provides a detailed assessment of group risk benefits. Michele highlights important trends which employers must consider when reviewing their benefit structures. She hypothesises that the future shift to standardised risk benefits may be more imminent than the industry anticipates. This could result in a demand-pull market where employees determine and influence the design of risk benefit products.

Anton Swanepoel and **Brett Ladouche** take a critical look at Section 37C of the Pension Funds Act. The allocation of death benefits must without a doubt be the most emotional and time consuming task for trustees. The risk of getting it wrong weighs heavily, as it has such far reaching implications for all stakeholders. Often it is the financial well-being of minor beneficiaries that needs to be considered above all other factors. Section 37C in its present form is inflexible and does not provide sufficient guidance on the distribution of death benefits. The industry is thus making a call for it to be revisited.

Rhoderic Nel provides an educational paper on building well-balanced investment portfolios. Rhoderic cautions that it is no longer appropriate to build portfolios relying solely on equities as a high-risk source of return. He stresses that financial markets have evolved significantly, with a number of the alternative asset classes starting to stake a valid claim for inclusion in mainstream portfolios. He suggests moving away from a focus on traditional asset classes and towards an alternative set of risk premia which can be exploited to allow for more diversified and robust portfolios. This will help investors move away from an exclusive focus on the equity risk premium and will highlight the essential role that other asset classes fulfil in the overall portfolio construction context.

Viresh Maharaj introduces the Sanlam Financial Wellness Benchmark. The Sanlam Financial Wellness Benchmark is a newly developed diagnostic tool that will enable engaged employers to measure the level of financial wellness within their organisations (in aggregate and by various demographic dimensions). Viresh provides compelling evidence through secondary research sources as well as the Sanlam BENCHMARK study with professionals who have provided the necessary insights to build the Sanlam Financial Wellness Benchmark.

Dawie de Villiers has long since been passionate about the evolution of employee benefits. In his paper on Simplicity, Transparency and Efficiency, he challenges the industry to address the inherent inefficiencies which exist within the retirement funding system. He questions and draws attention to the numerous sources and obstacles which are the primary causes of these inefficiencies. Dawie provides a perspective on what needs to change because he believes that while progress has been made on a number of fronts, there are still areas where greater simplicity, transparency and efficiency could be practically applied.

David Gluckman was tasked with the inevitable role of being the industry soothsayer. He takes the view that everything the industry wants to accomplish is within its control. David remains firm about the inefficiencies in the retirement funding system and questions whether Governments' much-anticipated reforms are an appropriate solution for South Africa. He shares his doubts about whether one of the central proposals can work for South Africa; that being the creation of a mandatory and contributory National Social Security Fund (NSSF) and specifically the retirement savings component thereof.

Avishal Seeth takes on the much-contested debate of advice in a constantly changing environment. The golden thread in Avishal's paper is the depreciating value of trust as an unintended consequence of common industry perils. He explores the impact of technology and the concept of robo-advice and whether the industry is in fact ready for Generation Y which currently makes up a significant proportion of the economically active workforce. Generation Y is an entire generation of young professionals born in the digital age, known as 'millennials'. He also puts forward the concept of an "excellent advisor" who will be able to holistically combine all of these aspects: the retirement fund, medical aid, wellness offerings, financial literacy and engaging member communication, so that when providing holistic needs analysis and advice for individual members, this is done through a multi-faceted prism, and with a view that the whole is greater than the sum of its individual parts.

Kobus Hanekom ponders whether our retirement system is still effective. Kobus investigates why it is that the pension models implemented by countries all over the world are no longer delivering the desired results. He unpacks the many shifts currently taking place in the world and in the retirement fund industry that are making it that much more difficult, particularly for millennials, to provide for a dignified retirement.

Johan Prinsloo explores the essential elements an administration model must have to robustly cater for end-to-end retirement fund administration. Johan achieves this by using a familiar analogy to illustrate exactly how an administrator can help contribute to the best possible retirement for a member.

Karen Wentzel demystifies the confusion faced by fund members when it comes to quantifying the capital needed at retirement. Karen concedes that it could be argued that the Net Replacement Ratio may not be considered the best measure for determining whether an individual is on track for retirement. Rather, she indicates that an easier or more appropriate measure for members to quantify the exact amount that should be saved is by expressing retirement savings as a multiple of current salary at different points in ones working life.

Sankie Morata shares the parables of a beneficiary fund administrator who has been in the field for a number of years. Sankie touches on the regulatory challenges concerning the management of the beneficiary fund and expounds on how it is different from the management of a retirement fund in that it is multi-layered and ever growing. Furthermore, the relationships now not only lie with the guardians and beneficiaries but also the industry at large.

Irlon Terblanche and **Shakeel Singh** provide an overview of their research conducted with participating employers in umbrella funds. Irlon and Shakeel uncover a few of the key emerging trends that were picked up during this year's survey, which included the need for transparency of fees and what they refer to as the "retailisation" of the institutional market. They point out that cost remains the most important consideration for employers when selecting an umbrella fund.

Irlon Terblanche recommends no fewer than 16 important considerations to take into account when selecting an umbrella fund. Irlon reports on consultants' ranking of these 16 key attributes to identify the considerations in choosing an umbrella fund. The research subjected the responding consultants to a process with a degree of rigour. This process forced each respondent to actively deliberate very carefully about the respective weighting assigned to each attribute.

Janus Engelbrecht debates whether a Net Replacement Ratio is a suitable measure for projecting members' retirement outcomes. Janus asks the very pertinent question: what if employers believe that, on average, only 18% of their retirees are able to maintain their current standard of living in retirement? What are the other 82% of retirees supposed to about the substantial shortfall in their retirement savings that using a net replacement ratio implies?

The Sanlam Benchmark research process

by

Viresh Maharaj
CEO: Client Solutions
Sanlam Employee Benefits

Since 1981, the Sanlam Benchmark research has enabled stakeholders of South Africa's retirement funding system to understand the topical issues of the respective era in order to make more informed decisions.

The research has evolved as the landscape of retirement funding changed with a shift away from defined benefits to defined contributions, the shift from standalone funds to umbrella funds and the shift from the fund to the individual.

The 2017 Sanlam Benchmark research process began in 2016 by consulting with stakeholders of the retirement funding industry to get a broad view of the issues driving member outcomes. Stakeholders included employers, funds, consultants, media as well as leading experts within Sanlam. Their feedback was consolidated and distilled to a number of key hypotheses to be tested that informed the content of the 2017 Sanlam Benchmark research.

In particular, we expanded the breadth of the research aimed at individual consumers of financial services to better understand the drivers of financial wellness amongst individuals.

We also interviewed employee benefits consultants, as key enablers of better retirement outcomes, to gain an understanding of their views of the changing dynamics of the formal retirement funding sector.

The sample in 2017 consisted of:

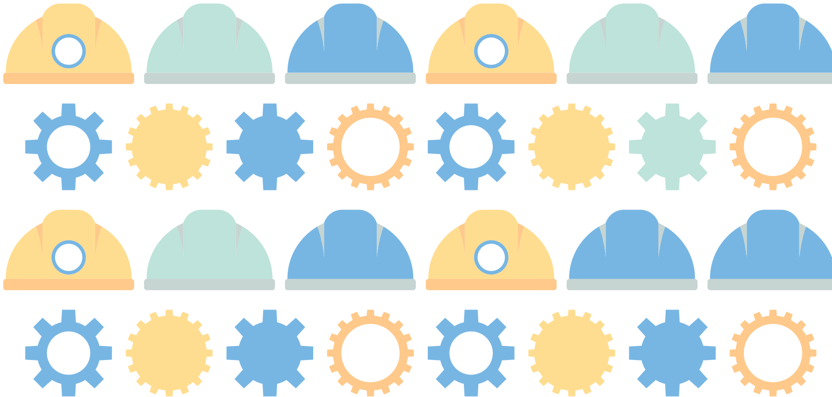
- 1,317 consumers of financial services;
- 10 interviews with professionals;
- 4 focus group discussions;
- 16 employee benefits fund consultants;
- 100 standalone funds (incl. 10 union funds); and
- 100 participating employers in umbrella funds.

The research was conducted over a two-month period in 2017.

The year on year participation of respondents in the standalone survey and umbrella fund survey is 69% and 59% respectively.

This represents the most holistic view of South Africa's commercial retirement funding landscape.

Unionised labour force and retirement fund benefits



by
Mxoli Sigenu
Business Development Executive
Sanlam Employee Benefits

> “Education is the most powerful weapon which you can use to change the world”
>
> Nelson Mandela

I was inspired by this quote as I reflected on the state of our nation and the ongoing challenges we face. The most recent struggle in education, brought to light by the #feesmustfall campaign. We have witnessed many changes in our democracy, and some changes have been more positive than others. The plight of the labour force remains an ongoing struggle for survival as we see a downward trend in job creation.

Over the last two decades we have seen a decrease in the number of registered trade unions from 213 (1994) to 186 (2016). Of the 15 657 000 employed individuals, it is estimated that 3 716 000 excluding Government employees are unionised. South African labour force's employment distribution is spread across 10 key sectors which include private households. These ten sectors account for the employment of at least 13 221 000 workers.

We have included a subset of union funds in the stand-alone retirement funds survey sample since 2013 because it represents the largest proportion of the workforce.

We are pleased that eight out of the ten union funds in this year's study also participated in the 2016 survey.

The ten funds reported on in this report have a combined asset value of R50.32 billion. Most of the principal officers or trustees who were interviewed have an average of ten years tenure on a Board of Trustees.

One positive result is the steady increase in normal retirement age from 62.3 years (2013) to 65.2 years (2017). But Trustees estimate that on average 23.8% (stand-alone) and 11.67% (union fund) members are able to retain their current standard of living in retirement. The impact of longevity will affect all South Africans in the longer-term and as such the ability of all fund members to retain their pre-retirement lifestyle becomes crucial.

Retaining the free standing-position

Since the first survey amongst union funds in 2013, we have come to appreciate that employer sponsored union funds will most likely remain on free-standing administration platforms. There appears to be minimal appetite to provide benefits to members via an umbrella fund arrangement.

One of the biggest detractors that would prevent union funds and other stand-alone retirement funds from moving to an umbrella arrangements is the perceived loss of control of decision-making.

Union: 10 funds participated in the survey	2017	2016	2015
Loss of control of decision-making	8	10	8
Risk of having all services with one provider	3	1	2
Don't believe one provider can offer best solution	3	1	1
Cost	3	0	2
Big enough to be independent	-	-	1

Retaining the free standing-position

Members' remuneration are typically not structured on a total cost to company (TCTC) basis

All those who structure remuneration on TCTC	2017	2016	2015	2014	2013
Union	30%	18%	10%	30%	40%
Stand-alone	56%	49%	60%	55%	52.%
Umbrella	57%	64%	65%	64%	72%

The percentage of total remuneration which comprises pensionable earnings (PEAR)

Average PEAR	2017	2016	2015	2014	2013
Union	89%	78%	71%	87%	86%
Stand-alone	78%	80%	75%	83%	84%
Umbrella	80%	75%	67%	84%	85%

Contributions

Average contributions are more or less aligned to other stand-alone funds and participating employers in umbrella funds. Member contributions have increased steadily over the five-year period.

	2017 Average	2016 Average	2015 Average	2014 Average	2013 Average	Average over last 15 years
Employer contributions	8.57%	9.60%	10.89%	7.55%	7.36%	8.79%
Employee contributions	7.35%	6.32%	6.66%	5.93%	6.94%	6.64%
Total Contributions	**15.92%**	**15.92%**	**17.55%**	**13.48%**	**14.30%**	**15.43%**

	2017 Average Union Funds	2017 Average Core stand-alone Funds
Total Contributions	**15.92**	**18.54%**
Deduction for life cover	1.75%	1.28%
Deduction of disability cover	1.42%	1.08%
Deduction for administration costs	0.81%	0.66%
Total provision for retirement	11.94%	15.52%

Risk benefits

Group risk benefits are clearly a set of products that are rather complex for members to deal with. Funds require more guidance from insurers regarding legislative and income tax changes. As we witness the move towards more automation and simplified processes in the retirement fund industry, it is believed that standard risk benefit policies would be easier for members to understand. While there is an increase in demand for flexible risk benefits by stand-alone funds, only one in three union funds offers this benefit to members. The biggest deterrent is that union members are largely low income earners, have a very limited understanding of group risk benefits and the inherent risk of members making the wrong choice is far too great.

All union funds are generally satisfied with the benefits currently offered and the level of service they receive from their risk providers. This level of satisfaction is driven by low fees or competitive rates and efficient claims handling procedures. When compared to other stand-alone funds, the cost for death and disability cover is slightly higher for union funds, which one can assume is the profile of membership, claims experience and other factors which have an impact on price.

The lumpsum payable on Approved group life cover has increased marginally year-on-year from 2.95 times annual salary (2016) to 3.25 times annual salary. Only three out of ten union funds offer group life cover on an Unapproved scheme basis.

The majority of funds provide members with a disability income benefit and claim to have received good advice from their broker or consultant regarding the benefit options after the most recent tax changes.

Half of union funds provide lumpsum disability on an Approved basis. The average size of the disability lumpsum is 2.75 times annual salary. This has marginally decreased from 3 times annual salary in 2016.

Only two unions offer critical illness. This is aligned with the experience of stand-alone funds and umbrellas funds with approximately 20% offering critical illness benefits.

Retirement benefits

The majority (eight out ten) do not have a targeted pension expressed as net replacement ratio (NRR) that the trustees actively work towards. This could be influenced by the fact that more than half (six out of ten) do not feel that a NRR is suitable measure for determining whether members are on track for retirement. There is a firm belief that members do not understand the measure or that there are too many variables to consider. As a consequence, funds do not measure the NRR on a regular basis.

Union fund trustees believe that the most important features of the default annuity are longevity projections (income for life) and annuity income which keeps pace with inflation and allows pensioners to retain their pre-retirement lifestyle as long as possible.

Investments

An overwhelming majority (80%) of funds have a trustees' choice as defaults in their fund's investments strategy, with 89% of the fund assets being invested in the default portfolio. The investment portfolio of the trustees default choice is mostly balanced active, followed by guaranteed/ smoothed bonus.

All funds invest in a socially responsible investment portfolio and half of the funds believe that there is a cost benefit or other benefits associated with it. The social good outweighs the cost and there is a belief that the shares selected through this process will provide a higher value to fund members.

Evolution of Employee Benefits

Almost all funds (nine out of ten) believe that it is possible to reduce complexity through standard risk and administration structures. The view is that a minimum set of benefits according to prescribed risk benefits rules could possibly be applied similarly in the way that prescribed minimum benefits on

medical aids are supplied across all product providers.

The issue of costs has long since been a priority. Most funds (eight out of ten) believe that there should be a cap on administration fees. This could be achieved by implementing a process whereby all providers quote according to standard charge structures for certain services, according to a specific standard for all, with full disclosure and transparent comparisons.

Advice 3.0

Only half of the funds have a formalised strategy for rendering financial advice to members. The other half advises members to speak to their own financial advisors. With regard to National Treasury's requirement for funds to provide benefit counselling, only half of the funds are either deploying the services of a dedicated salaried advisor to the fund or making available an HR specialist trained on default product features. Financial advice in terms of FAIS is left up to the consultant or broker (six out of ten) or the members' own financial advisor. Robo advice would only be considered if it is in conjunction with a person to assist the decision making.

Future Benefit structures

Draft regulation is considered as having a few key benefits in that it will help members to save for retirement in a more cost effective manner, and will encourage members to preserve their retirement benefits on withdrawal.

Section 37C and taking care of beneficiaries

Distribution of death benefits is probably one of the most challenging tasks for trustees. There is the view that Section 37C must be amended because the Pension Funds Adjudicator determinations, which state that minors' benefits may not automatically be paid into a beneficiary fund, are considered controversial. Section 37C also does not take into account the unique needs of different cultures, e.g. the specific needs of African communities. Three main reasons for delays in paying over the death benefit has been cited as:

- Lack of identification of dependants
- Family disputes
- Traditional practices vs legislation

The management of Beneficiary Funds remains the most sensitive yet vulnerable section in the retirement fund benefits and also in the welfare of the employees. Trustees needs to entrust the outsourcing of these benefits to credible service providers with proven credentials, in this way a lot of uncertainty and surprises will and could be avoided.

Looking ahead

When one considers all the changes which have taken place in the space, I remain confident that we are on the right track to change the retirement outcomes of fund members. I take comfort that more than 80% of members in all stand-alone fund members (including union funds) are invested in the trustees' default portfolio. Most trustees do not believe that preservation is an unrealistic ideal. This means that the default message will remain for members to preserve their withdrawal benefits. If six out of ten believe that employees would to some extent value having access to an integrated "one-stop-shop" via their employers, this mean that the integrated financial solutions and education could become the much needed catalyst.

If in the future employees wanted a broader range of financial services via the employer, it should include mortgage bonds, personal loans facilities, persona financial planning, tax advice and education loans for children.

I end my summation of this year's union funds research by reflecting on where I started. It is only through educating our fund members on the time value of money and how they can generate wealth within their retirement funds, that we as individuals and collectively as a nation will change our world.

A luta continua!

Contributions: 3 year average

by

Danie van Zyl
Head: Guaranteed Investments
Sanlam Employee Benefits

Contributions continue to edge higher

The average contribution rate (employer and employee) continues to edge up higher and continues to be significantly higher than the results of surveys conducted pre-2015. This is likely due to an increase in the number of large funds in the survey sample since 2015.

Of the funds surveyed, 37% indicated that the employer paid a fixed contribution per member, as well as fund administration and risk benefit costs, compared to 58% of employers who only paid a fixed contribution.

Employer contributions

The average employer contribution, as a percentage of salary, amounted to 10.70%, which was above last year's result of 10.36%. Similarly, average employer contributions for union funds amounted to 8.57% of salary, continuing the downward trend from the 2015 survey.

29% of employers allowed members to vary their employer contributions in terms of a package restructure arrangement, slightly higher than the 23% of employers in the 2011 survey.

Employee contributions

Similar to the employer contribution rate, the average employee contribution rate increased to 7.84% of salary, compared to 7.27% of salary in 2016. Average employee contributions for union funds amounted to 7.35% (2016: 6.32%).

44% of funds allowed their members to choose their own employee contribution levels, the same percentage as 2015.

90% of funds allowed 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) was 1.58%.

Deductions

The majority of funds continued to express their administration expenses as a percentage of a member's salary (61% of funds), while a further 34% expressed this cost as a fixed rand amount per member per month. Only 3% of funds expressed their administration expenses as a percentage of the fund's assets.

The fixed rand per member approach implies the lowest level of cross-subsidy, but this is one instance where cross-subsidy may be preferred. The fixed rand per member costs weigh more heavily as a percentage reduction on small salaries and have a much smaller effect on large salaries. Funds that use this method of cost recovery lose any cross-subsidies between higher paid and lower paid workers.

For those funds deducting a percentage of salary for administration, the average deduction amounted to 0.66%, significantly lower than in previous years, while the average fixed fee per member for standard members lowered to R53.71 a month.

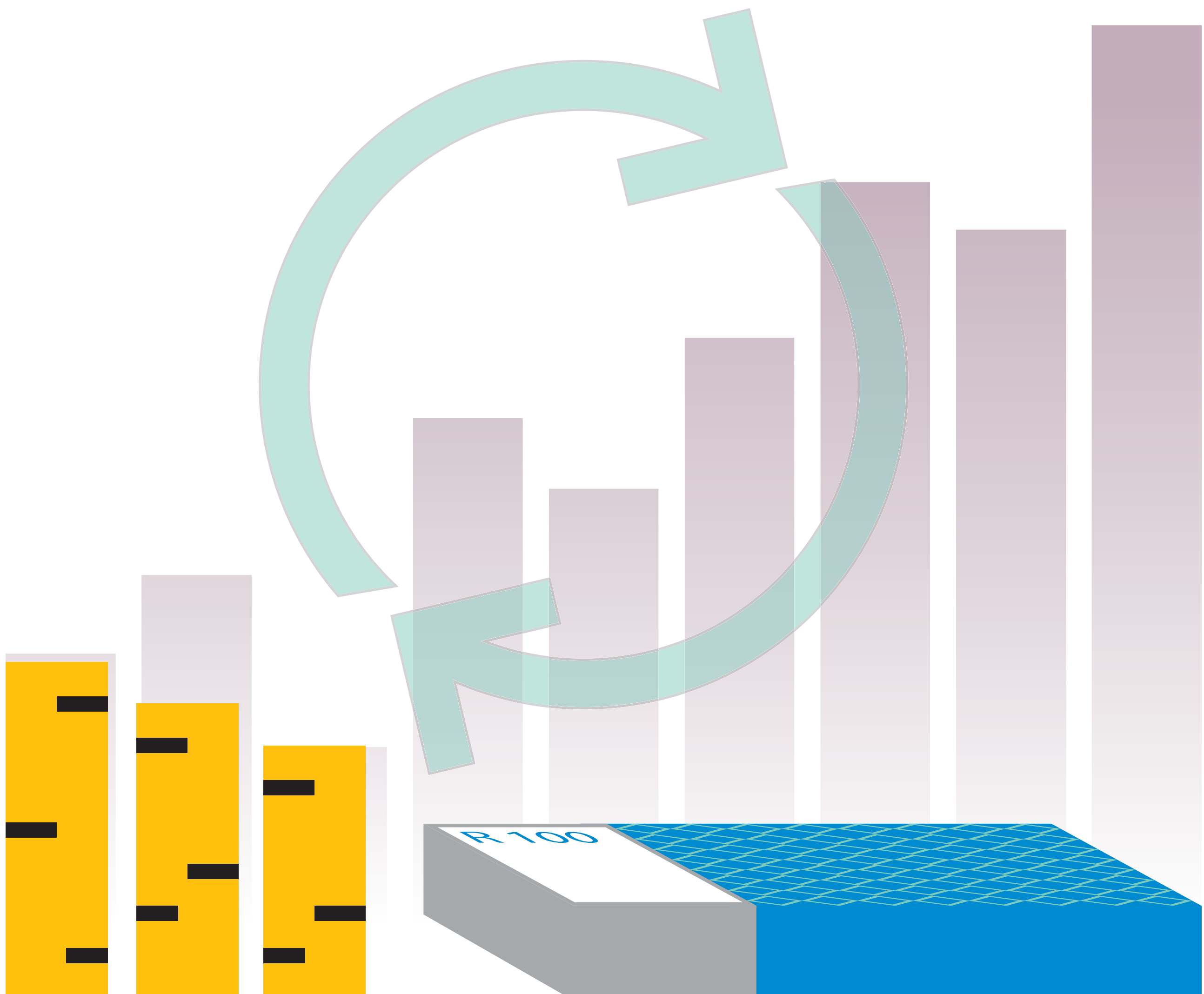
As in previous years, members of very large funds (more than 10 000 members) benefit from economies of scale and pay a lower administration fee (0.56%) compared to members of smaller funds (less than 500 members) who pay on average 0.93%%. Expressed as a fixed fee per member, this varies from R28.89 a month for very large funds to R86.38 a month for smaller funds.

The average deductions to cover the cost of life cover in the fund have decreased to 1.28%, while the cost of disability cover has remained fairly steady, at 1.08% of salary.

	Average over last 3 years		Average over last 5 years	
	All stand-alone funds	Funds with 10 000+ members	Funds with less than 500 members	All stand-alone funds
Employer contributions	10.72%	10.39%	10.22%	10.31%
Employee contributions	7.19%	6.49%	7.33%	6.78%
Deduction for life cover	-1.40%	-1.57%	-1.28%	-1.48%
Deduction of disability cover	-1.05%	-0.88%	-1.05%	-1.06%
Deduction for administration costs	-0.95%	-0.51%	-1.38%	-0.94%
Total provision for retirement	14.51%	13.92%	13.84%	13.61%

All figures as percentage of PEAR

** 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.*



Risk benefits

by

Michele Jennings
CEO: Group Risk
Sanlam Employee Benefits

At an insurance industry level there is a lot of focus placed on retirement funding outcomes for members. Whilst this is an appropriate priority, we do however believe that not enough attention is being placed on whether the member and his or her beneficiaries will have enough cover at a time of need.

Such as at the time of submitting a life or disability insurance claim. We also believe many market participants underestimate the likelihood of members claiming form an insurance scheme, with up to a quarter of employees that start working at age 20, dying before reaching retirement, and roughly 15% becoming totally and permanently disabled.

Whilst the very high levels of satisfaction displayed in the survey by clients of group risk providers may be commendable, the 2016 experience losses seen in the financial services industry are a cause of concern. Losses were most prevalent in disability products, reflecting an increase in disability claims relative to the past experience which was used to establish the premiums. The market is already seeing an increase in disability premiums, and the concern is that they reach a point of being unaffordable.

The 2017 Benchmark research shows that an overwhelming majority of funds are confident that all their members general risk benefit needs have been addressed by current market offerings, yet as many as 77% of funds currently do not offer benefits such as critical illness.

With insurers increasingly being placed under pressure to be far more transparent in their products and services, and the ongoing requirement for them to provide information in a way that enables easy price comparisons, we explored the potential demand for a standardised, basic risk cover. The intention was to identify the basic benefit structures that would be sufficient to cover the basic insurance needs of a member.

With 83% of funds indicating that they believe a standardised risk policy would reduce complexity and be easier for members to understand, and affirming that they are not satisfied with the current level of complexity in the market, it does seem that there is demand for a standardised, basic product.

It was also interesting to see that the view of almost 64% of the funds were that the industry regulator should prescribe a minimum set of risk benefits to all product providers in a similar way to how prescribed minimum benefits on medical aids are regulated.

This could be particularly useful for members, since there are many who obtain the bulk of their life insurance products and services via their employer's group risk arrangements.

The Sanlam Benchmark has been conducting research that includes group risk benefits for more than three decades now, and the research results have remained largely unchanged year-on-year. It would also appear that not much innovation has taken place in this space in the past three years, so perhaps this is the opportune time for such a product to be introduced.

Results from the Benchmark Survey

Half of the stand-alone funds prefer to provide risk benefits on an Approved basis where a third opt to do so via both Approved and Unapproved basis.

Preference for Approved or Unapproved Risk	2017	2016	2015
Approved (part of the fund)	50%	39%	43%
Unapproved (separate scheme)	19%	25%	18%
Both	31%	34%	39%

This year we have also seen a slight shift in the way that risk benefits are defined as a percentage of salary.

More funds are defining benefits as a percentage of Total cost to company (TCTC) and fewer as a percentage of PEAR, with a marked decrease (50%) in funds intending to move to a total cost to company model:

Approved risk benefits	2017	2016	2015
PEAR	74.1%	84.9%	80.5%
Total cost to company (TCTC)	21%	12.3%	19.5%
Both	3.7%	1.4%	
Unapproved risk benefits	**2017**	**2016**	**2015**
PEAR	68%	74.6%	77.2%
Total cost to company (TCTC)	28%	21.3%	21.1%
Both	4.0%	1.7%	

Life Cover

According to the results of the Benchmark survey, the percentage of salaries applied to the cost of life cover has generally decreased over the 3-year period.

Cost of Life Cover	2017	2016	2015
Mean: Approved	1.28%	1.38%	1.54%
Mean: Unapproved	1.25%	1.24%	1.27%

Between 2015 and 2017, the change in the cost of the life cover benefits has decreased by 17% for Approved funds, and 2% for Unapproved funds.

However, when looking at the change in the cost of the benefits relative to the level of cover purchased for these rates, the size of the lump sum payable on death has generally remained constant between 2015 and 2017 for Approved funds (-2%), but has increased by 6% for Unapproved funds.

Size of Lump Sum Payable on Death	2017	2016	2015
Mean (multiple of salary): Approved	3.33	3.4	3.4
Mean (multiple of salary): Unapproved	3.39	3.04	3.2

If the change in the cost of benefits are combined with the change in size of the benefits, we see that the cost per unit of group life cover has decreased significantly over the last 2 years:

	Change in cover	Change in cost of this cover	Change in cost of a 1 times multiple of salary
Mean: Approved	-2%	-17%	-15%
Mean: Unapproved	6%	-2%	-7%

This decrease in the cost of cover may be the combined effect of increased competition amongst insurers as well as favourable claims experience environment (which enabled the insurers to reduce prices).

Disability Benefits

Disability income benefits

Of the funds who have disability income benefits, 80% claim to have received good advice from their broker or consultant as to what form of benefit to select after the tax changes of 2015. One in three of these principal officers would however have appreciated more guidance from the insurance industry as to what solution is best for members in terms of value and price. Roughly half (44%) of respondents would appreciate more guidance in terms of legislation and tax changes from insurers.

Lump sum disability benefits

The percentage of salaries being applied to the total cost of lump sum disability benefits has also changed marginally.

Cost of Disability Cover	2017	2016	2015
Mean: Approved	1.08%	1.06%	1.00%
Mean: Unapproved	0.84%	0.92%	0.89%

The size of the lump sum payable on disability has also reduced by 15% for Approved funds but increased by 36% for Unapproved funds over the last two years.

Size of Lump Sum Payable on Disability	2017	2016	2015
Mean (multiple): Approved	2.5	3.31	2.94
Mean (multiple): Unapproved	2.9	2.8	2.13

Again when combining these movements in percentage of salaries (i.e. the cost of benefit) with the lump sum payable (i.e. the amount of benefits) we notice a decrease in the cost per unit for Unapproved funds but an increase for Approved funds.

	Change in amount of cover	Change in cost of this cover	Change in cost of a 1 multiple of salary
Mean: Approved	-15%	8%	27%
Mean: Unapproved	36%	-6%	-30%

While the fact that the cost of Approved and Unapproved benefits have moved in opposite directions can be considered strange at first this may be typical of the volatile nature of lump sum disability incidence rates. This enforces the view that a long term pricing approach is appropriate in order to stabilise prices.

Flexible Risk Benefits

Despite the low take up of flexible risk benefits, slightly more than half of the funds believe that there is still a future for offering flexible benefits, where the member can take control of their risk cover based on their own individual needs. In order to address this, one in five schemes offer some choice as to what level of salary their risk benefits are based on.

The low take up may also be the result of these benefits competing with the individual life market. These benefits may be more expensive than individual life products due to anti-selection that is sometimes more difficult to prevent in group flex schemes.

Cost of Risk Benefits

A favourable majority of respondents (86%) are confident that they understand how the risk benefit premiums are calculated and an even greater proportion (91%) of funds are satisfied with their current group risk premium rates.

An overwhelming majority (95% of funds) are satisfied with the benefits and services currently offered by their risk provider, which we understand to be primarily attributed to efficient claims handling and meeting member's needs.

Self-insurance

Only 17% of stand-alone funds self-insure their risk cover. Reasons stated for self-insurance include:

- A belief that self-insurance is cheaper,
- It is easier to manage and it provides the fund with more control,
- Rates are more accurate as it is based only on own company experience,
- There is greater flexibility in benefits and,
- The reserves built up in these self-insured funds can accommodate all claims volatility so no there is no need for an insurer.

It is interesting that only 1 in 3 of the funds that self-insure have investigated the possibility of moving away from self-insurance.

Conclusion

Although there is much support for the existing product ranges offered by group risk providers, it seems that there is a need for a standardised product offering that is similar and consistent across the group risk insurance industry. Demand remains for additional options for members to select depending on their personal circumstances and level of expertise or advice.

Given that the reality is that approximately one in three workers will not reach retirement due to either death or disability, it is important that as an industry we do as much as possible to ensure that we can meet the needs of members.

Building well-balanced default investment portfolios

by

Rhoderic Nel
CEO: Investments
Sanlam Employee Benefits

Investing is all about choice; the optimal choice between risk and reward.

In current times where markets are volatile and political uncertainty across the world seems to be the norm, it has become more and more difficult for members and trustees to make the right investment choices. Ultimately this is having an impact on the investment strategies funds make available for their members.

Over the last year, there has been a significant decrease in the percentage of surveyed respondents who offered their members investment choice, with 44% of standalone respondents not offering member investment choice compared to 36% in the 2016 survey. Similarly, as many as 36% of umbrella respondents did not offer member investment choice, up from 23% in 2016. However, only one out of 200 respondents from both the 2017 standalone and umbrella surveys did not offer a default investment choice, compared to the nine respondents in the 2016 surveys.

So how does one go about constructing a default investment portfolio that best meets the needs of many different members in a fund?

Shifting the focus from equity to include alternative asset classes

While equity remains the key asset class that investors rely on to produce inflation-beating returns, building portfolios relying solely on this source of return is no longer appropriate. Financial markets have evolved significantly, with a number of the alternative asset classes starting to stake a claim for inclusion in mainstream portfolios. This is definitely a good thing as one is able to build more efficient and robust portfolios that are better able to navigate turbulent financial markets.

The traditional reliance on equity stems from investors exploiting the equity risk premium, the additional return that equity offers for being exposed to equity risk. History shows that exploiting this premium over long periods of time adds significant value. However, there are periods when one is not adequately compensated for being exposed to equity risk. As such, relying on equity as the sole driver of portfolio returns leads to portfolios that are inefficient and subject to volatility.

Exploiting additional risk premia

Fortunately, the equity risk premium is not the only risk premium one is able to exploit. There are a number of other risk premia that the long-term investor can access. These typically include, amongst others, the:

Credit risk premium – the additional return compensation for taking on credit risk

Illiquidity risk premium – the additional risk premium earned for investing in assets with lower liquidity (such as infrastructure investing)

Term risk premium – the additional return earned as compensation for investing in longer-dated instruments

Inflation risk premium – compensation for the risk of unexpected (rising) inflation eroding real returns

By focussing on alternative risk premia, we remove the emphasis from traditional asset classes in portfolio construction, and show greater awareness of the drivers of underlying returns. Traditional asset classes purely become a tool to access the relevant risk premia that the portfolio is looking to exploit. These asset classes can then be blended to provide the desired (optimal) blend of risk and return at an overall portfolio level.

Lifestage default strategies

The percentage of respondents using a lifestage default investment strategy has remained around 60% for both the 2016 and 2017 surveys. However, it is interesting to note that there has also been a big increase in umbrella respondents who now use a lifestage approach, from 51% in 2016 to 60% in 2017.

According to the 2017 survey, 95% of standalone respondents switched their members to a less volatile portfolio seven years before retirement, compared to 83% of umbrella respondents. Although this final investment phase seven years before retirement is very important – particularly from a capital protection perspective – the biggest part of a member's retirement savings will be built-up through the accumulation phase.

Looking at the Sanlam Lifestage Accumulation portfolio through the lens of risk premia provides a deeper insight into the portfolio and its asset allocation. In addition, the rationale behind the recent enhancements also comes into sharp focus. The current asset allocation of a fund is made up of South African equities (split between active and passive allocations), South African nominal and inflation-linked bonds, hedge funds as well as foreign equities and nominal bonds.

Combining active and passive

Within the SA equity allocation, the main driver of returns is the equity risk premium. This remains an important driver of future returns. There are, however, a number of different 'strategies' within the SA equity allocation. At a high level, this would be the split between active and passive. This is in line with 70% of standalone survey respondents and 77% of the umbrella survey respondents who preferred a combination of active and passive strategies in their portfolios. An equity allocation managed actively by a number of specialist equity managers provides access to the skill premium highlighted earlier. The remainder of the SA equity allocation managed passively is designed to harvest the equity risk premium at a lower cost. In addition to traditional replicating passive strategies, the passive allocation has evolved to include derivative-based tracking solutions as well. In so doing, it enables further risk premia, in addition to the equity risk premium, to be extracted. In particular, the credit risk premium and, to a lesser extent, the illiquidity risk premium can be accessed.

The merits of active versus passive management should also be carefully considered separately for each asset class. In the Sanlam Lifestage accumulation portfolio, the SA nominal bond building block, until recently, had half of its assets managed passively. This was changed to allow the entire allocation to be managed on an active basis, primarily so we could find skilled active bond managers (and hence increase the exposure to the skill premium). In addition, the characteristics of the ALBI (All Bond Index), which is predominantly made up of government bonds, means that the passive element within the SA nominal bond allocation has not harvested the credit risk premium to the fullest possible extent. The nominal bond allocation also exploits both the term premium as well as the inflation risk premium. The range of underlying return drivers within the nominal bond portfolio highlights the central role that this allocation plays. Taken together with inflation-linked bonds that provide access to the illiquidity and term premia, it is clear to see why the traditional balanced fund combination of 60% equity, 40% bonds were so popular.

While some may argue, legitimately, that alternative investments such as hedge funds do not by themselves constitute an asset class, given the diverse nature of the underlying strategies, they can nevertheless complement traditional asset classes very well in a balanced fund. The key element that hedge funds provide is access to the manager skill premium. If one is able to identify skilled hedge fund managers (and this is the rationale behind not having a strategic allocation as it may not be possible to find such managers), it is possible to add significant diversification and value through an allocation to these strategies.

The role of a multi-manager investment strategy

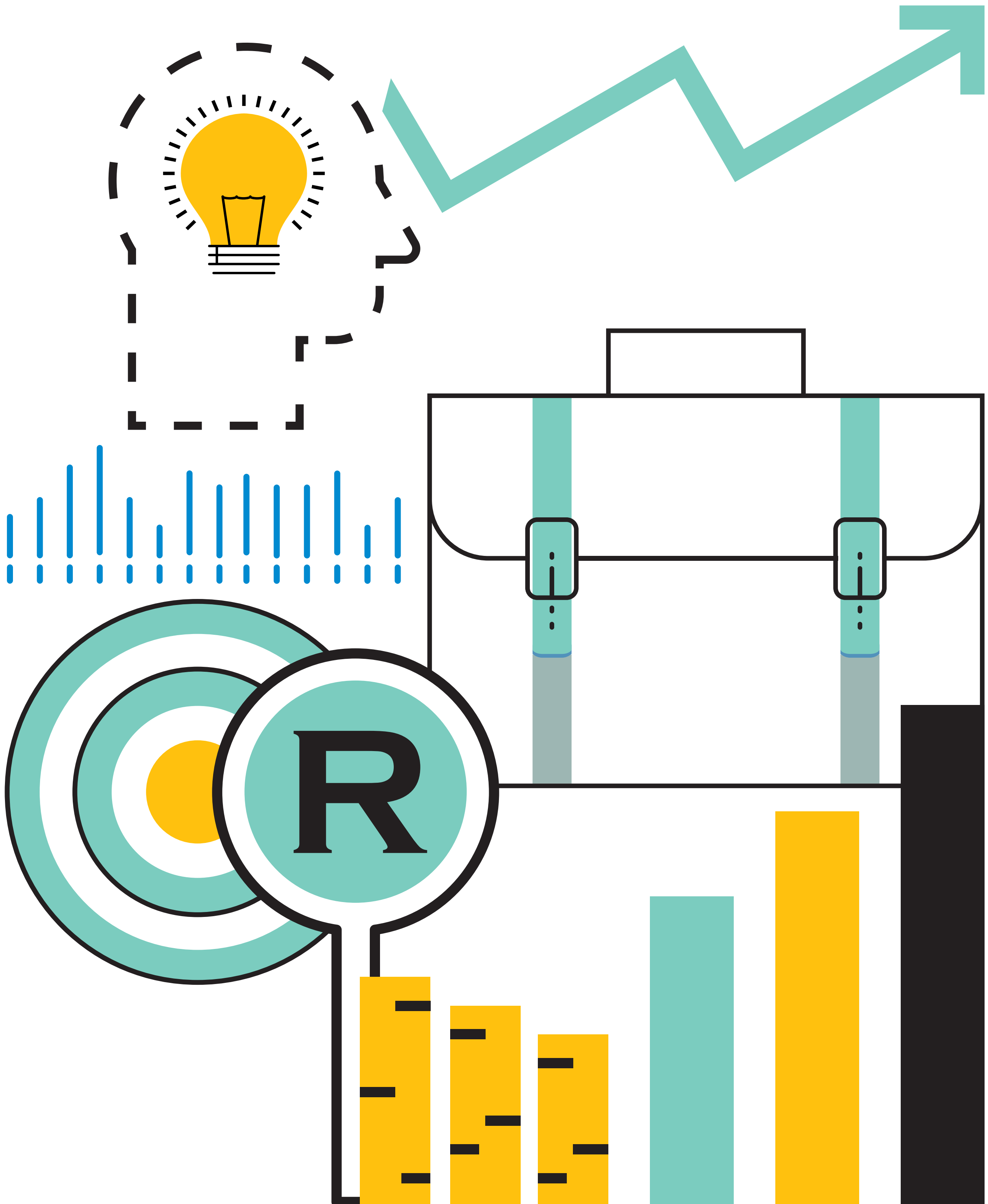
The final broad allocation in most balanced funds is to foreign assets, both equity and bonds. While these asset classes mirror the exposure to the risk premia that their South African counterparts bear, they do offer more through exposure to a foreign currency which provides excellent diversification benefits.

Unfortunately, one is only able to access the full range of return premia by using active investment strategies. This means that it is crucial to identify skilled active managers in the relevant asset classes. Using a multi-manager approach allows the portfolio to further benefit from the skill premium by having a skilled multi-manager select the underlying active managers. In addition to adding value from selecting outperforming managers, the multi-manager has discretion to take tactical asset allocation decisions, further exposing the overall portfolio to the skill premium.

It is important to harvest a number of risk premia

Moving away from a focus on traditional asset classes and towards a focus on the risk premia exploited allows more diversified and robust portfolios to be built. It helps investors move away from an exclusive focus on the equity risk premium and highlights the essential role that other asset classes, including alternatives, fulfil in the overall portfolio context.

Uncertain times create opportunities. To give members access to such opportunities, a carefully created default portfolio should be created using experts in different specialist building blocks to make those difficult investment choices.



Allocation of death benefits – quo vadis?

Section 37C(1) of the Pension Funds Act states that regardless of the provisions of a law or the rules of a registered fund, a benefit payable on the death of a member does not automatically fall into the member's estate; it must be dealt with in terms of that section of the Act.

by

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by

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For example, where a deceased member is survived by dependants and nominees, the board of trustees of the fund must distribute the death benefits fairly and equitably between them. The board must decide in what proportions the benefit must be paid - the board is not compelled to award an amount to each dependant and nominee.

The challenge for trustees starts with identifying and tracking qualifying dependants and nominees. Almost 90% of participating respondents in the 2017 Benchmark Survey indicated that these were the main factors causing delays in the allocation of death benefits. Needless to say, the duty of a board to trace all potential beneficiaries and then to make an equitable distribution is not an easy one to fulfil. Consequently 54% of respondents in the 2017 Benchmark Survey indicated that they first made a provisional or preliminary decision and gave potential beneficiaries the opportunity to provide input, before the board made a final decision on allocating the death benefit.

Once the dependants and nominees of a deceased member have been identified, the financial position and other circumstances of each must be considered by the board. The Act does not specify what factors the board should consider in deciding an equitable distribution. However, the Pension Funds Adjudicator has consistently held that in exercising an equitable distribution, the board needs to consider a wide range of factors, including:

- The actual wishes of the deceased;
- the financial status of each beneficiary;
- the future earnings capacity of each beneficiary;
- the extent of their dependency;
- the ages of the beneficiaries;
- the relationship with the deceased; and
- the amount available for distribution.

In the 2017 Benchmark Survey, it was found that:

- in 81% of cases, the trustees took the wishes of the deceased into account;
- in 95% of cases, the trustees took the extent of dependency into account;
- in 93% of cases, the trustees took the ages of the beneficiaries into account;
- in 83% of cases, the trustees took the relationship with the deceased into account; and
- in 60% of cases, the trustees took the amount available for distribution into account.

It is important to note that no single factor may be over-emphasised to the total exclusion of the others.

In the case of Dobie NO v National Technikon Retirement Pension Fund, the Pension Funds Adjudicator commented as follows:

> "One thing is certain about section 37C, it is a hazardous, technical minefield [..] potentially extremely prejudicial to both those who are expected to apply it and to those intended to benefit from its provisions. It creates anomalies and uncertainties, rendering it most difficult to apply. There can be no doubt about its noble and worthy policy intentions... By imposing a duty on the board to trace dependants the section advances such persons' interest. However, there is legitimate concern about the practical difficulties of tracing such dependants. One solution may be for the section to identify more precisely the steps required to be taken, including an appropriate form of publication, and then allowing for a final distribution to known dependants and nominees at the expiry of a reasonable period culminating in indemnification of the board against further claims."

It is therefore not surprising that in the 2017 Benchmark Survey, half of the respondents indicated that section 37C does not provide sufficient guidance to boards as to what is required of them in order to come to a decision on allocating a death benefit.

Perhaps the time has come to revamp section 37C, not only to make the task of boards easier, but also to provide more clarity to members early on as to how the benefit payable upon their death will be applied.

Beyond wellness

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 impact positively on the organisation's bottom line.

by

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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 can have on staff's ability 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.

Examples of wellness interventions include the proliferation of wellness days, testing protocols in the workplace, access to medical aid, counseling, stress management courses, etc. Given that the World Health Organisation (WHO) estimated that approximately one in four South Africans can be classified as obese, weight management, exercise and healthy eating programmes have become the popular focus areas. In the recent past, 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 being paid to a critical area that significantly impacts the psychological wellbeing of employees, their families and the economic wellbeing of employers – that of employee financial wellness. This is an area that warrants more as financial stressors potentially play a far greater role in influencing employee psychological health and stress levels than health stressors, which are the traditional targets for employee wellness programmes.

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

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

On the issue of financial wellness, the employer can play a more empowered role in affecting real positive change. And not just because it's the right thing to do and not just because it delivers a public good to our nation but also because it makes good business sense to get more involved in employees' financial wellness.

In fact, PWC's 2017 Financial Wellness Survey revealed that, in the US:

- 53% of employees found their financial situations to be stressful;
- 47% experienced a YoY increase in financial stress;
- Financial issues were found to be the leading cause of stress; &
- 50% of financially stressed employees 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. This is due to the reliance of South African employees on their retirement funds to build and create their lifetime wealth, and the responsibility placed on the individual to take ownership of their funding journey by virtue of investing within a defined contribution environment. Up until now, employers have not been able to evaluate, compare and track their employees' financial wellness.

The Sanlam Financial Wellness Benchmark is a newly developed diagnostic tool that will enable engaged employers to measure the level of financial wellness within their organisations (in aggregate and by various demographic dimensions), measure up to similar organisations or demographic segments, implement targeted interventions to address the area of concern highlighted by the tool within a specific segment of their workforce, and then measure the impact of the intervention over time on the financial wellness status of their workforce. It considers aspects of financial wellness beyond retirement planning and evaluates indebtedness, financial literacy and package composition, amongst other influential variables.

The Sanlam Financial Wellness Benchmark therefore gives employers the opportunity to efficiently and effectively manage the financial wellness of their employees by demystifying the drivers of financial stress and identifying the problem areas.

Simplicity, transparency and efficiency

by

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The South African retirement funding system needs to produce better financial outcomes for fund members but there are currently barriers that limit its ability to do so.

In particular, unnecessary complexity, inefficiency and a lack of transparency all interact to produce sub-optimal retirement outcomes. If we're going to succeed in moving more members to achieve better outcomes, then we need to candidly and collectively address the obstacles.

Sources of the Obstacles

Charging models

Many papers have been written to describe the complex charging models that exist within the retirement funding space. The various types of fees expressed in different forms across multiple providers result in consumers being unable to understand how much they are actually paying for services. At worst, there are fees that are not transparently disclosed by providers, leading to an even greater lack of understanding. As an example, the types of fees being charged include administration, performance, net-priced asset management, hedge funds, transaction costs, risk administration, guarantees, switching, investment platforms, etc.

Processes

The processes that we subject members to have unanticipated consequences, such as introducing layers of extra effort that add to the inertia that exists for many stakeholders.

The effort involved in the Section 14 transfer process acts as a significant barrier to employers and their consultants when transferring between umbrella funds, regardless of whether better alternatives exist. The recent requirement to obtain tax directives for each member further exacerbates the challenge of enabling employers to choose their umbrella fund provider.

FICA also acts as additional barriers for consumers to invest. An average employee changing jobs who does not have a large enough fund credit saved has very little economic incentive for a financial advisor. Similarly, joining a preservation fund can be unnecessarily complex due to the documentation involved. A more attractive and easier alternative might therefore be for the members to cash in their retirement fund benefit.

Distrust

There may be distrust permeating across the retirement savings industry. Advisors and consultants may distrust service and product providers, often based on historic conflicts. Similarly, consumers too may distrust advisors based on poor experiences received in the past. There is a definite distrust of government's ability to manage the savings of the nation. This was evidenced by the recent incorrect perception of the impact of the Taxation Laws Amendment Bill where some workers withdrew their retirement savings in an effort to protect their funds from being nationalized. Unfortunately, much of the distrust is grounded in the reality that consumers have been let down at some point and are wary to re-engage with a system that has disenfranchised them. That being said, distrust may be grounded in unjustified perceptions and needs to be addressed to enable greater degrees of financial inclusion.

Regulation

Often, the response to a breakdown in the trust relationship is increased regulation. This is certainly true of today, where we are experiencing wave upon wave of regulation. And while the intentions may be noble, the unanticipated consequences include increased cost of compliance, reduced competition and increased barriers to entry. An entire sub-industry has been developed to provide services relating to compliance with regulation, adding additional upward cost pressures in an environment where there is a fixation on reducing charges.

Regulatory uncertainty adds further complexity, reduces transparency and creates inefficiency as it becomes very difficult to plan for the future on a business or professional level. *It is critical that any new regulation aligns well with the intensions of the Pensions Funds Act as well as the needs of retirement fund members.*

When the forums for consultation have vested interests at play that are not necessarily aligned with those of the members it places the entire retirement fund system at risk.

Taxation

Taxation is complex by its nature and navigating the intricacies of funding within a tax efficient environment without specialist expertise is very challenging. The tax efficiency of retirement funding may not be fully appreciated as a result of the complexity of the system, which may lead to adverse behaviours.

Lack of independence

Agents of providers who only have a singular view, knowing only the product set of a given company, tend not to test the market or provide reasonable comparisons between potential providers. This leads to a strong status quo bias resulting in inefficient structures over time as clients are effectively locked into arrangements that may become progressively outdated. Ultimately, members bear the consequences of a fund within a sub-optimal context.

Product complexity

Many products are complex by design to provide perceived differentiation to the industry. Often, comparisons are difficult due to the various charging models at play as well as the incomparable 'bells and whistles' that integrate within the products. Members end up paying for features that they do not understand and may never utilize. Industry jargon adds to the product complexity as individuals are systematically excluded from engaging due to the code-words that we use in unsuccessful attempts to educate and communicate.

How do poor outcomes arise?

The interaction of the above factors results in increased costs (both monetary and non-monetary), reduced engagement and poorer outcomes as stakeholders throughout the retirement funding value chain are influenced.

Members disengage and follow the path of least resistance, which often leads to poor decision making, such as opting for a low contribution rate. This in turn may compound the negative impact on their retirement outcomes. Members feel overwhelmed, powerless and anxiety – a cocktail of emotions that can blind even the most rational investor and lead to bad decisions.

Consultants have to expend time and energy on navigating the maze for their clients in order to provide valid, accurate and complete advice that they are responsible and accountable for. This time and energy could be better used elsewhere in the quest to improve retirement outcomes – which would be possible if greater transparency and standardization existed. The current complexity creates an environment where many consultants feel disenfranchised and alienated. Their value-add is being questioned and many consultants believe that the platforms to have their views heard are lacking.

Funds themselves are faced with the risks of complexity and tend to favour the status quo, that is, if something is not irreparably broken, leave it as it is. The focus is on governance, compliance and managing red tape rather than having better member outcomes. In an uncertain environment, humans tend to narrow their focus to what has worked in the past, which may not be as appropriate into the future..

What is changing?

The retirement funding landscape has been changing and there are several major developments that address the challenges of complexity, lack of transparency and inefficiency.

The Power of Defaults

A carefully selected mix of defaults can help the majority of members to cut through the complexity of retirement funding. A single correct decision in the right ecosystem of defaults can set the member up for better outcomes. Such an ecosystem would consist of an appropriate default contribution rate, investment strategy, preservation fund, risk framework and annuitisation. More than 50% of consultants believe that defaults will enable members to save in a more efficient manner, result in increased preservation and that defaults will enable members to have incomes for life. The distrust mentioned above is still evident within the context of defaults as the majority of consultants are wary of providers who inappropriately channel funds towards their own capabilities. A common sentiment is that costs of defaults must be low and that investment portfolios should not be limited to those of the administrator.

Umbrella funds have already taken the lead with providers already introducing an integrated ecosystem of defaults as far back as 2015.

The rise and rise of umbrella funds

Employers have overwhelmingly begun the transition to umbrella funds, resulting in this being the fastest growing segment of the retirement funding industry. The ease of administration, lower costs and far less intense time requirements are the most commonly cited reasons for standalone funds to consider converting to umbrella funds. The umbrella fund model makes allowance for professionalised trustees who are able to focus on improving financial outcomes as governance and compliance requirements are satisfied within a scaled environment. This should release capacity for the employer and the consultant to focus on more value-adding components of the retirement funding system, such as communication and education.

Commercial umbrella funds have also taken the lead in driving innovation within the retirement funding arena due to competitive pressures. While stakeholders in standalone funds seem content to adopt a ‘wait and see’ approach, we find that the main umbrella funds and some of the newer entrants have taken the lead in implementing an ecosystem of defaults and benefit counselling. We believe that market forces will stimulate the umbrella product to evolve at a faster rate than the standalone fund model.

Technology

As the shift towards engaging members accelerates, member empowerment tools are becoming more available. From basic capabilities like short text messages (sms’s) through to sophisticated Fintech platforms that provide counselling, technology is being used to enhance members’ experience of retirement funding.

Technology has been the key driver of efficiencies within the industry by providing scalable platforms and reducing costs. The key issue here is that investing in new technology can be initially expensive with benefits that are only borne out over time. Providers typically need to do so on a regular basis to stay ahead of the curve and small players struggle to keep up with the pace due to high costs.

Generational shifts

The majority of the workforce have never heard of a Defined Benefits arrangement as these were phased out before they began working. Their attitude is geared towards – ‘What’s in it for me’ and rightfully so. Retirement is not a priority and we have to become more relevant to this part of our client base as they are becoming progressively more vulnerable. The language that we use, the emphasis that we take, the platforms used to communicate need to change with the times if we want to be and remain relevant. This generation is less tolerant of inefficiency and has grown up in a world of instant access to information. Many have never seen an encyclopedia because they have encyclopedic knowledge at their fingertips. Their need for a different style of engagement has resulted in various funds adopting communication strategies aimed at this emerging set of employees.

What still needs to change?

While progress has been made on a number of fronts, there are still areas where greater simplicity, transparency and efficiency can be practically applied.

Standardised risk policies

Group risk is effectively termed life assurance, and rebroked regularly with the freedom to switch between insurers. However, policy wording and certain conditions (such as exclusions, pre-exclusions, etc) differ between the various providers. Switching between insurers may carry risk as members may be prejudiced by the additional cost switching can incur. Typically, consultants would manage this for their clients by comparing policies and negotiating terms, which change over time. The proposed Policyholder Protection Rules also attempt to protect against this risk by requiring the CEO of the receiving company to provide written assurance in the replacement policy advice

record that the consultant has taken reasonable steps to satisfy themselves that the replacement policy was more suitable to the policyholder's needs than the policy that was replaced. Unless amended, this could arguably reduce the ability of consultants to switch insurers due to pricing differences. Differences in policy conditions may be difficult to replicate by the receiving insurer.

The possible solution to these issues is to have a standardized risk policy between insurers so that switching is easier to enable and to mitigate advice risk. While this may seem impractical given the respective commercial interests at play, we must note that 66% of funds and employers want standardized risk policies and that the vast majority of consultants interviewed believe in going this route. Complexity can be reduced and insurance will be easier to understand and communicate. Competition is still possible as insurers would still be able to differentiate by pricing, underwriting standards and processes, claims processes and repudiation rates. Comparing insurers on this basis would result in greater transparency. Like can now be compared with like without the noise created by bells and whistles.

Transparent charging structures

EEffective Annual Charging (EAC) was recently introduced in the retail space and will soon become a reality within the umbrella fund context. While there have already been valid criticisms of the measure, it does serve to address many issues. Our contention is that EAC, or an equivalent, needs to be introduced across the retirement funding value chain to enhance transparency and enable pricing decisions to be made with greater insight. Areas such as freestanding administration, asset management, fees attached to member level investment choice and annuities can be addressed. The consultants interviewed unanimously believed that charging structures were not transparent and more than 80% were in favour of introducing standard charging structures to reduce the scope of certain providers to shift fees. A common concern was that investment fees, in particular, were highly opaque and most were in favour of standardized investment fee structures being applied to portfolios.

Financial inclusion via the employer

The majority of employers indicated that they attempt to provide employee value propositions that serve the personal needs of employees holistically. These needs include financial inclusion, as almost 75% believe that their employee value propositions would be enhanced by providing access to financial services via the employer. Importantly, financial inclusion can be achieved via the framework of the employer by implementing interventions relating to financial literacy, budgeting practices, debt management, retirement planning and access to advice. Consultants believe that employees are the clients of the future and that a greater emphasis will be placed on serving their financial needs via their employer.

Investigative journalism in financial services

The financial press has a critical role to play in enhancing transparency within financial services by investigating and highlighting poor practices. Journalists have unearthed a number of political scandals in South Africa and a similar appetite needs to be displayed within the retirement funding space where there are longstanding rumours of corrupt practices. Such role players need to be called to account for their actions, especially given the socio-economic context within which such conflicted decisions are made. Our industry needs to function efficiently and we believe financial journalists can support this drive.

Conclusion

Stakeholders can address a number of practical issues immediately in order to take steps towards a simpler, more transparent and efficient funding mechanism. These would include:

- **Implementing a system of defaults that is simple, efficient and transparent**
- **Choosing partners that have the best technological enablers of better outcomes**
- **Finding and engaging excellent consultants**
- **Lobbying for standardized risk, and**
- **Using EAC where appropriate.**

The employee benefits industry in 2030

by

David Gluckman
Head: Special Projects
Sanlam Employee Benefits

> It is not in the stars to hold our destiny but in ourselves.
>
> William Shakespeare

"Predicting the future is easy ... getting it right is the hard part" **is a well-known adage associated with forecasting, but somehow I prefer the Shakespearean philosophy when thinking about the future employee benefits industry. We don't really need to make predictions when we control our own destiny.**

On 8 June 2016 Cabinet approved recommendations for overhauling our fragmented social security system (Figure 1) and the associated long-awaited Comprehensive Report was finally released in late November 2016. Already the Nedlac negotiation process on these recommendations has commenced.

Most commentators understand and support the need to reduce inequality in South Africa. Furthermore there are no doubt multiple inefficiencies in our current social security framework that should be eliminated. But I have my doubts about whether one of the central proposals can work for South Africa; that being the creation of a mandatory and contributory National Social Security Fund (NSSF) and specifically the retirement savings component thereof.

SOUTH AFRICA'S SOCIAL SECURITY SYSTEM

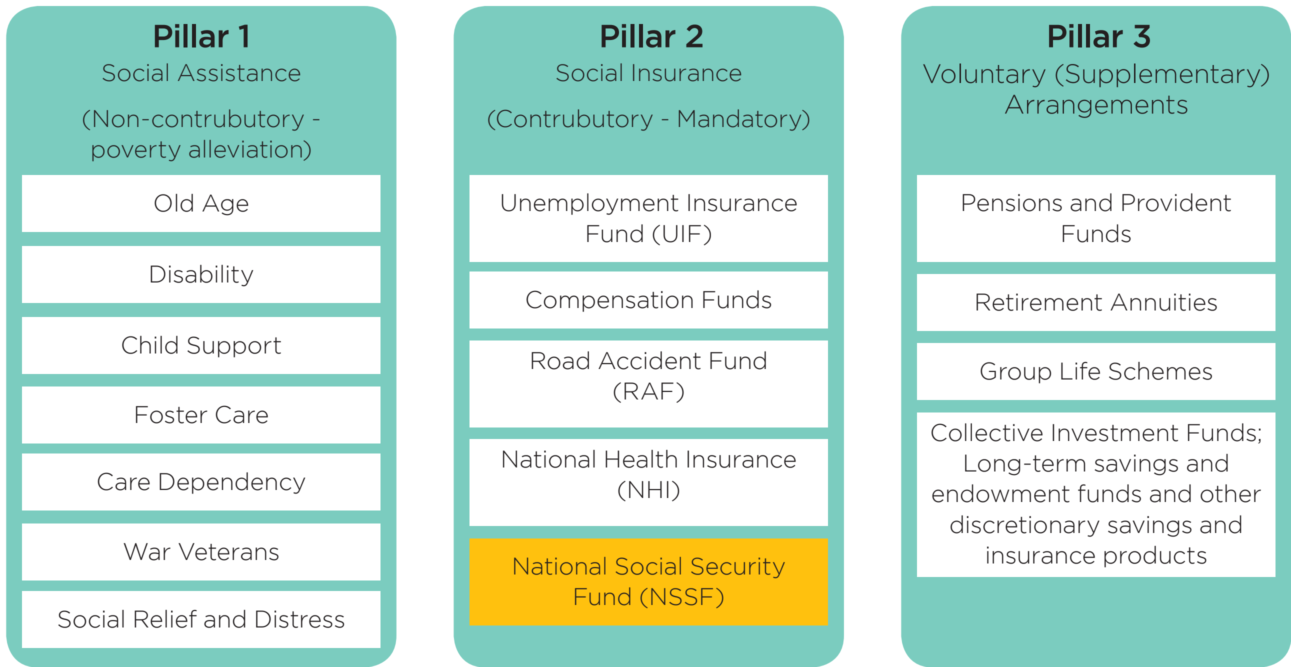


Figure 1

I have previously explored this subject matter in a paper presented to the Actuarial Society of South Africa in 2009[1] , and as captured in the following thoughts

"The needs of the vast majority of the population would be better served by concentrating our efforts on decreasing unemployment rather than imposing a mandatory new retirement funding model that might well pull in the opposite direction by increasing the cost of employment. A sensible approach would be to try to gradually increase in real terms the amount of the Social Old Age Grant – economic growth and reduced unemployment being necessary pre-conditions for such a policy to be successful."[2]

There are so many challenges to the successful implementation of the NSSF that I cannot envisage it being successfully implemented by 2030.

But that doesn't imply we cannot radically improve the current South African retirement fund system. We made this call as far back as the 2009 Sanlam Employee Benefits Benchmark Symposium, and this has also been a key initiative of National Treasury for the past five years, and not without some successes.

A central thrust of these reforms has been consolidation of the industry in order to reduce inefficiencies and gain economies of scale. This success is illustrated by Figure 2, and introduces the base for continued further gains.

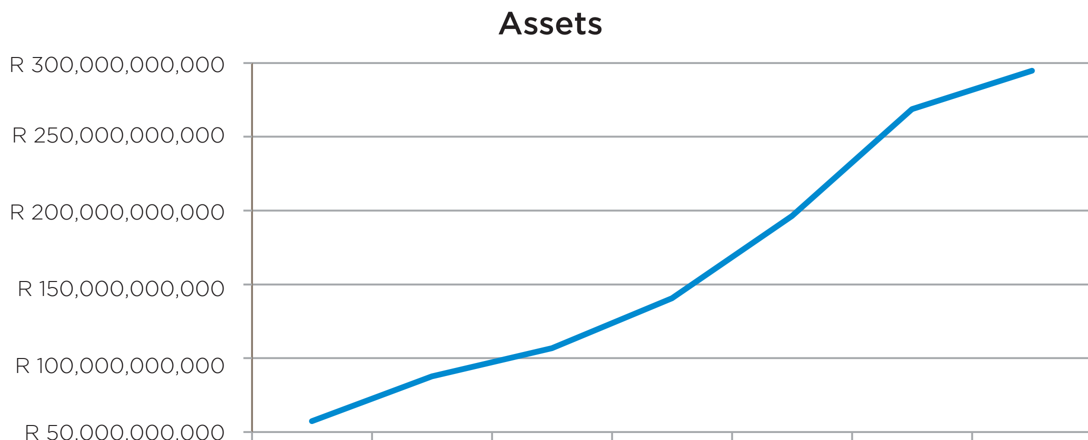


Figure 2

[1] Retirement Fund Reform for Dummies, Actuarial Society of South Africa Convention, 2009

[2] Guest Editorial, South African Actuarial Journal, 2010

The Benchmark Survey and our other research reveals quite a few successes achieved by commercial umbrella funds:

1. Average members' provision for retirement increased from 9.9% of salaries in 2009 to 14.2% of salaries in 2017.
2. Average reductions-in-yield for the Sanlam Umbrella Fund fell from 1.90% in 2011 to 1.66% in 2016.
3. Effective competition has significantly increased as measured by the number of significant recent new entrants to the market.
4. ASISA has already launched an Effective Annual Cost ("EAC") mandatory industry standard for retail savings products, and plans are far advanced to extend to the institutional market in the near future.
5. Government has also simplified the retirement savings landscape by harmonizing the tax treatment of pension funds, provident funds and retirement annuity funds.
6. Default regulations are anticipated to be finalized during 2017, and some funds have already implemented institutionally priced In-Fund Preservation and In-Fund Annuity options.

This is where I have chosen to concentrate my efforts. I prefer to concentrate on working every day to improve outcomes for members than to engage in endless debate on a theoretical possible future system.

So it's not so much me looking into a crystal ball to inform my view of the industry in 2030 (Figure 3), but rather looking and extrapolating what has already been achieved.

Figure 3

I believe this can work and how well we succeed as an industry is entirely up to us!

The need for advice in an ever changing environment

The evolution of advice

by

Avishal Seeth
Branch Head: Gauteng
Simeka

There are many people who will remember advisors driving from house to house selling various financial products to willing buyers in a time when purchasers of these products bought based on a concept we refer to as TRUST.

I'm sure that we can all agree that the landscape has changed a bit since the above-mentioned days.

In a world in which the rate of change is faster than the rate that research can actually keep up, gaps have opened up for those who think innovatively and are open to taking chances. This scenario plays out on a daily basis in the fast growing start-up industry where gaps or opportunities are identified as a result of improvements in technology and changes in the legislative environments. This is what start-ups have learnt to capitalise on.

Advisors to retirement funds and their members

Let's focus on advisors to retirement funds and advisors to members of retirement funds. We are aware of the numerous changes in legislation over the recent past and the manner in which advice had to be adapted to meet the demands of these changes. With the imminent adoption of default regulations, the role of the advisor has come under the spotlight even more so than in the past. Is your advisor able to hold your hand along the process of assessing the needs of the members of your funds and then suggest appropriate defaults based on these findings? Umbrella funds have been the forerunners in preparing for the adoption of default regulations. Not surprisingly, the default in-fund annuity option from the different providers varies significantly from one provider to the next. It's clear that this adds another consideration when deciding on the appropriate umbrella fund for your staff and only a capable advisor will be able to take you through this process.

Retailisation of institutional products

Aside from the obvious changes in regulations, the changing face of the actual client has resulted in providers and advisors being forced to review their approach and strategy when it comes to an advice framework. Understanding that we are now in a world of 'retailisation' of institutional products, (umbrella funds and the like) is key to ensuring relevance in the industry. Indeed, the actual clients are less and less the boards of trustees and joint forum members but more so the employers and fund members themselves. This change in focus has caught many advisors unaware.

The rise of digital

By far, the biggest contributor to the advisor evolution are the numerous advances in technology. Much has been said about the younger generations (millennials and Gen Y) and their inclination towards making decisions regarding finances, based on information provided via a digital platform. The comfort that they display in using these digital platforms has made many Gen X and Baby Boomers cringe at the thought but we cannot blame the younger generation as they've grown up in a digital world and

have learnt to use technology as a part of the everyday life. Indeed, many feel that removing technology from these so called digital natives will render them helpless! What is a surprise for some is the ease that the older generations have demonstrated in embracing technology and ease and convenience that technology has brought about. The Nielson Institute in the USA conducted research regarding social media usage across all generations and results actually showed that Gen X was the biggest user of social media!

Robo advice

Robo advice has been a hot topic recently and the Benchmark research shows that three out of five umbrella fund members would consider using robo advisors and half of stand-alone fund members would consider using robo advisors. This represents the biggest shift in the retail advice landscape in recent years. Would you consider making a financial decision based on advice from a robot? Offshore we've seen an increase in the use of so called algo trading where advanced and complex mathematical models are used to make high speed decisions and transactions in financial markets via computers that control the trading at a rate that humans cannot keep up. The real attraction of these algo-trading platforms is that they come at half the cost of traditional investment portfolios… Are you comfortable making investment decision with no face to face contact with an advisor?

We believe that advice today is more important than ever. In the South African socio-economic context, we know that we are a nation in need of saving. This saving must be enabled by advisors because there is a large amount of misinformation regarding changing tax laws that does not encourage a savings culture. The environment has also led to members being disengaged when it comes to savings and eventually the very same members are reliant on social grants, their children and greater society for support. The future excellent advisor must be able to consider the above and engage members in a constructive manner so that they understand that their ultimate financial outcomes are dependent on their choices now.

Consolidation

Consolidation has been spoken about ad nauseam in the past. Some of the challenges that consolidation brings about includes cost pressures, increased competition and buy outs of smaller advisory firms.

The **Retail Distribution Review** (RDR) poses significant regulatory reform which in turn will bring about significant advisory reform for many advisors. Independence is going to be true independence going forward with registered financial advisors not being tied to any single product house. This includes ownership as well as percentage of revenue tests. For Product Supplier Agents (PSA's), there are benefits of being associated with a product house including: capital, security, brand strength, and the already proven success of this model. But does this model allow for the client to experience all possible solutions? The real risk is that the client does not get exposure to a solution that may be more suitable for them as result of the PSA only selling its product house solution. It is clear from the steps that advisors and product houses have taken thus far that the implementation of RDR is less of a regulatory debate but more a debate about business models.

The future excellent advisor will look to diversifying their income streams and not focus just on advising a Board of Trustees regarding the retirement fund. The future advisor will recognise that there must be symbiosis between all service providers who attend to all employee benefits components. These include: medical aid, financial planning and wellness. The excellent advisor will recognise the value of financial literacy training to members in South Africa's current socio-economic context as the start to empowering individuals to make the right decisions at all points in their lifetime, (not just when changing jobs or retirement), so that they are able to optimise the total wellness outcomes of themselves and their families.

We believe that the 'excellent advisor' will be he/she who is able to combine all of these aspects: the retirement fund, medical aid, wellness offerings, financial literacy and engaging member communication, so that the whole is greater than the sum of its individual parts. This is the advisor who will thrive into the future.

Are our retirement fund systems still effective?

Many countries are reporting that a significant number of their retirement fund members are no longer able to retire comfortably and that prospects for the future look even bleaker.

by

Kobus Hanekom
Principal Officer: Sanlam Umbrella Fund
Contracted Principal Consultant:
Simeka Consultants & Actuaries

This topic will be discussed in more detail at a plenary session of the International Pension and Employee Benefits Lawyers Association conference in Prague later in 2017.

At Sanlam Benchmark, we have investigated the key criteria responsible for "good retirement outcomes" over a number of years. We are predictably keen to find out why it is that the pension models implemented by countries all over the world are no longer delivering the desired results. Which of the many shifts that are taking place in the world and in the retirement fund industry are making it that much more difficult, especially for millennials, to provide for a dignified retirement?

The countries that will participate in this discussion are Sweden, the United States and South Africa. A very interesting and divergent mix. Sweden is a Nordic country with a homogenous population. The United States has been the biggest and most affluent economy in the world for many years and South Africa is in the developing market with a mix of first and third world economies.

In preparation for the plenary, we did a comparison of these jurisdictions, based purely on the reports available on the internet.

Misery index

According to Bloomberg's misery index, South Africa is the second most miserable country to live in (out of 65 countries) with a score of 32.2, Sweden is 39th with a score of 8.3 and the USA is 49th with a score of 7. The misery index is calculated by adding together the forecasts for a country's rate of inflation and unemployment. South Africa's unemployment rate earned it the second place. The rate of youth unemployment is around 48% at present.

The world's richest and poorest countries

According to Global Finance, the USA is the 13th richest country with an annual GDP per person of USD 57.293. Sweden is 17th with an annual GDP per person of USD 49.678. South Africa comes in at a "respectable" 93rd with USD 13.179. To put SA's position in context one should take into account that a neighbour such as Mozambique is almost last on this chart at no 183, with USD 1.228. To rank the world's richest and poorest countries for 2016, Global Finance considered GDP per capita adjusted for relative purchasing power.

Melbourne Mercer Global Pension Index 2016

This Global Pension Index compares retirement income systems in 27 countries. They benchmark each country's retirement income system using more than 40 indicators. They also highlight some shortcomings in each country's system and suggest reform in the areas of adequacy of retirement benefits, sustainability over the longer term and integrity and trust in the pension system.

Sweden was graded B with an index value of 71.4%

Overall: 71.4 **Adequacy:** 67.6 **Sustainability:** 69.5 **Integrity:** 80.3

"Sweden's retirement income system was reformed in 1999. The new system is an earnings-related system with notional accounts. The overall system is in transition from a pay-as-you-go system to a funded approach. There is also an income-tested top-up benefit which provides a minimum guaranteed pension."

The United States was graded C with an index value of 56.4%

Overall: 56.4 **Adequacy:** 53.5 **Sustainability:** 57.1 **Integrity:** 59.9

"The United States' retirement income system comprises a social security system with a progressive benefit formula based on lifetime earnings, adjusted to a current dollar basis, together with a means-tested top-up benefit; and voluntary private pensions, which may be occupational or personal."

South Africa was graded D with an index value of 48.6

Overall: 48.6 **Adequacy:** 34.0 **Sustainability:** 44.7 **Integrity:** 77.3

"South Africa's retirement income system comprises a means-tested public pension and tax-supported voluntary occupational schemes."

SA did well on integrity (governance) with a score of 77.3%, just 3 % below Sweden. The country however lagged on adequacy and sustainability. It compared particularly poorly on the following criteria (schedule below). The average replacement rate (projected pension) at retirement is estimated to be below 20% on average – primarily as a result of members taking their benefits in cash when they change jobs. The household savings rate is very low. Too many persons in employment do not belong to a fund. Although the mean contribution rate (for those who do belong to a fund) is relatively high (2017 Sanlam Benchmark Survey - 18.57%), the average, including those who do not belong to a fund is low.

Labour force participation for those over 55 years is low and the system is therefore not able to deal effectively with the effects of increasing longevity. The qualifying age for the government old age pension is 60 in contrast to age 66 to 67 in most other jurisdictions. The normal retirement age of many corporate funds is also 60, primarily to support transformation policies. Government's capacity to formulate and implement quality policies came under the microscope with the implementation of the compulsory annuitisation requirement for provident funds. The likelihood of political instability relating to retirement reform measures are considered to be high.

	Indicators	SA	Sweden	USA
A2	Pension replacement rate	0	7.2	5.5
A3	Household savings rate	1	5.2	5.3
S1	Percentage of working population that are members of retirement funds	1.3	10	4.9
S4	Mandatory contribution as a percentage of wages	0	5.7	2.1
S5	Labour force participation rate for those over 55 years	0.7	8.3	6.1
R5	• Governments capacity to formulate and implement quality policies and promote private sector development • Citizens' confidence in the rules of society and the institutions that exercise power • Likelihood of political instability	2.8	9	6.9

The organisers of the Melbourne Mercer Global Pension Index made the following recommendations to improve the overall SA index value:

- Increase the coverage of employees in occupational pension schemes, thereby increasing the level of contributions and assets. *Comment: Government has already identified the implementation of auto-enrolment as a priority.*

- Introduce a minimum level of mandatory contributions into a retirement savings fund. *Comment: With auto-enrolment, a minimum contribution will be prescribed.*
- Increase the level of preservation of benefits when members withdraw from occupational funds. *Comment: The P-Day measures proposed by Government will achieve this. Given the levels of unemployment, it will not be possible to enforce preservation of the entire benefit. This is likely to be a very difficult matter to reach consensus on in the current political environment.*
- Introduce a requirement that part of the retirement benefit from provident fund arrangements must be taken as an income stream (this requirement currently only applies to pension funds and retirement annuities). *Comment: Compulsory annuitisation for provident fund members will kick in from 1 March 2018 if consensus can be reached between Government and the unions*

From a structural perspective, the private retirement system in South Africa is doing well - in context. Our institutions and retirement funds are generally strong and well run. We know what has to be done (by the Government) to align with the key indicators. The jury, however, is out on the future challenges posed by the gig economy.

In this new economy, temporary positions are common and organizations contract with independent workers for short-term engagements. Think Uber, Air bnb etc.

The trend toward a gig economy has already begun. Intuit predicts that by 2020, 40 percent of American workers would be independent contractors. The McKinsey Global Institute surveyed some 8,000 respondents across Europe and the United States in October 2016. They report that 20 to 30 percent of the working-age population in Europe and the United States engage in some form of independent work.

They identify:

- Free agents, who actively choose independent work and derive their primary income from it (30%);
- Casual earners, who use independent work for supplemental income and do so by choice (40%);
- Reluctants, who make their primary living from independent work but would prefer traditional jobs (14%) ; and
- The financially strapped, who do supplemental independent work out of necessity (16%).

The gig economy is creating a new generation of entrepreneurs with different needs and aspirations and with it, a new definition of financial freedom and retirement provisions.

The gig economy will place enormous pressure on the existing infrastructure and the legal framework and will require an additional set of rules.

ost retirement fund systems are not even able to deal effectively with the self-employed. The ability to effectively bring freelancers into the net and help them secure good retirement outcomes is a challenge that will require us to think and find solutions on an entirely different level. Can we, for example, accept that freelancers will be able to phase out of “work” into “retirement” just before they run short of energy, health and finances or will we have to implement special social security measures to provide for this group of near nomadic citizens?

Improving retirement outcomes for members through administration

It has become the mantra for all role players in the retirement fund industry:

anything you do should be done to ensure the best possible retirement for your fund members. This is especially true in South Africa with its notably poor savings culture. So, where a member does save, we want to be sure that every single person who plays a role in that process does their best to maximise the savings opportunity for that member.

by

Johan Prinsloo
Product Owner:
Retirement Fund Administration
Sanlam Employee Benefits

The basics

Simply put, a modern retirement fund administration model can be likened to a banking savings account where a customer can make monthly deposits, earn interest and at some point withdraw the deposit or savings held in the account.

Have you ever thought about how the bank keeps track of the end-to-end process of a deposit and withdrawal? Consider the following banking activities:

Bank	Administrator
Receives a deposit from a customer into a bank account	Ensures a members contributions go into a retirement fund
Invests that deposit into a financial product to earn interest	Transfers contributions to an investment manager to invest in the market
Keeps record of where the deposit is invested	Keeps accounting records of the Fund's investments
Allocates the interest to the customer	Receives investment returns from the investment manager and allocates this to the member's record, reflecting an increase or decrease in the unit price
Maintains recordkeeping on the customer's deposits, withdrawals and interest earned	Keeps and maintains individual member records and updates these to reflect unit prices and units purchased
Should the customer call for it, liquidates the account and pays the deposit out in cash	Processes a withdrawal benefit

In addition to the above, the bank makes accounting entries in its general ledger to produce a trial balance that keeps track of all the various transactions – deposits, fees, investments, investment returns and withdrawals. The bank must also compile cash flow statements to make sure that money reaches its destination in time and that there is enough cash available to pay for expenses and withdrawals.

Why keep track of cash flows?

Our Benchmark survey results indicate that approximately a third of funds rank tracking of cash flows as among the top five administration processes. Only a quarter believe that daily asset and liability matching is important. This indicates a lack of awareness among respondents as to the critical importance of these capabilities.

Most administration models allow for a match of member credits (deposits) back to investments on a monthly, quarterly or annual basis. With every match - in fact, at any given point in time - there may be a mismatch of up to 2% between the assets and liabilities (this is the maximum allowed by the FSB). The explanation would likely be that this is due to timing differences between the administrator's records and the investment manager's records.

Now imagine if your bank told you that R2 000 of your R100 000 investment was unaccounted for due to "timing differences" and that because of this, the bank was not really sure where the R2 000 was. Would this be acceptable to you?

Let us assume for a minute that the bank did not give you a fixed interest rate, but instead allowed you to earn the actual investment return of your deposit (your investment in the market) on a daily basis. Wouldn't you expect the bank, as the custodian of your deposit, to be able to track - on a daily basis - whether your R100 000 was actually invested and if it had been invested in a timely manner by the investment manager? Should the bank not know immediately whether the investment manager had deducted the incorrect investment fees? What if your investment returns were not in line with the portfolio you were invested in – should the bank then not pick-up on this immediately and query the discrepancy? Would you trust such a bank's capability to securely and robustly manage your hard-earned money in 2017?

The point is that any modern bank should be in control of the end-to-end process of your deposit and withdrawal. This is especially necessary where the bank agrees to pay you the actual investment return earned on your deposit (your investment in the market) on a daily basis. Similarly, we believe that a retirement fund administrator must have sight of the end-to-end process of a member fund's credit. Doing so is the only effective way that an administrator can provide assurances that all assets, liabilities and cash flows are accounted for at any given point in time. It is simply not good enough to leave this to chance.

Layers of Administration

Apart from the basics explained above, there are many layers when it comes to the administration of a retirement fund and this highlights the need to keep track of the end-to-end processes.

To explain further, let's start with the first one mentioned above, daily pricing.

a. Daily Pricing

Investment returns are allocated to defined contribution fund members on a daily basis, so it is imperative that all cash flow and administration activities take place as quickly as possible to keep members invested in the market for as long as possible. For every day that a member is not invested in the market, the member could lose out on investment returns. This means for example, that contributions must be paid to the investment manager within the agreed turnaround times as per the Service Level Agreement (SLA). The process does not stop there, though.

For the same reason, the investment manager must in turn invest contributions into the market as quickly as possible. If the daily cash flow between the administrator and the investment manager is not monitored daily, it is not possible to know whether the investment manager has invested contributions according to the agreed SLA. What if there was only a quarterly reconciliation between the cash flows of the investment manager and the administrator? In this instance, it would be possible for a member to lose out on an entire quarter's investment returns before any potential investment deposits missed by the investment manager were identified.

Cash flows between the administrator and investment manager are monitored on a daily basis. In this way, the administrator can immediately track whether the investment manager has missed a deposit, or has not invested according to the SLA, or establish which amounts are in transit to/from the investment manager. Monthly pricing leaves far too many missed opportunities to sufficiently improve member outcomes.

b. Unitisation

According to our Benchmark results, almost 50% of funds prefer it if the benefit administrator also provides unitisation and pricing services.

However, the question is why do we calculate our own unit prices from market value files already provided by an investment manager and not simply use the unit price provided? The reason is simple yet crucial. It is difficult to determine exactly how the unit price is made up or how the investment manager has calculated it. Consider the banking example again: if the bank allocates investment returns to the customer in the form of a unit price, surely the bank must know:

- what the gross investment return is, as well as the type of investment return, i.e. capital growth, dividends, interest, etc.;
- what costs, fees and charges have been deducted from the investment return;
- how the investment actually grew or did not grow; and
- whether underlying investments in the portfolio were rebalanced to align it with the portfolio mandate.

The bank must also be able to account for all these transactions in its general ledger, in order to produce financial statements. If like other administration models, the bank only reconciles assets and investment returns on a quarterly or annual basis, imagine the mammoth task it would be to record all these transactions on the fund's general ledger at year-end. Modern administrators pay attention to the detail and handle clients' money with complete discipline.

What if the assets held by the investment manager do not balance back to the corresponding member fund credits held by the administrator? Who will then be held responsible for the reconciliation? What margin of discrepancy will the Board of Trustees tolerate?

By reproducing the asset database of the fund from the market value files received from the investment manager on a daily basis, the administrator can calculate a unit price and from there onwards, you can expect a lot more control and data integrity:

- correctly, and in a timely manner, account for investment transactions on a daily basis;
- match investment transactions (assets) and member transactions (liabilities) on a daily basis;
- resolve discrepancies with the investment manager in a timely manner; and
- account for income types and capital movements in the general ledger on a monthly basis.

Correctly accounting for income types is a challenge in itself. The following income types must be reported on:

- Interest
- Dividends
- Realised profit
- Unrealised profit
- Foreign exchange gains/losses

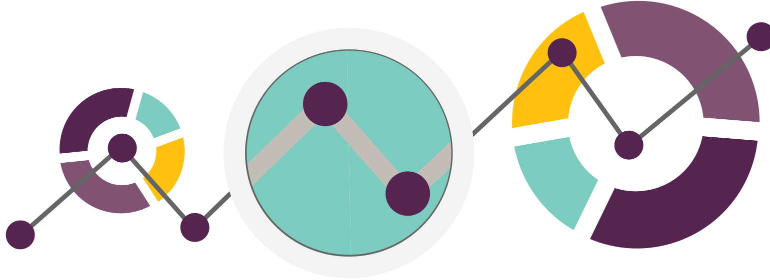
There is also another reason why it is important for the benefit administrator to calculate daily unit prices. Should an investment manager use an incorrect market value (on an underlying securities level) to calculate the unit price, or deduct the incorrect investment management fees from the investment return, it would mean that the unit price loaded on the member administration system would be incorrect. All the transactions that follow – contributions, switches and exit payments – will therefore all be done against the incorrect unit price. A fund administrator who does not carry an asset database and reconcile market value files of the investment manager daily, could let such a mistake go undetected for months. If all the transactions for that day are not redone, the recorded growth from there onwards would also be incorrect, as the investment growth is compounded. An error that is only discovered at year-end can have far-reaching consequences and possible losses for the fund – and the individual member. This would have a detrimental effect on member outcomes.

c. Performance Tracking

In addition to the activities set out above, modern fund administrators are also able to check whether investment returns reported by the investment manager correspond with the benchmark of that particular portfolio. If the return moves outside of the benchmark, attentive administrators will query it with the investment manager, and will not utilise that price to allocate returns to members until the issue has been resolved. In this way, modern administrators protect the integrity of the data loaded onto their administration system, by applying reasonability tests to the market values provided.

It could be argued that this is service not necessary – why not simply rely on the input from the investment manager? However, the risk is just too great – should the unit price be wrong, thousands of transactions in the fund could over a period of time also be wrong. Such an event would jeopardise data integrity and could result in mistrust amongst members. Modern fund administration means doing the right things in the right way.

Retirement matters: What is your number?



We are constantly measuring our wealth and health. The number of steps we take per day, our average heart rate per session, our smart shopper points, rewards, e-bucks, share portfolios... name it and we measure it.

by

Karen Wentzel
Head: Annuities
Sanlam Employee Benefits

But how often do we look at or know whether we are on track for arguably one of the most important events of our lives, that event known as "Retirement"? And more importantly – do we know what to measure or even how to get there?

Confirmed in the BENCHMARK Survey 2017, the two most important questions and burning issues in the financial planning process are:

- Exactly how much should I retire with? What is the final amount?
- How much must I save (monthly/annually) to retire comfortably?

Why are people so confused? In the BENCHMARK Survey 2017, 100% of funds indicated that their funds have a stated target pension (expressed as a NRR or PPR) that trustees actively work towards. Let's start by reminding ourselves what a NRR is. NRR is a Net Replacement Ratio and it is the percentage of a member's pre-retirement income that is paid out by a pension plan upon retirement, divided by his pre-retirement salary. It is a common measurement that can be used to determine the effectiveness of your pension plan. But is this measure effective if 40% of funds in the BENCHMARK Survey 2017 believe that NRR is not a suitable measure for determining whether a member is on track for retirement? The main reasons being that members do not understand the measure and the fact that there are too many variables and assumptions used in the calculation of the ratio. One of the biggest areas of concern is that most of the funds define pre-retirement salary as "pensionable remuneration", also referred to as PEAR, which can be any percentage and is normally less than 100%.

It could be argued, therefore, that NRR is not a suitable measure for determining whether an individual is on track for retirement. So what should your number be?

An easy number/measure for members to understand the exact amount that should be saved, it to express your retirement savings as a multiple of your current salary at different points in your life:

The question is: What multiple of current salary should a member save, assuming a retirement age of 65 years, with the following assumptions:

- A member saves 15% per year of annual salary (including the annual bonus/13th cheque)
- Investment returns of 10% per year
- Salary increases of 6.5% per year
- In the event of a married couple, both members contribute towards retirement savings.

Years worked	Multiple of current salary saved
5	1.2
10	2.3
15	3.7
20	5.3
25	7.2
30	9.4
35	12.0
40	15.0

What if you haven't started saving at age 25?

For those members who have not yet started saving by the age of 25, saving only 15% per year will unfortunately not lead to a multiple of 15 times final salary at retirement. The late starters will need to save much more every month. The following table sets out the percentage of salary needed to be saved if you are starting saving for the first time at later ages:

Based on these assumptions and a goal that a member should have a multiple of 15 times his/her final salary saved at retirement, the following table sets out some goalposts along the road to retirement as illustrated in the following table.

And remember that 15 is more than just a number. Currently for each R1million that a 65 year old member saves, a male will receive a monthly pension of around R 6 000 per month and a female (because of the longer life expectancy) will receive around R 5 400 per month, growing with inflation every year. So to invest in an inflation-linked annuity at the age of 65, a member would need to have saved 15 times their final salary by age 65 to afford to buy an annuity that will replace their salary.

Start saving at age	Percentage of salary needed to save
25	15%
35	24%
45	43%
50	60%

In what products should you save for retirement?

For the current group of Generation Z (millennials) who don't have any idea of what a Defined Benefit regime is, who don't know anything about net replacement ratios (NRRs) and who are moving on to a new mindset of flexibility and choice, they should consider a combination of products. You may consider saving not only in a traditional pension or provident fund, but also supplement your retirement savings with retirement annuities, a tax-free savings account, retail government bonds or an ordinary unit trust, which will give you (and especially Generation Z) more flexibility in terms of investment choice and accessibility to their investment.

Other methods to boost retirement investment

1. The first golden rule is to never cash out your retirement savings when changing jobs. This is still the biggest mistake that members make during their lives. Do not be tempted to access your money to pay off debt, buy consumables or upgrade your lifestyle. Do not even cash in your allowable third of your pension fund or retirement annuity, as the long-term need for a higher monthly pension is much more valued than the short-term luxuries that you are going to buy with your money.
2. Retirement savings should be as important a financial priority as a well-deserved holiday, rather than just a nice-to-have budget item. Know exactly what percentage of your monthly salary and annual bonus you have to save, and put in place an automatic debit order to keep you from the temptation of spending your salary on consumables.
3. Invest wisely, tax efficiently and know exactly what you are paying in fees. Seek advice from a certified financial advisor and be sure to invest according to your investment time horizon. Investing for retirement is a very long-term goal, so make sure you are sufficiently invested in aggressive assets (such as equities or listed property) to give you inflating-beating investment returns of at least 10% per annum after fees.

If you don't have a goal, there is nothing to aim for. Make sure that you know your "final number" is and make the best effort to stick to the plan to achieve it.

These rules of thumb discussed may not account for all personal circumstances. A sudden spike in your salary may mess up your multiples for a year or two, but be sure to have your retirement savings goalposts in place. Allocate any extra cash to retirement and not to a luxurious lifestyle. This is the best possible gift you can give yourself in your golden years.

The real truth about beneficiary funds in South Africa

by

Sankie Morata
Chief Operations Officer
Sanlam Trust

A colleague of mine once shared two stories from when she started working in this field. She always felt that it was special but over the years, she had seen it grow into something more beautiful and believed that more good was still ahead.

I share two stories that remained close to her heart.

Those left behind

I met Calvin 4 years ago when he was just about to turn 18. He was the head boy of his school and his mom had just passed away. He is an incredibly bright child. Because he was turning 18 years old in a couple of days from the claim being processed, the death benefit could pay out to him directly. The great team at his late mother's HR department told him of the beneficiary fund and the service that they had received from us.

He arranged for three companies to come and present to him, to help him decide what to do with his money. I remember presenting to him and his principal. A couple of days later he told me that he chosen our service. He had all his plans in order, what and where he would study after school, where he would live and how much it would cost. He even factored in a little car after he matriculated. He was so strong, so organised and remarkable. After his mom died, he had no place to stay so his church took care of his accommodation. He cooked and cleaned for himself. He matriculated well and kept in touch with me to tell me his results. He is a very successful student and I know his mother would have been proud of his achievements.

The second story is about another boy who was 7 years old when his mother passed away. He had to relocate and went to stay with his grandmother and grandfather in Vosloorus. A new home, a new school, a new life without mommy. I had a meeting with the family and they told me that they wanted to take care of him financially. The money that was left to him by his mother had to be invested and grown for him until he needed it. It was amazing that his aunts and uncles all put together what little they had for him. Unfortunately, soon after that he took ill and needed the beneficiary fund to take care of his medical bills. After a year, his asthma was under control, he had come to grips with the loss of his mother, and he had settled in and was doing well.

These are very real circumstances that the children of deceased parents have to face. There is a lot of turmoil and a serious emotional impact after the death of a parent. There are many child-headed households which social workers need to monitor; there is considerable poverty and educational needs.

The beneficiary fund industry is aware of these concerns. We must do what we do to the very best of our abilities and endeavour to make the entire process more comfortable for the families left behind.

The Beneficiary Funds in South Africa are regulated by the Pension Funds Act No 24 of 1956.

The Pension Fund industry and the regulator were concerned about the status of death benefits being administered for minor children, widows and other dependents. In order to improve governance, oversight and reporting, in 2008 they brought to life the "Beneficiary Fund" that can (inter alia) cater for the financial needs of children.

South Africa is ahead of our neighbouring countries in its legislation that protects these beneficiaries to ensure that there is money available for their maintenance, sustenance and education. In the future, it is this education that will make these beneficiaries our leaders.

Advancing through technology

Advances have been made by the industry with the use of the technology available. Now guardians can be kept quickly informed of developments by communicating with them via their cell phones as opposed to waiting for the post.

On the technological side, we are at the forefront of progress to make the payment of benefits faster, easier and more accurate. Communication is faster and far more effective than it was10 years ago. Beneficiary funds strive to give children the best sustainable growth for their investments, while still keeping maintenance going and keeping in line with the prudential provisions of Regulation 28.

Sanlam Trust Beneficiary Fund makes it easier for the guardian with regard to their "annual alive status", by going directly to the Department of Home Affairs to check on the status of beneficiaries. Furthermore, there are advantages that were negotiated on a corporate level with companies such as Edcon and Shoprite which ensure discounted purchases for the guardians.

The most important factor is the personal touch. This is something as simple as the time spent to talk to the guardian or caregiver. Giving them that care. Taking the time to talk to them and to establish what the needs of the children are under their care. Understanding their circumstances and lending an ear. Going out to meet the guardians and having roadshows, allowing them to interact directly with the fund and answering their most worrying questions. This is the traditional personal touch that we at Sanlam Trust Beneficiary Fund want to keep.

There are many beneficiary funds in South Africa. Each of the beneficiary funds has to comply with the regulations, governances and responsibilities set out before them. The trustees of these funds are responsible for the policies they draw up in terms of Pension Funds Circular 130. Yes, the management of the beneficiary fund is different from the management of a retirement fund; it is multi-layered and ever growing. The relationships are now not only with the guardians and beneficiaries but also the industry at large. It is good that the beneficiary fund is regulated as this provides alternative recourse for guardians who are uncomfortable, via the Pension Fund Adjudicator.

This is an active, hands-on business that plays an important social role in our society and endeavours to bring true value to the lives of children.

I know that in 10 years' time we will see a more efficient and innovative product, but at the heart of it, it will always be to do what is in the best interests of our children's futures.

Umbrella funds: research overview

by

Irlon Terblanche
Chief Executive Officer
Sanlam Umbrella Solutions

This is the ninth consecutive year that we have undertaken a separate study on umbrella funds. As a result, sufficient history has been accumulated to meaningfully analyse the emerging trends. Once again, we surveyed 100 employers that participated in umbrella fund. In addition, this year qualitative interviews with 16 independent brokers were held to obtain their views.

by

Shakeel Singh
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Sanlam Umbrella Solutions

The survey is easily representative of the commercial umbrella fund market, as an overwhelming 92% (2016: 88%) of employers (in line with overall industry trends) participate in one of the "Big 5" commercial umbrella funds sponsored by Alexander Forbes, Liberty, Momentum, Old Mutual and Sanlam.

Notable trends

Some of the key emerging trends that were picked up during this year's survey included the need for *transparency of fees* and what we call the *"retailisation" of the institutional market*.

It was pleasing to note that both employer and employee *contribution rates have again increased* compared to the previous year. More employers are also allowing their members to select their own contribution levels.

The trend by employers to move into an *inclusively costed arrangement* is worth noting. Although this allows the employer to contain costs, any upward pressure on costs can impact a member's NRR (Net Replacement Ratio).

With the recent trend of administrators including their administration costs in the asset management fees, participating *employers are now placing a much greater weighting on the transparency of costs*.

In a world where freedom of choice is becoming ever more important, it is interesting to see that over the last three years, *fewer participating employers now offer member investment choice to their membership base.*

When it comes to active versus passive investing, *employers prefer to invest in a combination of both*, ie, to have the best of both worlds instead of trying to choose between the two. The majority of employers do, however, feel that their *younger members are investing too conservatively*, and this could mean that the default investment strategies are not aggressive enough (perhaps Regulation 28 needs a re-think?).

In line with what is happening abroad, more consultants*/brokers are moving away from the traditional statutory commission model and onto a fee for service model.*

With Net Replacement Ratio (NRR) calculators becoming more accessible to members, we have seen a *significant increase in the use of these calculators*. The use of the NRR calculator is key to helping members improve their retirement outcomes.

When it comes to selecting an umbrella fund, the *majority of participating employers believe that costs are most important*. Costs are important but to what end? Your costs should be commensurate with the services rendered.

The vast majority of participating employers have also never considered moving between umbrella funds. There is definitely a need to review providers on a regular basis, as the umbrella fund industry is continuously evolving with better fees and differentiated service offerings.

Contributions

In 2017, 57% of respondents (2016: 64%) stated that remuneration packages were based on total cost to company, ie, the contribution rate to a retirement fund would not affect the employer's cost but rather affect an employee's take-home pay. This is becoming an ever increasing trend as it allows the employer to have greater control over their expenses. The alternative would be to have the package structured as "cost plus benefits" where an employee's contribution rate (benefit) affects the employer's overall costs but not an employee's take-home pay. Put another way, 57% of the employers' remuneration packages are currently 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. 18% of participating employers (2016: 24%) indicated that their PEAR percentage was less than 70%, with 57% of the respondents (2016: 50%) saying their fund's PEAR was more than 80%.

50% of the employers have a total monthly pensionable salary bill of between 1 and 10 million rand and 49% of the employers have a total membership ranging from 40 to 300 members.

- The average employee contribution, as a percentage of PEAR, is 7.3% (2016: 7.1%).
- The average employer contribution, as a percentage of PEAR, is 10% (2016: 9.5%).

41% of the participating employers (2016: 28%) allowed members to select their own level of contribution, whereas only 22% (2016: 25%) permitted members to elect their employers' level of contribution.

46% of respondents indicated that the employer pays a fixed contribution only (ie, total cost to company and no additional costs) and 39% indicated that the employer pays a fixed contribution plus the cost of administration and the cost of risk benefits.

	2017	2016	2015
Fixed contribution only (ie, total cost to company - no additional costs)	46%	40%	33%
Fixed contribution plus the cost of administration and the cost of risk benefits	39%	50%	60%

From the table above it can be observed 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

The average cost of administration, expressed as a percentage of salary, remained at 0.7% for the second year in a row. However, with increased competition, improved technologies and economies of scale in the bigger commercial umbrella funds, this figure is expected to be slightly lower. There is significant downward pressure in this segment of the market, especially when new business is tendered.

Overall, as the umbrella fund industry achieves economies of scale, the model seems to be working well for consumers. Similar to the BENCHMARK Surveys conducted in 2016, 2015, 2014 and 2013, this figure is lower than the comparable cost for standalone funds.

Contributions

An increase in total contributions of 0.7% (2016: 1.4%) from last year resulted in an increase of 0.7% (2016: 1.6%) in the total provisioning for retirement.

	2017	2016	2015	2014	2013
Employee contributions	7.3%	7.1%	6.4%	5.6%	5.6%
Employer contributions	10%	9.5%	8.8%	8.5%	8.1%
Total Contributions	**17.30%**	**16.60%**	**15.20%**	**14.10%**	**13.70%**
Death benefit premiums	(1.3%)	(1.3%)	(1.3%)	(1.6%)	(1.6%)
Disability benefit premiums	(1.1%)	(1.1%)	(1.2%)	(1.2%)	(0.9%)
Operating costs	(0.7%)	(0.7%)	(0.8%)	(0.8%)	(0.8%)
Total provision for retirement	**14.2%**	**13.5%**	**11.9%**	**10.5%**	**10.4%**

Transparency of costs

A new trend has started to emerge where some product providers claim not to charge an administration fee, but all costs are included in the investment fees. When employers were asked if they were comfortable with this pricing model, 59% indicated that they were not and only 34% said they were comfortable with this model, with a further 7% still unsure.

When consultants/brokers were presented with the same question, some saw it as a means to hide costs and reduce transparency. Other consultants were comfortable with the pricing model, as long as it was transparent enough to allow for comparison purposes.

All in all, consultants/brokers as well as employers consider the transparency of costs imperative. When employers were asked about all the aspects of retirement fund administration, the second highest ranked aspect, based on importance, was identified as the transparency of costs at 83% (2016: 59%). This was second to paying claims timeously at 95% (2016: 89%).

Investments

The majority of employers surveyed (64%), offered member investment choice. However, this figure seems to have decreased over the last three years, from 80% in 2015 to 76% in 2016, to the current figure of 64% in 2017. Consultants/brokers don't believe that this is a necessity for the majority of members and should be paid for by the members who use it.

Investment choice

An average of six investment options (2016: 7) were offered to members, which is slightly less than what was observed in the previous years.

On average, 76% (2016: 84%) of the respondent claim their members were invested in the trustee choice or default investment option.

The trustee choice / default portfolio was classified as follows:

Trustee choice	2017	2016	2015
Lifestage	60%	52%	59%
Guaranteed / Smoothed bonus	22%	26%	23%
Balanced active	10%	14%	15%
Cash/Money market	3%	4%	3%

Responsible investing

There was an increase to 59% (2016: 53%) in the respondents that indicated they had a responsible investing policy in place, which incorporated ESG (environmental, social & corporate governance factors). This seems to indicate that the awareness of responsible investing is rising.

Active versus passive investing

77% of respondents (2016: 75%) indicated they preferred a **combination of both passive and active investments**. Of these respondents, 28% preferred the majority to be invested in passive investment instruments, while 30% preferred the majority to be invested in active investment instruments.

When asked about the measures or criteria of a successful asset management/investment company, 56% (2016: 62%) indicated consistent delivery on the benchmark (over 5-10 years) and 42% (2016: 33%) indicated consistent inflation-beating returns.

61% of the respondents were concerned that young fund members were investing too conservatively.

The majority of consultants/brokers interviewed believed that achieving the long-term investment objectives was the number one priority. Transparency of fees was also considered important to allow the comparison of investment products.

Lifestage investing

The majority (60%) of the default investment portfolios (2016: 52%) can be described as a lifestage vehicle and, on average, 78% (2016: 80%) of a participating employer's assets are invested in the default investment option. In a lifestage vehicle members are switched to a less volatile portfolio during the period just prior to normal retirement age (pre-retirement phase). The most common pre-retirement phase is five years (for 50% of respondents in 2017 and 2016) and less than five years for 28% (2016: 25%) of respondents.

There has been a significant increase from 46% (2016) to 60% (2017) in respondents who reported that their lifestage investment strategy was explicitly aligned to their post-retirement annuity strategy.

Most popular annuities allowed for in the pre-retirement phase	2017	2016	2015
Living annuity (ILLA)	43%	29%	36%
Guaranteed annuity (level or increasing)	33%	25%	39%
Inflation-linked annuity	27%	35%	45%

87% of participating employers (2016: 83%) provide members with advice when they enter the pre-retirement phase of the lifestage model.

Insured Benefits

Most participating employers (67%) provide risk benefits as part of the umbrella fund package only (2016: 55%), and 17% (2016: 24%) provide risk benefits by way of a separate scheme only. Some, 16% (2016: 21%) provide risk benefits both as part of the umbrella fund package and as a separate scheme.

In general, most respondents (95%) were satisfied with the benefits currently offered by risk providers and 94% were satisfied with the current level of service received.

Risk Benefits – Umbrella Funds

The most popular risk benefits provided as part of the umbrella fund package are death benefits at 96% (2016: 97%), disability benefits at 93% (2016: 86%) and funeral benefits at 45% (2016: 62%). Over the past five years there has been a trend towards income replacement cover as an alternative to capital disability benefits.

- The average lump sum death benefit is 3.1 times (2016: 3.1 times) annual salary.
- The average lump sum disability benefit is 2.4 times (2016: 2.5 times) annual salary.

These benefits remained fairly constant with last year's figures.

Risk Benefits – Separate Schemes

- The average lump sum death benefit is 2.9 times (2016: 3.3 times) annual salary.
- The average lump sum disability benefit is 1.9 times (2016: 2.2 times) annual salary.

There is a slight decrease in the cover provided via a separate scheme since last year.

Other trends

The majority of consultants/brokers now encourage participating employers to offer critical illness (trauma) benefits due to the increased prevalence of illnesses that are typically covered by these products.

Consultants/brokers in general encourage flexible risk benefits and believe that these benefits will be the norm in the future. These benefits allow the member to control the balance between insured benefits and retirement savings, ensuring that a member is able to tailor their needs to their specific circumstances.

Taking Care of Beneficiaries

53% of respondents confirmed that the typical turnaround time for a death claim, from the date that the death benefit was approved by the fund, was less than 3 months (2016: 56%). When asked to rank the three main causes for delays in order of prevalence, the feedback was as follows:

1. Lack of identification of dependants as defined, 81% (2016: 91%)
2. Family disputes, 78% (2016: 69%)
3. Lack of a valid will, 48% (2016: 46%)

An overwhelming number of respondents (79%) indicated that they believed it was better to pay the minor's benefit to the beneficiary fund as opposed to the guardian. Only 12% believed that the guardian would be the better option.

44% of the respondents were of the view that Section 37C should be amended because it did not provide sufficient guidance to the trustees as to what was required of them in order to decide on the allocation of the benefit.

Advice

The participating employer's strategy for rendering financial advice to active members, 42% (2016: 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 advisor. A further 26% (2016: 17%) indicated that the participating employer offered advice services to members by way of an advisor paid for or subsidised by the participating employer, and 21% (2016: 28%) indicated that they referred members to preferred financial advisors.

When benefit counselling, usually provided by product providers, crossed into the advice domain, it became a point of concern. Brokers noted that clear lines should be drawn between benefit counselling and advice.

Consultants/brokers believe that the role of the product provider is to provide factual information about their products and administrative capabilities. It is then the role of the consultant to provide independent advice to the employers.

Robo Advice

Still only 9% (2016: 9%) of participating employers believe that robo-advice could be a suitable and cheaper advice channel for members. More participating employers, 30% (2016: 28%), believe that robo-advice – in conjunction with human support – could represent appropriate advice for their members. The vast majority of respondents, 61% (2016: 63%) were of the view that robo-advice would not be suitable for their members.

Employers' perceptions about the role of robo-advice have not changed significantly over the last year.

Consultants/brokers believe that they are well placed to bridge the advice/counselling gap, but typically lack the capacity to offer individual tailoring on a large scale. They believe that robo-advice is potentially a cost-effective solution, especially for the bottom end of the market where most members find themselves.

Retirement

Respondents estimated that, on average, only 18% of their retirees (2016: 14%) would be able to maintain their current standard of living in retirement.

The use of NRR (Net Replacement Ratio) as a suitable measure for determining whether a member was on track for retirement, seems to have gained some traction with respondents, up from 51% in 2016 to 62% in 2017.

Fewer respondents, 19% (2016: 29%) believed that members did not understand this measure.

36% of participating employers (2016: 29%) had a target NRR that the trustees were actively working towards. Of these participating employers, 83% (2016: 62%), indicated a default employer and employee contribution rate that was aligned with the stated target NRR. These participating employers had an average replacement ratio target of 74% (2016: 67%).

In spite of the above, consultants/brokers indicated that they considered 50% - 60% a more realistic target NRR. In reality, the majority of members are destined to retire on an NRR of less than 40%.

Only 29% (2016: 27%) of respondents believed that the trustees of their umbrella funds had implemented an appropriate default annuity strategy for members. Of these, the most popular default annuity products selected were as follows:

Annuity Product	2017	2016	2015	2014
Living annuity	45%	26%	8%	47%
Guaranteed annuity (level or increasing)	17%	22%	32%	40%
Inflation linked annuity	17%	22%	8%	-
Living annuity converting to a guaranteed annuity at predetermined ages	6.9%	-	-	-

A further 13% (2016: 12%) of participating employers stated that the trustees of the umbrella fund were in the process of putting a default annuity strategy in place within the next 24 months. Nearly half, 49% (2016: 47%) believed that this was not being done.

The most important factors in selecting a default annuity provider were identified as security of the product (45%), cost of the product (24%) and smooth transition from pre- to post-retirement (21%). Consultants/brokers considered costs and investment fees as the most important factors.

Special topics
Evolution of Employee Benefits

The most popular suite of benefits and services that should be included for all employees were identified by the respondents as a retirement fund (100%), medical aid (82%) and group risk (76%). Virtually all the consultants/brokers interviewed placed a retirement fund at the top of the list of the optimal suite of benefits whereas medical aid was considered a draw card in attracting new employees.

If employees did want access to a broader range of financial services via the employer, they would include education loans for children or study loans (38%), personal loans (35%), mortgage bond (29%) and tax advice (28%). This was similar to what consultants/brokers were experiencing. When they were asked about the key questions that members raised, it was clear that members wanted to know how they could gain access to their retirement savings, with questions like "Can I borrow against my fund?" and "How can I access my money?"

73% of the respondents believed that employees would value having access to an integrated "one-stop-shop" financial solution via their employer. Consultants/brokers had mixed views on this. Some believed employees would welcome it, provided the offering was controlled by the employer and not the product provider.

Thus, from the employer/employees' perspective, there seems to be a real need for access to an integrated "one-stop-shop" financial solution, but more specifically to retirement provision, medical aid, group risk and access to some form of a loan. Benefits like short-term insurance and rewards programmes were not amongst the most popular benefits.

Competition within the Umbrella Fund Market

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

- The number one reason for joining an umbrella fund was cost savings at 68% (2016: 55%). This displaced ease of administration at 53% (2016: 59%).. The third most popular reason remained less fiduciary responsibility at 35% (2016: 27%).
- 16% of participating employers (29% in 2016) reported that they sought comparable umbrella fund quotations in the market on an annual basis. The most popular cycle for getting comparable quotations were observed to be 3 years.
- 21% of participating employers (22% in 2016) reported that they had considered moving between umbrella funds and 76% (78% in 2016) had not.
- Cost savings at 52% (55% in 2016), investment performance at 38% (41% in 2016) and ease of administration at 33% (27% in 2016) were the top three reasons for employers considering moving between umbrella funds. The need for better expertise from the umbrella fund provider increased significantly from 14% in 2016 to 29%.

Consultants/brokers agreed that a barrier to competition in the umbrella fund market was the Section 14 transfer process and, more specifically, the time it took to effect these transfers. They also indicated that employers required a compelling reason before considering a change. For example, significant cost savings, poor service delivery, change in member needs, etc.

On balance, these measures show encouraging signs that the umbrella fund market is steadily becoming more competitive. It is worth noting that employers may be making decisions with too much emphasis placed on the cost of the umbrella provider; the cost should be commensurate with the service offering.

Emerging Trends

With the proposed default regulations, umbrella funds and administrators have already implemented solutions to maintain members after their employment has ceased with the participating employer. This is one example where the member, as opposed to the employer, is now becoming the client. This "retailisation" of the institutional market is a trend that is expected to increase in the future.

There is significant interest in the standardisation of risk benefits and administration structures to reduce complexity for employers and members in an effort to make it easier to understand benefits and compare service providers.

Product providers are making use of improved technologies to improve service delivery through automation. This is particularly prevalent with the larger umbrella fund providers.

This year the demand for greater transparency in investment fees from consultants/brokers and employers was quite prominent and is expected to continue going forward.

As umbrella funds evolve and become more flexible, we are seeing an increase in large employers joining umbrella funds as opposed to having their own stand-alone retirement funds.

More to choosing an umbrella fund than costs

This was the headline of a 2016 Personal Finance editorial by the acclaimed (but now retired) financial journalist and consumer champion Bruce Cameron.

by

Irlon Terblanche
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Sanlam Umbrella Solutions

The editorial highlighted that employers should consider a long list of issues when selecting an umbrella fund provider and specifically highlighted costs, administration and governance as key factors in the decision-making process.

The 2016 Sanlam Benchmark Survey took this recommendation one step further, listing no fewer than 16 important considerations to take into account when selecting an umbrella fund.

But listing these 16 factors is surely only the start. What specific weighting should be given to each of these factors is possibly an even more interesting question.

The Umbrella Fund Study of 100 participating employers within commercial umbrella funds has for some years asked two questions that are directly relevant to this topic:

1. What were the three main reasons for joining an umbrella fund?
   a. More cost effective/cost savings
   b. Ease of administration/less time consuming
   c. Less responsibility/less fiduciary responsibility
2. In cases where employers had considered moving to another umbrella fund, what were the three main reasons for doing so?
   a. Cost savings
   b. Better investment returns
   c. Better/easier administration

Research commissioned by Investec during 2016[1] reported that in deciding which umbrella fund to use "the decision is heavily influenced by an employee benefits consultant". This research also found that "in the large majority of cases, there is a strong correlation between the consultant and the umbrella fund which trustees ultimately choose".

Interestingly, participating employers themselves do not rank the influence of the consultant as a key factor in their decision to join an umbrella fund, according to the Benchmark Survey responses. But I suspect that is simply because this is never a factor formally rated in the decision-making process, and my own experience aligns with the Investec findings i.e. the consultant's recommendations are very often the key determinant of what unfolds.

This year we decided to survey 16 employee benefits consultants on how they weighted the 16 identified key considerations in choosing an umbrella fund. Note that these consultants are independent of any commercial umbrella fund or sponsoring company. By restricting the survey to truly independent consultants, we were hoping that the answers would not be biased by what might suit any specific provider's own umbrella fund.

[1] *Who is picking your umbrella fund?, Moneyweb article by Patrick Cairns, 13 December 2016*

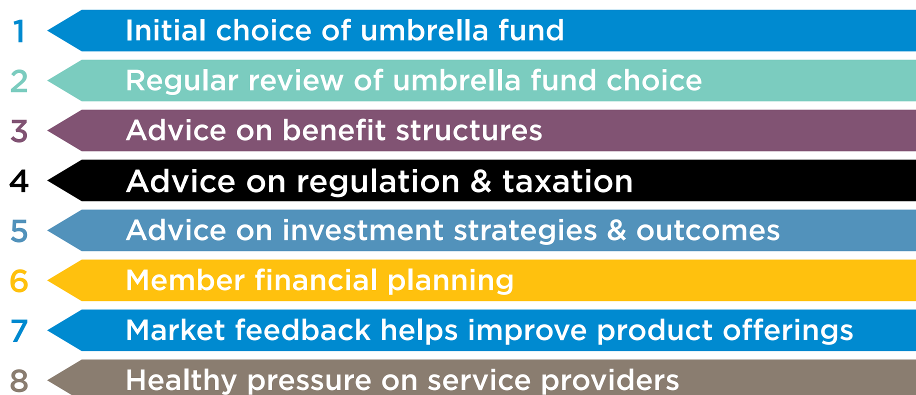

Figure 1

We not only asked these consultants to rank the 16 attributes, but also to assign percentage weightings to each factor, totaling 100%. This added a degree of rigour to the process, and ensured each respondent had to think very carefully about each weighting.

The overall results are shown as Figure 2 below

Factor	Number of Mentions	Umbrella Fund Benchmark Weighting
Administration delivery	15	22%
Charges and costs	16	20%
Investments	12	11%
Transparency	14	10%
Flexibility	12	7%
Communication delivery	12	6%
Track record	11	4%
Governance infrastructure	10	4%
Insured benefits	8	4%
Client satisfaction / retention	9	3%
Quality of advice	6	2%
Preservation and annuitisation	5	2%
Experience	6	2%
Sponsor covenant	2	1%
Black economic empowerment	3	1%
National footprint	4	1%
		100%

Figure 2

One can quite rightly argue that other factors might also be important, or that the weightings should vary between different employers, or that there is an overlap between some of the factors. I agree – but nonetheless for the first time this survey enables industry players to start debating these important considerations with our clients and to move us closer to a situation where rational factors take precedence in the umbrella fund decision-making process.

It's certainly interesting that the independent consultants differed slightly from participating employers by placing a slightly higher weighting on administration delivery than on costs. Could these be insights from practical experience?

I'd like to propose that these 2017 results be used as base Umbrella Fund Benchmark Weightings for employee benefit consultants to use when debating the choice of umbrella fund provider with their clients. The Benchmark Weightings should be up-weighted or down-weighted as appropriate in each case, but at least these can be used as a basis for discussion with clients.

Bruce Cameron ended his editorial by stating "The question that must be answered is which fund will best suit the needs of the employers and employees". Hopefully this research takes the industry one step closer to answering that question.

The gift of not being dependent

by

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As we get older, we start to think about what we'll be leaving as an inheritance to our children. An inheritance can give them that financial boost at a time of their lives when they need it most. However, the current reality is that the gift of merely 'not being dependent' after retirement is a much more realistic goal.

As part of this year's BENCHMARK survey, 16 independent employee benefits consultants were asked about Net Replacement Ratio (NRR) as a measure of determining whether or not an individual is on track for retirement. The idea behind a NRR is to project, based on various factors and assumptions, what portion of an individual's salary he/she will be able to "replace" with their retirement savings at retirement. The industry target NRR is 75%, since certain expenses will cease after retirement, such as having to save for retirement, having to travel to work, etc. A targeted NRR of 75% suggests that your goal should be to replace every R10 000 you earned before retirement with R7 500 after retirement. Think about your personal circumstances; would you be able to retire on a monthly income of 75% of your current salary?

The jury is still out on whether a NRR is a suitable measure for projecting members' retirement outcomes. The major arguments against this measure relate to other savings provisions that might not be taken into account. However, that is a debate for another day. If your retirement fund is the primary vehicle used to save for retirement, your NRR should give you a very good indication of the income you'll be able to retire on.

The consultants that were surveyed considered a NRR of 50% - 60% a more realistic goal. Thus a NRR of 75% would be good however, the reality is that this is not easily obtainable. The concerning part though is that consultants believe that members of retirement funds are destined for a NRR of 15% - 40%, based on their current actions. Thus, based on their experience, consultants believe that the majority of retirement fund members will only be able to retire on somewhere between R1 500 and R4 000 for every R10 000 they earned before retirement.

From the research it is clear that the bulk of retirement fund members are not making sufficient provision for retirement. Employers believe that on average only 18% of their retirees are able to maintain their current standard of living in retirement. What will the other 82% of retirees do? Scaled down on their standard of living or become financially dependent?

What now?

What options are available to someone who has not made sufficient provision for retirement? There are various options available to improve retirement outcomes such as preserving withdrawal benefits, delaying retirement, etc. The one that will be focussed on in particular is increasing contributions towards a retirement fund. If someone is not already contributing the maximum tax-deductible amount towards a retirement fund, that is 27.5% of remuneration to a maximum of R350 000 annual contributions, they should strongly consider this option.

Did you know that if a person (paying tax at a marginal rate of 26%) makes a constant monthly contribution towards a retirement fund, and those contributions grow at 9% pa, it is possible after 5 years to have an investment amount that is the equivalent to earning 20% on a product that is not tax deductible?

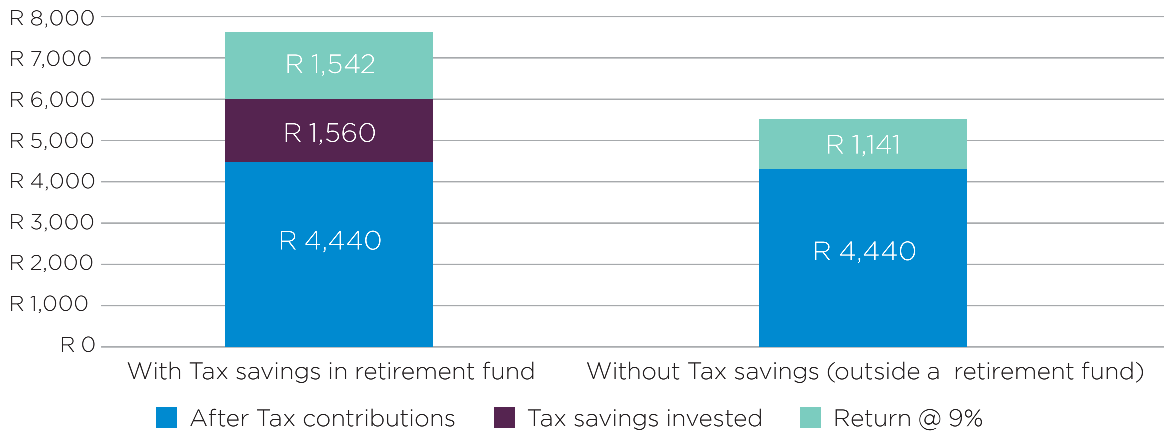
To illustrate the point, certain assumptions have to be made:

- An environment where the average return is about 3% above inflation of say 6% (that is, an environment where the average investor earns 9% on savings).
- An investor for whom the marginal tax rate is 26% (that is, for every additional R100 this investor earns, R26 tax is deducted).
- An investor that is not contributing the maximum tax-deductible amount towards a retirement fund (that is, 27.5% of the greater remuneration for PAYE purposes or taxable income up to a maximum of R350 000).
- Reduced taxes, resulting from contributions towards a retirement fund, will be immediate.

If R100 is contributed towards a retirement fund, that R100 is no longer taxable and will be invested in full towards your retirement. However, if that R100 is not contributed towards a retirement fund and used to increase your take-home pay, it will be taxable at the marginal rate (26% in this example) which means that take-home pay will only increase by R74. Put simply, if it is invested in an alternative savings product after tax has been deducted, only R74 will be invested.

Therefore, if R100 is invested monthly at a rate of 9% pa (compounded monthly), the value in five years' time would be R7 542.

Comparison between investing in a retirement fund vs. non-tax deductable product over 5 years



To have R7 542 after five years with a monthly investment of R74, that investment will have to earn approximately 20% p.a.

Do you know of any product that will grow at 20% pa for five years in an environment where the average investor can only earn 9%?

Can you afford to make additional monthly contribution towards your retirement fund? I believe that this is the wrong question. The question should be: **"Can you afford not to make an additional contribution towards your retirement fund?"** Or "Can your children afford you not to make an additional contribution towards your retirement fund?"

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