Sanlam

100 years

Benchmark 2018

Empowering insights

Research summary

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Empowering insights

Sanlam, 100 years of building a better world

by

Dawie de Villiers
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This is an exciting year for us at Sanlam because we celebrate our centenary in June. I am particularly pleased that the Sanlam Benchmark survey has been running for just over one quarter of the company's lifespan. Throughout its history Sanlam has been at the forefront of transformation in South Africa, with a number of firsts to market, such as the first major BEE deal in South Africa in 1993 when Sanlam sold control of Metropolitan Life to a black consortium that established New Africa Investments Limited (NAIL). Our efforts in fostering transformation have continued into the employee benefits industry, and through our research process we have examined the retirement fund industry's commitment to transformation.

Transformation and the retirement fund industry

The amended Financial Services Sector Code was issued in terms of Broad-Based Black Economic Empowerment (B-BBEE) on 1 December 2017. The code applies only to the top 100 funds on a voluntary basis. The aims of the Code are to actively promote a transformed, vibrant and globally competitive financial services sector that reflects the demographic profile of South Africa, provides accessible financial services to black people and directs investment into targeted sectors of the economy.

On the back of the amended Code we incorporated a few questions in our surveys conducted among trustees and consultants. One of the key statistics that stood out for me was the strong gender bias in the retirement fund industry. Gender representation on boards is split 9:1 males versus females. Even within our sample of stand-alone union funds with an average of 16 board members, often only one female holds a senior management position on the Board of Trustees. The retirement fund industry has a long way to go to create an equal distribution of talent and resources across all demographic profiles.

Growth and labour market trends in South Africa

Since 2001 the total population has increased by 26% to 56.2 million in 2017. The total employed market stands at 16.1 million, which indicates that approximately half a million jobs were created year on year. Slightly more employees had access to retirement benefits, with 48.2% in 2017 and 46.5% in 2016. Our research shows that after steadily increasing since 2013, total contribution levels have declined to pre-2013 levels. The number of employees with access to private medical aid provision has remained flat at 30% year on year.

The unemployment rate stood at 27.7% at the end of the second quarter of 2017.

Proportion of employed South Africans with access to medical aid and retirement provision

	2011	2012	2013	2014	2015	2016	2017
Medical aid	32%	33%	32%	31%	30%	30%	30%
Retirement fund contribution	47%	49%	49%	49%	46%	47%	48%

Member retirement readiness

Retirement fund members are still no closer to moving towards their desired financial outcomes, where they are able to maintain their pre-retirement standard of living. Despite attempts to monitor performance over time, the proportion of members thought to be able to maintain their standard of living in retirement continues to drop and is estimated at just 19% of members in stand-alone funds and 14% of members in umbrella funds.

Not all fund members have access to advice or benefit counselling. Only half (49%) of stand-alone funds and 64% of employers participating in umbrella funds have a formalised strategy for providing advice to members.

Among stand-alone funds, advice/counselling is mainly provided at withdrawal (71%), and to a lesser extent when switching investments (47%) and at life events (33%).

Among umbrella fund participants, advice/counselling is mainly provided when switching investments (64%), and to a lesser extent at withdrawal (55%), and at life events (38%).

Change is the only constant

From an economic and political point of view it seems that 2018 is set to be as turbulent as last year. Regulatory changes are as certain as death and taxes. Sanlam remains committed to conduct and provide you with empowering insights as you navigate these uncertain times.

Expression of gratitude

The annual Sanlam Benchmark research would not be possible without the survey respondents. Each year, principal officers, trustees, employer representatives, intermediaries and retirement fund members sacrifice some of their valuable time to participate in various telephonic and personal interviews and online surveys.

I thank you for your commitment to partner with Sanlam in making our annual Sanlam Benchmark research a huge success. Your research responses provide valuable data on the basis of which stakeholders make informed decisions regarding their retirement benefit structures.

A sincere thank you to my team who tirelessly and relentlessly worked around the clock to produce a body of information that is well researched and referenced. They have once again revamped the online research repository at **www.sanlambenchmark.co.za** where all the research reports are published.

I am sure you will enjoy the new fresh look and feel of our research hub and, as always, will find the research insights valuable.

Dawie de Villiers

CEO Sanlam Employee Benefits

Executive summary Empowering an industry through fact-based insights

by

Wagieda Suliman

Market Insights
Sanlam Employee Benefits

Empowering insights

Preparations are well under way to celebrate the centenary of Sanlam, the second-largest life insurer in South Africa since 1918. Sanlam has expanded its footprint globally and across the African continent, partnering with local long-term and short-term insurers. The main objective of the Sanlam Benchmark research over the past 26 years has been to provide industry stakeholders with a credible reference point for making retirement fund-related decisions. We are proud of Sanlam's heritage of empowerment and commitment to transformation. **Empowering insights**, the theme we have selected for our annual Sanlam Benchmark Survey and Symposia this year encapsulates our strategic intent and continued commitment to contributing to the South African retirement fund industry.

The **research insights** contained in this report are based on five separate studies. Each of the studies had the following main objectives:

- Predict changes in Employee Benefits over the next 10-15 years
- Determine how employers are likely to respond in terms of the employee benefits they offer and the value propositions they develop in the light of these changes
- Profile funds/sub-funds in terms of their benefit structures, contribution levels and associated costs
- Obtain a view on how employers are preparing for implementing the Default Regulations
- Gauge the extent to which the retirement fund industry is transformed
- Test the impact of Broad-Based Black Economic Empowerment on the retirement fund industry
- Explore the provision of employee benefits across the rest of the African continent.

The authors have separately analysed the raw data and provide an overview of their insights and interpretation of the impact thereof.

Dawie de Villiers provides the context in which the research was conducted this year. He gives an overview of the South African landscape and takes time to acknowledge Sanlam's commitment to transformation and the empowerment of retirement fund members.

Viresh Maharaj provides a complete summary of the research programme and an overview of the various research components. He compares contribution levels and costs of stand-alone retirement funds and those of participating employers in commercial umbrella funds. He also addresses the role of advice in the new reality of benefit counselling.

Mxoli Sigenu once again hones in on the subset of union funds that participate in the stand-alone retirement fund survey. He highlights that despite tough economic times union funds have managed to maintain their contribution levels. But in a world of escalating costs the cost of risk benefits and administration has increased, which has reduced the total contribution to retirement savings.

Each year **Danie van Zyl** reviews members' ability to save for retirement by calculating the impact of risk benefit and administration costs on net contributions to retirement. This year he has observed with some concern the decline in total contribution, which has reverted to the pre-2013 level. Danie also explores in greater detail the impact of B-BBEE.

David Gluckman believes the retirement fund industry is at a tipping point. He conducted research among the retirement fund clients of Sanlam and Absa Consultants & Actuaries. David shares his research insights on this body of research and predicts that the retirement fund industry will look very different in the future.

Karen Wentzel and **Rhoderic Nel** consider default annuities and the options available to retirement funds for setting up an appropriate strategy to comply with the Default Regulations by March 2019. In their paper they look at the impact of different pricing strategies and the factors to consider when choosing a default annuity product and the most suitable service provider.

Avishal Seeth presents us with a paper on Total Wellness Outcomes. He looks at the impact of lifestyle-related diseases in the workplace. Avishal believes preventative measures attempt to diagnose and treat diseases in the early stages before the onset of complications. The logic of wellness interventions is therefore based on influencing the behaviour of individuals to positively impact on their health, which has a range of mutually beneficial outcomes.

Michele Jennings discusses the importance of critical illness and looks at the challenges businesses face. She considers the impact of macroeconomic variables on disability claims experience. Michele takes a positive view of the current political environment in South Africa and hope generated among the citizenry of more employment generation and opportunities for growth.

Dominic Sides looks at the implications of the Default Regulations which require that members have access to retirement benefit counselling before receiving a withdrawal or retirement benefit. This being one of the key elements of the new regulations aimed at improving retirement outcomes for members. He shares some of views of consultants regarding the role of benefit consultants in light of this new legislative requirement.

Shakeel Singh once again provides a complete summary of the entire study conducted with 100 key representatives at participating employers in commercial umbrella funds.

Janus Engelbrecht looks at the power of compounding and considers the impact of non-preservation and low contribution levels. He sketches a few potential scenarios and bravely suggests how any shortfall in retirement provision could be overcome with the knowledge and application of compounding.

Tebogo Legodi is a new addition to the Sanlam Benchmark team. She unpacks and debunks a number of widely held myth about millennials and their needs in the world of work. She provides retirement fund stakeholders with a few functional tools on how to communicate and engage with millennials.

This research report is packed with statistics, research insights and Sanlam's view on what it all means. Please feel free to contact me or any of the contributors should you wish to access any of our data or would like us to run additional analysis for you.

All the research is available at www.sanlambenchmark.co.za, our research hub created especially for you.

A full body scan of the retirement funding industry

by

Viresh Maharaj

CEO: Client Solutions
Sanlam Employee Benefits

Amongst our team we used to commonly refer to the research as full body scan of the retirement funding industry. We can actually liken the Benchmark Research to an MRI scan.

Where X-Rays give you low-resolution, two-dimensional images of bone structure. MRI scanners are able to not only create hi-resolution images of bone and soft tissue ... you can literally take images, slice by slice, at any angle through the body.

Sanlam does exactly the same. From our full body scan of the retirement industry each year, we are able to slice into the data and begin building an accurate picture of the statistics and trends that are affecting decisions being made; and to provide insights that empower better decisions that need to be made, all to help improve retirement outcomes.

This year we interviewed:-

- 100 standalone funds
- 100 employers in Umbrella Funds
- 10 professional EB consultants
- 2 focus groups of millennial members.

We also conducted received electronic feedback from

- 100 standalone funds (incl. 10 union funds); and
- 100 participating employers in umbrella funds.

Of the 100 standalone funds interviewed, 50% had over R1bn in AUM and over 2,000 members.

Interestingly, we found that it is becoming harder and harder to find small to medium standalone funds to interview. This speaks to the rapid consolidation into umbrella funds and was cited by the EB consultants polled, as the biggest trend in the industry over the past 5 years. We believe that this trend is going to accelerate, as 75% of standalone funds with less than R1bn AUM having already considered or are considering transitioning into umbrella funds. Also of interest is that 60% of the umbrella participants interviewed begun participating in umbrella funds from 2010 onwards, adding further weight to this trend.

Costs are usually top of mind as one of the key drivers for this consolidation. So let's go head first into unpacking these.

52% of standalone funds express admin costs as a percentage of salary with 36% expressing this as a Rand per member per month. For umbrella funds, this split is closer to 70/30.

The average admin fee expressed as a percentage of salary for standalone funds is 0.54% and R54.00 when expressed in Rands per member per month. When we look a bit closer at the standalone fees, we would expect and do find that bigger funds have lower fees. For funds with fewer than 500 members, the average fee is 0.77%/R68 compared to 0.41%/R34 for funds with more than 10,000 members.

The average umbrella fund admin fee expressed as a percentage of salary is 0.64% and R44.00 when expressed in Rands per member per month. Interestingly, more than the average cost of standalone funds when expressed as a percentage of salary but less than when expressed in Rands per member per month. When we compare like with like, we find that umbrella fund administration fees are generally cheaper than standalone funds for employers with fewer than 500 members – 0.68% vs 0.77% and R52.40 v R68.00. Adding the host of other expenses that would be saved for such funds going into umbrellas, the cost savings and subsequent impact on financial outcomes are helping to drive the consolidation.

A small minority of standalone funds (8%) express their administration fees as a percentage of assets with the average fee being 0.55% of AUA. Quantifying the costs per AUA band, we estimate annual administration expenses in the order of:

AAV Cost	(%AUM)	Rand Cost PA
R 25,000,000	0.88%	R 22,000,
R 75,000,000	0.78%	R 585,000
R 400,000,000	0.26%	R 1,040,000
R 2,500,000,000	0.13%	R 3,250,000
R 5,000,000,000	0.32%	R 16,000,000

These are based on the average costs per AUA band according to the research.

It may be very worthwhile for the 2 large funds who indicated that they pay administration costs on this basis to re-engage with their consultants and administrators to unpack the fees being paid. On a Rand pmpm basis, that fee would be closer to R4m pa, which is a substantial annual saving of R12m.

Investment fees are under the microscope as well. Only 7% of Consultants interviewed indicated that investment fees were very transparent with 25% indicating that they were not transparent at all. 93% of Consultants indicated that Total Expense Ratios and Total Investment Charge's need to be published for all investment options with most believing that better transparency is better for the industry.

Moving further down the body we get to the immune system, providing protection when you need it … which prompts us to take a close look at risk cover.

The cost of approved life cover for standalones and umbrellas is 1.45% and 1.51% respectively.

For unapproved life cover, it is 1.23% and 1.09% respectively.

The average cost of PHI is 0.96% for standalone funds and 0.88% for umbrellas.

Last year, I cautioned attendees that the industry was likely to experience significant price corrections due to the remarkably poor claims experience across most insurers. We have seen this come to pass with increases of up to 80% in insurance costs being delivered to members. The constant downward pressure on prices through horse-trading between insurers has contributed to this situation. This is obviously unsustainable and the volatility is not in the interests of any participant in our industry. Robust disability claims management support systems and intelligent healthcare interventions are required to help contain the poor claims experience and move the costs to a stable base.

The average cover multiples are represented in the table below:

	Standalone	Umbrella
Approved Life Cover	3.25	3
Unapproved Life Cover	3.57	3.53

The proportion of standalone funds that offer risk benefits purely through the fund to only via a separate scheme to a combination of both structures is 45/26/28.

For umbrellas, this ratio is 68/25/6.

This demonstrates a marked preference for approved benefits within umbrella structures. Possibly as a result of more rigid insurance frameworks within umbrella funds as well as reduced complexity for employers to administer.

75% of Consultants polled would advise employers to offer Severe Illness cover to employees. In conversation, the key reasons for this are the growing prevalence and awareness of the impact of Cancer specifically.

Revised product structures make Severe Illness more accessible than ever before and Consultants are actively advising on this basis.

Examining the heartbeat of savings, contributions, we find the following:

	Standalone	Umbrella
Employer	9.9%	8.4%
Member	5.7%	5.5%
Total	15.6%	13.9%

A bit less than in previous years. We attribute this partially to changes in the sample set but also partially to changes in the definition of pensionable earnings. Where contributions were previously expressed in terms of pensionable earnings, many funds now express them as a percentage of total cost to company. Hence, a lower percentage amount but a similar Rand contribution.

2/3 standalone funds and just 1/4 umbrella funds have a targeted pension for members. Encouragingly, of these, the majority use a default contribution rate that aligns with the pension being targeted.

The jury is still out on the use of Net Replacement Ratios to demonstrate quality of life in retirement with 1/3 standalone funds and 2 out 5 umbrella respondents indicating that they were not in favour of using the NRR as a projection device. The primary reasons cited were that the outcome and methodology were not widely understood and that it is too complex for most members to easily relate to. Many of the Consultants interviewed expressed similar concerns.

For a moment let's take a closer look at the core of retirement funding – assets.

Close to 80% of assets are invested in the respective default portfolios. The structures of the defaults are noted in the table below:

	Standalone	Umbrella
Balanced Active Fund	23%	18%
Balanced Passive Fund	10%	10%
Smooth Bonus Fund	5%	20%
Lifestage Strategy	60%	50%

This is very much aligned with the Consultant's views where 60% would recommend Lifestage as a default. The popularity of Lifestage as a default strategy is notable so let's dig deeper.

The principle of Lifestage strategies is to take the right investment risks at the right lifestage to optimise one's salary in retirement. One of these stages is just before retirement. It's at this stage that an individual would need to start considering their annuity options. And there is a difference in how you should be investing in this pre-retirement stage depending on the type of annuity that you wish to purchase. Here we find the following:

	Standalone	Umbrella
Not explicitly aligned with annuity strategy	52%	32%
Unsure whether aligned with annuity strategy	2%	26%
100% Cash in pre-retirement stage	40%	28%

A misalignment can result in a mis-match between the individual's assets and their liability. A mis-match between their investments pre-retirement and their investments post-retirement. For example, most annuitants purchase living annuities post-retirement.

Being transitioned out of the market into 100% cash in the years leading up to retirement can result in significant value destruction and reduction in post-retirement income as the individual has to reinvest cash into the market having missed out on potential gains.

For example, assume an individual has R10m in assets, cash delivers 7% and a balanced conservative fund delivers 10%. They would be R300,000 worse off in 100% cash than being in the balanced conservative portfolio. That's value destruction. Ie. They have less money available to purchase into a now more expensive market. A pre-retirement investment strategy that aligns with the post-retirement annuity strategy provides a relatively seamless transition at retirement with minimal mis-match risk.

An area that needs a similar degree of exploration is transformation. It is a national imperative and as massive contributors to the economy and influencers of transformation, retirement funds wield great responsibility. In the context of the voluntary FSC scorecard, we've researched the status quo and attitudes towards transformation. Representation does not yet reflect the demographics of our nation. As evidence, please note the gap between the composition of boards and that of the employed population in South Africa:

	Trustees	South Africa Employed	Transformation Gap
Black	47%	75%	28%
Women	25%	45%	20%
< 45	33%	70%	37%

Furthermore, half of respondents did not know if or how much of their procurement spend was being directed at entities that were Black owned. Of those who provided an estimate, 15% were able to state that 0% of their expenditure was towards Black owned providers. About half of respondents believe that the FSC Scorecard would stimulate transformation while 35% were uncertain as to the impact of the scorecard and 18% believe that it will have no meaningful impact. 30% of Consultants believe that it will not have an impact on their ability to obtain new appointments and only 20% believe that their existing appointments may be negatively affected by the scorecard. Interestingly, only 20% of consultants would take the scorecard into account when recommending service providers to clients. That's about 1 in 5. I'm not saying that the scorecard must trump all other factors. It should be one of the factors. Funds and Consultants cannot stick their heads into the sand here and we all have to play an engaged role in driving transformation if we want to be relevant.

A type of transformation that has emerged is South Africa being the gateway into sub-Saharan Africa for multi-national firms. 33% of Consultants indicated that they consult to employers with businesses and employees based elsewhere in Africa, primarily sub-Saharan Africa. 55% of the employee benefits arrangements are managed centrally from South Africa with 30% allowing each regional entity to locally negotiate, source and manage their own benefits. The primary obstacle for Consultants is to understand the legislative, regulatory and operating context of each African country in order to provide meaningful advice. The constraints in advising such employers are that Consultants have to make use of different providers per country and that there is a lack of standardisation in benefits and policy conditions. Employers need advice on how to leverage the insurance arrangements through the continent and consultants need to lean on the African IP of partners in order to provide such advice.

Ok … so we've looked at quite of the key statistics that have emerged from our body scan of the industry … In the medical world this data would then result in formal diagnosis and recommended treatment from professional specialists.

In the retirement industry we have our own professional specialists – advisors.

In our survey we were keen to know the response to providing advice.

	Standalone	Umbrella
Referral to preferred advisor	40%	34%
Advice subsidised/paid by fund	22%	22%

For the respondents that do not have any strategies in place, they simply tell members to go speak to their own advisor. I suspect that not too many actually do.

This is where Retirement Benefits Counselling can play a key role. You can liken Retirement Benefits Counselling to going to the over the counter section at your pharmacy. You don't get medical advice but you can get information to empower a reasonable buying decision. Mid-way between going to a doctor and simply consulting Dr Google.

EB Consultants have weighed in with their views on the form that Retirement Benefits Counselling can take:

Paper communication	17%
Access to Benefits Counsellors	22%
Member sessions	20%
Contact by Financial Advisor at withdrawal	17%
Contact with HR at withdrawal	13%
Robo-counselling	11%

Only 10% of Consultants see Benefits Counselling as infringing on their role as consultants. About 50% actually indicate that there is no infringement whatsoever. 97% of Consultants actually indicated that Retirement Benefits Counselling will provide impactful information (empowering insights) to members who would not ordinarily receive financial advice. 90% of Consultants indicated that they believe that counselling will improve rates of preservation for withdrawing members. But – here is the disconnect. 66% of Consultants believe that Funds will do the minimum to comply with regulation with 34% believing that Funds will go beyond the minimum and use counselling to improve member outcomes. These are heavyweight consultants that responded and their positivity towards counselling combined with their scepticism regarding the buy-in of funds to proper counselling indicates that their interaction with boards does not fill them with confidence that trustees will maximise this opportunity.

These survey results naturally reflect how consultants would recommend to their clients to go about providing retirement benefits counselling with the means at their disposal today. But we anticipate that administrators will be bringing to the market new ways of connecting with members as a consequence of the default regulations. In a manner that complements the advisory services of consultants, and enables a far stronger combined value proposition to enable better retirement outcomes for members. Surely this was Treasury's aim in bringing in the new requirement for retirement benefits counselling rather than merely re-positioning member sessions.

An interesting finding was that 92% of the EB consultants that we polled indicated that employees want a one-stop-shop of financial services via their employer with two key conditions:

- Employees must not be locked into a single product provider; &
- Products must not be pushed to employees.

This, in addition to the impact of default preservation and trustee endorsed annuity strategies, touches on the implicit trend of the integration of retail solutions and models into institutional markets. It is a trend that will continue to accelerate.

The consultants that we interviewed represent many of SA's largest EB consulting firms. And the value that a high quality consultant adds to better retirement outcomes is immense. And they're very positive that counselling can and will make a difference if it is implemented properly. In addition, these Consultants believe that it must become compulsory to review one's retirement funding arrangements at least once every three years due to the changes that we've seen in the market and the consistent downward pressure on pricing. When polled, the Consultants were asked to indicate their preferred provider for Umbrella Funds, there was a clear outcome.

Answer	%
A	11%
B	0%
C	26%
D	10%
Sanlam Umbrella Fund	34%
Other	19%

Things change and this picture may have probably looked different 5-10 years ago. Hence the need for regular reviews to ensure that employers are at the very best in the business simply because things change. New entrants join the market. Existing providers innovate while others fall behind. For instance, none of the EB consultants picked a certain incumbent big 5 umbrella fund. It may be time for consultants to employers in that fund to start asking a number of serious questions. High quality consulting leads to better outcomes and the value delivered by such consultants cannot be taken for granted.

Empowering workers through retirement provision

by

Mxoli Sigenu

Business Development Executive
Sanlam Employee Benefits

Currently trade unions in South Africa represent 3.9 million registered union members, which equates to approximately 24% of total employment. According to a definition cited by the South African Institute of Race Relations, a trade union is a workers'/employee organisation constituted for the purpose of furthering and defending the interests of workers. Since the early 1990s, trade unions have been instrumental in empowering workers by negotiating fair access to employee benefits to which they were not previously entitled.

This being the 6th year we have conducted research among union funds, I have reviewed whether much progress has been made to improve member outcomes. One of the positive trends is that the average employer contributions have been on a steady upward trajectory, having increased by 35% since 2013.

All union funds in the survey operated as stand-alone retirement funds. Slightly more union funds considered moving to an umbrella fund structure during the past year.

On average, trustees or Principal Officers who participated in the survey had been a fund representative for at least 11 years. An interesting observation is that despite all the progress we have made since the 1990s, a strong gender bias still remains in the retirement fund industry. Gender representation on boards was split 9:1 male versus female. The average size of the board of a union fund comprises around 16 trustees, 75% of whom are black, with only 3 females. One quarter of the board holds management positions such as Principal Officer, Deputy Principal Officer and other senior management posts, with again only one female on average holding a management post.

Broad-Based Black Economic Empowerment

There is a strong belief that retirement funds have a critical role to play in the transformation of the financial sector, since they are largely responsible for the appointment of private sector service providers. The majority of union funds are aware of the fact that the revised Financial Sector Code has a voluntary B-BBEE scorecard specifically for retirement funds.

As regards preferential procurement, about half of the funds had measured the percentage of the funds' total procurement spend (which included fees to service providers, asset management fees, and group risk premiums) that was being directed towards firms that are at least 51% black owned. It was found to constitute approximately 60% of their total spend.

Service	%*
Asset Management spend	47%
Group Risk	32%
Fund Administration	63%
Consulting	63%
Actuarial	50%

* Where % is: Percentage of total product spend or allocation

An overwhelming majority (90% of funds) were of the opinion that the revised Financial Sector Code (FSC) would stimulate the necessary transformation in the retirement industry. However, some trustees believed the definition of "black" in the FSC was too broad, and that it should be limited to African black management control and procurement spend.

Benefit design and cost structures

This year we surveyed funds with the highest average number of members (114 750) and asset value of R8.1bn. We were able to secure interviews with 5 funds that have an asset value in excess of R5bn.

While employer contribution levels have increased, so too have costs escalated by more than 30% year on year. The pure fund administration fee is still typically expressed as a fixed cost per member per month. The average costs have increased by 33% year on year from R27.38 (2017) to R40.60 (2018).

Total average employer contribution levels:

2018	2017	2016	2015	2014	2013
11.33%	8.57%	9.6%	10.89%	7.55%	7.36%

Total average employee contribution levels:

2018	2017	2016	2015	2014	2013
7.25%	7.35%	6.32%	6.66%	5.93%	6.94%

The cost of death benefits under the fund has also increased from 1.75% (2017) to 2.58% (2018). Average multiple of salary for life cover under the fund has remained constant at 3.2 x annual salary (2017) and 3 x annual salary (2018).

None of the union funds in the sample provided death benefits under a separate scheme.

Retirement

Normal retirement age is holding steady at 64 years (2017) and 65 years (2018).

Half of the funds had a stated target pension expressed as a Net Replacement Ratio (NRR) with a default contribution rate to support it. Average NRR targeted hovered around the 60% to 75% range. Most funds indicated that they already had a suitable measure in place to determine whether members are on track for retirement.

Net Replacement Ratio targeted:

2018	2017	2016	2015	2014	2013
57%	56%	75%	59%	75%	59%

Trustees believed 85% of members would not be in a financial position to maintain their pre-retirement standard of living. On the other hand, they were confident that their members could achieve the stated target pension if they remained in the default portfolio, which has been designed to achieve desired retirement outcomes.

Percentage of members believed to be financially on track for retirement:

2018	2017	2016	2015	2014
15.8%	11.67%	17.45%	15.25%	17.33%

Default Annuities

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. Half the funds indicated that they had already determined an appropriate default annuity product. Interestingly, the provident funds in the research sample believed having a default annuity in place was not applicable to them. However, the jury is still out on pending legislation on provident funds and the impact of compulsory annuitisation.

For those trustees who had already determined an appropriate default annuity, the two most important features to consider were:

- Allowing for pensioners to maintain their pre-retirement lifestyle as long as possible (even if not for the full duration of retirement)
- Annuity income that keeps pace with inflation.

When it comes to the type of default annuity selected, trustees opted for:

- Guaranteed annuity (level or increasing at a fixed percentage)
- Combination of different annuities.

Investments: Default investment strategy

The investment portfolio of the default investment strategy is typically balanced active or balanced passive.

2018	2017	2016	2015
82%	89%	89%	81%

Funds that offered a Member Investment Choice had on average 4 to 5 investment options from which members could choose.

The expectations for investment return in FY2018 were in the range of 9% (2017) and 10% (2018).

Special Topics

Some union funds had a formalised strategy for rendering financial advice to active members (whether in consultation with the employer or on their own), while others simply advised members to speak to their own financial adviser.

Union funds were split on the issue of whether the benefits of the draft Default Regulation would justify the cost.

All things being equal, I have observed an overall positive trend towards good financial retirement outcomes, with contribution levels increasing. However, the costs of fund administration has increased significantly. The in-fund levels of risk benefits expressed as multiples of annual salary have remained relatively flat year on year, with group life averaging around 3 times and lump-sum disability at 2.75 times.

Escalating costs have a material impact on members' ability to retire with sufficient capital to last throughout their retirement. This issue remains high on the agenda of the retirement fund stakeholders.

Saving for retirement

Calculating the net contribution to retirement savings

by

Danie van Zyl
Head: Guaranteed Investments
Sanlam Employee Benefits

For most members, their contribution to their retirement fund consists of two components, namely an employer and employee contribution. This distinction is mostly due to historical differences in how the employer and employee contributions were treated in calculating a member's income tax. Since the March 2016 tax changes, some employers have done away with this distinction. In this year's survey, 8% of funds (double that of last year) indicated that the employer makes no retirement fund contribution, remunerating staff on a cost-to-company basis and any contribution to a retirement fund being viewed as an employee contribution.

For ease of comparison all figures below refer to pensionable salary (also known as PEAR).

Employer contributions

The average employer contribution, as a percentage of salary, was 9.91%, dipping below 10% for the first time since 2014. On a positive note, average employer contributions for union based funds bucked the trend and increased to 11.33% of salary.

Employee contributions

Similar to the employer contribution rate, the average employee contribution rate decreased from 7.84% of salary in 2017 to 5.68% of salary. By comparison, average employee contributions for union funds remained more or less stable at 7.25%.

Thirteen per cent of funds indicated that members could choose their own contribution rate and that they were therefore unable to provide a specific rate.

Administration costs

The majority of funds (52%) continued to express their administration expenses as a percentage of a member's salary, while a further 36% of funds, mainly those with more than 10 000 members, expressed this cost as a fixed rand amount per member per month. Only 8% of funds expressed their administration expenses as a percentage of the fund's assets, which is more in line with the charging model in the retail savings market.

A fixed rand per member approach implies the lowest level of cross-subsidy between members, but this is one instance where cross-subsidisation 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 administration expense cross-subsidy between higher-paid and lower-paid workers.

For those funds deducting a percentage of salary for administration, the average deduction amounted to 0.54%, significantly lower than in previous years, while the average fixed fee per member for standard members remained flat at R53.72 a month. Five funds indicated that they pay in excess of R80 per member per 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 (0.41%) compared to members of smaller funds (fewer than 500 members) who pay on average 0.77%. Expressed as a fixed fee per member, this varies from R33.92 a month for very large funds to R68.11 a month for smaller funds.

Group risk costs

The average deduction to cover the cost of life cover in the fund has increased to 1.45%, while the cost of disability cover has remained fairly steady at 0.98% of pensionable salary.

Total provision for retirement

For the 2018 Sanlam Benchmark Survey, the net provision for retirement, combining the employer and employee contribution rate, less administration and group risk costs, amounted to 12.62%. As this figure can vary significantly from year to year, the table below shows the average provision for retirement over a 3- and 5-year period, which is more indicative of long-term trends.

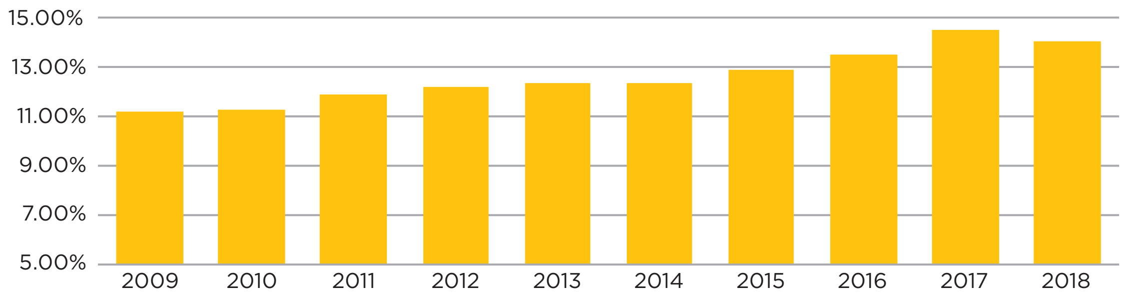
	Average over last 3 years			Average over last 5 years
	All stand-alone funds	Funds with 10 000 + members	Funds with fewer than 500 members	All stand-alone funds
Employer contributions	10.32%	9.86%	9.54%	10.34%
Employee contributions	6.93%	6.49%	7.52%	6.74%
Deduction for life cover	-1.37%	-1.41%	-1.32%	-1.45%
Deduction for disability cover	-1.04%	-0.86%	-1.22%	-1.03%
Deduction for administration costs	-0.80%	-0.48%	-1.18%	-0.87%
Total provision for retirement	14.05%	13.60%	13.34%	13.73%

All figures as percentage of PEAR

Conclusion

The reduction in the contribution rates for both employer and employee contributions in this year's survey has led to a lower net provision for retirement. The result of this is that the upward trend in the 3-year moving average of the net provision for retirement since 2014 has ended.

Total provision for retirement (3-year moving average)



In addition, respondents believe only 18.92% of their members will be able to maintain their standard of living in retirement. This is the lowest figure in the past 5 years.

Default Regulations

An industry tipping point

by

David Gluckman

Head: Special Projects
Sanlam Employee Benefits

"These final regulations are meant to improve the outcomes for members of retirement funds …"

National Treasury Media Statement, 25 August 2017

A worthy objective, we can surely all agree. But will this objective be achieved, or will retirement funds simply concentrate their efforts between now and 1 March 2019 on ensuring compliance with the letter of the law but without going that extra mile to yield maximum benefit for ordinary members?

To put this another way, unless retirement outcomes for members are measurably improved as a consequence of changes that must be made within the next 9 months, the legislation would not have achieved its objectives. This is about a paradigm shift for the retirement fund industry.

As a litmus test of how well or otherwise the industry is fairing, we decided to conduct an online survey on progress towards the 1 March 2019 implementation deadline among Sanlam and ACA retirement fund clients represented by stakeholders such as trustees, principal officers and consultants. The results were collected in the first few weeks of April 2018, which makes this quite fresh research at the time of going to press.

And there were some encouraging findings, though this introduces the thought that possibly it is the better-prepared funds that responded:

- Fifty-five per cent of respondents believe the regulations will be extremely effective or very effective in improving retirement outcomes.
- Fifty-three per cent of respondents believe there will be increased take-up of passive investment products and hence a reduction in investment management fees.
- Sixty-nine per cent of respondents believe there will be a large increase in preservation.
- Thirty-nine per cent of respondents believe charges on annuities will decrease.

As regards readiness for 1 March 2019, it seems the aspects of the regulations that still require the most work relate to the annuitisation strategy and retirement benefits counselling (see figure 1).

How confident are you that your fund can have everything in place by 1 March 2019 as required by the regulations in terms of having implemented the following?

Answer	Extremely likely
Default Investment Strategy	80%
Default In-Fund Preservation	69%
Trustee Endorsed AnnuitisationS trategy	53%
Retirement Benefit Counselling	44%

Figure 1

On the important new requirement for retirement benefits counselling, there was a wide dispersion of views as to how best to implement.

A separate survey of professional employee benefits consultants (see figure 2) produced mixed results – on the one hand these experts believe retirement benefits counsellors can make a meaningful impact on retirement outcomes if done well, yet on the other hand there is a belief that retirement funds will only concern themselves with doing the bare minimum to comply.

Professional EB consultants positive yet sceptical ...

- access to benefit counsellors was the most favoured model
- 51% said no infringement on role as consultant / advisor

- 76% said could be a great deal or a lot impactful on members who would not ordinarily receive financial advice
- 53% said can improve preservation a great deal or a lot

yet ...

- 66% of consultants believe funds will choose to do the bare minimum to comply

Figure 2

Sixty-seven per cent of respondents believe the regulations will definitely or probably increase the risks of being a trustee – so perhaps the short-term focus on compliance is understandable. No one wants to be sued in his or her personal capacity for non-compliance.

When asked how paid-up members should be serviced in the future, the clear preference by some margin (49% of respondents) was for these members to be serviced directly by the administrator. This is perhaps not surprising as the employer-employee link will have been severed for such members (the same logic applies for retired employees).

This is in line with the service model we have had to develop within the Sanlam Umbrella Fund over the past 2½ years since In Fund Preservation and In Fund Annuity categories were launched to the market. It's a complete paradigm shift for retirement fund administrators and boards of trustees – how to service individual members directly with no intermediation by a human resources department. I call it a quasi-retail servicing model. The Sanlam Umbrella Fund has had to redesign member interfaces, member support and member communication to cater for this new servicing model.

My prediction is that these default regulations will prove a tipping point for the retirement fund industry. Entirely new ways to interact with members must be developed so as to try to achieve the objectives of the legislation. I suspect the industry will look very different in 5 years' time to what it does today. Hopefully by then we will have collected measurable evidence that retirement outcomes for members have been improved, or at the very least that the trend is positive. Time will tell!

Default Annuities

Is your fund in trouble?

by

Karen Wentzel
Head: Annuities
Sanlam Employee Benefits

Rhoderic Nel
CEO: Investments
Sanlam Employee Benefits

For the past 20 years, individuals in defined contribution schemes were left on their own to make one of the most important financial decisions of their lives. Too many people, retirement funds and financial advisers focus on building wealth before retirement, paying little or no attention to what should happen in retirement. Members often fall prey to unscrupulous advisers or make the wrong investment decisions. To address this issue, the National Treasury published revised "default regulations" during August 2017, which set out requirements for setting up default strategies.

The regulations stipulate that all defined contribution retirement funds, including retirement annuity funds, will therefore be required to have in place a trustee-endorsed default annuity strategy that is appropriate and suitable for the members who will be enrolled in it. The regulation for the default annuity is an "opt in" rather than an "opt out" arrangement.

The specific requirements relating to a default annuity are set out in Regulation 39 of the PFA Act and are as follow:

- **The proposed annuity strategy must be appropriate and suitable for the members of the fund.**

Although there is not one annuity that will be suitable for all members, an annuity strategy may include a few options for members with different risk profiles and income levels. Most members will benefit from having a part of their annuity in a guaranteed income stream for life to cover their compulsory monthly expenses and medical scheme contributions for life. A composite annuity, combining a guaranteed life annuity and a living annuity, may be a great option for higher earners.

- **The fees and charges of the proposed annuity or assets must be reasonable and competitive.**

Currently, individual members do not have access to institutionally priced annuities, both as guaranteed life and living annuities. Default regulation will force boards of trustees to negotiate reasonable and competitive fees and pricing with insurance companies to ensure members have a cost-effective annuity option at retirement to consider with other options available in the market. Sanlam (and some other insurers) has developed a new institutionally priced living annuity to address these requirements.

- **The annuity strategy needs to be reviewed annually and may include traditional life annuities and living annuities being paid from the fund or an external provider.**

The investment choice for living annuities is limited to 4 investment portfolios that are compliant with Regulations 28 and 37. The prescribed standard for drawdown rates is in a draft format with ASISA.

- **Members are given access to a retirement benefits counsellor not less than 3 months before their retirement date.**

Choosing an annuity may be a daunting task and is one of the most important financial decisions ever made. Most members make the choice without enough financial knowledge about and insight into financial markets and the effect of longevity (living longer than expected) on their financial planning.

Members will at least need to consider a trustee-endorsed, competitively priced annuity strategy and will have access to a retirement benefits counsellor, which will hopefully improve retirement outcomes. These requirements will not only impact the wallet of South Africans, but will also possibly affect the focus of annuity products and trends in the insurance industry.

Blending the retail and institutional world … the effect on fees

The default regulations stipulate that the annuities chosen must have reasonable and competitive fees, which will definitely put the focus on fee structures again.

In a perfect world all members may want personal advice and a tailored annuity to both accumulate funds and address lifestyle expectations, like in the retail world. The ultimate objective is to enable every member in a fund to get as close to this ideal as possible. The key is to balance the level of advice and choice offered with an appropriate fee structure. Another crucial factor is that it should be a scalable proposition that works for the trustees of a fund that has thousands of members.

Funds will thus need to realise that the closer their offering is to an individualised retail offering, the closer the fees will also be to retail fees. Some companies are offering different levels of flexibility and choice at different fee structures.

Will your fund be able to meet the March 2019 deadline?

In **Sanlam's 2018 Benchmark Survey** of stand-alone funds, around 32% of funds indicated that they have already determined an appropriate default annuity strategy, 34% indicated that they have been working on it, and 30% of funds might not meet the March 2019 deadline. During the past 6 months, after the publication of regulations in August 2017, Sanlam experienced an increased number of requests for proposals for default annuity strategies.

In reply to a question in the Benchmark Survey on the most important features of a default annuity strategy, trustees indicated that the **three most important features** of a default annuity strategy are:

1. Longevity protection and an income for life
2. Annuity income that keeps pace with inflation
3. Allowing for pensioners to maintain their pre-retirement lifestyle as long as possible.

The **2 most popular annuity products** selected for a default annuity strategy were:

1. Living Annuities
2. A combination of different annuities.

The choice of products correlates well with the most important features trustees want to address.

Additional services and features, over and above the annuity products, **that were important to trustees** in appointing a provider for their default strategy, were:

1. The cost of the product
2. The security of the product provider.

With living annuities being the most popular product so far, what are the most important factors to consider in choosing a product or service provider?

It's very easy to remember the 5A's, namely:

1. Administration
2. Advice
3. Asset choice
4. All-in-charges
5. All-in-one solution.

The aim is to enable more members to retire comfortably in a cost-effective way, understand the features of the products they have bought, and help members to not outlive their income in the later years during retirement. Members still need to realise this goal can only be achieved by saving enough during their working life, investing effectively during pre-retirement and not cashing in any retirement savings during their lifetime or at retirement.

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

Enabling Total Wellness Outcomes

by

Avishal Seeth

Branch Head: Gauteng
Simeka

Employee assistance programs or wellness programmes have become widespread across South African employers. And for good reason. There is an increased prevalence and impact of lifestyle-related diseases in the workplace, diseases such as diabetes, pulmonary conditions and heart disease at younger ages than in the past. Much of this may be attributed to behaviour such as inactivity, smoking, poor nutrition and alcohol consumption.

The impacts of these lifestyle diseases on individuals are material and range from a decreased quality of life to disablement to premature death. The employer experiences the financial costs of increased absenteeism and decreased presenteeism. Furthermore, costs of healthcare and group insurance are correlated with the increased prevalence of such illnesses. As an industry, we are also affected as the long-term affordability of insurance cover is impacted.

There are two general approaches to implementing wellness initiatives, namely Primary Prevention and Secondary Prevention. Primary prevention is aimed at preventing the onset of the disease through impacting health-related behaviours and risk factors. Secondary prevention attempts to diagnose and treat diseases at an early stage before the onset of complications. The logic of wellness interventions is therefore based on influencing the behaviour of individuals to positively impact on their health, which has a range of mutually beneficial outcomes. A win-win-win for individuals, employers and the industry.

Programmes typically consist of screening protocols, evaluations and proposals of preventative steps. Such steps may include the introduction of on-site clinics, diet and exercise plans, access to smoking cessation programmes, alcohol rehabilitation programmes, etc. The key challenge is that the usage of such programmes is limited, with less than 50% of employees participating on average. Of those identified for preventative interventions, less than 20% actually utilised the services offered. Even then, such programmes do not typically extend to the family members of the employee, who may often be as at risk and impactful on the employee's performance at work.

That said, the impact of wellness interventions is widely recognised in the academic literature. Our meta-analysis indicated that those employees who were highly engaged in wellness initiatives demonstrated the following characteristics relative to their peers who were not:

- Shorter stays in hospital
- Fewer admissions
- Lower healthcare costs
- Less traumatic for members and families
- Less personal financial burden
- Higher degree of insurability
- Able to access life insurance cover with fewer (if any) restrictions.

Studies have shown clinically meaningful and statistically significant changes in behaviours such as frequency of exercise, reduction in smoking and changes in diet as a direct result of wellness interventions. When converted into actual rand returns, studies broadly show returns in cost savings from 2 to 6 times the investment made, which are compelling.

The health interventions are great and necessary, but do not result in Total Wellness Outcomes.

We need to broaden the scope of traditional wellness beyond physical and mental wellness to materially include financial wellness in an integrated ecosystem if we aim to unlock the full potential of such interrelated interventions. The American Psychological Association recognises financial stress as the leading cause of smoking, weight gain, alcohol and drug abuse among employees in the USA. Forty-five per cent of employees polled by PWC in the USA indicated that financial matters were their main cause of stress – more than jobs, relationships and health combined. The Sanlam Benchmark research showed that 73% of respondents experienced financial stress, with more than half admitting that it was having a negative impact on them at the workplace. Unsurprisingly, debt was identified at the key contributor to financial stress.
Debt has been shown to negatively affect both physical and mental health.

Employees with debt have been shown to present a higher prevalence of the following physical ailments:

- High glucose
- High blood pressure
- Migraines (3x)
- Heart disease (2x)
- Fatigue
- Restlessness
- Ulcers
- Digestive tract problems (3x)

That is a very worrying set of findings.

It gets even more worrying.

Employees with debt have been shown to present higher prevalence of the following mental health ailments:

- Severe anxiety
- Suicide ideation
- Depression (5x)
- Anger
- Helplessness

The higher degree of mental health impact exacerbates the potential for physical health impact as such individuals are shown to cope with anxiety by consuming more alcohol, smoking more and exercising less, and they have poorer nutrition.

Using the terminology introduced earlier, debt is a lifestyle disease. And programmes aiming to deliver Total Wellness Outcomes must address it in order to have a material impact through both primary and secondary preventative measures. This means screening, evaluation and intervention.
Health screening is fairly routine. Needles, scales, measuring tape, etc. Screening for debt can be more difficult as it doesn't easily present and one's finances are often a more sensitive topic to discuss than one's health, especially when engaging with your employer. As such, we have to consider various ways to identify who within an employer is displaying risk factors that are indicative of potential problems.

An approach was made evident via a case study run by Sanlam at one of South Africa's largest employers.

Sanlam was approached by the employer to combine our actuarial, health and consulting expertise to identify the key health and financial correlations impacting absenteeism at the employer. The study found that there were indeed correlations between financial circumstances, mental wellness, physical wellness and absenteeism. By identifying the key health and financial indicators negatively impacting productivity within the employer, they have been provided with insights that will empower them in applying interventions in problem areas.

The key insights gained from the deep actuarial analysis are that:

- Earning weekly wages rather than a monthly salary correlates with the degree of absenteeism.
- The absolute value of an employee's salary is inversely correlated with absenteeism.
- The structure of the employee's package is correlated with absenteeism and physical wellness.

- What an employee spends his money on is correlated with mental wellness.
- Employees with monthly contributions to financial instruments and lifestyle factors (retirement savings, insurance, gym, etc.) had an inverse correlation with being mentally unwell.
- Financial indebtedness is positively correlated with absenteeism.
- Financial indebtedness is inversely correlated with physical health.
- Financial indebtedness is inversely correlated with mental health.
- The intensity of an employee's illness is positively correlated with his financial indebtedness.

These insights have helped to identify potential risk factors that suggest whether an employee is in debt and the extent to which financial indebtedness is correlated with the issues of absenteeism, mental health and physical health at that specific employer. Another form of screening would be to run employee records through various credit bureaus on a regular basis to identify at-risk employees. Or to check whether the employee preserved previous retirement savings when joining his current employer as the Sanlam Benchmark findings have previously shown that the majority of members that withdraw do so to settle short-term debt. These models are not definitive but utilise the data available to demonstrate how risk factors can be identified from readily available information to identify employees in need of possible intervention. Using the language introduced earlier, these would be primary prevention strategies to help prevent employees from getting into debt and secondary prevention strategies to prevent employees who are in debt becoming more indebted.

When chasing Total Wellness Outcomes, there are a few challenges to implementing successful interventions, namely that utilisation of interventions is relatively low; interventions have to compete for employees' share of attention and time; there are stigmas attached to mental health issues and debt; and the initial funding costs of such interventions may not be budgeted for.

Let's consider the last issue first. Our research indicates compelling returns on investment in total wellness ranging up to R6 for every rand spent. For instance, we anticipate that the employer we analysed would experience an annual saving of up to R20m in the first year after the implementation of a successful intervention based on our insights. In addition, there are providers, Sanlam included, that are able to fully fund such interventions at their own cost depending on the package of services sourced from said provider due to the demonstrable positive impact that such interventions have on mortality, morbidity and health experience.

Based on an analysis of various programmes, the following factors were identified as necessary conditions for the successful implementation of such interventions:

- Excellent communication – including face-to-face sessions, mass communications and clear messaging from the leadership of the employer as well as the direct line managers
- Convenience of interventions – ability of employees to access interventions re time, distance and cost
- Public buy-in from leaders – the leadership team need to publicly endorse the intervention and participate openly to act as examples for their teams
- Utilising existing infrastructure – minimise costs by leveraging existing space, programmes and communication channels
- Continuous evaluation and feedback – the impact of interventions must be measured individually and in aggregate to iterate and improve approaches.

When considering communication and education, it is worth noting that particular focus has to be paid to reducing the stigma attached to mental health issues as well as to the related matter of debt. These are uncomfortable topics but materially impact employees' lives. An engaged employer would need to apply specific education drives to change attitudes and behaviours towards these issues using an omni-channel approach. Often an issue with such programmes is that employees do not know what support systems are available to them. As such, education and communication should be aimed at helping employees to understand what is available and how to access the support systems.

Support systems can include:

- On-site medical clinics
- Access to psychologists
- Access to debt counselling – shown to have a statistically significant impact on health
- Access to financial advice
- Family counselling sessions

Now for the BIG question – we are in the retirement funding industry, why should we bother about Total Wellness Outcomes? The answer comes down to considering a person and his behaviour in totality and not just in the isolated context of retirement funding. Debt is a lifestyle disease brought about by behaviour patterns, it is the leading cause of financial stress in SA, it is prevalent at epidemic levels among employees across socio-economic, education and demographic bands, and it contributes significantly to physical and mental health problems. Retirement funding can't fight for attention in that context. If we want to help move more members of our funds to better retirement outcomes, we first have to empower them to move towards better financial behaviours. And this requires dealing intelligently with the big issue of debt. Looking at individuals through the lenses of physical, mental and financial wellness allows employers to provide integrated and holistic measures to improve Total Wellness Outcomes.

A disabled economy

by

Michele Jennings
CEO: Group Risk
Sanlam Employee Benefits

South Africa has endured a tough couple of years – both from an economic and a political perspective. Employers and employees alike are facing financial pressure and are looking for ways to cut costs. Due to the subjective nature of disability claims, these costs are often the first to escalate in a struggling economy, and thus may be the first to be cut. Despite this, brokers and employees are recognizing the need for a solid critical illness offering and there has been significant growth in this area.

Challenges facing businesses

Clients identified the two biggest challenges facing them today.
The biggest challenge identified was the lack of economic growth in the country. One of the primary reasons for this is the political instability and corruption over the last few years. Financial pressure causes companies to try to cut costs, and often the first cut made is to employees' costs. This can come in the form of retrenchments or reduced employee benefit offerings. Personal financial stress also causes an increase in the cost of insurance, as financial health has a direct correlation to disability, and even life, insurance claims.

The second biggest challenge identified was the new regulation and compliance requirements. There are many new regulations being introduced in the coming months and all of these have additional costs to implement – both in terms of monetary expenses as well as time spent deciphering and implementing. In the end, most of the new regulations are good for the market, but the short-term pressures introduced by them can be significant.

Disability

There is a real need for disability cover in our society - disability cover provides a lump sum or income in the unfortunate event of a member becoming disabled. If the member becomes disabled and cannot earn a salary, the potential economic damage to their families (and themselves) is enormous. Despite this, around 75% of respondents did not offer disability as a lump-sum benefit, with 45% not offering disability income benefits to members. Furthermore, of those that offer lump-sum benefits, the average multiple of salary has dropped from over 3 to under 2.5 over the last three years. Unfortunately, disability can be an expensive product – particularly in tough economic times when insurers tend to face increasing claims. Disability is often the first product to be cut or to be removed completely. It is imperative for insurers and clients to work together to structure the disability offerings to be affordable and suitable to the clients' needs.

Critical Illness

On a positive note, more than 85% of the brokers surveyed recommended critical illness benefits to their clients. Respondents indicated that they increasingly saw the need for critical illness products and that there was a greater awareness of health – particularly cancer and heart conditions - among their clients. However, the respondents found that the product was still very complicated. Unfortunately, despite some effort, there is no real standard for illness definitions or benefit structures. Products can have different definitions or different tiering options. This makes comparison between insurers very difficult. Insurers can work harder to ensure some standardization, which would make this increasingly necessary product easier to understand and more attractive to clients.

To BEE or not to BEE

The B-BBEE Scorecard for retirement funds

by

Danie van Zyl
Head: Guaranteed Investments
Sanlam Employee Benefits

The recently revised Financial Sector Code (FSC) is the B-BBEE framework for the entire financial services industry. It is an interventionist policy tool aimed at promoting transformation in the industry. Retirement funds, as the custodians of members' savings, play a critical role in driving change in the industry. For this reason the Revised FSC has for the first time introduced a scorecard targeted specifically at retirement funds.

The FSC scorecard reinforces the need to consider B-BBEE in selecting service providers as set out in the revised Regulation 28 of the Pension Funds Act.

Although voluntary for now, the top 100 retirement funds (including umbrella funds) will be under pressure to complete the FSC scorecard as well as provide additional disclosures. Unsatisfactory progress may well result in the scorecard becoming compulsory.

In this year's survey we tested respondents' awareness of the revised FSC, with 71% of fund respondents indicating they were aware of the revised FSC and the scorecard for retirement funds. Awareness was particularly high among union-based funds (90%).

Many of the requirements of the FSC are not applicable to retirement funds as they are non-profit entities without shareholders. The scorecard for retirement funds therefore focuses on 2 elements only, namely Management Control and Preferential Procurement, as set out below:

<table>
<tr><th>Element</th><th>Scorecard</th><th>Public disclosure</th></tr>
<tr><td>Ownership</td><td>N/A</td><td>Recommended</td></tr>
<tr><td>Management control</td><td>20</td><td>Recommended</td></tr>
<tr><td>Skills development / Trustee education</td><td>N/A</td><td>Recommended</td></tr>
<tr><td>Preferential procurement</td><td>80</td><td>Recommended</td></tr>
<tr><td>Empowerment financing, enterprise and supplier development</td><td colspan="2" rowspan="3">N/A</td></tr>
<tr><td>Access to financial services</td></tr>
<tr><td>Socio-economic development</td></tr>
<tr><td>TOTAL</td><td>100</td><td></td></tr>
</table>

Management control

The FSC scorecard aims to increase the participation of black trustees (including black women) with voting rights. Increasing the number of black senior management, relating to control of a retirement fund, is also targeted. Funds in this year's Survey indicated that on average 47% of board members were black, while 25% of board members were female. The FSC scorecard target for black board members is 50%.

Preferential procurement

The FSC scorecard aims to increase the rand value of procurement spend towards black-owned enterprises in general, and specifically enterprises owned by black woman, as well as Exempted Micro Enterprises (EMEs) and Qualifying Small Financial Institutions (QSFIs).

To date, only 19% of retirement funds polled in the Survey have measured their procurement spend towards black-owned enterprises. Roughly half of the funds surveyed were not sure if their procurement spend towards either investment management, group risk provider, fund administration, consulting or actuarial services was towards enterprises with at least 51% black ownership.

Impact of the FSC on the retirement industry

Less than half the funds surveyed (47%) believed the FSC will stimulate transformation in the retirement industry. When asked whether the definition of "black" in the FSC might be too broad and should be limited to African black management control and procurement spend, only 23% of all respondents agreed. When limited to African black respondents, the result rose to 60%.

Sanlam response

At Sanlam we recognise that economic empowerment is a key priority for us, our clients and society at large. Sanlam has always been at the forefront of empowerment in the industry, starting with the first major empowerment transaction in South Africa in 1993. To expand the range of choice retirement funds have in supporting independent black asset managers, we have launched the Progressive Smooth Bonus Fund, a smoothed bonus portfolio where all the underlying assets are managed by asset managers that are majority black owned, black managed and with majority black investment professionals.

New challenges for trustees

Helping members improve their retirement outcomes

by

Dominic Sides

Head: Retirement Outcomes
Sanlam Employee Benefits

New regulations in terms of the Pension Funds Act, commonly known as the Default Regulations, were issued in August 2017 and all retirement funds must comply by March 2019.

The new regulations require that members have access to retirement benefit counselling before receiving a withdrawal or retirement benefit. This is one of the key elements of the new regulations aimed at improving retirement outcomes for members.

Planning is essential for a good retirement outcome. However, Sanlam Employee Benefits research shows most members are very poorly informed regarding their retirement planning generally and their options at retirement specifically.

The new regulations present trustees with new questions and challenges, such as the following:

1. The definition of counselling in the regulations could be described as cryptic. What is the minimum requirement for compliance, and is human intervention necessary? One approach is to adapt existing formats such as member sessions or paper-based communication to comply, as suggested by 20% and 17% respectively of those surveyed. However, this is already available and is therefore unlikely to have a material impact on outcomes, which is the purpose of the regulations. An alternative is robo-counselling as suggested by 11% of those surveyed. This will appeal to millennials who typically do not want to be told how to do things but prefer to be guided on how they can begin doing it themselves using online and mobile tools. DIY is the way of the millennial but may not suit other member groups or be accessible to them. A familiar issue for many retirement funds is the low level of member engagement, despite best efforts to address this. This lies behind many poor or uninformed decisions made by members and may be why 51% of those surveyed suggested some form of individual human intervention.
2. If individual human intervention is required, who is best placed to fulfil the function? One suggestion is an HR representative, but will such a person have the knowledge, skills and time to do this effectively? An alternative is a financial adviser. In this case, how will the financial adviser recover the cost of providing the service and what are the possible conflicts of interest? A specialist benefit counsellor was suggested by 22% (of the 51% suggesting human intervention) of those surveyed.
3. If a specialist benefit counsellor is the solution, what should a fund look for from potential service providers? The whole concept of counselling is new, so there are no established precedents or track records for trustees to consider. How would trustees evaluate the knowledge and skills of counsellors and required operational capabilities?

4. Of those surveyed, 76% believed retirement benefit counselling could provide a great deal or a lot of impactful information to those who would not ordinarily receive advice. It seems the concept of counselling is being well received, although the actual mechanisms have perhaps not yet been fully resolved. How should funds prioritise and allocate budget to new counselling offerings, and what can funds expect to pay? Is it possible to ascertain where the most impact on retirement outcomes is generated, for example through counselling and traditional member education initiatives? Member needs vary considerably, based on time to retirement, income and life circumstances. The traditional 'one size fits all' approach of group-based member education may not engage members enough to have the desired impact on retirement outcomes.
5. The regulations provide some direction regarding the scope of benefit counselling, but are actually quite generic. They refer to "disclosure and explanation, in a clear and understandable language, including risks, costs and charges" for available investment portfolios, preservation and annuity strategy, despite these being very different situations from the perspective of the member. There is also a catch-all for "any other options made available to members", which is perhaps deliberately vague.
6. An interesting question is how the counselling capability can be "tweaked" to add additional value for members and increase the positive impact on decision making and ultimately retirement outcomes.
7. Lastly, but very important, how do trustees retain oversight of the counselling process so that they can meet their governance and fiduciary responsibilities? Trustees may be wary of using the services of counsellors if they are not confident that the interactions with members will be managed and delivered according to their requirements. Trustees must be able to hold benefit counsellors to account for the service they provide.

Retirement benefit counselling is a new concept, with a great deal of room for interpretation and innovation. It will be fascinating to see how retirement funds and service providers respond. Competition will add spice to this process. Sanlam Employee Benefits believes this is generally positive for members, and over time will make a contribution towards improving retirement outcomes.

Cyber risk and resilience

by

Johan Prinsloo

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At Sanlam we view the threat cyber risk poses to clients' data, technology and information and brand in a very serious light. We view it as the type of risk that threatens the very continuity of business and one that is quite unique in nature: it comes from humans, is forever adapting and changing and has the ability to move beyond the physical barriers used to contain traditional catastrophic risks.

We support the views of authorities such as the World Economic Forum, our regulators and ASISA that we cannot defend single-handedly against this risk. We are therefore playing an active role in our industry's Computer Security Incident Response Team (CSIRT) and in sharing threat and response intelligence with other industries' CSIRTs. We also believe in establishing intelligence feeds beyond industry level and are actively engaging with the Financial Services Information Sharing and Analysis Centre's Europe and Africa operations. We furthermore support the notion that one needs to establish a system of resilience that not only protects against the threats, but is also capable of responding to cyber incidents and crises. This we also don't do on our own and we have secured the assistance of cyber incident and crisis consultancies.

Our active response to the risk culminated in a cyber-resilience strategy for Sanlam. At a high level the strategy focuses on 5 interrelated areas, namely Intelligence (or early warning), protection, monitoring, detection and response (which includes cyber incident and crisis management). The information security controls we focus on are those required by the external framework that we align with, namely the Centre for Internet Security. We use this framework because it is practical, based on experience with real-life incidents and updated regularly. We have extended the framework into a Sanlam Cyber Resilience framework that defines the "canvas" for all our efforts.

Our crown-jewel risk assessment method is based on the IRAM risk management method of the Information Security Forum (ISF). We use this to identify and focus our efforts on our mission-critical information resources. We also recognise that all entry and exit avenues in the network, on our systems and in our security processes need to be secured and are therefore executing a security architecture that ensures this.

Our monitoring and detection capability is realised through the use of technology that deals with the masses of event data and enables our blue team to sift through the data, looking for anomalies that spell danger. These team members are formally educated and certified. As a team they are trained through simulations by our cyber consultancies and we endeavour to keep improving their capability and maturity. The same holds true for our red team who strengthens the process by continually looking for gaps in our defences.

We monitor emerging threats and adapt our controls in response to these, focusing specifically on any new advanced threat techniques. Our information security management system has been in operation since 2001. We have also been ISF members since 2000 and frequently take part in their security benchmark.

Empowering Millennials

by

Karishma Ramkelawan
Consultant
Simeka

To get a better understanding of millennials, we need to separate the myth from reality. So, let's confront a number of pervasive myths. Firstly, millennials are not kids and are broadly classified as people born between 1981 and 1996 … therefore 37- to 22-year-olds. Thus they are people broadly from Kendall Jenner to Venus Williams - and that's a big group.

A group that comprises more than 40% of the South African workforce.

A myth that exists is that millennials are needy. In a world of work that has never been faster, never been more demanding and complex, most new employees need coaching and mentoring in order to get up to speed. It's not a generation thing. It's a matter of acclimatisation and maturity, which only happens with time irrespective of when you were born.

Another myth is that millennials are job hoppers. The US Bureau of Labour Statistics forecasts that the typical millennial will have between 12-15 jobs in his working lifetime – not as a function of hopping for hopping's sake, but due to the rapidly evolving and changing nature of the job market. And, these jobs are not necessarily at different employers but simply working in different contexts. A heightened ability to adapt and being comfortable with technology mean millennials are in demand for emergent opportunities.

Speaking of technology … No, millennials are not obsessed with technology. It's simply how they operate in the world. Just as we cannot imagine a world of work without cars, email, Word and Excel, millennials have grown up with certain technology at their fingertips and cannot imagine functioning without these. These are tools and a means to an end. It's important to understand this as technology needs to enable and empower, otherwise it's useless.

Another myth is that millennials don't care about their finances. This is simply not true. They hustle in different ways to make money and to make their money work for them. Millennials save for specific tangible goals – a holiday, a car, a deposit! Goals that are relevant to them.

Bitcoin, for instance, is a great example of how to capture the imagination of millennials. Immediate feedback, top of mind awareness, harnesses technology, a little bit rebellious and a topic of conversation at the coffee shop. A cocktail of psychological triggers that speak directly to the millennial mindset. The challenge for our industry is to realise that we do not connect with millennials in a manner that resonates with them. And then to act with intent.

The paradox of millennials is that, on average, they are better educated than any previous generation. Yet they have lower real earnings, higher levels of debt, experience more unemployment and have less disposable income. Critically, they are unattached to conventions – for instance, getting married in your 20s, having 2.5 kids, religiosity, nationalism, retirement, etc. This means that as a generation they face fresh socioeconomic challenges in a context where appeals to conventional values and approaches are ineffective due to changes in their buying behaviour.

Typically, millennials do not want to be told how to do things but prefer to be guided to how they can begin doing it themselves using the ubiquitous array of online and mobile tools. DIY is the way of the millennial. We find that millennials will research any new potential purchase online, seek peer group feedback on the potential purchase, review ratings for items, rely on word-of-mouth recommendations from trusted sources and only then make the purchase. Think about millennials buying the new iPhone. This is the process that is followed. Within a day, they are able to discuss key technical differences between the options available and have developed a vested emotional connection to their purchase. The breadth of information to inform a purchase is incredible from reviews to blogs to YouTube videos. Millennials are being empowered with the insight to make an informed choice.

When considering the retirement funding context, we find that our industry does not support the buying process of millennials. Information is available but not in the format that is relatable to most millennials and not really in the format they want. Infographics, snackable content and videos work better. The types of comparisons needed are also not available as this would usually fall into the realm of advice, with all of the related implications. There isn't a trusted peer group to test recommendations for a variety of reasons. Product complexity is usually touted as one of the reasons. Yet, millennials are able to explain and engage on Bitcoin and Blockchain, which are far more complex. The issue lies not in complexity but in relatability. And that's within our scope of influence.

A key issue for millennials is whether their purchase aligns with their values. We find that millennials prefer products from companies that help people, communities and the environment. In an investment context, approximately 75% of them want to know that their investment is doing social good, do not want to invest in companies known to be doing social or environmental harm and will only invest in companies that are aligned with their personal values. This speaks directly to the application of CRISA and ESG principles to investment decisions. It speaks even more directly to the need to engage millennials so they understand and appreciate that their institutional investments are being directed towards assets that have a positive impact on society. Currently, there is a vacuum as millennials do not know how their money is being used to help develop our nation. And it's not their fault. It's ours. We need to join the dots for millennials. Doing so would help to emotionally vest the role they are playing in such development through their investment. This would influence future decisions on whether to withdraw such investments going forward, as they are emotionally invested and not just financially invested. And this takes communication.

Millennials tend to respond differently to communication channels and content than other generations. They have grown up in a context where information is being flung their way constantly and pervasively. It's everything and the only thing they know. So, while they will actively draw information when they need to, they are resistant to information being pushed at them. This is a subtle but important difference as our industry tends to rely on push, push, push. Which only results in push back. Our research has shown that millennials favour face-to-face interventions and are most likely to respond positively to word-of-mouth recommendations from a trusted peer. Despite the best intentions, member sessions on retirement funding are available but are about as attractive to millennials as dental surgery. Creating the forum to engage millennials at the workplace requires a different approach. And it is necessary, as millennials are the generation most at risk of achieving poor retirement outcomes.

No clever investment strategy, magical asset manager, sophisticated administration system, transparent costs or anything else matters if members don't preserve. If there's one thing our industry needs to get right, it is preservation.

And it is the most relevant issue to millennials as they will change jobs more often than any previous generation and are therefore exposed to the temptation of withdrawing their savings more than ever before. Exacerbating the problem are FIVE distinct characteristics of millennials.

Firstly, they do not relate to retirement as a goal. Their views on retirement are associated to aging, planning and taxes. This is not an emotionally resonant set of triggers to engage millennials. Or anyone apart from the actuaries. Millennials' pain points with our industry are that there is very limited face-to-face engagement, they are not empowered to be in control of their choices, they feel very isolated during tax season, they are unclear as to what they are paying and what they are actually paying for, and feel the annual feedback cycle is too long. This results in cognitive dissonance whereby millennials disassociate with the construct of retirement and consequently the need to plan for retirement.

Secondly, they are more distrusting of financial institutions as they are experiencing the poor outcomes faced by their own parents. With the blame being placed on our shoulders, rightfully and wrongfully. Furthermore, jargon, hidden fees and a severe lack of diversity act as barriers for South African millennials to relate to our industry. Please remember, this is a generation that entered the workforce around the time of the 2008 great financial crisis. They saw savings being decimated. They have experienced the first part of their careers during the economic slump of the Zuma years. The recent corporate failures are also influencing and shaping their views on who can and cannot be trusted with their money. And any Google search for positive news results in ads and company website hits. A search for cautions and failures leads to press articles.

The net result is that they are highly sceptical.

Thirdly, millennials are both highly confident in their own abilities and highly optimistic about their futures. They expect they will have enough and are self-directed to seek and use information to forge their own path. They don't know what they don't know. In fact, 60% of millennials who indicated that they would not use a financial adviser also indicated that they are well equipped to craft their own financial plan.

Fourthly, despite being highly educated, they have low levels of financial education and literacy relating to budgeting, managing debt and the impact of compound interest.

And finally, millennials typically do not have enough accumulated assets to be of economic interest to financial advisers and wealth managers. As such, they may be left to make critical decisions, especially relating to the preservation of seemingly small amounts initially.

So, millennials cannot relate to the concept of retirement, they are overconfident in their own abilities, distrusting of financial services, have low levels of financial literacy and are generally not receiving advice at withdrawal. That's a perfect storm.

And they make almost 50% of our respective membership bases!

How do we change this?

The research points to a multipronged engagement approach aimed at influencing millennials to make better financial decisions. The first strategy is to enhance how we engage millennials using technology as an enabler. Technology needs to hit the psychological triggers of putting millennials in control, providing relatable insights to empower decisions and make users feel safe. In the context of money, technology is mainly used by millennials to speed up mundane transactional processes. Think efiling, banking, transacting, etc. In our specific context, that means benefit statements, fund values, insurance amounts, transacting and getting immediate feedback on common enquiries. Technology can also be used to communicate and educate. According to Google, 70% of millennials watch YouTube to learn how to do something new or learn more about something in which they are interested. In fact, their findings show that millennials were 2.7x more likely to prefer watching a YouTube video to reading content to learn something new. If you want to be engaging your millennial members, you need to be on YouTube. And in a manner that is relevant if we as consultants, administrators and funds wish to be relevant.

Touching on relevance, representation is required in order for funds to make decisions that are relevant to their constituents. While millennials account for approx. 50% of fund member bases, they account for approximately 5% of Boards of Trustees of SA funds or Management Committees of Participating Employers in umbrella funds. The voice of this generation is not being heard in such forums to the extent required, so it is little surprise that our actions are not resonating with this constituency. Transformation now includes generational transformation.

We must also critically re-evaluate how member sessions are structured and facilitated. Even just including the word 'retirement' on the invitation or agenda will immediately disengage millennial invitees due to the strong negative emotions invoked. An alternative would be to focus on very specific issues to be able to educate in an influential manner. For instance, using internet click-bait tactics to generate interest. Examples: Staff member makes millions: Find out how! The number one secret of millionaires revealed – Durban mom earns R1 000 a day with no effort! Also, the individuals conducting sessions need to be relatable and credible. Millennials don't want to be told what to do or be spoken down to. Such sessions should be conducted by experts who are millennials themselves so they are better able to relate to the challenges faced by their peers.

Retirement benefit counselling presents an incredible opportunity to engage millennials proactively. Engaging such members at pre-set events can demonstrate the level of personal care and recognition they appreciate. For instance, a focus group member cited in a research paper indicated that her fund had contacted her to indicate that she was in the inappropriate asset class for a person of her age. She was engaged, educated and influenced to change her asset strategy. She felt she was being cared for. Consequently, the others in the focus group requested the details of the provider as that is the type of positive experience they want and it also demonstrates the impact of word of mouth. The counselling can do this and more by engaging millennials and influencing them to stay preserved. It's not a silver bullet but it is a bullet that can lead to better outcomes. Our initial analysis has shown that the average fund value of millennial members of the Sanlam Umbrella Fund is R42,000. Typically, not enough for the average adviser to consult on. And this is where

where counselling makes a difference in reality as such members now have a better opportunity to receive the type of insight needed to make better decisions at a compelling time in order to address preservation.

Rather than try to leverage fear tactics to dampen the confidence of millennials by highlighting their lack of financial literacy or viewing them as unrepentant lost causes, we suggest we build their confidence authentically by influencing them towards better financial decisions. Millennials want to be at the centre of their life decisions, and an approach that appreciates this provides the likelihood of better outcomes than the current model of delegated decision-making power. Millennials do not want to be told what they can and cannot do. They want insight that empowers them to self-evaluate what is in their own interest and gives them the ability to make better decisions.

The digital evolution

by

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Digital Lead
Sanlam Employee Benefits

Millennials have been a focus point of many large organisations in the recent and not so recent past. Research has been extensive and at the same time narrow with regard to the findings in respect of these much-maligned creatures workplaces find it seemingly impossible to manage successfully.

As a millennial, it is often frustrating to be so easily classified based on research attempting to demystify us as a group of homogenous beings. For me, millennials are nothing more than a grouping of people within a certain age group (22 – 37). Everyone within this age group will be defined by the experiences they have had during their lifetime. In the US, this could mean 9/11 or the election of the first black president, the sub-prime crisis of 2008/2009 and the numerous natural disasters that have affected that country over the past 15 years.

In South Africa, millennials are defined by the advent of democracy and the subsequent strengthening of the South African economy. We are also influenced by the post-Mbeki era where widespread looting of national funds and 'state capture' resulted in a cautious outlook on life for many, as well as the virtual destruction of the South African economy. In South Africa, however, our exposure to technology/digital (arguably the most defining characteristic of millennials) has not been as widespread as that of the developed world and this drastically affects the extent to which we can be compared to developed-world millennials (on whom most of millennial research is based).

The cost of technology (in the form of smartphones and data) in South Africa has heavily weighed on our ability to leverage off the 'connectedness' as experienced by our developed-world counterparts. What's important though is that as millennials age, we are able to access technology more and more. This is a function of the increased earnings of millennials as well as the reduction in the cost of data and smartphones. Research by Growth from Knowledge indicates that 82% of millennials have purchased a smartphone in the past 2 years.

Digital and millennials

Let's bring all of this back to the workplace and ultimately the retirement fund industry. The reason we need to do this is that millennials now make up the biggest proportion of the working population in South Africa. In the workplace, older generations' perception of millennials is mostly negative (this hasn't been helped by the research by many institutions that are funded by Generation X – probably just a coincidence). Let's take a step back and consider some of these perceptions in context. Student Village, a company based in Johannesburg that assists businesses to connect with the youth market in South Africa, has coined a great term that more appropriately describes young adults in South Africa: Afrillennials.

The research they've undertaken also explains the different points of view of the afrillennial vs the bosses of the afrillennial quite well...

- In the below table, the disconnect between the generations is quite clear:

Afrillennial	What the boss thinks
Techno savvy	You're constantly online and not working
Work smarter	You're lazy
Want feedback	You're so needy
Seek flexibility	You're too lazy! How do you expect to progress without applying yourself?
Ambitious	You're arrogant

Perhaps what we should be doing is taking note of what millennials are looking for and capitalise on that to improve outcomes, both in the workplace and from a retirement industry perspective.

Utilise regulations to engage with millennials

Default regulations make it clear that benefit counselling has to be provided to members of retirement funds. While it would be easy to simply do the minimum required by providing the information (in the form of written documentation) to retirement fund members and leaving them to their own devices, we should take advantage of this opportunity to engage and empower millennials through benefit counselling.

While the above solution may be focused on millennials, there is no doubt that all other generations will also benefit from proactive and well-placed benefit counselling. It's time we stopped looking at solutions for millennials in isolation of other generations, and rather start understanding that solutions for millennials are simply about ease of access and convenience - characteristics from which all generations will benefit.

Umbrella funds research overview

by

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Sanlam Employee Benefits

This is the tenth 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 who participated in umbrella funds.

This research overview will cover the following topics:

Contributions

After 4 years of steady increases, provisioning for retirement funding appears to have dropped to 2014 levels this year due to a reduction in contribution rates. This might be an indication that members are experiencing a financially challenging period. It also highlights the fact that cost savings can only marginally improve retirement funding provision. The main contributor remains actual contribution rates.

Investments

There has been a gradual decrease of investment in employers' default investment options from 80% in 2016 to the current level of 75%. This indicates that members are increasingly making use of investment choices.

Lifestage, as a default investment strategy, has decreased in popularity, although it remains the preferred choice of most employers. Passive balanced funds have gained some traction as a default investment strategy.

Insured Benefits

Risk benefits can be provided via the umbrella fund, a separate scheme or a combination of both. Employers seem to be more in favour of providing risk benefits either through the umbrella fund or the scheme solution, and are less interested in a combination of the two options.

Benefit Consulting and Advice

More participating employers have a formalised strategy in place for rendering financial advice to members. The favoured strategy is to refer members to a preferred financial adviser, as opposed to last year when members were referred to the umbrella fund administrator for factual information as a first port of call.

Retirement

Respondents believed that fewer retirees would be able to maintain their current standard of living in retirement. This is probably as a result of the reduction in contribution rates observed.

Understanding the Participating Employers surveyed

Approximately 86% (2017: 92%) of employers (in line with overall industry trends) participated in one of the "Big 5" commercial umbrella funds sponsored by Alexander Forbes, Liberty, Momentum, Old Mutual and Sanlam.

They were mainly operating in one of the following business sectors: Manufacturing 30% (2017: 27%), Wholesale and retail 15% (2017: 21%), Agriculture, forestry or fishing 10% (2017: 9%), Transport or Logistics 8% (2017: 7%), Hospitality 6% (2017: 5%) and Professional or business services 5% (2017: 9%).

The average membership was 533 (2017: 500), with 59 (2017: 55) of the participating employers having a membership of between 20 and 300. The remaining 41 employers had more than 300 members.

The average value invested in an umbrella fund by a participating employer was R200 million (2017: R257 million), with 41 (2017: 33) employers having less that R50 million invested.

Fifty-nine per cent (2017: 50%) of the employers had a total monthly pensionable salary bill of between 1 and 10 million rand and 52% (2017: 49%) of the employers had a total membership ranging from 40 to 300 members.

- The average employee contribution, as a percentage of PEAR, was 5.5% (2017: 7.3%).
- The average employer contribution, as a percentage of PEAR, was 8.4% (2017: 10%).

Cost of administration

The average cost of administration, expressed as a percentage of salary, decreased to 0.6% (2017: 0.7%). This is most likely the result of increased competition, improved technologies and economies of scale in the bigger commercial umbrella funds. There is significant downward pressure in this segment of the market, especially when new business is tendered. Thus this figure is moving in line with expectations. There is an ever-increasing regulatory burden placed on retirement funds, which will probably have the opposite effect and may prove to reduce (or even reverse) the cost savings achieved in the past. 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 2017, 2016, 2015, 2014 and 2013, this figure is lower than the comparable cost for stand-alone funds.

Contributions

A decrease in total provisioning for retirement of 3.5% (2017: increase of 0.7%) from last year was recorded.

There was a significant reduction in total contributions from 17.3% in 2017 to 13.9% in 2018. This could be partially attributed to the changes in the tax treatment of retirement fund contributions effective 1 March 2016. Some employers might have increased the pensionable earnings (PEAR), which might have been a portion of total guaranteed package (TGP), to equate to TGP. This could have resulted in the same R/c contribution, but a reduction in the percentage of PEAR.

The other obvious (and possibly the largest) contributor to this reduction in contribution percentage was the employees' choice to contribute less towards retirement savings.

	2018	2017	2016	2015	2014	2013
Employer contributions	5.5%	7.3%	7.1%	6.4%	5.6%	5.6%
Employee contributions	8.4%	10%	9.5%	8.8%	8.5%	8.1%
Total Contributions	**13.9%**	**17.30%**	**16.60%**	**15.20%**	**14.10%**	**13.70%**
Death benefit premiums	(1.5%)	(1.3%)	(1.3%)	(1.3%)	(1.6%)	(1.6%)
Disability benefit premiums	(1.1%)	(1.1%)	(1.1%)	(1.2%)	(1.2%)	(0.9%)
Operating costs	(0.6%)	(0.7%)	(0.7%)	(0.8%)	(0.8%)	(0.8%)
Total provision for retirement	**10.7%**	**14.2%**	**13.5%**	**11.9%**	**10.5%**	**10.4%**

Investments

The most prevalent investment strategy utilised by sub-funds is a default investment portfolio, plus member choice, 61% (2017: 62%). Trustees Choice, i.e. no choice for members, was used by 29% (2017: 36%).

The majority of employers surveyed (71%) offered a member investment choice. This figure has increased since last year, after decreasing for a period of three years, from 80% in 2015 to 64% in 2017.

Investment choice

An average of 15 investment options (2017: 6) were offered to members, which is significantly more than what was observed in previous years.

On average, 75% (2017: 78%) of assets were invested in the default investment option. There seems to be a gradual downward trend from the 80% recorded in 2016, when this question was introduced. This may indicate that more members are gradually starting to invest outside the default investment strategies.

The table below shows the trustee choice/default portfolio classification and utilisation over the past years:

	2018	2017	2016	2015
Lifestage	49%	60%	52%	59%
Guaranteed / Smoothed bonus	20%	22%	26%	23%
Balanced active	19%	10%	14%	15%
Balanced passive	10%	4%	3%	5.3%
Cash/Money market	1%	3%	4%	3%

There has been a significant move towards balanced funds as a trustee choice/default portfolio from 14% in 2017 to 29% in 2018.

Lifestage investing

The majority (49%) of the default investment portfolios (2017: 60%) can be described as a lifestage vehicle. 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 was 5 years (for 64% of respondents in 2018 and 50% in 2017) and less than 5 years for 17% (2017: 28%) of respondents.

This year there was some uncertainty (26% vs 10% in 2017) among respondents about whether their lifestage investment strategy was explicitly aligned to their post-retirement annuity strategy. However, 43% (2017: 60%) stated that their lifestage investment strategy was aligned. The uncertainty might indicate that some communication is needed regarding the role of a lifestage strategy and how it fits in with a post-retirement annuity strategy.

Thirty per cent of respondents (2017: 43%) indicated that they had more than one end-stage portfolio intended to align with members' annuity selection.

Most popular annuities allowed for in the pre-retirement phase	2018	2017	2016	2015
Guaranteed annuity (level or increasing)	49%	60%	52%	59%
Guaranteed / Smoothed bonus	20%	22%	26%	23%
Balanced active	19%	10%	14%	15%

It is interesting to note the shift in popularity of the Living annuity (ILLA) from most popular in 2017 to the least popular compared to Guaranteed and Inflation-linked annuities. However, this might just be a result of the uncertainty observed this year.

Seventy-five per cent of participating employers provided members with retirement advice and 13% provided retirement benefit counselling when members entered the pre-retirement phase of the lifestage model.

Other instances where employers (using lifestaging) would provide advice or counselling were when members switched investment portfolios (68%), at withdrawal (when members need to decide whether to preserve or withdraw) (55%) and at life events (marriage, divorce, etc.) (38%).

Insured Benefits

Most participating employers (68%) provided risk benefits as part of the umbrella fund package (2017: 67%), and 25% (2017: 17%) provided risk benefits by way of a separate scheme. Some (6%) (2017: 16%) provided risk benefits as a combination of the umbrella fund package and a separate scheme. The growth in preference for a separate scheme seems to have come only from the combined offering.

Risk Benefits – Umbrella Funds

The most popular risk benefits provided as part of the umbrella fund package were death benefits at 99% (2017: 96%), disability benefits at 96% (2017: 93%) and funeral benefits at 68% (2017: 45%).

- The average lump-sum death benefit was 3.0 times (2017: 3.1 times) annual salary.
- The average lump-sum disability benefit was 2.4 times (2017: 2.4 times) annual salary.

These benefits were fairly consistent with last year's figures.

Risk Benefits – Separate Schemes

- The average lump-sum death benefit was 3.5 times (2017: 2.9 times) annual salary.
- The average lump-sum disability benefit was 2.5 times (2017: 1.9 times) annual salary.

There has been an increase in the cover provided via a separate scheme since last year.

Benefit Consulting and Advice

Twenty-five per cent of consultants/brokers (2017: 25%) were remunerated based on statutory commission, while 61% (2017: 62%) negotiated a fee with the participating employer. The percentage of consultants/brokers who negotiate a fee with the participating employer has been increasing every year since 2014, from 24% to the current level where is seems to have remained stagnant since last year.

Of the 100 participating employers, 31 selected consultants or brokers based on company brand, 27 based on price and 13 based on the range of advice offered.

A significant portion (64%) (2017: 62%) of participating employers had a formalised strategy in place for rendering financial advice to members. When asked to describe this strategy, 34% (2017: 21%) indicated that they referred members to preferred financial advisers. A further 27% (2017: 42%) indicated that the umbrella fund administrator provided factual information about available options and only then, if members required further advice, were they referred to the fund's financial adviser. Twenty-two per cent (2017: 26%) indicated that the participating employer offered advice services to members by way of an adviser paid for or subsidised by the participating employer.

Retirement

Respondents estimated that, on average, only 14% of their retirees (2017: 18%) would be able to maintain their current standard of living in retirement.

Only 50% (2017: 62%) believed the use of Net Replacement Ratio (NRR) was a suitable measure for determining whether a member was on track for retirement. A number of respondents (22%) (2017: 19%) believed members did not understand this measure.

Twenty-five per cent of participating employers (2017: 36%) had a target NRR towards which the trustees were actively working. Of these participating employers 72% (2017: 83%) 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 68% (2017: 74%).

A consistently increasing number of respondents believed the trustees of their umbrella funds had implemented an appropriate default annuity strategy for members. This figure has increased from only 15% in 2014 to the current level of 33%. The most popular default annuity products selected were as follows:

	2018	2017	2016	2015	2014
Combination of different annuities	27%	0%	11%	28%	13%
Guaranteed annuity (level or increasing)	18%	17%	22%	32%	40%
Guaranteed annuity (level or increasing)	18%	17%	22%	8%	-
Living annuity	12%	45%	26%	8%	47%

A further 16% (2016: 13%) 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 and 21% (2017: 23%) believed this was not being considered at all. Seventeen per cent (2017: 9%) were participating under a provident fund and believed a default annuity strategy was not applicable to them.

The most important factors in selecting a default annuity provider were identified as security of the product (33%) (2017: 45%), cost of the product (30%) (2017: 24%) and a smooth transition from pre- to post-retirement (21%) (2017: 21%).

When annuity product features were considered, participating employers indicated the following to be the most important:

	2018	2017	2016
Longevity projections (income for life)	30.0%	25.0%	24.0%
Allowing for pensioners to maintain their pre-retirement lifestyle as long as possible (even if not for the full duration of retirement)	28.0%	32.0%	20.0%
Annuity income that keeps pace with inflation	24.0%	30.0%	43.0%

The Power of Compounding

by

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Picture a small ball of snow increasing in size as it rolls down a hill. With each rotation, the surface of the snowball increases, which in turn allows more snow to accumulate with the next rotation. Thus the snowball is not only growing, but it is growing faster with each rotation.

It is no secret that South Africans will be in trouble when they reach the age of 60 to 65, at which stage the employee-employer relationship will end. It is at this point that savings will have to be used in order to substitute remuneration previously received from the employer.

Our research shows employers estimate that on average only 14% of their employees will be able to maintain their current standard of living when they reach that 60 to 65 age band. This is worse than last year's 18%. Even worse is the fact that total contributions, expressed as a % of pensionable earnings (PEAR), have decreased from 17.3% to 13.9%. This was the average experience in the major commercial umbrella funds.

Enough doom and gloom. How do we go about improving this situation? There are various options, among others increasing contributions, preserving withdrawal benefits and postponing retirement. Combining these three is extremely powerful. Similar to the snowball effect, retirement savings start out small and have the potential to grow significantly due to the compounding effect of growth.

Not preserving when changing jobs would be similar to stopping the snowball halfway down the hill and starting with a small snowball all over again. If this is done multiple times along the journey, one might end up with an insignificant "snowball".

Postponing retirement would be like allowing the snowball to roll further down the hill, i.e. allowing more time for the snowball to accumulate "snow". Increasing contributions would be like increasing the size of the snowball as it is rolling down the hill.

From the snowball analogy one can see how each factor plays a role and how the combination can have an impact on savings. Quantifying the impact of each factor will help illustrate its importance.

- Take a hypothetical 25-year-old member with:
- Starting salary of R5 000 p.m.
- Starting contribution rate of 8% of salary
- Salary increases of 6.5% p.a. throughout his career
- 9% p.a. interest earned on retirement savings
- No break in contributions during the period in question.

If we now assume the following:

1. **Contribution Rate**
   The starting contribution rate of 8% remains constant throughout the member's career
2. **Preservation**
   The member starts preserving at the age of 35 when changing jobs, i.e. effectively starting to save for retirement at the age of 35.

3. **Retirement age**
   Retirement age is 60.

Based on these assumptions the savings at retirement age would be R1 504 567.

By changing each of these three assumptions in isolation results in the following:

Contribution Rate
If only the 1st assumption is changed by increasing the contribution rate by 10% each year, capping the contribution rate at 20% (after 10 increases) - i.e. from 8% in year 1 to 8.8% in year 2 etc. and finally to 20% in year 10 - the savings at retirement age would amount to R3 761 417 vs. R1 504 567.

Preservation
Reverting to the original set of assumptions, if only the 2nd assumption is changed to preserving from day 1, i.e. age of 25, then the savings at retirement age would be R2 449 882 vs. R1 504 567.

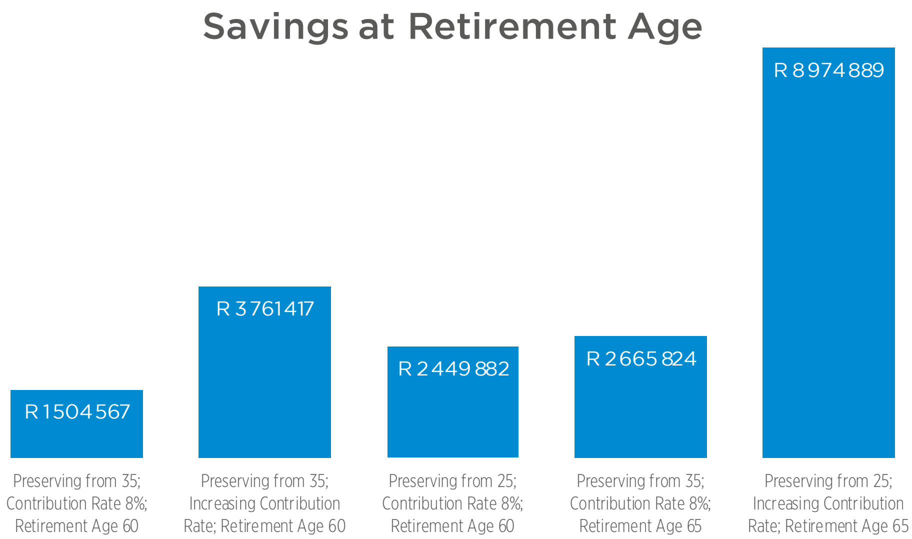
Retirement age
Reverting to the original set of assumptions again, if only the retirement age was changed to 65, the savings at retirement age would amount to R2 665 824 vs. R1 504 567.

As you can see, these changes in isolation make a difference, but the real impact is made when you combine them, i.e. if we change all 3 assumptions to:

1. The starting contribution rate of 8% increasing by 10% each year, capping it at 20% after 10 years.
2. Preserving from day 1, at the age of 25 when changing jobs.
3. Retirement age is 65.

By doing so, the savings at retirement age would amount to R8 974 889.

The graph below summarises the effects.



Staying with the last set of assumptions, let's assume you cannot make any contribution from age 60 to 65. In that case the savings at retirement age would still amount to about R8.2 million.

How does one practically accomplish this?

Firstly, prepare yourself mentally.
Do not spend your annual increase, bonus or withdrawal benefit (mentally) before you've received it.

Secondly, try to increase your contribution rate the same month that you receive your annual increase. This will reduce the impact on your take-home pay. If you are not allowed to change your contribution rate, increase your contributions by way of an additional voluntary contribution (AVC). Also, try to make additional contributions in the month you receive your bonus.

Thirdly, try to preserve full withdrawal benefits when changing jobs.
If it is not possible, try to preserve a portion of it.

Lastly, try to postpone your retirement as long as practically possible. If you have to retire from employment at a certain age but do not need your retirement savings to provide you with an income at that point, consider phased retirement, where the election pertaining to retirement pay-outs is essentially deferred.

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