



# Benchmark 2019

Enabling Financial Resilience

## Research Summary

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# A nation built on economic and political resilience

Post national elections, there appears to be a sense of hope and renewed energy in the country. As I reflect on these positive sentiments I am reminded of the courage of South Africans who have remained resilient in the face of economic and political challenges over the past 30 years.

As in 1990, South Africa is once again experiencing a sense of euphoria and hope, albeit on a much smaller scale. The winds of change are upon us. This time it will require sound economic policies and effective implementation with a level of accountability to withstand the economic forces that detract from value.

Despite the glimmer of hope, the South African economy will still be challenged by three structural inefficiencies for years to come:

- » Unemployment,
- » Education, and
- » Healthcare.

The unemployment rate in South Africa increased from 27,1% to 27,6% in the first quarter of 2019. In essence, the number of people without an income is approximately 6,20 million and the number of employed individuals decreased by some 237 000 to 16,29 million.

This year our research included a deep dive into the concept of financial resilience, which is essentially the ability of individuals and corporates to withstand the financial impact of a downturn in the economy.

Our research has highlighted that the two mutually dependent variables that have the biggest impact on an individual's ability to be financially resilient are:

- » Income, and
- » Education.

This does not suggest that educated professionals always make the correct financial decisions. In fact, they are perhaps more open to financial messages and are better able to recognise where remedial action on their part is required to improve their personal financial resilience score.

Incidentally, we asked the Principal Officers who participated in our research whether they were personally financially, emotionally and psychologically ready for retirement and fewer than half (41%) were confident that they are prepared for it.

Preparing for retirement requires careful planning and commitment to the process and the conviction that the advice you receive along the way will assist you in reaching those desired financial outcomes.

I believe all stakeholders in the employee benefits industry can be held accountable to safe-guard and future-proof the retirement savings of those employed individuals who participate in employer-sponsored retirement schemes.



by

**Jocelyn Hathaway**  
Acting CEO  
Sanlam Employee Benefits

## **Healthcare versus retirement benefits conundrum**

While the industry can take accountability for the outcome, it cannot take full responsibility for the decisions and actions taken by individuals or corporates. As an industry we can provide information and tools that will assist individuals and corporates to make informed decisions.

Intermediaries (13%) indicated that employers buy down on benefits due to financial constraints as a consequence of a downturn in the economy. One third (37,5%) indicated that some corporates regard healthcare as more important in the lives of their employees than retirement funding. Costs aside, why does it have to be either/or in some instances when both benefits are critical to ensure the health and financial well-being of individuals?

## **The threat of cybercrime on retirement funds**

Funds and members are increasingly being placed at risk by cyber-related crime. As a response, many corporates have made significant monetary investments in administration platform upgrades and have implemented revised IT policies and procedures with the aim of making it more secure and mitigating any potential risks or the threat of risks. This is a fairly new item on the consulting agenda. An overwhelming 71% of funds/employers have experienced an increase in the level of governance required to future-proof administration platforms.

## **But what is Sanlam doing to enable financial resilience among staff?**

In response to this question, I am pleased to say we have also conducted the Financial Resilience Index research among Sanlam staff. The results confirmed that regardless of the sector and the functional roles individuals have, across the board people are finding it hard to cope financially. Within the process we have identified a number of strategic deliverables, which the Sanlam Group is exploring with the aim of making a difference and empowering staff along their financial journeys.

## **A word of appreciation**

I invite you to read this report and engage with anyone in my team if any of the issues we have raised herein are of interest to you. They are all available to discuss their research insights in greater detail and willing to present their views on industry platforms.

Once again, I thank my team who have worked tirelessly over the past 8 to 10 months to complete this body of research, which we hope will become a useful consulting tool.

The research data book containing the detailed data tables and graphs can be downloaded on [www.sanlambenchmark.co.za](http://www.sanlambenchmark.co.za).

At Sanlam we have been trying to make a difference for the past 38 years through our detailed research insights and will continue to do so.

Financial resilience is not just a concept, but a way of empowering individuals to be in control of their finances and to help people feel more financially secure.

# Executive Summary: Financial resilience in retirement

“The best way to predict the future is to create it.”

*Peter Drucker*

This year our research looked at retirement funding from a financial resilience perspective. The golden thread throughout the research papers in this report is that retirement readiness requires active planning and commitment on the part of all stakeholders.

We provide a view of significant trends that have occurred since the 1980s and which have shaped the industry into what it is today. We note the ongoing shift from stand-alone funds to umbrella funds and the continuing convergence of the institutional and retail sectors. The retirement fund industry is evolving into a competitive landscape with a focus on members. For the first time journey mapping is being used as a blueprint to plot member journeys from on-boarding to their transition into retirement.

The retirement fund industry remains a formidable force in the lives of individual members, employers and intermediaries. Each of the authors below provides his or her unique take on the various studies conducted in 2019.

**Kobus Hanekom:** *Watershed developments in South Africa.*

In his paper based on his Article published in volume 90 of The International Pension Lawyer Kobus looks at significant shifts that have taken place in the South African retirement fund industry from the early 1980s and at the present-day challenges facing trustee and members of stand-alone funds. Notably the shift to DC umbrella arrangements and regulatory changes are informing much of the discussion points. The retirement reform white papers that were first introduced in the early 2000s but were never enacted and the more recent Default Regulations come under scrutiny and review by Kobus.

**Thulani Mbolekwa:** *Financial resilience and stand-alone union funds.*

Thulani presents an overview of his research insights based on the subset of union-influenced stand-alone retirement funds. One of the key findings Thulani reports on is the fact that members' priorities for risk benefits versus retirement savings vary according to income levels. The level of income where shifts in behaviour are notable is estimated at R30 000 a month. Despite all the information available on the impact of longevity there has not been a demand by members for employers to increase the normal retirement age.

**Viresh Maharaj:** *Megatrends.*

Viresh provides a deep-dive analysis into the various studies that make up the Sanlam Benchmark research for this year. He unpacks the data from the perspective of four consulting disciplines, namely fund administration, investments, retirement and governance. One of the key themes he extracts from the data relates to the consolidation of stand-alone retirement funds and its impact on the broader retirement funding landscape.



by

**Wagieda Pather**

Market Insights  
Sanlam Corporate

### **Danie van Zyl:** *How much are we putting away for retirement?*

Danie compares the different contribution levels towards retirement savings and deliberates whether these levels are adequate enough to meet members' retirement objectives. Interestingly over the three- and five-year periods the net provision for retirement is just short of 14%, which indicates the positive trend in contribution levels and saving for retirement.

### **Karen Wentzel:** *Trustee-endorsed default annuity regulation – the scorecard*

Karen provides insight into the research relating to Section 39 of the Pension Funds Act that requires defined contribution retirement funds, including retirement annuity funds, to have in place a trustee-endorsed default annuity strategy. She lists the attributes required for the ultimate success of default strategies.

### **Michele Jennings:** *Climate Change in the Group Risk industry.*

Michele poses the question whether the industry was avoiding the early warning signs of climate change in the industry. She affirms that too little is currently being done to ensure group risk is a sustainable proposition for insurers and, more importantly, members of group schemes. She raises some concerns about the impact of income tax legislation changes, which have resulted in deteriorating disability experience since 2015.

### **Rhoderic Nel and Darryl Moodley:** *South Africa's new normal.*

Rhoderic and Darryl report on investment returns for the 10-year period to April 2019 and the impact thereof on the vast majority of retirement fund portfolios. These typically have a large proportion of their assets invested in South African equities and were consequently not able to generate double-digit returns. They affirm the importance of communicating with members during times of volatile (and low) investment returns. They also point out that a communication strategy should be able to drive the right behaviours rather than focus exclusively on investment returns.

### **Jason Liddle and Fred White:** *Regulation 28 - are we getting there?*

Jason and Fred forewarn about inherent challenges within recent changes and revisions, which Regulation 28 still has to heed. These include managing concentration risks, keeping pace with changes in technology and societal behaviour patterns, accessing measured exposure to countries and regions over time, and managing our own country and political risk.

### **Barend le Grange:** *Deciphering the individual – One size does not fit all.*

Barend reintroduces the Sanlam Financial Resilience Index (SFRI) and recaps on the intent of Retirement Benefit Counselling. He highlights that on members' retirement journey, the proverbial devil is in the detail. Having access to member data allows funds to run a number of statistical models that could potentially uncover the tiniest details which often contain some of the most valuable information upon which important decisions need to be based.

### **Tebogo Legodi:** *Information insecurity.*

Tebogo sounds the alarm bells about one of the biggest risks the industry faces - the threat of cybercrime against legacy retirement fund administration platforms. Information security is the practice of preventing the unauthorised use, disclosure, disruption, modification, inspection, recording or destruction of information, whether physical or electronic.

### **David Gluckman:** *Make retirement great again.*

David argues that in a properly constituted competitive market, "doing good is good business". He reviews the specific calls to action made in the 2009 Benchmark presentation and which have been core to the reform movement over the past 10 years. From as early as 2007 he was clear that it was about going to work every day with the idea of working towards improving member retirement outcomes – much more powerful rhetoric than the ongoing debate in industry committees.



**Anna Siwiak:** *Changing the perception of retirement.*

According to Anna it's critical that we change the perception of retirement from an idyllic view to a more realistic one with a practical approach. Some retirees are dreading retirement as the prospect of possibly running out of capital is a real concern. Not all employers have the resources to offer employees work opportunities beyond retirement. The key to coming as close as possible to the desired retirement is to start planning immediately.

**Avishal Seeth:** *Future advice: The spectrum is widening but the focus is becoming clearer.*

Avishal hypothesises that the right communication with members at specific points in their retirement journey will have profound effects on their ability to retire with their desired financial outcome. He explains that retirement funds are an integral part of the total financial wellness system. The greater focus on members rather than on funds or employers is becoming the new norm. With members at the centre of the value chain, employers and retirement funds must be able to communicate with or educate members at the right point in time. The key to a good communication strategy is understanding this journey at a micro level.

**Richard van Dijk:** *Empowering advisors to participate in employee benefits.*

Richard points out that the convergence of institutional and retail business has created both challenges and opportunities for advisors. Consequently, some advisors might be reluctant to be involved or participate in the employee benefits space. The advisors who are able to provide holistic financial advice will be positioned to make a positive impact on retirement outcomes for members. In pursuit of an enhanced Member Services Programme for funds, stakeholders should further this by facilitating access to membership of funds to professional advisors to best represent members and lifelong financial planning needs.

**Johan Prinsloo:** *The fourth industrial revolution and saving for retirement.*

Johan presents his view on the much-publicised Fourth Industrial Revolution from a retirement funding perspective. He believes that at its core it's a combination of big data, analytics and physical technology. Big data and data analytics are believed to be a key differentiator in retirement funding in the future as it could potentially improve savings and preservation levels. Data-driven insights are drawn from member data to monitor their behaviours in respect of the preservation or withdrawal of their retirement benefits at termination of employment.

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.

**Martin Neethling:** *Importance of healthcare solutions for employer groups.*

Martin confirms that employers have long recognised the link between business success and employee well-being. For many South Africans, medical cover is their second-highest monthly expense. Increased cost and shifts in healthcare needs are having a significant impact on members' financial resilience. Studies estimate that fewer than 10% of medical scheme members currently have gap cover, the absence of which could be a strain on finances, upsetting a carefully calculated financial plan on a monthly basis.

**Shakeel Singh:** *Umbrella funds research overview.*

Shakeel provides a synopsis of the umbrella funds research across all the standard disciplines of contributions, investments, insured benefits consulting, advice and retirement. Total provision for retirement has dropped back to 2016 levels. He points out that there is a notable shift away from employers paying the total contributions plus cost.

All the research is available at [www.sanlambenchmark.co.za](http://www.sanlambenchmark.co.za), our Benchmark research hub created especially for you.

# Watershed developments in the South African retirement fund industry

*Article published in volume 90 of the International Pension Lawyer*

During the 1980s the South African retirement fund industry made a significant shift away from defined benefit (DB) funds to defined contribution (DC) funds. Today, only a handful of employers offer DB fund membership to new employees, civil servants being a notable exception.

## The shift to DC umbrella funds

During the 2010s another significant shift took place. This time away from stand-alone funds established by employers for their own staff to commercial umbrella funds (multi-employer funds). As the industry became more and more regulated and litigious, many employers realised they simply do not have the economies of scale to ensure appropriate governance or offer their members the same range of benefits, communication and IT-driven tools and resources at the same competitive rates as those offered by commercial umbrella funds.

The shift to DC has been near complete. One of the aspects that has made it so popular, especially with union members, is the fact that in a DC fund the member is entitled to both the employer and employee contributions (including benefits transferred from another fund) plus the investment return thereon. In the typical DB environment members were entitled only to the member contributions plus a nominal return. Another big contributor to the popularity of especially DC provident funds is the fact that in a provident fund members are entitled to take their entire benefit in cash at withdrawal and retirement. This level of certainty and control made provident funds very popular among union members, so much so that the legislation designed to make annuitisation of two thirds of the lump-sum retirement benefit compulsory in respect of provident funds (only with regard to contributions made after the effective date) has been postponed for four years in a row now.

## Retirement reform

During the early 2000s, National Treasury embarked on a retirement reform programme and published a number of research papers. An early finding was that although the industry is well run, members do not have adequate pensions when they retire. The reason for this is not so much insufficient contributions but the fact that members rely on their pension benefits to tide them over when they lose their jobs or experience other life crises. Contributing factors are the DB mindset and the level of apathy of the typical member. Although membership of retirement funds is compulsory for eligible employees, the level of benefit that may become available at retirement is often not understood and effectively left to chance by most members.



by

**Kobus Hanekom**

Independent Principal Officer  
**Sanlam Umbrella Fund**



During the past decade, the SA industry has therefore been confronted with the shortcomings of the DC funding model. In a country with a very high unemployment rate (officially around 27.6% but closer to 48% when those who have given up seeking employment are included) and a high level of leakage from the system (many take their benefits in cash when they change jobs or when they retire), pressure is mounting on the immense cost of the means-tested old-age pension system.

## Dealing with the shortcomings of DB and DC

In jurisdictions such as the Netherlands and Canada the shortcomings of the DB system led stakeholders to develop solutions such as “collective DC” and “targeted benefits”. In these jurisdictions there was a realisation that to allow a large employer to go under on account of a pension deficit would be such a massive blow for all those employed by it, as well as for the local economy, that the model was simply not sustainable and had to be modified. The solution was to replace the existing pension promise with one that was more flexible and could be adjusted actuarially to take into account the realities of a negative economic cycle, where required.

In the South African DC environment these concepts found little traction. Instead, the industry focused on member education and awareness and the development of retirement calculators and tools that could assist members to start their careers with a good retirement funding strategy and to monitor and adjust it on a regular basis.

This notion gave rise to the industry supporting a more holistic approach to retirement provision, introducing a form of targeted retirement benefits measured in terms of a replacement ratio. This required the design of the default investment portfolio and annuity options at retirement no longer being considered in isolation but as part of an integrated plan to ensure good retirement outcomes.

## The Default Regulations

A set of requirements, issued in terms of the Pension Funds Act and known as the Default Regulations, became effective on 1 March 2019. These requirements formalised and elevated the holistic approach to a whole new level. The regulations require the board of every fund to implement

- a default investment portfolio(s) that is/are appropriate for the profile of members who will automatically be invested in it;
- a default preservation strategy that the withdrawal benefit can be invested in and preserved, in the event of job changes etc., and
- an appropriate annuity strategy for retiring members.

The Default Regulations were the first measures to require boards of trustees to be proactive and to develop or find the most efficient and cost-effective solutions and products. This means they have to sign off on both the design as well as the products and service providers and report on the costs and outcomes on a regular basis. It also means they have to provide benefits and services to paid-up or deferred members who are no longer contributing employees. This aspect introduces a retail element with all the complications of retail type business. For many boards the introduction of the Default Regulations was a watershed moment. The complexity, responsibility and the level of personal risk each trustee is exposed to under the new regulations are such that many opted to transfer their members and participate in an umbrella fund.

This shift exposed another fault line in the group retirement fund industry, namely the massive difference between wholesale and retail costs and charges. Some stand-alone funds opted not to provide these benefits (e.g. annuities) in-fund but outsourced them, often at a higher price.

The appetite umbrella funds displayed in the development of in-fund solutions and products is instructive. For umbrella funds it was less of a disruption and more of an opportunity to attract and retain business. Given the highly competitive nature of the industry, the cost and efficiency of the solutions offered will be studied closely by benefit consultants and will no doubt have an impact on future business flows.

## The most compelling default investment portfolio

Another one of the many challenges funds faced in the implementation of the Default Regulations is the extent to which they should focus on the needs of the member profile as opposed to what is considered appropriate and responsible as a general rule.

One example is the selection of default investment portfolios. On paper, the most effective long-term investment strategy is a form of lifestage strategy. This strategy is able to adjust to the needs of each member relative to his or her normal or selected retirement age. During the accumulation phase the portfolio construction is as aggressive as the risk profile would allow.

A few years before normal retirement age, however, the member is systematically invested in a more conservative gliding path. This is done to protect against negative returns and to align with the most compelling annuity option for a person in that position. On paper, this solution is good for all members.

In reality, however, it does not satisfy the needs and preferences of a significant percentage of the membership. For them the following indicators dominate: lower levels of job security, lower levels of financial literacy, intense discomfort with negative fluctuations in the investment market, inclined to interpret short-term investment fluctuations as losses that can translate into industrial action, investment horizon not aligned with retirement but whenever a life crisis compels the member to rely on his or her retirement benefits. For such members a smoothed bonus or guaranteed type portfolio is a better fit. Even though the cost may be significantly higher, the guarantee provides the certainty, the trust and legitimacy of the system that workers require.

### The most compelling annuity strategy

Another example is the choice between a guaranteed annuity and a living annuity (a drawdown). On paper, the most sustainable and appropriate solution is a guaranteed type annuity linked to inflation. In reality, however, a significant proportion of members have not saved enough to be able to retire with dignity and, as a result, the guaranteed annuity is inappropriate and just too expensive. The living annuity, on the other hand, allows a member to select an income of between 2,5% and 17,5% of the balance of the capital invested, on an annual basis. It allows members to draw a more liveable pension in the first few years – even if it means they will run out of money and will have to rely on the old-age pension at a later stage.

### The structure and design of umbrella funds

The next important development that is playing out in South Africa at present is the structure and design of umbrella funds. These multi-employer funds have been allowed to develop and grow into mega funds despite the fact that the Pension Funds Act, designed for stand-alone funds, was never a perfect fit.

One of the reasons for the delay in finding appropriate solutions is that influential commentators see the narrow design of stand-alone funds as an essential part of the genetic code of a retirement fund and have great difficulty with the notion that commercial fund offerings have developed into products that can be offered and supported only by a commercial sponsor. Those who lobby for more appropriate legislation tend to align with the concepts and developments with regard to master trusts and contract-based arrangements in the UK and Australia.

Umbrella funds are vibrant and lead the industry not only in respect of their economies of scale but also when it comes to innovation and the use of the latest technology to facilitate greater member communication and support. They are well run, enjoy wide support and have shown exceptional growth over the past few years. In an industry where the authority encourages the consolidation of retirement funds (down from 13 000 in the mid-2000s to around 2 000, with a target of 200 to 300 funds), umbrella funds are no longer attracting business only from the small and medium to the odd large stand-alone funds. In the past few years they have increasingly attracted the participation of very large stand-alone funds with thousands of members and billions of rands under management.

# Financial resilience and stand-alone union funds

Financial resilience is the ability to withstand events that impact one's income and/or assets while being able to take advantage of opportunities for growth. Some financially stressful events, such as death, disability, divorce, health problems and retirement, affect people in different ways. The solutions our industry provides enable members to be more financially resilient.

Sanlam has been conducting research among union funds since 2013. This year the sample of 10 funds collectively represented R55.5 billion assets under management and 272 600 active members. Seven of the 10 funds have participated in the study each year since inception. This is significant as it allows us to report on shifts in the data and highlight any potential impacts on members' ability to future-proof themselves towards their desired financial outcomes at retirement.



by

**Thulani Mbolekwa**  
Head: Public Enterprises  
Sanlam Employee Benefits

## Advice

Our research revealed that members' priorities for risk benefits versus retirement savings vary by income levels. Lower-income earners tend to prioritise risk benefits and higher-income earners prioritise retirement benefits to some extent. The level of income where shifts in behaviour are notable is estimated at R30 000 a month.

More than half (6 out of 8) funds have a formalised strategy for rendering financial advice to active members. Advice is critical at the point where members make any change in their benefit choices. This is especially true when members buy down the level of risk benefits or simply reduce their level of contribution towards their retirement savings. Unfortunately most funds make advice available only when new members join the fund and on exit from the company, when members need to be encouraged to preserve their withdrawal benefit.

Principal Officers have indicated that the top two priorities for the income segments are as set out in the table below.

| Low-income earners  | High-income earners                  |
|---------------------|--------------------------------------|
| Funeral cover       | Retirement savings                   |
| Life and disability | Life and disability, and medical aid |

## Retirement Benefit Counselling

Most funds have indicated that by March 2019 they complied with the Default Regulations that require members to have access to Retirement Benefits Counselling before receiving a withdrawal or retirement benefit. The majority (80%) of funds are of the opinion that Retirement Benefits Counselling will assist in improving retirement outcomes for members.

Funds have reported that Retirement Benefits Counselling is being provided to members by either:

- The administrator;
- Human Resources; or
- Written communication.

Some funds have opted not to implement Retirement Benefits Counselling with human interaction because:

- It simply creates another layer of cost that will have to be carried by the member.
- There is still some lack of clarity regarding exactly what Retirement Benefits Counselling entails.
- The fund/employer is not willing to pay for the service because it will not add enough value.

### Default preservation and paid-up benefits

The majority of the funds (80%) believe it is a good idea that a member’s withdrawal benefit cannot be paid in cash unless the member instructs the fund in writing after having been provided access to Retirement Benefits Counselling. However, 20% of the funds believe members will do anything to access their benefit in cash.

### Retirement

Only one of the union fund employers has considered increasing the fund’s retirement age due to the potential impact of longevity. It seems as if there is a lack of demand from members to increase the retirement age despite the fact that trustees believe only 16% of members will be able to maintain their current standard of living in retirement.

Most funds believe the Net Replacement Ratio (NRR) is a suitable measure to determine whether members are on track for retirement. About half of the funds have a stated target pension (usually expressed as NRR) that trustees actively work towards achieving.

### Income Replacement Ratio targeted

|      | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
|------|------|------|------|------|------|------|------|
| Mean | 74%  | 57%  | 56%  | 75%  | 59%  | 75%  | 59%  |

### Fund administration costs and fees

In 80% of the cases fees are negotiated between the employer and advisor, with 7 out of 10 funds expressing the administration fee as a fixed cost per member per month, averaging R34.

### Fund administration fees

|      | 2019   | 2018   | 2017   | 2016   | 2015   | 2014   | 2013  |
|------|--------|--------|--------|--------|--------|--------|-------|
| Mean | R34.22 | R40.60 | R27.38 | R34.60 | R29.50 | R25.00 | R26.0 |

The fund’s consultant or broker is appointed on the basis of the consulting company’s brand or track record and the price or cost of service.

Interestingly, for the one employer who considered providing benefits under an umbrella fund structure, competitive fees ranked as the main deciding factor.

### Cost and level of group risk benefits

About half of the funds’ percentage of remuneration that is pensionable ranges between 70% and 100%.

On average, the group life benefit has remained constant for the past seven years at around three times annual salary.

### Group life cover as a multiple of salary

| Approved Group Life | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
|---------------------|------|------|------|------|------|------|------|
| Mean                | 2.92 | 3.00 | 3.25 | 2.69 | 3.50 | 3.00 | 3.5  |

### Group life cost as a percentage of salary

| Approved Group Life | 2019  | 2018  | 2017  | 2016  | 2015  | 2014  | 2013  |
|---------------------|-------|-------|-------|-------|-------|-------|-------|
| Mean                | 2.25% | 2.58% | 1.75% | 1.81% | 2.68% | 0.92% | 1.25% |

This year the replacement ratio of the income benefit payable upon disability averages around 78,3% and two of the funds have considered reducing this benefit due to changes in the income tax legislation that came into effect in 2015 when disability benefits were no longer taxed. The current rate of providing this benefit is around 1,1% of salaries.

Only one of the funds provides a critical illness benefit of R75 000, which is payable in the event of a severe illness.

### Contribution levels

Since inception, contribution levels have remained fairly constant, with the average employer contribution at around 9% while the employee contribution hovers at the 7% level over the 7-year period.

### The total employer contribution

|      | 2019  | 2018   | 2017  | 2016  | 2015   | 2014  | 2013  |
|------|-------|--------|-------|-------|--------|-------|-------|
| Mean | 8.20% | 11.33% | 8.57% | 9.60% | 10.89% | 7.55% | 7.36% |

### The employee contribution (excluding additional voluntary contributions)

|      | 2019  | 2018  | 2017  | 2016  | 2015  | 2014  | 2013  |
|------|-------|-------|-------|-------|-------|-------|-------|
| Mean | 7.45% | 7.25% | 7.35% | 6.32% | 6.66% | 5.93% | 6.94% |

### Investments

The services of a specialist investment consultant is used by 9 out of 10 funds. Half of those funds believe it is the responsibility of the fund administrator, while the others are of the opinion that it is the responsibility of the specialist investment consultant to consolidate investment reporting and performance as well as to reconcile the investment amount.

Investment performance is assessed against CPI-related performance and/or composite indices.

An asset manager's performance is reviewed over a three- to five-year period before the decision is made to dismiss or replace him. The two factors that have the greatest influence on this decision are performance (80%) and fees (20%).

Over the period 2015 to 2019 the proportion of the funds' assets invested in the Default Investment Strategy has gradually increased.

### Percentage of assets invested in Default Portfolios

|      | 2019  | 2018  | 2017  | 2016  | 2015  |
|------|-------|-------|-------|-------|-------|
| Mean | 95.00 | 81.40 | 88.90 | 89.40 | 80.60 |

## Cybersecurity

Funds and members are increasingly being placed at risk from cyber-related crimes. Funds have experienced an increase in the level of governance required in order to future-proof administration platforms. To this end, funds have instituted the following steps to protect themselves and their members from the threat of cyber-related crime:

- Administration has been upgraded and revised IT policies and procedures have been implemented.
- System protocols and applications have been revised.
- Investment has been made in IT infrastructure to make it more secure and to mitigate any potential risks or the threat of risks.
- Extensive education and training programmes for staff have been rolled out.

## Directive 8

Most funds have taken a practical approach to implementing Directive 8 whereby all gifts regardless of value have to be declared and approved by all board members. In some instances, board members are not allowed to accept any gifts from any service providers. The majority of Principal Officers indicated that they would have no problem reporting any transgression.

The research has highlighted that, except for contribution rates, union-based stand-alone funds are not too dissimilar to other stand-alone funds. Union funds' contribution rates are more aligned with those of participating employers in umbrella funds and slightly lower than those of other stand-alone funds.



# Megatrends

In 1982 an American Futurist, John Naisbitt, published what at the time was considered to be a ground-breaking book called Megatrends. He was very specific in how he saw the future of the world; and today many of his predictions have come true. To arrive at his future view, he applied the maxim that “the most reliable way to anticipate the future is to understand the present”. And that is where the Sanlam Benchmark helps all of us to understand the state of the retirement industry in order to anticipate not only where we going but also to be able to influence the destination.



by

**Viresh Maharaj**  
Chief Executive:  
Corporate Sales and Marketing

When looking at the data it is clear that the biggest megatrend in our industry of the past decade is continuing, and this is the rapid consolidation of stand-alone funds into umbrella funds. Our sample of 100 stand-alone funds consists of only four that started over the past 10 years, whereas 55 of the umbrella employers started in this same period. Go back a bit further and the comparison is starker. This speaks to the slowdown in the growth of the stand-alone funds and the movement into umbrella solutions. In reviewing the FSCA’s data, we find that there are now only about 1100 funds that can broadly be categorised as stand-alone compared to about 13,000 in 2005. It’s worth noting that over and above these, there are 358 funds that are in the process of transferring primarily into umbrella funds. Of the stand-alone funds in our sample, 48% have fewer than 2 000 members and 24% have fewer than 500 members. In our view, many of these smaller stand-alone funds will ultimately decide to move over to the umbrella environment.

I must caution that one structure is not necessarily better than the other. Trustees and employers must apply themselves to considering various dimensions, with the ultimate question being what best enables financial resilience for members. For some, this means enhancing existing frameworks within standalone funds, for others it means transitioning from stand-alone funds to high-quality umbrella funds, and increasingly this also means switching from one umbrella fund to another.

This speaks to our findings among the umbrella respondents, which indicates that employers are now beginning to review their existing providers and are engaging on potential switches between providers. This is reflective of a maturing and competitive market. This is also reflected in the findings of our survey of 100 professional independent Employee Benefits Consultants. When asked to indicate which of the Big 5 umbrella funds is capable of enabling financial resilience, there were three key findings:

- Sanlam once again ranked as the most capable and by a large margin.
- The same umbrella fund that received zero votes in 2018 received zero votes in 2019.
- The category of ‘Other’ collectively received more votes than any of the four of the Big 5 excluding Sanlam.

| Q: In your view, which of the following umbrella funds is the most equipped to enable members to be financially resilient? | %       | Count |
|--|---------|-------|
| <b>Sanalm Umbrella Fund</b>  | 45.26%  | 43    |
| <b>A</b>   | 15.79%  | 15    |
| <b>B</b>   | 9.47%   | 9     |
| <b>C</b>   | 8.42%   | 8     |
| <b>D</b>   | 0.00%   | 0     |
| <b>Other</b>   | 21.05%  | 20    |
| <b>Total</b>   | 100.00% | 95    |

Now, these findings suggest that EB Consultants see great potential in the smaller players to enable financial resilience and should actively be comparing the large incumbents with them. Another take-away is that the fund that received zero votes for two years has thousands and thousands of participating employers – they need to be urgently reviewed as the results are quite disturbing. Competition has increased and greater attention to reviewing the choice of umbrella providers can enable financial resilience for more members.

As ever, the issue of fees is topical and when comparing how administration fees are charged, we find the split as noted in Table 1.1. The average administration fees across stand-alone and umbrella funds are noted in Table 1.2.

**Table 1.1:** How the cost of pure administration fee is expressed

|                    | Standalone | Umbrella |
|--------------------|------------|----------|
| <b>R pmpm</b>      | 38%        | 28%      |
| <b>% of salary</b> | 50%        | 65%      |
| <b>% AUM</b>       | 7%         | 3%       |

**Table 1.2:** Average administration fees

|                    | Standalone | Umbrella |
|--------------------|------------|----------|
| <b>R pmpm</b>      | R 52.00    | R 40.00  |
| <b>% of salary</b> | 0.58%      | 0.59%    |
| <b>% AUM</b>       | 0.78%      | 0.75%    |

On the issue of group risk, we asked the EB Consultants to provide the Top Advice Themes in the Group Risk space. Their feedback was the following:

- Increase in funeral cover
- Increases in insurance rates
- Introduction of Severe Illness Benefits.

The increase in funeral cover is intuitive and the introduction of Severe Illness Benefits is the continuation of a trend we've identified over the past three years.

On the issue of an increase in insurance rates, we find that half of consultants have experienced large rate increases over the past three years and 1 in 5 indicated that they have experienced a trend of more claims being declined by insurers.

The average contributions are broadly similar at about 16% p.a.

Taking this a bit further, we've estimated an average net contribution of 13.0% based on the average risk premiums, administration fees and estimated consulting fees. So, what does 13.0% actually buy?

When looking at the respective time periods on the table, it gives a new employee a net replacement ratio of 56% and an older employee with 10 years to go and no other savings a ratio of 9%. The point here is that the average on its own does not provide significant insight as it means wildly different things to individuals, and that average net contribution levels are too low.

So, let's bring the issue of costs into play in order to increase the net contribution. If we remove all admin and consulting costs, will this have a material effect on outcomes?

In short – no.

The impact of waiving average admin and consulting fees over a 40-year period is just a 5% uplift on a 20-year-old's replacement ratio. The impact on a 50-year-old is 1% more.

What about investment fees? Assuming a TIC of 1%, removing investment fees completely adds another 13% to the 20-year-old and 1% to the 50-year-old.

In the context that EB Consultants have indicated that employers and funds fixate on costs, the minimal impact of removing costs completely needs to be recognised. Cost is what you pay and value is what you get, and from the research the number 1 thing that EB Consultants would change in our industry is that clients stop fixating on costs and pay more attention to value. For better or worse though, the megatrend of fixating on costs is here and is an issue that needs to be managed.

Most stand-alone and almost half of umbrella respondents have a targeted replacement ratio in place, and of these the majority have contribution rates that align with their stated targets. Seventy-five per cent is the most popular target, so let's revisit the individuals in the previous table to see what contribution rate aligns with this target.

The fixation on costs can distract from more impactful issues such as healthcare, which is seen by the EB Consultants as slightly more important to members than retirement funding. The consultants also largely indicated the integrated employee benefits would have a large impact on the financial resilience of members and we see this as a sign of the future.

Let's turn our attention to defaults. We've been through an interesting reform process over the past four years, with the 1st draft of the Default Regulations being tabled back in 2015. The regulations were published in 2017 with implementation set for March this year. EB Consultants were, and still are, enthusiastic about the potential impact of the Regulations. But they were sceptical about their own clients seizing the opportunity provided.

Our independent research firm conducted the interviews with stand-alone respondents at the end of February and at the beginning of March. We asked whether their funds would be ready for D-Day across the respective legs required. The vast majority indicated that this would be the case, but at that late stage up to 24% of respondents indicated that they were unlikely to be compliant by 1 March.

I take you back to an earlier point made that stakeholders need to critically evaluate where and how financial resilience is best enabled for members. These findings, together with reports that at least 600 funds had requested exemptions from the Regulations from the FSCA at the end of February, suggest that too large a proportion of our industry has been apathetic to the opportunity to improve outcomes for members. The approach to implementing the Default Regulations can provide meaningful insight into the appetite of a fund to genuinely act in members' interests, and unfortunately too many funds have not done so.

It is never too late to do the right thing and we call upon these funds to fully apply themselves to answer the question: How best do we enable financial resilience for members? In this context, doing the right thing means significantly enhancing the default ecosystem within their stand-alone funds or transitioning to high-quality umbrella funds that have such ecosystems in place.

On the topic of investments, Lifestage remains the dominant choice, with respondents expecting returns in the region of 7-8% over the next year. Zooming into Lifestage, we find that approximately 40% of respondents have 100% cash as their end-stage portfolio, which is archaic.

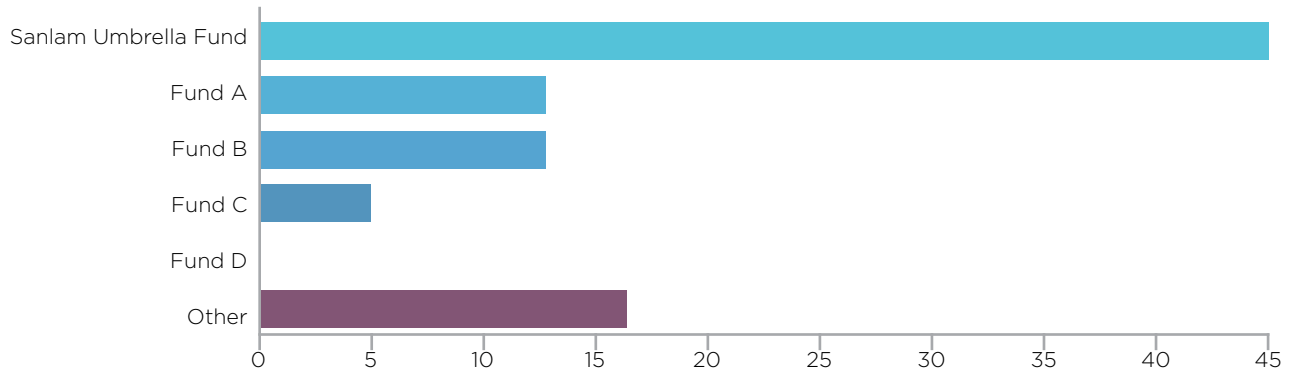
On the topic of annuities, we can note the split between the various types of annuities selected as part of trustee-endorsed annuity strategies. With-profit annuities are noted as the most popular given their investment upside, cost and longevity protection. We do caution that trustees need to stay vigilant about insurers passing on poor mortality and investment experience to annuitants over time, as a significant portion of these risks is handed over to annuitants in such structures. Another interesting finding is that combinations of annuities are popular. For clarity, this is where a fund offers multiple annuities from which members may select. This is different to hybrid annuities where the annuity transitions over time from a living annuity to a guaranteed one, for instance.

Closing the loop on the Default Regulations, we have the split of Retirement Benefits Counselling on the screen. Many funds have opted for more than one channel of counselling hence the numbers displayed. It's worth noting that 9 out of 10 EB Consultants believe Retirement Benefits Counselling will help to improve retirement outcomes.

High-quality financial advice is a key component of an enabling ecosystem. Approximately 60% of respondents have a formalised strategy to provide financial advice to members. Of these, two thirds have implemented access to a preferred panel of financial advisors and just under a third do provide subsidised advice. We have previously demonstrated that members who receive high-quality financial advice tend to have better outcomes in retirement, and access to advice therefore becomes a transformative component of financial inclusion.

Directive 8 was introduced last year and funds have responded in the following manner: 40% have implemented a No Gifts policy, while 54% now have to declare all gifts. Common feedback from various commentators though is that adherence to policy is a different matter than simply implementing policy. On this issue, we find that 53% of respondents would blow the whistle if they become aware of a breach or attempted breach of Directive 8. Thirty-five per cent would first engage with the affected party before taking any further action, but these individuals need to be aware that the obligation to blow the whistle nevertheless remains in place.

King IV is the foundation of good governance for retirement funds, including umbrella funds. Given the increased prominence of such structures and the spotlight on good governance, we asked EB Consultants to indicate whether the umbrella funds they utilise were aligned with King IV. About 60% indicated Yes, with 7% stating No, which is worrying. About a third of EB Consultants were unsure. Given the importance of good governance, consultants should engage their providers and take commensurate action based on the facts. We polled the same consultants to identify the best-governed umbrella fund in the industry and there are a few points worth making here:



- Sanlam ranked as the best-governed fund and, for disclosure, King IV has been implemented.
- The same larger umbrella fund received zero votes.
- My call remains the same – if you are an employer in that fund or a consultant with clients in that fund, review.
- The category of ‘Other’ once again performed strongly and the smaller funds that make up this category need to also be scrutinised to evaluate their respective governance capabilities.

Good governance matters, it is worth paying for, and we see enhanced governance as one of the 10 megatrends that will shape the future our industry:

- Governance and Regulation
- Consolidation
- Review of Umbrella Providers
- Default Regulations
- Risk Rate Increases
- Cyber Risk
- Technological Innovation
- Fixation on Costs
- Transformation
- Individualisation.

# How much are we putting away for retirement?

## Pensionable salary and retirement savings

For most South African retirement fund members, their contribution to their retirement fund consists of two components, namely an employer and employee contribution based on their pensionable salary. The employer/employee contribution distinction is mostly due to historical differences in how the employer and employee contributions were handled in calculating a member's income tax.

Pensionable salary is the income used by an employer to calculate a member's retirement fund contribution. This will typically include any fixed remuneration, such as salary or wages, but may exclude variable amounts such as commission, bonuses or overtime. For ease of comparison, all figures below refer to pensionable salary (also known as PEAR). Our Benchmark Survey reveals that on average this amounts to 76%

of total remuneration, although the percentage varies significantly between respondents. What is worrying is that 31% of funds indicated that pensionable salary amounts to less than 70% of total remuneration. For these funds the contribution rate may seem high, but it is based on an amount much lower than total remuneration.

## Employer contributions

The average employer contribution, as a percentage of salary, was 10,02% - an improvement on last year's result of 9,91%. The average employer contribution for union-based funds amounted to 8,2% of salary.

Four per cent of funds indicated that the employer does not make any contribution to retirement funding - in all likelihood some of these employers remunerate staff on a cost-to-company basis and all contributions to a retirement are viewed as employee contributions.

## Employee contributions

Similar to the employer contribution rate, the average employee contribution rate improved from 5,68% of salary in 2017 to 6,63% of salary. By comparison, average employee contributions for union funds remained more or less stable at 7,45%.

Fifteen per cent of funds indicated that their members do not make employee contributions to a retirement fund. These are mainly provident funds, with all contributions deemed to be employer contributions.

## Administration costs

Most funds continue to express their administration expenses as a percentage of a member's salary (50% of funds), while a further 38% of funds, mainly those with more than 10 000 members, expressed this cost as a fixed rand amount per member per month. Only 7% 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.



by

**Danie van Zyl**

Head: Guaranteed Investments  
**Sanlam Employee Benefits**

A fixed rand per member approach implies the lowest level of cross-subsidy between members, but this is one instance where Sanlam believes 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 0,58%, broadly in line with the result over the past three years, while the average fixed fee per member for standard members amounted to R51.80 a month. Five funds indicated that they pay in excess of R90 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 (0,54%) compared to members of smaller funds (fewer than 500 members) who pay on average 0,67%. Expressed as a fixed fee per member, this varies from R32.68 a month for very large funds to R96.38 a month for smaller funds.

## Group risk costs

Thirty-seven per cent of employers provide risk benefits (group life and disability cover) via their retirement fund (so-called approved risk benefits), while 28% provide these benefits under a separate scheme (unapproved benefits). The remainder (35%) provide benefits both via the retirement fund and separate scheme. The average deduction to cover the cost of life cover in the fund is similar to last year (1,44% vs. 1,45% last year) with an average level of cover of 3.3 times annual salary. The cost of disability cover amounts to 1% of pensionable salary.

## Total provision for retirement

For the 2019 Sanlam Benchmark Survey, the net provision for retirement, combining the employer and employee contribution rate, less administration and group risk costs amounted to 13,63%. This excludes any additional costs, such as consulting fees. As this figure can vary significantly from year to year, the table below shows the average provision for retirement over a three- and five-year period, which is more indicative of long-term trends.

Interestingly, both very large funds and very small funds have had a lower total provision for retirement over the past 3 years than mid-sized funds (with membership numbers in between). For very large funds, this is due to lower contributions and higher group risk costs, while for the smaller funds this is mostly due to relatively higher administration costs.

|   | Average over past three years |                            |                                   | Average over past five years |
|---|-------------------------------|----------------------------|-----------------------------------|------------------------------|
|   | All stand-alone funds         | Funds with 10 000+ members | Funds with fewer than 500 members | All stand-alone funds        |
| <b>Employer contributions</b>             | 10.21%                        | 9.46%                      | 9.70%                             | 10.42%                       |
| <b>Employee contributions</b>             | 6.72%                         | 6.68%                      | 7.35%                             | 6.78%                        |
| <b>Deduction for life cover</b>           | -1.39%                        | -1.56%                     | -1.40%                            | 1.42%                        |
| <b>Deduction for disability cover</b>     | -1.02%                        | -1.10%                     | -1.17%                            | -1.02%                       |
| <b>Deduction for administration costs</b> | -0.59%                        | -0.50%                     | -0.79%                            | -0.79%                       |
| <b>Total provision for retirement</b>     | 13.92%                        | 12.98%                     | 13.69%                            | 13.69%                       |

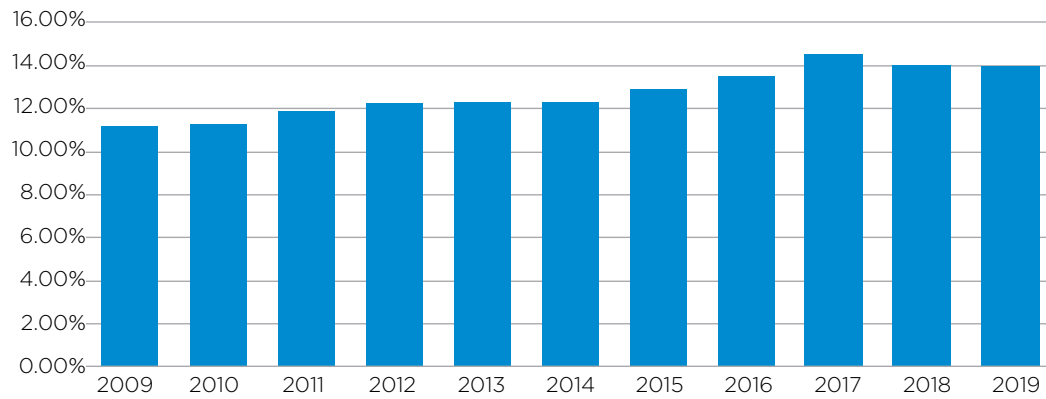
*All figures as percentage of PEAR*

## Conclusion

The three-year moving average of the net provision for retirement seemed to have plateaued, after a number of years of improvement since 2014. However, this is still high by historical standards as can be seen on the next page.



### Total provision for retirement (three-year moving average)



In addition, respondents believe that only 23,12% of their members will be able to maintain their standard of living in retirement. This is slightly higher than the average result over the past five years of 22,06%. During this time respondents have estimated that between 18,9% and 24,8% of their members will be able to maintain their standard of living in retirement.

# Trustee-endorsed default annuity regulation – the scorecard

Regulation 39 of the PFA Act stipulated that from 1 March 2019 all defined contribution retirement funds, including retirement annuity funds, are required to have in place a trustee-endorsed default annuity strategy. The proposed annuity strategy must be appropriate and suitable for the members of the fund, with reasonable and competitive fees and charges. The strategy needs to be reviewed annually and may include traditional life annuities and living annuities being paid from the fund or an external provider.

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.



by

**Karen Wentzel**  
Head: Annuities  
**Sanlam Employee Benefits**

## Too early to judge

It is still too early to determine whether this regulation will improve retirement outcomes. In Sanlam's 2019 Benchmark Survey of stand-alone funds, around 80% of funds indicated that they have set up a trustee-endorsed annuitisation strategy that complies with Regulation 39 and 20% of funds did not meet the March 2019 deadline.

In reply to a question in the Benchmark Survey on the most important features of a default annuity strategy, trustees indicated that to them the two most important features of such a strategy were:

1. Longevity protection and an income for life
2. Annuity income that keeps pace with inflation.

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.

The three most popular annuity products selected for a default annuity strategy from the sample being surveyed were:

1. With-profit annuities
2. Living annuities
3. A combination of different annuities.

Due to the requirement that trustees must monitor the sustainability of living annuities, fewer schemes than anticipated initially endorsed this option. Most of the life annuities in the trustee-endorsed options were selected from external annuity providers (insurance companies). For living annuities, about one third of the trustee-endorsed solutions were provided by the fund and two thirds of living annuities were provided by an external annuity provider.

In the Benchmark Survey participants indicated that if they wanted to distinguish the trustee-endorsed annuity strategy for different categories of members, applying the following factors would be the most appropriate way to do so:

1. Size of the member share
2. Demographic profiling (age, income group)
3. Employee type (professional, blue collar, specialist).

### What will determine the success of default strategies?

Regulation 39 also stipulates that members should have access to retirement benefits counselling. The counselling must include full disclosure and explanation, in a clear and understandable language, of risks, costs and charges, as well as the terms of the fund's annuity strategy and other options available to members.

Most funds selected more than one annuity type as a trustee-endorsed solution. The three most popular annuity products selected from Sanlam were:

1. With-profit annuities
2. Guaranteed escalation annuities
3. Institutional living annuities.

When considering income products at retirement, members want:

- Access to good returns with some investment choice
- Protection against risk and, in particular, investment risk and longevity risk
- Access to capital, before and after death.

Given the combination of needs that individuals will have and risks they will face throughout their retirement years, a single retirement product is unlikely to be appropriate and suitable for all. This opens the old debate of “life vs living annuities” again. Every financial product has advantages and disadvantages, benefits and costs. Incorrect product knowledge and a misunderstanding of the features of annuities could lead to mixed emotions and different opinions.

When it comes to making important investment decisions, it is always best to get professional advice from people who have the required skills and training. A good accredited financial advisor will sell financial products that meet your financial needs. Investors are protected by The Financial Advisory and Intermediary Services Act (FAIS Act) to prevent miss-selling.

Find an advisor who discloses his or her identity, the company, method of financial planning, the services he/she can provide, as well as the remuneration system.

### Good financial advice will include the following:

- The advisor collecting your personal details and data and setting out the responsibilities of both parties
- Setting realistic goals after an analysis and evaluation of your financial position, taking into account all your active insurance policies
- Developing and presenting financial planning recommendations or alterations
- Implementing the recommendations and monitoring them regularly
- Getting a second opinion
- Your being informed – check benefit statements, investment performance, default options, vote for trustees, take responsibility.

The success of the Default Regulations will not only be determined by the annuity product chosen, but also by the individual member support, including advice to ensure members choose the most suitable institutional priced annuity that meet their needs.

“The secret to living well is to die without a cent in your pocket. But I miscalculated, and the money ran out too early”. *Jorge Guinle*

# Climate change in the Group Risk Industry

Just like the debates around climate change, are we ignoring the early warning signs relating to the sustainability of group disability insurance? Have we become too complacent to notice the steady deterioration in disability experience and the ultimate impact on the affordability and availability of these products in the future?

In the recent Benchmark Survey, Employee Benefits Consultants identified increases in group risk rates as a dominant advice trend. The consultants interviewed indicated that over half had experienced large rate increases over the past three years and 1 out of 5 have seen an increase in the number of claims being repudiated. Could these be the early warning signs of a “climate change” in the group risk industry?



by

**Michele Jennings**  
Chief Executive Officer  
Sanlam Group Risk

We believe this is indeed the case and that too little is currently being done to ensure group risk is a sustainable proposition for insurers and, more importantly, members of group schemes.

## What are the main drivers of rate increases?

We believe a combination of factors has led to the current status quo. The group market is particularly competitive, with insurance products being treated as commoditised items that are moved between insurers based on the cheapest price and highest medical proof-free limits.

From 1 March 2015 disability premiums are no longer tax deductible and disability income payments are tax-free, with the unintended consequence of this change being that new and existing disability claimants with an income above the tax threshold get significantly increased income in their pockets (after tax). This results in increased claims incidence as well as reduced return-to-work rates for higher earners, which impacts negatively on disability experience.

Insurers anticipated these consequences at the time, but employers and consultants were hesitant to implement scaled benefit structures to mitigate these anticipated risks. To emphasise the point, despite the deteriorating disability experience since 2015, more than 70% of respondents indicated that their existing replacement ratio is between 75% and 79% of annual salary, which is the historical level before the tax changes. Only 15% of respondents in the 2019 Sanlam Benchmark Survey indicated that they would consider implementing reduced benefits to counter the effect of these tax changes.

South Africa's well-documented economic woes have also impacted on insurers' disability experience. Many employers have come under pressure to retrench staff and this has led to increased disability claims as employers try to “outsource” the liability to insurers. While these are mostly valid claims, these individuals would probably still be able to work despite their disability. Furthermore, they will have very little incentive to rehabilitate in future, as their disability income is stable, and their jobs no longer exist.

Other indirect effects of the economic downturn include unhappy work environments and excessive work demands due to downscaling. These lead to increased stress levels and higher incidence of illness, resulting in death or disability. Various global actuarial studies have found that increased disability claims incidence is positively correlated with higher unemployment, lower corporate profitability and also lower consumer confidence.

## How do we avert a catastrophe?

In other words, how do we contain the cost and ensure the sustainability of disability insurance in South Africa?

There are some lessons to be learnt from countries like the USA and Australia. In both countries, insurers eventually withdrew certain disability products from their markets due to prolonged negative experience. To avoid a similar fate, the role players in the South African group risk market will have to come up with creative solutions to the problem.

Various solutions to remedy the current situation, without resorting to these extreme measures, were tabled to the stand-alone and umbrella fund respondents in the 2019 Sanlam Benchmark Survey. The following benefit changes were suggested:

- Scaling down the disability income according to the size of the member's salary. The idea is to bring the after-tax income replacement ratios of high-income earners more in line with those of low-income earners, as was the case before the tax changes were implemented, by putting members in approximately the same position as before the tax changes. This will not only help to contain the deteriorating claim experience but also prevent the deteriorating disability experience caused by the high-income earners being subsidised by the low-income earners.
- Scaling down the disability income depending on the age of the claimant. Younger claimants will get a higher benefit relative to older claimants, which might influence older members to opt for early retirement rather than disability benefits, which ultimately would reduce the cross-subsidies existing between younger members who have a lower risk of disability versus older members with a higher risk of disability.
- Determining the replacement ratio according to the % of functional impairment the claimant is experiencing. A claimant suffering from paraplegia or total blindness would get a higher benefit than someone who cannot work due to a lower-back problem. This is one way of addressing the problem of whether a person qualifies for the full benefit or no benefit, by allowing the insurer to differentiate between the different levels of impairment.
- Disability income benefits that are linked to the % of the job description the claimant cannot perform. A claimant who cannot perform 100% of his/her regular duties get a higher benefit than an employee who cannot perform 40% of his/her regular duties. This allows the insurer to differentiate between different levels of job performance, and will enable employers to accommodate their disabled employees at appropriately reduced salaries.
- Using a reduced benefit scale for claimants who do not meet fitness for work criteria due to a diagnosis or medication, but who have no real impairment. This type of benefit would apply for certain occupations like underground mining, where employees are required to meet certain minimum fitness criteria to be allowed to work at the mine. The reasoning is that these employees may be able to perform other types of work not related to mining.
- Scaling down the disability income depending on the severity of an employee's pre-existing impairment/disability before joining the group scheme. This will help manage the risk of selection by newly appointed employees with known illnesses or disabilities compared with other members of the group scheme. This is especially relevant given the practice of employing individuals with existing disabilities who are insured via the group scheme without exclusions or limitations.
- Increasing the replacement ratio gradually over a period of five years from the time the employee joined the group scheme. This will mitigate the risk of anti-selection by newly appointed employees with known medical conditions compared with existing members of the group scheme.
- Taking certain lifestyle factors and compliance with medical treatment into account in determining the replacement ratio of the claimant, e.g. an employee with a poor lifestyle (obese, smoker, inactive) or who does not comply with medication gets a lower benefit than an employee who is fully compliant. The idea is to promote a healthy lifestyle among employees and identify employees with certain risk factors early on to help manage the risk of disability and improve their quality of life.
- Determining the replacement ratio according to the prognosis for the medical condition. Employees who are unfit for work due to a terminal illness or have a poor prognosis get a higher replacement ratio than others with a condition that has a good prognosis or is not life-threatening. This allows the insurer to differentiate between employees depending on the prognosis for the medical condition, with the reduced payment being part of the return-to-work incentive.

- Using a reduced benefit scale for diseases and injuries that are not related to the workplace. Employees who suffer from diseases and injuries that are related to the workplace get a higher level of compensation. This would be appropriate for employers who want to provide disability cover mainly for work-related diseases or injuries or where employees participate in high-risk activities outside of work.

Unfortunately, the responses to these suggested remedies in the 2019 Sanlam Benchmark Survey were largely negative, with 80% of the respondents indicating that they were not in favour of these proposals. This begs the question whether the various role players in the market, specifically employers and consultants, fully understand the seriousness of the current situation. It also shows that insurers have an important role to play in educating them on the consequences of the current market trends.

As an industry, we have the responsibility to enable the financial resilience of our members by providing meaningful cover at sustainable rates. The lesson to ourselves is to find ways to work together to sustain the financial inclusion provided by group disability products, which provide meaningful access to a vital insurance mechanism to millions of people who would otherwise be uninsured.



# South Africa's new normal

The “New Normal”, a term used extensively around the Global Financial Crisis of 2008/2009, suggested that the world was about to enter a prolonged period of lower returns from investment markets. Instead, what happened from March 2009 was that the world saw the longest global bull market on record. Over the 10-year period to April 2019, the MSCI World Index (in US dollars) returned 11,6% per annum – significantly ahead of global inflation.

Locally, however, the picture has been less rosy, with the five-year return on the FTSE/JSE All Share Index being a meagre 6,8% p.a. in Rand terms and just 0,4% p.a. in US dollars (to 30 April 2019). This means that the vast majority of retirement fund portfolios, which typically have a large proportion of their assets invested in South African equities, were not able to generate the double-digit returns with which investors became familiar in the preceding decades. In fact, and as pointed out frequently by investors, simply investing in cash over the past five years may have yielded a higher return and without the wild swings associated with the movements in the SA equity market.

It therefore comes as no surprise that the expectation of umbrella participants in the Sanlam Benchmark survey for gross investment returns for the next calendar year dropped from 8,66% in 2017 to 6,79% in 2019 – a drop of almost 2% in just two years. Being still fresh in the minds of investors, the dismal recent market returns have undoubtedly also contributed to these lower prospective return expectations. However, the role advisors, consultants and investment managers have played in tempering return expectations should not be downplayed.

Theoretically, the acceptance that equities should outperform bonds and cash over the long term has a long and distinguished lineage. Why else would a rational individual willingly choose to invest in a risky asset class if not for the lure of a higher return? For the past decade, however, asset consultants, advisors and investment managers have been beating the drum on their expectations for lower real returns from these traditional asset classes. And it seems to have been working, as demonstrated by the trend in survey responses. For the past few years most asset consultants and investment managers have also been encouraging long-term investors to consider including “alternative” assets (such as private equity and private debt) in their portfolios to enhance the return potential while increasing diversification. With the benefit of hindsight, this appears to have been sound advice given the poor performance of the traditional asset classes over the past five years. Importantly, the broader South African industry is now also beginning to appreciate the benefits that alternative asset classes can bring to retirement fund portfolios.



by

**Rhoderic Nel**  
CEO: Investments  
**Sanlam Employee Benefits**



and

**Darryl Moodley**  
Head: Tailored Investments  
**Sanlam Employee Benefits**

## Costs are important

Asset managers have generally struggled to show positive real returns in the current low-growth, low-inflation environment. And bearing in mind that asset managers' performance is most commonly assessed against a CPI-related benchmark (according to 49% of umbrella fund participants and 38% of stand-alone funds), investors are more frequently questioning the appropriateness of (relatively) high active management fees in generating fairly pedestrian returns. The rise of passive investment management has of course increased competition both globally and locally, and has had a remarkable effect in compressing investment fees – to the benefit of the end-investor!

## Communicating better

It is ostensibly more important that during times of volatile (and low) investment returns, funds are not only able to communicate clearly and effectively with members, but also do so. The most common media used to communicate with members in times of volatile returns are written rather than verbal – regular member newsletters (used by 68% of stand-alone funds and 58% of umbrella fund participants) and email updates (mentioned by 38% and 45% respectively). In an era when information on the internet may potentially be used by members in making inappropriate decisions (such as attempting to time the market, or switching from poor-performing to the best-performing portfolios), one has to question whether the industry needs to look at more innovative ways to engage effectively with members. The recently implemented Default Regulations introduced the requirement for the appointment of a Retirement Benefits Counsellor. These regulations are a step in the right direction, but holistic investment planning for the average member (who is usually not investment savvy) is critical in generating the best retirement outcomes.

## Perspective

While there is usually an inordinate focus on investment returns when evaluating retirement outcomes, investment performance is usually not the biggest culprit in detracting from intended retirement outcomes. While we at Sanlam certainly recognise that we are navigating a New Normal in South Africa characterised by stagnant economic growth and lower investment returns, several other important “behaviours” do deserve attention – “behaviours” that have at least as big an impact on retirement outcomes as investment returns do. These include:

- i. Paying attention to investment fees
- ii. Maintaining a high contribution rate
- iii. Preserving fund credits when changing jobs
- iv. Remaining invested in an aggressive growth portfolio (despite the volatility) when still  
someway from retirement, and
- v. Not attempting to time the markets during extreme market volatility.

An effective communication strategy should be able to drive the right behaviours, such as those highlighted above, rather than focusing exclusively on investment returns. And this will surely result in more engaged members, who are better-equipped to navigate this New Normal.

# Regulation 28 - Are we getting there?

Regulation 28 continues to divide opinion. The intention behind it (the “asset limits” portion) is to ensure retirement savings are invested responsibly through 1) diversification within and across the principal asset classes, while 2) concomitantly limiting exposure to the ‘riskier’ growth asset classes. In being client centric, our view at Sanlam Investments is always formed through the lens and experience of the client. While recent changes and revisions are welcomed there are other challenges that Regulation 28 has yet to heed.

- Managing concentration risks:** South African clients are still limited in their pursuit of true diversification benefits. We still have inherently more risky portfolios due to increased concentration risk, with exposure to one to three equity counters per sector. Due to the limited number of large cap stocks listed on the JSE, our ability to diversify is compromised. The global weight of technology stocks (prior to recent reclassification) is closer to 20%. This is not too dissimilar to the Naspers weight in the local market, but the global opportunity is far less concentrated. The same holds for oil and gas/energy exposures; South Africans are pretty much limited to Sasol, whereas globally investors have a whole list of energy stocks to diversify away from single-stock risk. As Steinhoff has shown, it is not impossible for the unforeseen to happen to an individual stock, which could permanently impair our retirement fund savings.

- Keeping pace with changes in technology and our societal behaviour patterns:** Retirement fund members have reduced access to global growth opportunities and we have reduced ability to adjust clients’ portfolios according to the developmental and spending patterns of society. As an example, increasing numbers of South Africans are making use of Amazon, Uber or Apple products (buying pattern), yet our investment pattern can’t access the potential growth of these sectors in a free unlimited fashion. The investment access to entities involved in rising sectors might not be available in the local market. We were possibly very fortunate that Naspers happened to invest in a counter that turned out to be an extraordinary technological success and which we could access. Industries change over time and the way society spends its money changes over time too, leading to the rise and demise of entire sectors. More than 80% of the value of the US stock market in 1900 was in companies and sectors that are now extinct or very small. Consider also the change in gold mining (and later general mining) as a percentage of market cap of the JSE. Investment opportunities will continue to change and evolve and only a subset of them is properly represented and available on the local market.



by

**Jason Liddle**

Head: Institutional Business  
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and

**Fred White**

Head Balanced Funds:  
Sanlam Investments

- **Accessing measured exposure to countries and regions over time:** The growth in countries and regions can differ materially over long periods of time. This implies that the opportunity set for (earnings) growth available to different companies operating in different regions also differs materially. In the 1940s emerging markets (“EM”) took a huge knock as Japan, then an EM, lost 98% of its value post World War 2 and China closed its markets after turning communist. Since 1950 to date EMs have outperformed developed markets by about 1,2% p.a. At that rate of outperformance, an investor with a 30-year horizon would have 43% more money at the end of his/her term – that is a very material difference and even though EMs have not outperformed over the past decade they remain an investment opportunity worth pursuing with a long-term orientation.
- **Managing our own country and political risk:** South African retirement savings are likely to be poorly diversified in terms of total EM exposure and also likely to be underexposed to other EM investments despite the fact that they might well derive superior long-term returns from such investments. Local politics has clearly contributed to the demise of growth in the local economy, which has contributed to the poor returns generated by local equities. In the same way that one should diversify one’s investment between counters in a sector in order to reduce single-company risk, so one should spread one’s risk between countries to avoid single-country risk. However, not only do we have a hugely disproportionate exposure to a single EM, but given the limited allocation to foreign assets a local investor is afforded, combined with the tendency of emerging-market returns to be reasonably correlated, local investors often also feel uncomfortable allocating a material portion of their foreign exposure to other/more emerging-market investments and hence are indirectly forced into developed markets where the long-term returns are likely to be lower.

Over the last few revisions, Regulation 28 has progressively been able to relax the offshore (subject to changes in exchange controls on institutions) and alternative asset class capital limits while also addressing the use of securities lending and derivatives. This allows us greater access to the growth and investment opportunities beyond our shores and further uncorrelated and diversified sources of return from private unlisted markets in support of the retirement funds’ socio-economic, developmental and ESG objectives. This has been greeted warmly given the expectation of tepid growth from our domestic real economy and the need for productive investment towards these objectives. While we agree that these have been meaningful steps in the right direction we should also guard against being too complacent that the full investor need has been addressed.

**Flash Fact: Over the past 8 years**, from the end of April 2011 (the initial high of the post GFC recovery) to the end of April 2019, the **MSCI World Index delivered a total return of 8,5% p.a. in US\$ terms**, whereas the JSE SWIX returned a mere 1% p.a. in US\$ terms. During that time Naspers delivered more than 20% p.a. in US\$ terms. **The rest of the SWIX, excluding NPN, delivered a negative return in US\$ terms.**

# Deciphering the individual – One size does not fit all

One of the challenges in a world of big data is that the tiniest details often contain some of the most valuable information upon which important decisions need to be based. But if these kinds of details get swallowed up in some kind of industry average, an important opportunity may be lost. And in our industry that could mean an important decision that directly impacts on the outcome of an individual member's retirement journey.

## One size does not fit all.

In 2017's Sanlam Benchmark Symposium, we introduced the Sanlam Financial Resilience Index (SFRI). The intention of this Index was to offer a diagnostic tool that could be used to determine what obstacles exist that prevent retirement fund members from improving their financial resilience. Since 2017 we've engaged with numerous fund members and have had over 5 000 responses.

The SFRI assigns a financial resilience score that can be used as a benchmark to measure the financial resilience of any given fund against the industry in general, across the following six categories:

- Income and package composition
- Financial wellness
- Level of indebtedness
- Budgeting
- Provision for retirement
- Advice and financial planning.

The SFRI shifts the focus from issues that should 'generally' be addressed, to what the members' specific needs are for any given fund. The analysis of the data means a fund can see where it stacks up against the industry and get meaningful insights into the areas that should be addressed by the fund.

The outcome to date has been disappointing: Financial resilience has been decreasing steadily over the past three years. The main areas needing more focus are Financial Wellness and Provision for Retirement. These are the areas where we should start focusing our attention in providing member choices that will improve a member's financial resilience.

This is merely one example of how we can start adopting a one-size-does-not-fit-all approach and start paying attention to members' individual needs.

Research was done on a sample of over 450 individuals, at different stages throughout their retirement funding journey. As opposed to getting a very broad sample set, the focus here was to get in-depth insights into what these individuals' experience and expectations were with regard to their lifestyle, finances and retirement.



by

**Barend le Grange**

Head: Individual Member Support  
**Sanlam Employee Benefits**

One major finding was that the industry has been putting solutions in place to facilitate member choice, but the member's actual experience has been pretty bleak: disappointment, shock and regret!

- They were disappointed with the level and type of advice they receive, disappointed with their providers and, in fairness, disappointed with themselves for not doing more earlier to secure their future.
- Taxation of benefits often comes as a huge shock for people, but the biggest shock of all is the net outcome of the pension they have managed to accumulate for themselves.
- Taxation of retirement savings is often news to members and consequently they are shocked at the net outcomes achieved at retirement.

Regret then sets in. With two aspects being mentioned:

- Regret in terms of poor choice of retirement vehicles; and
- Regret in terms of their own behaviour towards savings and preservation.

The key challenges people cited were the following:

- Insufficient Information;
- Lack of accessibility to their option, their progress and even the values of their funds and benefits; and
- Jargon used in our industry, which prevents members from understanding their choices.

This leads to members feeling isolated and unengaged.

The Default Regulations have been more than just a disruption to our industry. They have provided an opportunity to let go of an outdated mindset and adopt a new approach for members. Not only do we need to consider member choice in a fund, but also member engagement. Again, one size does not fit all.

Individual member engagement includes the frequency, timing, method and simplification of complex topics. To do so, you have to understand who the members are, what they want, how they want you to engage with them, as well as when to engage with them. Retirement Benefits Counselling can be one of the tools that facilitate such meaningful engagement.

A quick recap of what Retirement Benefits Counselling is: It is the disclosure and explanation, in clear and understandable language, of the risks, costs and charges of:

- The fund's available investment portfolios;
- The terms of the fund's annuity strategy;
- The terms and process by which a fund handles preserved benefits in terms of Regulation 38; and
- Any other options made available to members.

An important question trustees have to ask themselves is whether the effectiveness of Retirement Benefits Counselling can be measured and if so, how this will be done. Essentially, there are two elements to this question:

Firstly, trustees will need a view of members' engagement in terms of Retirement Benefits Counselling. For example, in the case where counsellors are used, this would mean knowing how many members called the Retirement Benefits Counselling service and what the nature of their counselling needs were. In the case of proactive counselling, knowing how many members were reached and whether they were successfully counselled is important.

Secondly, trustees will need the means to measure what impact Retirement Benefits Counselling has on actual member behaviour, irrespective of the method of counselling. This means measuring, for example, whether fewer members opted to take cash when withdrawing from the fund, and the number of members who opted to retire in-fund (should this option be part of a fund's annuity strategy).

All of this highlights the importance of partnering with a provider that has the systems, infrastructure and capabilities required to assist trustees in making the most of any interventions put in place and thus enabling financial resilience for their members.



# Information insecurity

Managing risk. That's what we do. From advisors to trustees to asset managers to insurers to administrators. All stakeholders in the retirement funding value chain have a vested interest in managing risk. Which is why it is surprising that there is a risk that exists that we are collectively exposed to and which in our view may be the most frightening one we face.

Cybercrime is a reality and our industry is exposed.

Before exploring this risk and what can be done to become cyber resilient, let's first understand what is at stake ... information. I've listed some of the types of information typically held by administrators, insurers and consultants. These include:

- Names
- ID numbers
- Tax numbers
- Age
- Gender
- Contact details (Cell & Email)
- Employers
- Employee numbers
- Salaries
- Fund values
- Beneficiary details

of hundreds of thousands of people. On legacy systems.

Information security is being applied but we have to question the maturity, depth and breadth of application across the industry as this is a key enabler of financial resilience. For clarification, information security is the practice of preventing the unauthorised use, disclosure, disruption, modification, inspection, recording or destruction of information, whether physical or electronic.

It's not a nice-to-have. It's a must-have for many reasons, including the fact that information security is required by the Protection of Private Information Act as noted below:

## **Protection of Personal Information Act 4 of 2013 Section 19**

*(1) A responsible party must secure the integrity and confidentiality of personal information in its possession or under its control by taking appropriate, reasonable technical and organisational measures to prevent—*

- (a) loss of, damage to or unauthorised destruction of personal information; and*
- (b) unlawful access to or processing of personal information.*

*(2) In order to give effect to subsection (1), the responsible party must take reasonable measures to—*

- (a) identify all reasonably foreseeable internal and external risks to personal information in its possession or under its control;*
- (b) establish and maintain appropriate safeguards against the risks identified;*
- (c) regularly verify that the safeguards are effectively implemented; and*



by

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*(d) ensure that the safeguards are continually updated in response to new risks or deficiencies in previously implemented safeguards.*

*(3) The responsible party must have due regard to generally accepted information security practices and procedures which may apply to it generally or be required in terms of specific industry or professional rules and regulations.*

It's worth noting that the censure for breaches of POPI can stretch up to fines of R10m or up to 10 years in jail.

The imminent Cybercrimes Bill also notes that South Africa's high internet connectivity rates and poor levels of cybersecurity, especially in the business environment, result in an increased threat level of attack. The Bill also puts financial services providers under an obligation to report cybercrime and to preserve evidence. In practice, this may mean freezing systems and the handover of computers and servers that were potentially breached so that SAPS can conduct a criminal investigation which, given resourcing, breadth of investigation and specialist skills required, could take a while. Consider the business interruption risk that this presents.

The blueprint for good governance, King IV, for the first time addresses IT governance in detail given the increased recognition of the importance of information and IT in the ecosystem of good governance. It specifies the establishment of the Information Governance Framework that encompasses the following:

- Integration of people, technologies, information and processes across the organisation
- Integration of technology and information risks into organisation-wide risk management
- Arrangements for business resilience
- Proactive monitoring of intelligence to identify and respond to incidents, including cyber-attacks and adverse social media events
- Management of the performance of, and the risks pertaining to, third-party and outsourced service providers
- Assessment of value delivered to the organisation through significant investments in technology and information, including the evaluation of projects throughout their life cycles and of significant operational expenditure
- Responsible disposal of obsolete technology and information in a way that has regard to environmental impact and information security
- Ethical and responsible use of technology and information
- Compliance with relevant laws.

This is far-reaching, and good governance requires the Information Governance Framework to be robust, practicable and comprehensive. Before moving on, I would challenge you to obtain the Information Governance Framework from your administrator and to provide one to your fund too. This is the baseline framework upon which cyber resilience is built and if it does not exist or is insufficient, you are at risk immediately.

### **And you are not alone.**

The 2019 Allianz Risk Barometer of Top Business Risks comprised feedback from 2 415 respondents globally, indicating that Cyber Risk is the top worldwide business risk alongside Business Interruption. Interestingly, within the category of Business Interruption, cybersecurity was cited as the most feared threat. The cyber risk moved from 5th place in 2015 to 1st in 2019 due to an increased appreciation that for many entities their primary asset is data. And their assets are being threatened by a new generation of criminality.

The IBM X-Force Threat Intelligence Index daily monitors data across 70 billion security events globally. These include tens of millions of spam and phishing attacks daily. Just reflect on those numbers for a moment. IBM has stated that the level of cyberthreat is becoming unmanageable due to the rapidly evolving threat battleground, increased risk of exposure and the ever-growing attack landscape. From its ongoing analysis, IBM has identified Financial Services as the most attacked industry in the world, being the target of one in five cyberattacks. This is mainly due to the large quantities of personal information held and the ability to monetise this data rapidly, either directly or via resale.

The 3rd most attacked industry is Professional Services such as Consulting. This is due to such firms handling large volumes of personal information on clients while managing lower IT budgets. They tend to have smaller staff complements, so it is easier to isolate weak points, and they generally display an immature information security position. IBM notes that such firms are viewed by cybercriminals as 'vulnerable and lucrative'. Adding these findings together means we are collectively at risk and that there is a real threat of loss.

The Refinitiv Revealing the Cost of Financial Crime Survey among 2 373 global respondents, including 123 from South Africa, indicated that 20% had experienced loss due to cybercrime. The average cost of such losses increased by 60% over the past five years to a typical cost of such a breach coming in at about \$4m. Refinitiv estimates the annual cost of cybercrime to be in the region of \$600bn. For context, the average cost of natural disasters over the past 10 years is about \$208bn p.a.

Taking this closer to our industry context, the losses are likely to extend to potential litigation and liability imposed on trustees, advisors or administrators. Funds, consultants and sponsors are at severe reputational risk. The business interruption risk is material for administrators, consultants and the ongoing operation of funds should such criminality take place, due to the need to conduct the operations of the fund in an environment that is breachable. Regulatory sanction may apply in the light of POPI as well as breaches of King IV. And given our context, we could experience mass action should funds go missing due to improper governance of the fund.

I reiterate that we are under threat and that cybercriminals are looking for vulnerable entities and industries to exploit. And the criminals are not teenagers in garages. They are skilled, ruthless and greedy professionals based around the world. They are part of sophisticated criminal networks often playing key roles in organised crime activities, even to the extent that there is evidence of state-sponsored hacks. They are not to be taken lightly.

A few examples of how cybercrime can affect you are the following:

### Extortion

- Denial-of-service attacks occur when systems are bombarded at weak points, preventing the organisation from conducting its business until it pays a ransom for the attacks to stop. This may be an ongoing ransom along the lines of protection money.
- Bug poaching occurs when hackers identify weaknesses in an entity's system and either sell these on to professionals looking to exploit such vulnerabilities or extort money from the entity to prevent such sales.
- Data theft, where data is stolen and ransomed. This may include client, employee, financial or confidential data.

### Personal information

- Personal information is stolen and either exploited or resold. Often such information is sold on to 3rd parties who purchase such data sets from various providers in order to aggregate the data to build more comprehensive information on individuals, which they can then more easily and more profitably exploit for nefarious purposes.
- Ultimately, such data may be used for identity theft.

### Inadvertent inside job

- Criminals use phishing tactics whereby they impersonate legitimate entities to steal passwords and log-in credentials from users in order to access sensitive platforms. Just imagine what could be done if cybercriminals were able to phish access to your administrator.
- Sometimes it doesn't take much effort to access sensitive platforms as password practices may be weak. Quite recently, Liverpool seems to be a preferred password for users globally and one that is quite easy to guess if you apply social engineering practices.
- Social engineering is the practice of targeting key individuals within organisations by building a social profile of them. An example is checking their Facebook, Instagram or Twitter feeds for their favourite soccer teams and simply trying passwords related to that team. It gets more sophisticated than that though. Criminals may misrepresent themselves as colleagues, clients or superiors in order to unlock access through a mix of intimidation, helplessness or name-dropping to influence vulnerable employees to share sensitive information.

- An example could be conducting a SIM swap and then hijacking a WhatsApp profile. The criminal may then request sensitive information from subordinates or from providers via a seemingly legitimate WhatsApp profile, given that most of us do use WhatsApp to engage with each other. Your conversation history is available so the professional criminal is able to manipulate you into believing he is the person in question, especially if he's built a social profile of that person as well as of the target himself. Both share an interest in Liverpool, start the conversation on how next year will be their year and pivot into a business chat.

This is scary, but criminality has always existed and we have always implemented measures to counterattack. Key enablers of cyber resilience include crafting, implementing and continuously refining a robust Information Governance Framework as required by King IV. Ultimately, resilience comes down to people as we are the most easily exploitable flaw in the system. A culture of security, appropriate and ongoing training, as well as the correct organisational security structure are required to enable resilience.

We asked the 2019 Sanlam Benchmark respondents to share their practices, and the results are worrying. A minority of respondents seem to have implemented the appropriate measures and are even sceptical about the positive responses. This represents a clear and present danger.

We also explored this issue with EB Consultants and their responses were just as worrying, as evaluating cyber risk was identified as their least important business challenge. Cyber risk ranked as the lowest risk and IT expertise was the lowest-ranked differentiator among consultants. This points to a lack of awareness and capability to evaluate the risks.

Yet, 68% claim to evaluate the administrators' ability to mitigate cybercrime when placing umbrella funds. I find this very hard to believe as Sanlam has performed over 8 000 umbrella quotes over the past few years and in only a handful of instances were we asked to provide any information on our cyber resilience. Given that we've been the fastest-growing umbrella fund for a number of years, this suggests that employers and consultants have been ignoring this absolutely critical aspect of governance when placing umbrella funds. This must receive a higher priority given the risk to which members are exposed. Unsurprisingly, almost all consultants believe liability rests with the administrator in the event of losses due to cybercrime, but it is more complex than that.

What if trustees and employers rely on consultants to provide their best advice on the placement of administration, including an evaluation of governance that brings cyber resilience into scope? Should administration be placed without a deep understanding of an administrator's Information Governance Framework? Also, please bear in mind that data loss may occur at the administrator but also at the consultant or front office given the flow of information. Far greater collective rigour needs to be applied by consultants, employers and funds when evaluating providers. Not just because it's the right thing to do, but because there are very real grounded risks to ignoring this critical aspect.

Trustees have a fiduciary responsibility to exercise their powers to act in the best interests of the fund and its members. This means the fund must have the proper control systems and its rules, operations and administration must comply with the relevant Acts. Failure to appropriately address cyber resilience is a dereliction of this fiduciary duty and trustees must reflect upon the question asked earlier: How can I best enable the financial resilience of my members and what can I do to act in their best interests? This may require obtaining specialist skills to address cyber resilience or it could entail further consideration of transitioning into a cyber-resilient umbrella fund.

Consultants have a key role to play as they provide expert opinion on service providers and play an influential role in enabling financial resilience. Cyber risk is largely ignored and material differences in cyber resilience do exist between services providers. These have not been evaluated properly and have not typically formed a meaningful part of the conversation when comparing providers. As an illustration, I refer to the ranking of umbrella funds by their capability to enable financial resilience.

One would assume the Big 5 sponsors would have mature approaches to cyber resilience, but you should not assume this. As consultants, trustees and employers you must be convinced that this is indeed the case. Now, given that there is a marked preference by consultants for many of the smaller umbrella funds, this question becomes even more relevant as smaller sponsors, including many broker-sponsored umbrella funds, simply do not have the IT budgets, technical resources or skills to be cyber resilient. Legacy systems and a concentration of duties at certain individuals further expose smaller administrators to cyber risk. Questions must be asked about their ability to protect members' data from cybercrime and the ongoing sustainability of such entities into a very different future landscape.

To equip you to ask the relevant questions, we have established the Cyber Resilience Benchmark to enable you to evaluate your providers. This is not intended to be a comprehensive diagnostic but a starting point to have meaningful and ongoing conversations. Please make use of the tool. We have provided Sanlam's responses to each of the questions so that you have a point of reference. Some of the measures may seem insignificant but could have a significant impact. For instance, let's consider the question on Data Storage and Portable Media Protection.

The J2 Software Survey across 46 million activities, including 196 000 USB drive insertions, found that 40% of users mishandle sensitive corporate information, 70% of entities do not have control or visibility of administrative rights, and fewer than 1% of entities encrypt data on their hard drives or USB drives. What this means is that you need to question whether a person can stick a USB drive into a computer and download all of your members' data.

And while we call this data, it actually represents the crown jewels of your fund. And they are at risk.

Collectively, we must make information security an integral part of our culture and overall structure across funds, employers, consultants and administrators.

What we can do right now is to—

- apply the Cyber Resilience Benchmark
- seek expert guidance
- implement corrective action
- choose cyber-resilient service providers
- Repeat.

| Cyber Resilience Benchmark |  |
|----------------------------|--|
| Governance                 | Has your administrator established formal governance policies and processes for information security, Information governance, cyber security, third party management, etc.?  |
| Preventative               | Does your administrator have cyber insurance to enable financial stability for significant cyber events?   |
|                            | Does your current administrator have dedicated information security staff who proactively identify and resolve cyber security vulnerabilities?   |
|                            | Is your administrator's information security staff trained to respond to cyber security incidents?   |
|                            | Does your administrator have processes in place to manage cyber security in terms of: <ul style="list-style-type: none"> <li>• Prevent data from being stolen from computers (USB port blocking and encrypted hard drives)?</li> <li>• Continuous monitoring of antivirus/anti-malware software to ensure that they are up-to-date?</li> </ul> |
|                            | Does your administrator have processes in place to restrict system accessibility? (privileged account management and segregation of duties reviews, etc.)  |
| Monitoring                 | Does your administrator have a dedicated team to actively detect and respond to cyber-attack attempts?   |
| Response                   | In the event of an incident, breach or hacking activity, does your administrator have a programme in place to: <ul style="list-style-type: none"> <li>• Respond to a crisis;</li> <li>• Forensically experts to help investigate; and</li> <li>• The capability to recover data systems after cyber incidents?</li> </ul>                      |

# Make retirement great again



“Make Retirement Great Again” is just another way to consider the issue of Financial Resilience. I regard this title as a blank canvas to imagine the future as it ideally could be, or perhaps should be.

I would like to look back at my 10 Benchmark presentations over the past decade and pick out the key trends and build on those to make predictions for the next decade:

by

**David Gluckman**  
Head: Special Projects  
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| Year | Topic   |
|------|---|
| 2009 | NSSS versus Free Market Retirement Reform             |
| 2010 | 2nd Umbrella Funds Benchmark Study & Charges Analysis |
| 2011 | 3rd Umbrella Funds Benchmark Study                    |
| 2012 | Reform ... the Umbrella Fund Response                 |
| 2013 | Retirement Fund Charges                               |
| 2014 | Crunch Time for Umbrella Funds                        |
| 2015 | Retirement Reform in Action                           |
| 2017 | South Africa and the EB Industry in 2030              |
| 2018 | Default Regulations - A Tipping Point                 |

We can be proud that the specific calls to action we made in that 2009 Benchmark presentation have indeed been core to the reform movement over the past 10 years:

- **Harmonising** the tax treatment of different retirement funding vehicles
- Implementing soft **defaults** to try to encourage preservation and annuitisation
- Implementing standardised cost disclosure measures and efforts to **reduce charges**
- **Consolidating** the industry and radically reducing the number of retirement funds
- Defining a clear role in law for the umbrella fund **sponsor**.

Let’s make no mistake. This is not about doing good for charitable or social reasons only. My thesis is that in a properly constituted competitive market, doing good is good business. The winners will not only add value for their clients, but also for their shareholders, and that creates opportunities for staff. And it’s very important that in such an environment the commercial winners are well rewarded monetarily, else we won’t get strong competitors to enter the market or stay the course in the market.

As an industry we should collectively stand up for what we all know is the right thing to do and together we should strive harder to dramatically improve member outcomes.



## Do you believe in destiny?

We launched the Sanlam Umbrella Fund to the market in early 2008 using the payoff line “SHIFT HAPPENS” with this thinking top of mind.

I need to thank Ant Lester of Fifth Quadrant for his insight when he shared with me their success story. I still remember Ant’s precise words “the industry came to us”. This made it so easy to make important product development decisions for the Sanlam Umbrella Fund – always consider the member and the market will come to you. To highlight a few examples that we decided on from the outset:

- Fifty per cent genuinely independent trustees
- Absolute transparency and simple, easy-to-understand pricing methodology
- Launching the industry’s first Regulation 28-compliant global balanced fund, SIM Enhanced Tracker Balanced Fund, now with a >10 years track record and with almost R2 billion member money invested
- Standardisation of product design as a prelude to technological investment and automation
- No commissions – all fee for service (this has worked well for Sanlam to date, but my prediction is it’s going to work even better over the next decade).

Over the years most research has focused on charges borne by members. However, I would like to tackle the topic from a different angle – provider costs.

There has been one outstanding body of research on this topic – the 2009 National Pensions Study commissioned by ASISA, which analysed costs over the first six months of 2009 for eight large retirement fund administrators, including Sanlam.

This study showed that average costs on a rand per member per month basis were as follows:

- R37.44 per member per month for stand-alone funds (with Sanlam faring slightly better than average)
- R62.37 per member per month for umbrella funds (with Sanlam faring slightly worse than average).

If we inflation proof these costs for 10 years at an inflation rate of 5,2% per annum, they translate to:

- R62.23 per member per month for stand-alone funds
- R103.67 per member per month for umbrella funds.

Our latest numbers for Sanlam costs are:

- R46.80 per member per month for stand-alone funds
- R52.30 per member per month for umbrella funds.

This implies that our efforts over the years have resulted in Sanlam driving down costs to become 25% more efficient than 10 years ago for stand-alone funds, and an incredible 50% more efficient for umbrella funds. These gains can make a real difference in enhancing members’ financial resilience and in making retirement great again!

One of the key findings of the 2009 National Pensions Study was “umbrella administrators still need to find 38% savings to compete with the international reference group”. Today I can proudly say we have achieved those savings and much more! And we’ve managed to do so with increases to clients of below inflation over the full-year period. The average Sanlam Umbrella Fund client would have received administration fee increases more or less in line with CPI inflation over the 10-year period, and larger participating employers would have fared even better.

So the question could be asked whether this hurt our shareholders. They had to invest massively in technology, and only enjoyed below-inflation client fee increases over this decade. Surely the shareholders are hurting?

But no, the R72 million loss on administration in 2007 was reversed to create a profitable situation with administration by 2018. And if we consider the wider picture beyond just administration, we see that SEB operating profits increased almost fourfold in the same period. It’s also clear that client service delivery has improved demonstrably.



And I think our SEB staff would testify to the great career opportunities this growth has afforded them. Look no further than Mike O’Donovan who started the journey in our umbrella fund subsidiary SUFA overseeing the operations for around 10 000 members under administration. Today he heads all our umbrella fund and stand-alone fund administration, including ACA, and is now responsible for close to 1 million members under administration - a hundredfold increase!

So what does all this imply?

This is not a **zero sum game**.

Free market reform implies a shared values system where everyone can win – members, employers, staff and shareholders. And even wider stakeholders such as the Regulator. And I don’t think this free market reform is so difficult. What it requires is vision, passion, determination, integrity and focus. Even with these attributes there will be ups and downs, but in my opinion success is ultimately assured.

It also demonstrates that I have been saying for years – commercial umbrella funds represent our best vehicle to reform the retirement fund industry. And the Sanlam experience is that our stand-alone fund clients have also benefited from the strategy. The investment in technology made possible by the Sanlam Umbrella Fund strategy is now also yielding tangible benefits for our stand-alone fund clients.

To use an expression of the Liverpool manager, Jurgen Klopp, what we need to make retirement great again is ‘tunnel vision’. Of course, Klopp faces a genius competitor in Pep Guardiola, so things are never that easy, but that is also what makes life interesting and challenging.

Talking about competition, let’s look at how the commercial umbrella fund market looked around one year back (latest statistics available from the FCSA):

| <b>Sponsor</b>       | <b>Total Assets</b>      | <b># Members</b> |
|----------------------|--------------------------|------------------|
| Old Mutual           | R 110,836,377,720        | 442,145          |
| Alexander Forbes     | R 79,626,293,231         | 381,063          |
| MMI                  | R 52,818,894,445         | 386,348          |
| Liberty              | R 36,649,408,982         | 356,613          |
| Sanlam               | R 32,091,496,403         | 229,380          |
| Willis Towers Watson | R 6,710,441,509          | 13,402           |
| NMG                  | R 6,224,142,328          | 41,718           |
| Grant Thornton       | R 5,630,583,754          | 36,108           |
| Sygnia               | R 3,584,651,424          | 15,528           |
| 10X                  | R 3,499,033,0            | 32,320           |
| <b>Total</b>         | <b>R 337,671,322,888</b> | <b>1 934 625</b> |

The picture shows that we have a Big 5 in place, but also with some smaller competitors keeping us on our toes. There is no doubt in my mind that the industry is much more competitive today than it was in 2009 – and that has to be good for members and employers.

And the above numbers, being around one year outdated on average, are significantly understated. The Sanlam Umbrella Fund assets are now very close to R50 billion, including outstanding Section 14 transfers and secured new business.

We are also making real progress on efforts to have the critical role of the umbrella fund sponsor formally recognised in law. I still believe we need to answer the question we posed at the 2014 Benchmark, viz. “If the wheels come off, who is accountable?” In my opinion this should be the sponsor, and it will be cold comfort for members to learn that six or eight individuals (possibly ‘men or women of straw’) stand behind a R100 billion+ retirement fund. And with final accountability must come final decision-making power. But let’s leave that as a subject for another day ...

Perhaps at this juncture, I should mention how lucky we are to have people of integrity driving the reform process both at the policymaker, being the National Treasury, and the FSCA. I truly believe these key people have the industry’s best interests at heart.

Many of you will recall Dr David McCarthy, formerly a consultant to National Treasury, and a keynote speaker at the 2008 and 2012 Benchmark Symposiums at which we tackled the subject of reforming the retirement industry to better benefit members. He was not afraid to publicly highlight what he believed were industry bad practices. I do believe his tunnel vision approach was needed to shake things up at the time, and commentators will probably look back and conclude he truly made a profound difference. He helped lay the foundation for financial resilience to happen and make retirement great again.

In my opinion the National Social Savings Scheme (NSSS) is further away in 2019 than it was in 2009. Do I have inside information? No! But what I do know is that President Ramaphosa and his government have many more important issues to resolve, including attracting investment, creating jobs, and greatly improving education and health service delivery. The NSSS will remain in political manifestos, but don’t hold your breath that this is the solution to make retirement great again.

Around the time of the P-Day impasse I asked David which he thought was more important and should be prioritised – member-level charges disclosure or employer-level charges disclosure. He said it had to be employer-level charges disclosure as that could impact a product purchase decision and hence such disclosure would have a greater immediate beneficial impact on the industry. That feedback was given to ASISA, and it’s a key reason why the employer-level Retirement Savings Cost (“RSC”) disclosure was prioritised and will become mandatory for all ASISA members to disclose this in umbrella fund quotations from 1 September 2019.

I am proud that the Sanlam Umbrella Fund was once again the industry leader when we made the call to start disclosing as per this standard for all new business quotations involving assets of >R10 million from March this year.

One could argue that the RSC is only intended to be a tool to compare charges across providers, but I predict that there are still going to be big challenges for small blue-collar worker funds where the RSC numbers are likely to be very high. Particularly given we still have a means-tested social old-age pension system.

I don’t know the solution here. A part of me thinks the charges are high but at least members have some savings after a few years, whereas otherwise chances are they’d have no savings whatsoever. But often the retirement funds are intertwined with very valuable group risk benefits that offer tremendous social good in this market segment. So it’s not a simple debate about what is value for money.

Disclosing all charges as a % of assets is no doubt also going to again raise the discussions about whether the structure of charging a percentage of assets is the way to go to enable financial resilience. I won’t tackle that vast subject today, but let me just remind you that you heard it here first!

Let me now briefly touch on the default legislation. One of the key issues I discussed in my 2018 Benchmark presentation was compliance versus better retirement outcomes. We made a very strong call for trustees to choose better retirement outcomes. Our then CEO Dawie de Villiers subsequently announced at the Johannesburg Benchmark Symposium that Sanlam would provide free retirement benefits counselling to qualifying administration funds, and challenged SEB to make it work and lead the industry.

As a consequence, we decided to establish and staff Individual Member Support (“IMS”) as a specialist business unit in an attempt to build on and enhance what had been started in the Sanlam Umbrella Fund in late 2015. IMS is currently on the frontier of the Institutional versus Retail battleground, and I believe the learnings from this endeavour are going to place SEB as the industry leader in the decade to come. But sadly I have to conclude that at this stage it seems as if the industry has largely opted for compliance over better retirement outcomes.

I hope I am proved wrong, and I admit it's very early days yet, and maybe some funds will still improve their initial offerings. Standardised measurement will be needed from the FSCA before we have a clear picture. But my gut feeling is there will be minimal take-up of trustee-endorsd annuity strategies in particular, and the cost of this element of the new regulations will exceed the net benefit – not for the better, more progressive funds, but for the industry as a whole.

One of the new developments we rolled out for the Default Regulations was an SMS facility to obtain members' written consent for the employer to pay out the withdrawal benefit in cash. It's interesting to note members' responses for the first three months. More than 2 000 such SMSs have been sent and sadly but not unexpectedly the member response in more than 90% of cases has been to pay out benefits in cash.

Some of the written responses are interesting (amended slightly to protect member confidentiality and because this is a family symposium):

“I really don't want to discuss anything further. I just want my money else I will land on the streets. I left my work to lift my burden, now you tell me about this nonsense. My kids need food. I want my money.”

And to illustrate the dangers of written communication:

“Please don't pay me in cash ... rather pay by EFT into my bank account.”

I recently attended an intermediary seminar - more in the personal financial planning space - and was kind of ashamed and disappointed to see the pretty obvious efforts by some to paint defaults as sub-optimal and not in members' interests. No doubt there is a real worry that if counsellors succeed, then financial planners fail. I once again don't think this needs to be a zero sum game. Counselling done well must surely result in better member decisions, and that in turn will mean a bigger pool of money in the system, and even more need for quality financial advice. That is our challenge in the decade to come ... we need a bigger retirement savings pool in South Africa if we're going to create a significant change in financial resilience. Arguing about how to slice the cake is not going to achieve anything positive.

Let me conclude by referencing our 2019 Benchmark research – particularly focusing on our theme of Financial Resilience.

We asked the 100 Principal Officers “What is the number one industry change you would like to see?” and the top results were:

- |  |     |
|--|-----|
| 1. Compulsory preservation                 | 22% |
| 2. Simplification of regulations           | 11% |
| 3. Better leadership from FSCA             | 10% |
| 4. Better member communication / education | 9%  |

The sad reality is the top two on this wish list are realistically not going to happen. But I hope I have managed to convince you that better leadership from FSCA, and better member communication / education are very real possibilities.

Better member communication is really up to everyone in this room, and better member communication will result in members who are more financially resilient.

When we asked a similar question of the 100 independent EB consultants, the top wishes were:

- |   |     |
|---|-----|
| 1. Clients to stop fixating on costs over value | 21% |
| 2. Licensing of specialist EB consultants       | 20% |
| 3. Reducing compliance burden                   | 19% |
| 4. Reducing complexity                          | 14% |

If we want to make retirement great again over the next decade, we need to win the battle against the armies of compliance and risk managers that make providers and trustees too scared to do anything positive. When an actuary is not allowed to talk to a member about financial matters for fear of straying into advice, or when people claim that no one aside from a financial adviser is allowed to indicate to a member how tax on benefits work (i.e. basic information), then something has gone very wrong with our industry.

“The retirement industry megatrends for the next decade have been well set out throughout this booklet. If I had to choose the four that I really believe will be the key battlegrounds for the decade to come, I’d have to go with:

1. The Institutional v Retail clash;
2. Analysis of member data and the insights therefrom on product design;
3. Security ... Security ... Security – everything else will serve no purpose for members if the entire fund is lost owing to cyber insecurity;
4. Few but far better consultants will dominate.”

Barend, Tebogo, Avishal and Elrina have covered these megatrends in detail in their research articles so it seems the Sanlam team is well prepared for the decade to come.”

I can’t tell you how proud I am on the depth of talent we have within Sanlam Employee Benefits. I can’t wait to be sitting in the audience at Benchmark 2029 listening to all that was achieved for our members.

# Changing the perception of retirement

The image of retirement is often portrayed as a person sitting on a beach, with his feet up, sipping cocktails. That sounds rather idyllic! But if you ask the average South African whether he or she is even remotely excited about retirement, the answer will most likely be a firm “No”. People often associate retirement with being old and frail, and having no purpose or drive to get up in the morning. It is often also associated with getting sickly and not being able to look after oneself. If this is the impression retirement creates, then it is no wonder most people dread the day.

I think it’s critical that we change this perception of retirement. There are a few things that we could consider that might help change our outlook on retirement. Firstly, on the day before you retire you will probably be wealthier than you will ever be. You will have spent your working career accumulating your retirement savings. Ideally, most retirees will be debt free at this stage, and will have paid off their house and car. Yes, you may not live in the mansion you once dreamed of, and many retirees may have to scale down in order to achieve this goal, but the burden of debt may be lifted off your shoulders for the first time. As a retiree, you will no longer have to contend with traffic on a daily basis, and can take advantage of cheaper mid-week flights or off-peak holiday packages. Retirees get to sleep in, or stay up late without the consequence of having to go to work tired in the morning. Many retirees express a great relief at no longer having to pursue that career path or having to fight for that next increase.

In this year’s Benchmark results, about 20% of members are believed to be able to retain their standard of living in retirement. Although this is up from last year’s figures, the number is still relatively low. Perhaps this is another reason we all dread retirement - the fear of running out of money. Life expectancy is increasing, and we may very well live longer in retirement than we spent saving for it. This is why planning for your retirement is critical. I read a study recently that found that most people spend less time planning their retirement than they do buying a television!

Retirement does not mean you can no longer earn an income. If planned properly, many retirees get involved in activities that interest them and which can also supplement their retirement income. Some retirees do contract work for their previous employers or other companies to share the wealth of knowledge they have accumulated over their working careers. Our Benchmark results show that one in four employers have considered increasing the normal retirement age for new entrants, with the key motivation to retain skill sets and knowledge. Some retirees focus on a hobby to which they can now devote more time and from which they can also earn additional income, such as dressmaking, painting, or baking. Those lucky enough to have made sufficient provision for retirement can volunteer at a charity close to their heart, or even offer to coach their grandkids’ football team.



by

**Anna Siwiak**

Head: Product Development

**Sanlam Employee Benefits: Umbrella Solutions**

Often people sacrifice saving more towards their retirement because they fear the unexpected expenses that may arise from time to time prior to retirement. However, the industry has seen a trend of using discretionary savings vehicles, such as a tax-free savings account, to supplement retirement savings. This is a great solution, since these savings are available at any time should an unexpected expense pop up, but also provide a tax-friendly environment for saving over the longer term to supplement retirement income. Planning, however, is critical.

Ok, so although the beach, feet up, sipping cocktails image of retirement is not a reality for most of us, there are still many things to look forward to during this life stage. I believe we all need to make a conscious effort to change the negative perceptions of retirement and start focusing on ways to make the experience a pleasant one. Start small, writing down all the books you want to read and movies you just haven't got around to watching. Start planning the activities you want to get involved in after your retirement and perhaps even sign up for some relevant clubs now already. Then move on to the more technical financial side, like your savings. But the key thing is to **START PLANNING!**

# Future advice – The spectrum is widening but the focus is becoming clearer

## Consolidation

In the recent past, the speed at which retirement funds have consolidated into umbrella arrangements has been clear to see. While the move was inevitable for many funds, the advent of default regulations has been the 'push over the edge' for many stand-alone funds that were not considering umbrella funds as an option. This isn't the only consolidation that has taken place in the industry. The view of employee benefits has been consolidated as well. We are no longer able to look at retirement funds and the benefits of being a member of a retirement fund in isolation. It's very clear that retirement funds are an integral part of the total wellness system from a financial wellness perspective. The biggest problem South Africans face at the moment is financial stress as a result of debt, which then has a direct impact on general health. It is easier to look at this as simply the employer, fund and individual, but now you cannot ignore healthcare, dependants of members, decisions at joining funds, and retirement where the member is actually a 'member for life'.

## Customer is King!

Things have gotten more complicated than they have ever been in the advisory space because of the need to take into account the interconnectedness of all employee benefits. The realisation that all of these benefits must be built around the needs of the member rather than the appetite of the employer or capability of the consultant has ruffled a few feathers. The truth is that this should have been the case all along.

The saying 'the customer is king' has been used to the point of it becoming a cliché in the retail space, but now more than ever it is applicable to the retirement fund environment. It is clear the status quo cannot continue. What we've been doing in the industry since the advent of defined contribution funds simply hasn't worked, with retirement outcomes at their worst levels ever. For many years, advisors have been focusing on employers and funds, but where we should be focusing our efforts is quite simply the member, because the customer is king.

The Benchmark research indicates that consultants believe the 2nd most dominant trend in advice is the shift to focusing more on members rather than on funds or employers. The Regulator has forced this upon us through the Default Regulations and Policy Protection Rules. We certainly believe this is an essential extension of the advisory offering.



by

**Avishal Seeth**  
Branch Head: Gauteng  
Simeka



and

**Elrina Wessels**  
Head: Strategic Consulting  
ACA Employee Benefits



The Default Regulations are, in our opinion, the biggest defining moment in the industry since the move from defined benefit to defined contribution funds. But it is up to all of us as participants in the retirement funding system to ensure the change is for the betterment of member outcomes. The Default Regulations are made up of three broad areas:

1. Default preservation
2. Default investments
3. Trustee-endorsed annuity strategies.

But for us, a fourth requirement is as important:

- Retirement Benefits Counselling.

A well-implemented Retirement Benefits Counselling offering does have the potential to influence members' decisions and inevitably their retirement outcomes. To illustrate the effect benefits counselling can have on influencing members' decisions, a case study was performed with one of our clients.

### Case study

We identified one fund that had proactively implemented a formal annuity strategy coupled with retirement counselling in 2015 and used the experience of this fund to illustrate the impact of retirement counselling on member choices. For the purposes of this article, the fund will be referred to as Fund X.

Fund X has a membership base of >30 000 active members and >9 000 pensioners, with assets of >R25bn. Fund X conducted an annuity strategy review in 2015 in anticipation of the Default Regulations. Given the demographics of the membership of Fund X, the board of management was of the view that the in-fund life annuity remained the best option for most of the members. In addition, members retained the right, separate to the annuity strategy, to retire on an in-fund living annuity basis or to purchase a life/living annuity from an external provider.

Although the considered opinion was that a life annuity was best for the majority of the members, and irrespective of the fact that proper written communication was provided to members at retirement, past experience of Fund X was that 60% to 70% of retiring members elected to retire on a living annuity basis.

As a result, the board of management of Fund X appointed a retirement counsellor (on a salaried basis as to remove any commission incentives) in November 2015, with the specific task to contact each retiring member at least three months prior to retirement to discuss the retirement options (life as well as living annuity).

As illustrated in the table below, the impact of the formal annuity strategy coupled with a competent retirement counsellor is noticeable immediately:

| Year  | Retirements** | Life annuity | Living annuity | % to life annuity - formal strategy of Fund | % to living annuity |
|-------|---------------|--------------|----------------|---|---------------------|
| 2013  | 316           | 115          | 201            | 36%   | 64%                 |
| 2014  | 350           | 131          | 219            | 37%   | 63%                 |
| 2015  | 351           | 103          | 248            | 29%   | 71%                 |
| 2016  | 243           | 160          | 83             | 66%   | 34%                 |
| 2017* | 267           | 169          | 98             | 63%   | 37%                 |
| 2018* | 242           | 169          | 68             | 72%   | 28%                 |

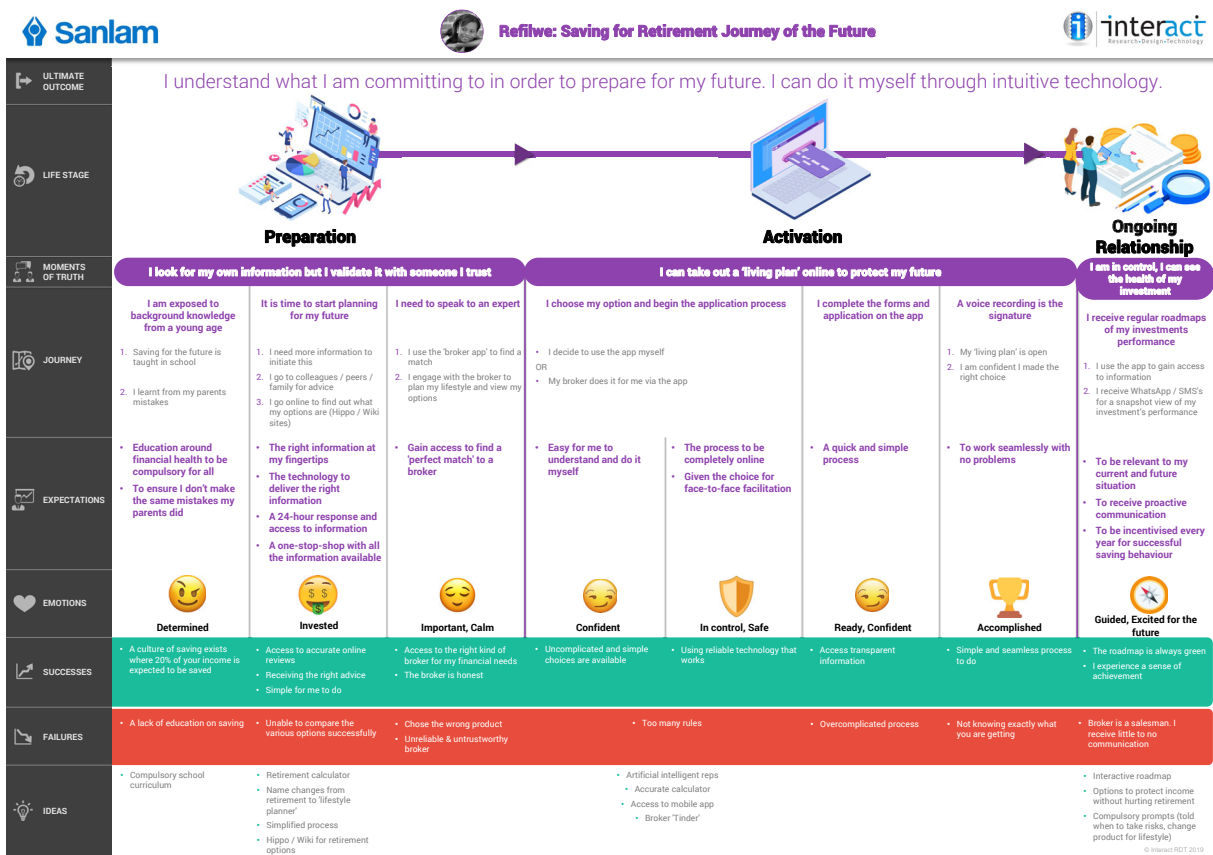
\* Retirement Counsellor appointed in November 2015.

\*\* Members retired outside of the Fund are not listed in this comparison. Effectively on average 18,4% of members who have retired since 2016 have purchased a pension outside of the Fund.

Future advice – The spectrum is widening but the focus is becoming clearer

The effect of effective implementation of counselling is evident in the case study and that is why benefits counselling together with a well-implemented communication or member education strategy can really make a difference to members' outcomes. This won't just improve outcomes at retirement through assisting members in choosing the correct annuity, but will influence members' decisions in terms of preservation when changing jobs as well. These are just two events that occur during one's lifetime where important choices need to be made, but there are many, many more where education and counselling can make a positive impact on members' overall financial wellness.

The key is that you must be able to communicate with or educate members at the right point in time. At specific points in their journey we must be able to influence them to make the best decision for both themselves and their families. The key to a good communication strategy is understanding this journey at a micro level. The question is: How well do decision makers understand the journey that a member embarks upon when preparing for retirement and even into retirement? This is where we are taking a page out of the books of Google and Amazon by making use of journey maps. These are tools that enable you to visualise and analyse all customer touch points throughout their journey.



By using these journey maps we are able to:

- understand user experience;
- determine when decisions are made;
- determine what triggers interest; and
- how to influence at these points.

It's almost like comparing it to a consumer decision-making process and this is a big part of this change in mindset. We must look at members as customers and make every possible effort to improve the customer experience.

Trustees, POs and advisors alike need to spend time on serious introspection, recognise the need to partner with stakeholders in the greater Wellness System, and utilise the technology to achieve better outcomes. Human touch points are critical and consultants must take up the mantle of being the coordinating and enabling force of all of the above.

If Apple and Amazon can do it and get people to spend lots of money on gadgets they don't necessarily need, maybe, just maybe we can use this to get people to simply be aware and spend a little bit more on ensuring they are financially resilient.

# Empowering advisors to participate in Employee Benefits

Given the technical nature and complexity of employee benefits, compounded even further by compliance and governance requirements, it is not surprising that advisors may be reluctant to be involved and participate in the employee benefits environment. Although the reluctance may be understood, it is unfounded and indeed advisor participation is to be encouraged, now more than ever before.

The evolving convergence between institutional and retail business has created both challenges and opportunities and advisors who embrace the responsibility of providing holistic financial advice will fulfil their role in delivering the best outcome for all members.

In an ever-changing financial services landscape, smart solutions are required to assist members to maximise their membership, benefits and pre- and eventual post-retirement outcomes and that is where professional advisors have such a crucial role to play. Previously, members merely joined a fund where retirement was the funding goal, with a few options to be exercised at retirement age. With improvements in longevity, the post-retirement period of a fund member now requires lifelong financial planning, as opposed to the traditional and outdated retirement planning paradigm.

The retirement fund industry is well managed and governed, yet the actual outcome of members is way below levels that will ensure a comfortable retirement with adequate income. It is estimated that only 1 in 5 fund members will maintain a similar standard of living after retirement. The reason for this can in part be attributed to the non-preservation of savings upon resignation during working years when changing jobs; however, fund charges, low contribution rates and investment portfolio selection also contribute to a poorer result for a large percentage of fund members.

Member apathy to participate is a comment often voiced by stakeholders within the retirement fund industry to respond to criticism of poor results for members; however the entire financial services industry bears the responsibility to improve both perception of members and, importantly, the financial outcome.

Telling members to start investing as soon as possible, to contribute as much as possible, not to opt for cash withdrawal benefits when changing jobs, that compound interest is the eighth wonder of the world (Albert Einstein) and to delay retirement for as long as possible, is correct and sage advice. However, it is the ability to communicate, educate and advise members throughout their lifetime that remains the real challenge the industry faces, and where advisors can make the most positive difference. In recent years there has been some improvement, but much still needs to be done.

The FSCA, trustees, sponsors, administrators, joint forums and fund consultants all share the same objective to ensure the best possible outcome for members. In pursuit of an enhanced Member Services Programme for funds, stakeholders should further this by facilitating access to membership of funds to professional advisors to best represent members and lifelong financial planning needs.



by

**Richard van Dijk**  
CEO: Employee Benefits  
**BlueStar**











Recent changes including Default Preservation, Portability, Counselling, Annuity Strategy and Retirement Savings Cost Disclosure (RSC) will undoubtedly have a positive impact on the savings future and again, this is where the advisor is called upon to communicate and advise members. Advisors provide unique skills towards achieving the objective member communication and advice. This also extends to investment portfolio advice where this is a fund option, to align with the overall financial plan.

Another important step in the lifelong planning approach is when the member retires from the fund. Counselling services will provide members with potential options available, but the question of living annuities with drawdown amounts and guaranteed annuities, with the myriad of considerations, needs to be addressed by advisors.

Included in the planning will be the assessment of levels of risk benefit structure and cover. The tax treatment of approved and unapproved benefits has a significant impact at date of claim and this needs to be factored into the plan. Equally, the updating of beneficiary nomination forms by members will assist trustees with the distribution of approved benefits and, where unapproved, ensure that benefits go to intended beneficiaries. Another area where advisors contribute is the continuation of risk benefit cover when members leave a fund.

All stakeholders in the retirement fund industry have specific and specialised roles to fulfil, where the advisor is integral to ensuring a holistic approach towards improving outcomes for members.

Partnerships between fund consultants and advisors are the ideal value proposition to fund members as this enables holistic advice, where fund benefits are also considered in the individual financial planning needs of members.

| <b>Advisers add value to fund members</b>            |   |
|--|---|
| • Assist with member communication                   |  |
| • Group and one-on-one sessions                      |  |
| • Encourage completion of beneficiary nominations    |  |
| • Individual needs analysis to include fund benefits |  |
| • Advise members on fund withdrawal                  |  |
| • Asset preservation and risk benefit continuation   |  |
| • Assist beneficiaries of deceased members           |  |
| • Attend Joint Forum fund meetings                   |  |
| • Provide advice on retirement investment options    |  |
| • Ongoing lifelong financial planning                |  |

# The fourth industrial revolution and saving for retirement

Most people can still remember what life was like before a cellphone – a rotary dial telephone, the noise of dial-up internet and carefully planned road trips with no satnav! The technologies introduced in the late 1970s, such as internet and cellphone technology, were the Third Industrial Revolution, a period that is still ongoing.

## Industry 4.0

So, what is the Fourth Industrial Revolution? Simply put, it is the emergence of digital systems, networked communications, machine learning and large-scale data analysis. It refers to the increasing integration of these technologies into business and production processes in order to make them self-sustaining and more efficient.

At its core is the combination of big data, analytics and physical technology. The aim is to provide increasingly enhanced, customised offerings to help meet the needs of individuals and organisations that can adapt and evolve to changing situations and requirements over time.

But what can this ‘big data’ and ‘data analytics’ mean for members who save for their retirement?

## Industry meets data

It is a moot point that members do not save enough for their retirement, as only 1 in 5 employees are able to maintain their standard of living once they retire. The objective is to combat employee apathy and encourage members to take an interest in their retirement savings and enable them to preserve these once they become entitled to payment.

We also know that HR practitioners and retirement fund administrators accumulate vast amounts of data in the day-to-day administration of payrolls and retirement fund benefits. This data includes statistics such as salaries, salary increases, period to retirement, contribution rates, investment choices and member decisions at exit. This is typically what is referred to as ‘big data’.

As we now know that big data exists and that members do not save enough for retirement, can these statistics and data sets be used to help improve retirement outcomes for members? We believe they can.

For example, we can use data-driven insights drawn from member data to monitor their behaviours in respect of the preservation or withdrawal of their retirement benefits at termination of employment. This data can be presented in the form of a periodic report to the employer. The employer in turn can launch interventions to educate employees about the importance of preservation of their retirement savings. The impact of and insights drawn from such an intervention can be tracked and also reported back to the employer. The employer then has the ability to see whether behaviours improve over time.



by

**Johan Prinsloo**

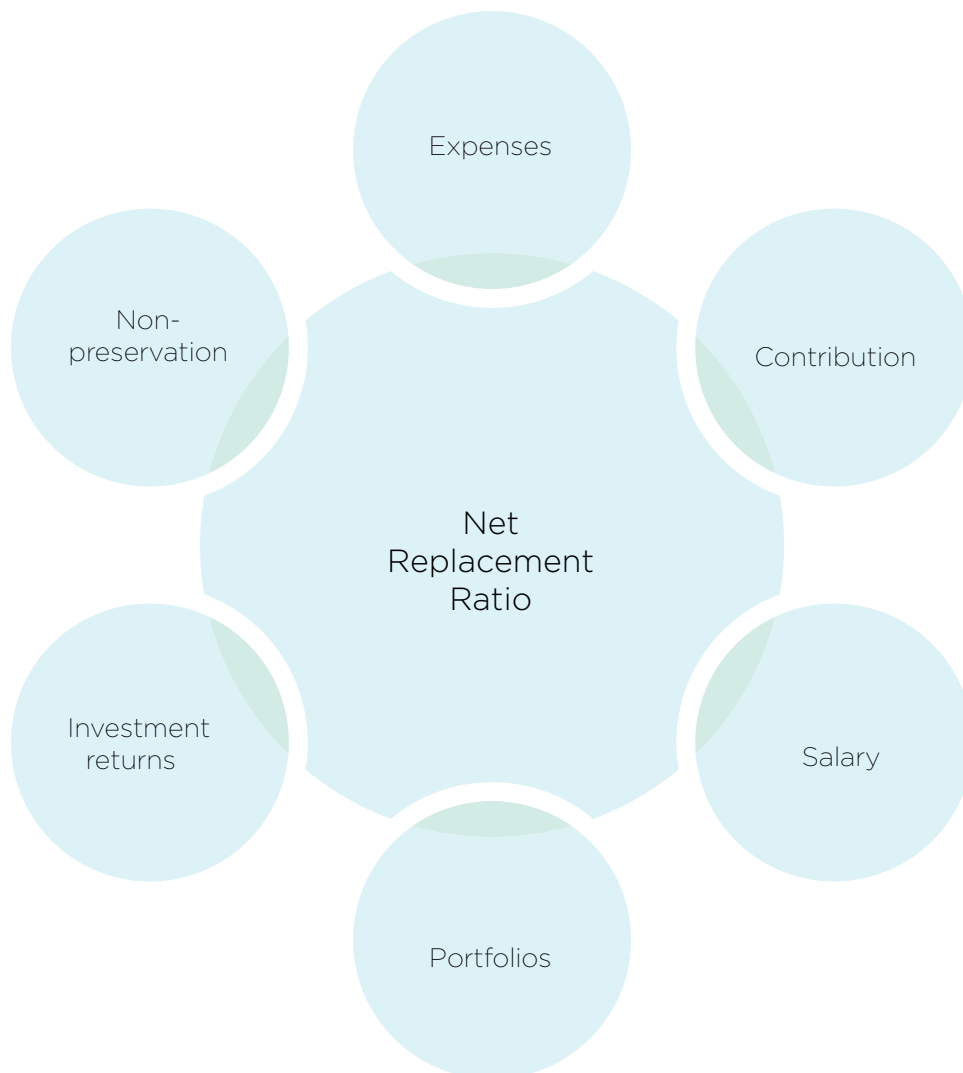
CEO: Retirement Fund Administration  
**Sanlam Employee Benefits**

However, we also know that preservation specifically is easier said than done. Another question is then whether other statistics can be used to help members improve their retirement outcomes. The answer here is also positive.

The term 'retirement wellness' or a member's ability to retire comfortably can be correlated with a more technical term, the 'net replacement ratio' (NRR) of an employee's retirement savings.

Briefly, NRR is a measure used to determine whether an employee has saved enough for retirement to generate an income from this saving that would sustain his/her lifestyle as it was prior to retirement. It is generally accepted that the measure is set at 75% of income prior to retirement. In ordinary terms this means you would need a large enough retirement saving (capital) to give you an income of no less than 75% of your income prior to retirement.

Although preservation is the largest contributing factor, other factors also exist that influence an employee's NRR. The illustration below is a depiction of these factors.



We can take salary as an example. Contributions are based on salary, therefore the increase in salary over the term of the employee's savings will affect the size of the amount of capital from which an income can be drawn. The catch is that the retirement saving must keep up with inflation and if the employee's annual salary increase is below inflation, it effectively means the employee must increase his/her contributions to counter the effect of inflation. It is therefore important for an employee to annually check his/her salary increase against the relevant inflation rate. If we assume that salary increases are on average 6% year on year, an employee should have increased his/her contributions in 2008, 2009, 2014 and 2016 to counter the effects of inflation. Conversely, reported to the employer, the employer can have an intervention with staff specifically targeting appropriate contribution levels.

## Exploratory analytics

Drawing statistics and keeping track of something like members' cash withdrawal behaviour is only the start of big data analytics. It becomes much more interesting to know whether correlations exist between key factors within member data, as well as with external data, where possible. Examples of possible correlations include the following:

- In which salary bracket do most divorces occur?
- Does changing an investment portfolio by a member create or erode value?
- Do males or females save more or less towards retirement at the same age and in the same salary bracket?
- Is there any correlation between members who get divorced and members who terminate employment?
- Is the rate at which members take out pension-backed loans a precursor to divorce or termination of employment? Or is it a factor of GDP growth?
- Considering the various factors of NRR, what is a millennial's attitude towards saving for retirement?

## Conclusion

Big data already plays a huge role in our lives. It is already used to target advertising based on factors including our age, gender, shopping habits and location. Companies say they use such data on an aggregate and anonymous level, but the technology is there to target advertising specifically to an individual. The question is why we cannot use this same technology to improve retirement outcomes for members.

As we delve deeper into the reality of a Fourth Industrial Revolution, big data will play an increasingly crucial role.



# Importance of healthcare solutions for employer groups

The importance of healthcare benefits as part of employer group offerings cannot be disregarded as employers recognise the link between business success and employee well-being. The cost of medical schemes and health insurance on not only current needs and financial provision but also post-retirement financial planning, greatly impacts the financial position of each employee. Easily accessible healthcare becomes more important as employees are exposed to increased economic pressures annually. Healthcare needs includes access to pharmacists, doctors, dentists and optometrists, as well as to radiology and maternity benefits as soon as symptoms arise – either in a subsidised context or based on employee contributions. Preventative care, access to day-to-day healthcare and wellness services are often in everyone's best interests to avoid staff spending a significant amount of time at public clinics where queues can be long, which then has a dire impact on staff attendance and negatively impacts a company's profitability.



by

**Martin Neethling**

Head: Sanlam Health  
**Insurance and Distribution**

For many South Africans, medical cover is their second-highest monthly expense. Add to this any day-to-day out-of-pocket expenses and you're looking at an even bigger portion of salaries being spent on medical-related cover only. Although people pay high premiums towards their medical schemes, they often still end up shouldering exorbitant shortfalls when admitted to hospital or requiring expensive out-of-hospital treatment. Gap cover aims to provide a top-up to cover the difference between service provider charges and what the medical schemes cover when you are admitted to hospital. Studies estimate that fewer than 10% of medical scheme members currently have gap cover, the absence of which could be a strain on finances, upsetting a carefully calculated financial plan on a monthly basis. Even the most comprehensive schemes seldom pay for the total cost of hospital treatment and may impose limits, sub-limits and co-payments, which a Gap Cover product covers at a fraction of the cost of your medical scheme contribution.

The bad news is that the cost of healthcare increases annually, becoming an even bigger part of future financial spending. During the past 10 years medical inflation has averaged more than 11% , more than 5% above the Consumer Price Index (CPI)

Annual medical scheme inflation is driven by both increasing cost of services and the increase in utilisation. The higher demands are driven by an ageing medical scheme population, with each year of ageing, the healthcare claims increase by approximately 2%-3% per year, along with an increase in the number of chronic diseases. Slow economic growth and affordability prevent many younger people from joining, while the cost of services for medical schemes increase mainly due to increased cost of technology, infrastructure and new-generation medicines.

There are many products and providers to choose from, all with complex benefits and, in most instances, confusing information in terms of cover. It is recommended that great care be taken to review a possible solution for affordable medical cover annually, consulting with a healthcare-accredited broker or financial planner, to ensure benefits are in line with health needs and current financial abilities.

Medical schemes are regulated by the Council of Medical Schemes, demarcation regulations govern medical gap cover, and hospital cash plans and primary healthcare are governed by the Long-term and Short-term Insurance Acts. Each of the products you may need cover a variety of healthcare needs that have their own rules, benefits and regulations, and address specific needs. The choice of products will depend on individual healthcare needs and affordability. Many people put their whole family on the most expensive option as a comfort blanket for unforeseen issues. This means they could be paying for high benefits, which they may not need or for which there is no foreseeable risk. It might be a better option to keep family members with greater healthcare needs on a separate plan so you don't end up paying more for benefits not needed by everybody. A comprehensive option is always desirable but, depending on your or your family's unique needs, extensive formularies and prosthesis benefits, dentistry, optometry or specialised cosmetic interventions can be further down on your healthcare options menu.

Not everyone can afford a medical scheme option and individual healthcare needs may not require the specific benefits offered by a medical scheme option. There are different solutions for people with a limited budget or limited healthcare needs:

Primary healthcare insurance allows you access to GPs, medicine, basic blood tests and X-rays in the private sector, avoiding the time-consuming and inefficient clinics and state hospitals for these services. This limits the risk of hospitalisation and chronic diseases.

While delivering the State of the Nation Address (SONA) in Parliament earlier this year, President Ramaphosa said the wheels would start turning on National Health Insurance (NHI), a policy to ensure access to universal health coverage. NHI aims to enable South Africans to receive free services at the point of care in public and private quality-accredited health facilities. By applying the principle of social solidarity and cross-subsidisation, government aims to reduce inequality in access to healthcare. Realising the magnitude of the challenges in healthcare, an NHI and quality improvement War Room in the Presidency was established, consisting of various key departments to address the crisis in the public health system while preparing for the implementation of the NHI. Government has funded a national quality health improvement plan to improve every clinic and hospital that will be contracted by the NHI. "By introducing the NHI, as a proposed state-run health-financing system that aims to pool funds to provide access to quality health services for all South Africans regardless of their economic status, all South Africans are meant to be covered by NHI by 2025. Together with a multipronged quality improvement programme for public health facilities, we are working towards a massive change in the healthcare experience of South Africans," Ramaphosa said.

The implementation of NHI and Council for Medical Schemes (CMS) efforts to provide a set of benefits for a low-cost medical scheme option have been on the table for many years, but still need to produce a practical and affordable solution for implementation. Recently, the Council of Medical Schemes granted only 23 of 40 providers exemptions for primary healthcare plans. New insurers cannot enter the market because the exemptions were only available to those already providing these benefits when the regulations were issued.

Primary healthcare can also be provided to employees outside of the Medical Schemes Act, under the Occupational Health and Safety Act. Insurance products can be offered to employees who want to take out the cover, or an employer can make the cover compulsory for employees. The compulsory products have proven to be significantly cheaper.

Today, employers have a variety of healthcare options to offer their staff for both treatment and preventative options. Finding the right solution for employees can make a material and financial difference. The products and services in the medical environment, ranging from wellness programmes, on-site clinics, employee assistance programmes, primary health solutions, medical schemes, gap cover as well as complementary life products (Dread disease/Critical illness/Cancer products ) and integrated rewards programmes, would help curb absenteeism, increase morale and productivity, thereby positively impacting business's bottom line and profitability model.

# Umbrella Funds Research Overview

This is the eleventh consecutive year a separate study was conducted on umbrella funds and the history provides for a meaningful analysis of the emerging trends. Once again, we surveyed 100 employers who participated in umbrella funds.

This research overview will cover the following topics:

## Contributions

- Due to an increase in the total contributions, provisioning for retirement funding has also increased. Operating costs increased slightly after steady decreases over the past six years.

## Investments

- The trend of employers offering more investment choices is continuing, with more than 70% of employers offering some sort of choice.
- Lifestage models have increased in popularity and remain the preferred choice of most employers. Passive balanced funds have gained some traction as a default investment strategy, but have remained stable at last year's level.

## Insured benefits

- Death and disability benefits remain the most popular, with critical illness benefits starting to gain some interest.

## Benefit consulting

- From a remuneration perspective, there is a move away from a negotiated fee towards statutory commission.

It is interesting to note that, when selecting a benefit consultant, the range of advice and independence of the broker are considered only by a quarter of employers. The most prevalent factors considered are relationship, company brand and price.

## Advice for members

- Most employers have a formalised strategy in place for rendering financial advice to members, which was done using a preferred panel of advisors or a salaried advisor from the fund.
- There is a great disparity between the priorities of lower- and higher-income members. The only commonality is the fact that both groups considered loyalty/rewards programmes to be their lowest priority.

## Retirement

- Simplicity seems to be the theme coming through this year, from the need for a simple measure to track and set retirement goals to trustee-endorsed annuity products. Trustee-endorsed annuity providers should focus on cost, security and simplicity.

## Understanding the participating employers surveyed

Approximately 88% (2018: 86%) of employers 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 27% (2018: 30%), Wholesale and retail 15% (2018: 15%), Transport or Logistics 10% (2018: 8%), Agriculture, forestry or fishing 9% (2018: 10%).



by

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The average membership was 615 (2018: 533), with 52 (2018: 59) of the participating employers having a membership of between 20 and 300. The remaining 48 employers had more than 300 members.

The average value invested in an umbrella fund by a participating employer was R256 million (2018: R200 million), with 37 (2018: 41) employers having less that R50 million invested.

## Contributions

Total provisioning for retirement increased by 2,3 percentage points when compared to 2018, which saw a decrease of 3,5 percentage points.

|                                       | 2019       | 2018          | 2017          | 2016          | 2015          | 2014          | 2013          |
|---------------------------------------|------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Employee contributions                | 7%         | 5.50%         | 7.30%         | 7.1%          | 6.40%         | 5.60%         | 5.60%         |
| Employer contributions                | 9%         | 8.4%          | 10%           | 9.5%          | 8.80%         | 8.50%         | 8.10%         |
| <b>Total Contributions</b>            | <b>16%</b> | <b>13.90%</b> | <b>17.30%</b> | <b>16.60%</b> | <b>15.20%</b> | <b>14.10%</b> | <b>13.70%</b> |
| Death benefit premiums                | (1.3%)     | (1.5%)        | (1.3%)        | (1.3%)        | (1.3%)        | (1.6%)        | (1.6%)        |
| Disability benefit premiums           | (1.0%)     | (1.1%)        | (1.1%)        | (1.1%)        | (1.2%)        | (1.2%)        | (0.9%)        |
| Operating costs                       | (0.7%)     | (0.6%)        | (0.7%)        | (0.7%)        | (0.8%)        | (0.8%)        | (0.8%)        |
| <b>Total provision for retirement</b> | <b>13%</b> | <b>10.70%</b> | <b>14.20%</b> | <b>13.50%</b> | <b>11.90%</b> | <b>10.50%</b> | <b>10.40%</b> |

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 since 2013, this figure is lower than the comparable cost for stand-alone funds.

It is worth noting that since 2015 there has been a gradual shift away from employers paying contributions plus costs, which decreased from 60% in 2015 to the current 34%. This implies that more costs are being borne by the members as participating employers try to manage their expenses in a sluggish economy. This has a direct impact of members' retirement savings.

## Investments

The majority of employers surveyed, 73, offered member investment choices. This figure has increased over the past two years from 64 in 2017.

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

| Trustee choice            | 2019 | 2018 | 2017 | 2016 | 2015 |
|---------------------------|------|------|------|------|------|
| Lifestage models          | 56%  | 49%  | 60%  | 52%  | 59%  |
| Balanced active           | 17%  | 19%  | 10%  | 14%  | 15%  |
| Guaranteed/Smoothed bonus | 16%  | 20%  | 22%  | 26%  | 23%  |
| Balanced passive          | 11%  | 10%  | 4%   | 3%   | 5.3% |
| Cash/Money market         | 0%   | 1%   | 3%   | 4%   | 3%   |

Over the past five years, there has been a significant move away from guaranteed/smoothed bonus funds as a trustee choice/default portfolio towards balanced funds (active and passive combined). This is perhaps due to guaranteed/smoothed bonus funds traditionally being more expensive than balanced funds due to their capital guarantee premiums.

There was some uncertainty (25% vs 26% in 2018) among respondents about whether their lifestage model was explicitly aligned to their post-retirement annuity strategy. This uncertainty may indicate that education is needed regarding the role of a lifestage model and how it fits in with a post-retirement annuity strategy.

Thirty-six per cent of respondents (2018: 30%) 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 | 2019 | 2018 | 2017 | 2016 | 2015 |
|--|------|------|------|------|------|
| Living annuity (ILLA)  | 34%  | 21%  | 43%  | 29%  | 36%  |
| Guaranteed annuity (level or increasing)                       | 30%  | 28%  | 33%  | 25%  | 39%  |
| Inflation-linked annuity                                       | 28%  | 26%  | 27%  | 35%  | 45%  |
| Balanced passive   | 11%  | 10%  | 4%   | 3%   | 5.3% |
| Composite annuity  | 25%  | 11%  | 7%   | 0%   |      |

Composite annuities (combination of a Living Annuity and another type of annuity offered by an insurer) have become increasingly more popular over the past couple of years.

### Insured Benefits

Most participating employers (66%) provided risk benefits as part of the umbrella fund package (2018: 68%), and 21% (2018: 25%) provided risk benefits by way of a separate scheme. Some (12%) (2018: 6%) provided risk benefits as a combination of the umbrella fund package and a separate scheme.

The most popular risk benefits provided as part of the umbrella fund package remain death benefits at 96% (2018: 99%), disability income benefits at 77%, and funeral benefits at 69% (2018: 68%). Critical Illness benefits are also becoming a popular approved benefit with 17% (2018: 15%) of employers providing it.

- The average lump-sum approved death benefit was 3,1 times (2018: 3,0 times) annual salary.
- The average lump-sum unapproved death benefit was 3,1 times (2018: 3,5 times) annual salary.
- The average lump sum payable at disability amounted to 2,8 times annual salary.
- The average size (replacement ratio) of the income benefit payable at disability was 78% of annual salary.

### Benefit Consulting

Thirty-seven per cent of consultants/brokers (2018: 25%) were remunerated based on statutory commission, while 50% (2018: 61%) 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 61% in 2018. However, this year there was a definite swing away from this approach back towards the statutory commission.

The table below highlights the most prominent factors participating employers take into consideration when appointing consultants or brokers.

| Factor  | Considered by |
|---|---------------|
| Existing relationship   | 55%           |
| Company brand/track record  | 53%           |
| Price/cost of service   | 51%           |
| Independence of the broker  | 27%           |
| Range of advice offered, including employee benefits, medical aid, short-term insurance, financial wellness | 22%           |

### Advice for Members

A significant portion (62%) of participating employers had a formalised strategy in place for rendering financial advice to members. When asked to describe this strategy, 67% indicated that they referred members to preferred financial advisors and 24% indicated that they offer advice services to members by way of a salaried advisor offered by the fund.

Seventy-seven per cent of the employers believe there is scope for a financial advisor to provide holistic financial advice to members of the sub-fund via a worksite advice model.

Employers were asked to rank the priorities of lower and higher income members separately, and the table below summarises these findings.

| Priorities                          | Lower Income Importance | Higher Income Importance |
|-------------------------------------|-------------------------|--------------------------|
| Funeral cover                       | 1 <sup>st</sup>         | 7 <sup>th</sup>          |
| Meeting short term debt obligations | 2 <sup>nd</sup>         | 6 <sup>th</sup>          |
| Insurance: Life and disability      | 3 <sup>rd</sup>         | 2 <sup>nd</sup>          |
| Meeting long term debt obligations  | 4 <sup>th</sup>         | 5 <sup>th</sup>          |
| Retirement savings                  | 5 <sup>th</sup>         | 1 <sup>st</sup>          |
| Medical aid                         | 6 <sup>th</sup>         | 3 <sup>rd</sup>          |
| Tax free savings                    | 7 <sup>th</sup>         | 4 <sup>th</sup>          |
| Loyalty/rewards programme           | 8 <sup>th</sup>         | 8 <sup>th</sup>          |

It is quite clear that there is a significant difference in the priorities of lower- and higher-income members. The only area of commonality is the fact that loyalty/rewards programmes are the lowest priority, irrespective of income. This implies a definite need for employers to offer different benefit structures to their employees.

### Retirement

Respondents estimated that, on average, only one in five of their retirees would be able to maintain their current standard of living in retirement.

Sixty-one employers believed the use of a Net Replacement Ratio (NRR) was a suitable measure for determining whether a member was on track for retirement, but 25 of these believed a better solution was needed. Seventeen respondents believed members did not understand this measure.

Forty-five per cent of participating employers (2018: 25%) had a target NRR and of these, 60% (2018: 72%) indicated a default employer and employee contribution rate that was aligned with the stated NRR target.

The Default Regulations came into effect on 1 March 2019. One of the requirements is that every fund must have in place a default annuity strategy to ensure members are able to convert their retirement savings into an income that is efficient, transparent and cost effective. A consistently increasing number of respondents believed the trustees of their umbrella funds had implemented an appropriate trustee-endorsed annuity strategy for members. This figure has increased from only 15% in 2014 to the level of 30% in 2019. What is concerning is that 14% (2018: 16%) of participating employers stated that the trustees of the umbrella fund were still in the process of putting a trustee-endorsed annuity strategy in place within the next 24 months and 26% (2017: 24%) believed this was not being considered at all.

The most popular trustee-endorsed annuity products selected were as follows:

|  | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 |
|--|------|------|------|------|------|------|
| Living annuity                           | 53%  | 12%  | 45%  | 26%  | 8%   | 47%  |
| Combination of different annuities       | 27%  | 27%  | 0%   | 11%  | 28%  | 13%  |
| Guaranteed annuity (level or increasing) | 3%   | 18%  | 17%  | 22%  | 32%  | 40%  |
| Inflation-linked annuity                 | 3%   | 18%  | 17%  | 22%  | 8%   | -    |

The most important factors in selecting a trustee-endorsed annuity provider were cost of the product (43%) (2018: 30%), security of the product (13%) (201: 33%), and simplicity (13,3%) (2018: 0%).



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