



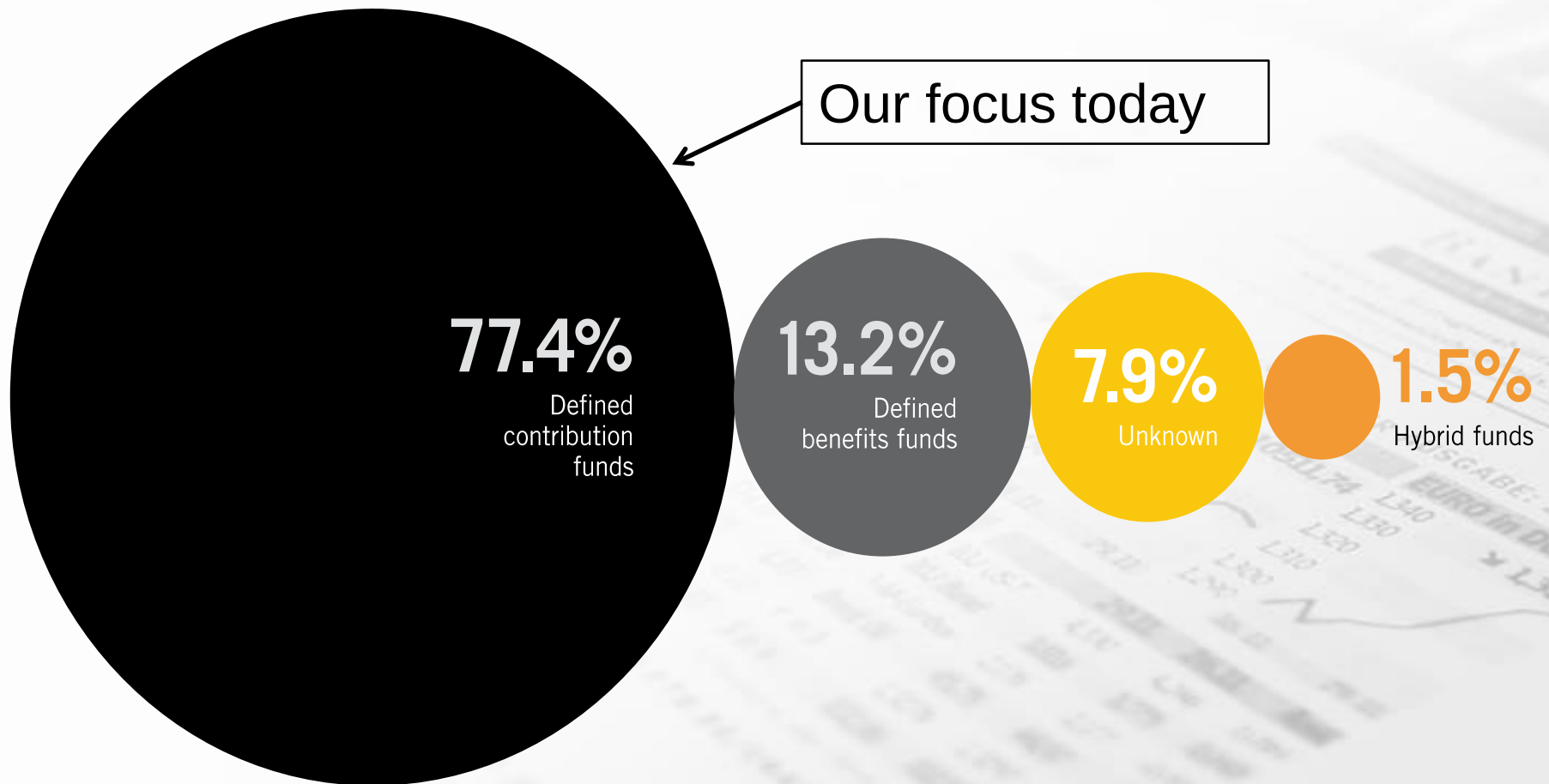
QUANTIFYING RISK, ENABLING OPPORTUNITY

Michael Prinsloo

Alexander Forbes - Research and Product Development

Fund types – does it really matter?

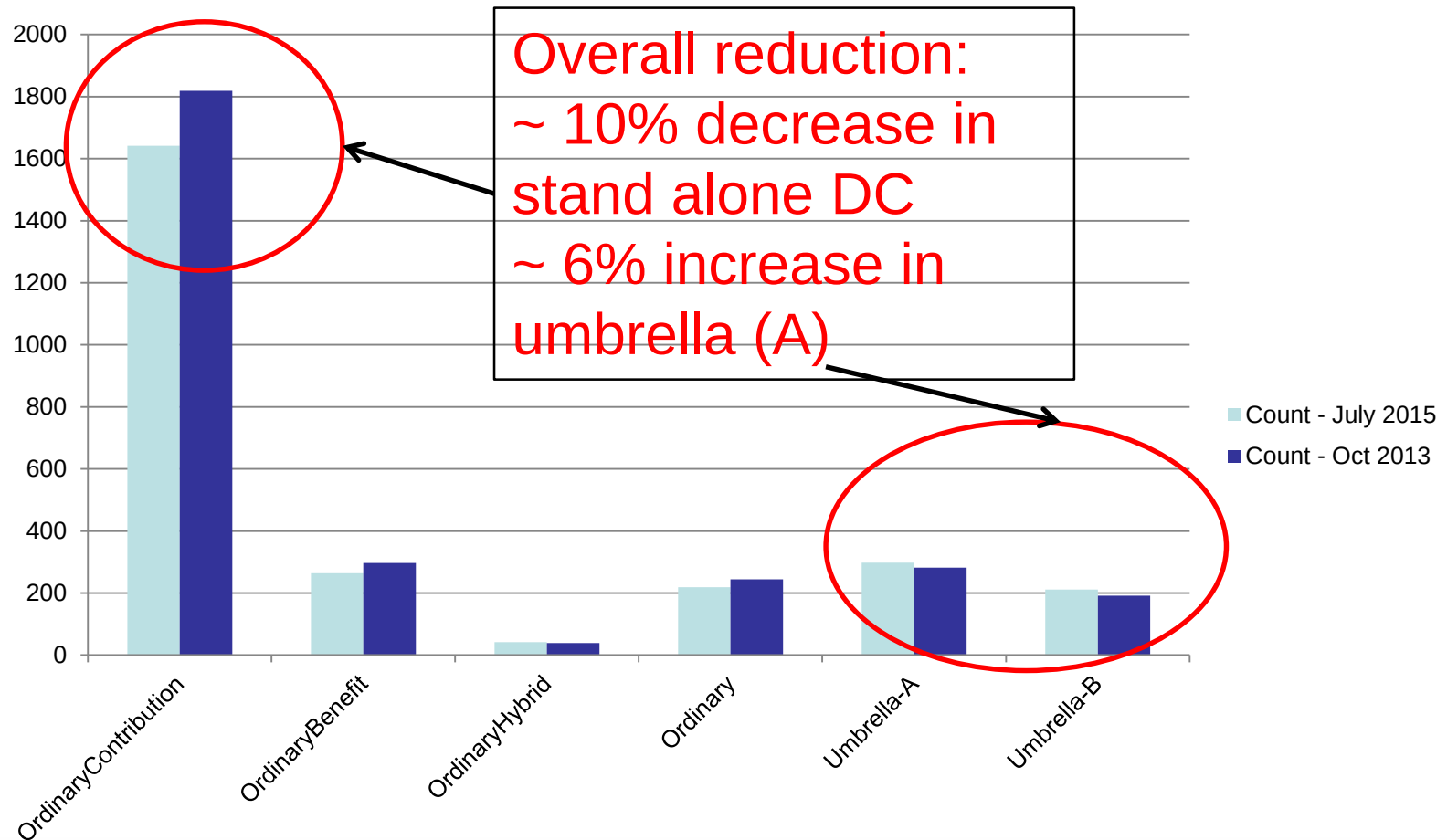
SA situation



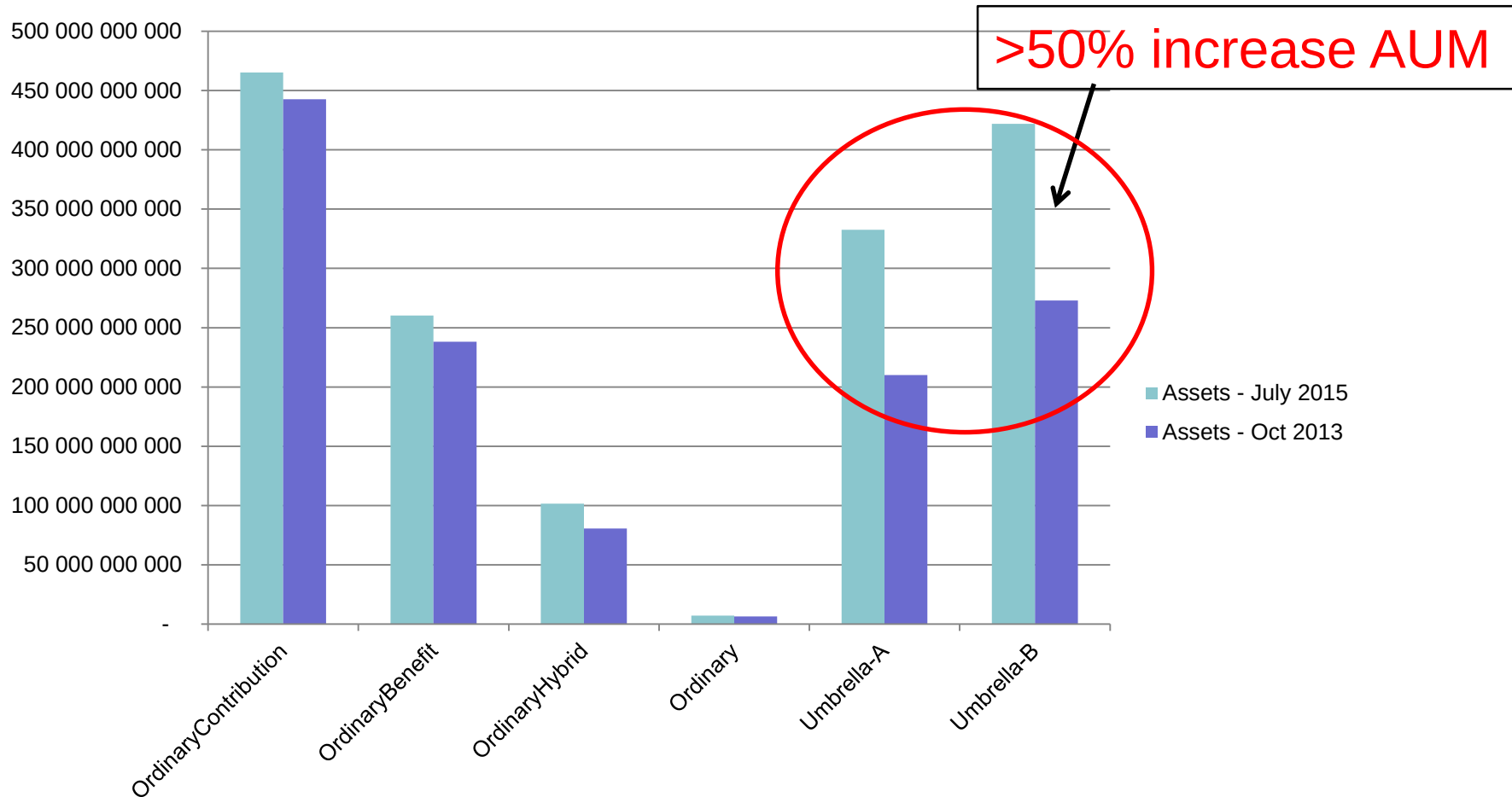
And within DC ...

- Significant growth in umbrella funds versus other fund types (#, assets and members).
- There are now more members in umbrella fund type A than in stand-alone DC funds.
- Decline in the overall number of stand-alone funds and members in these.
- Increase in number of free-standing hybrid funds due to former free-standing DB funds

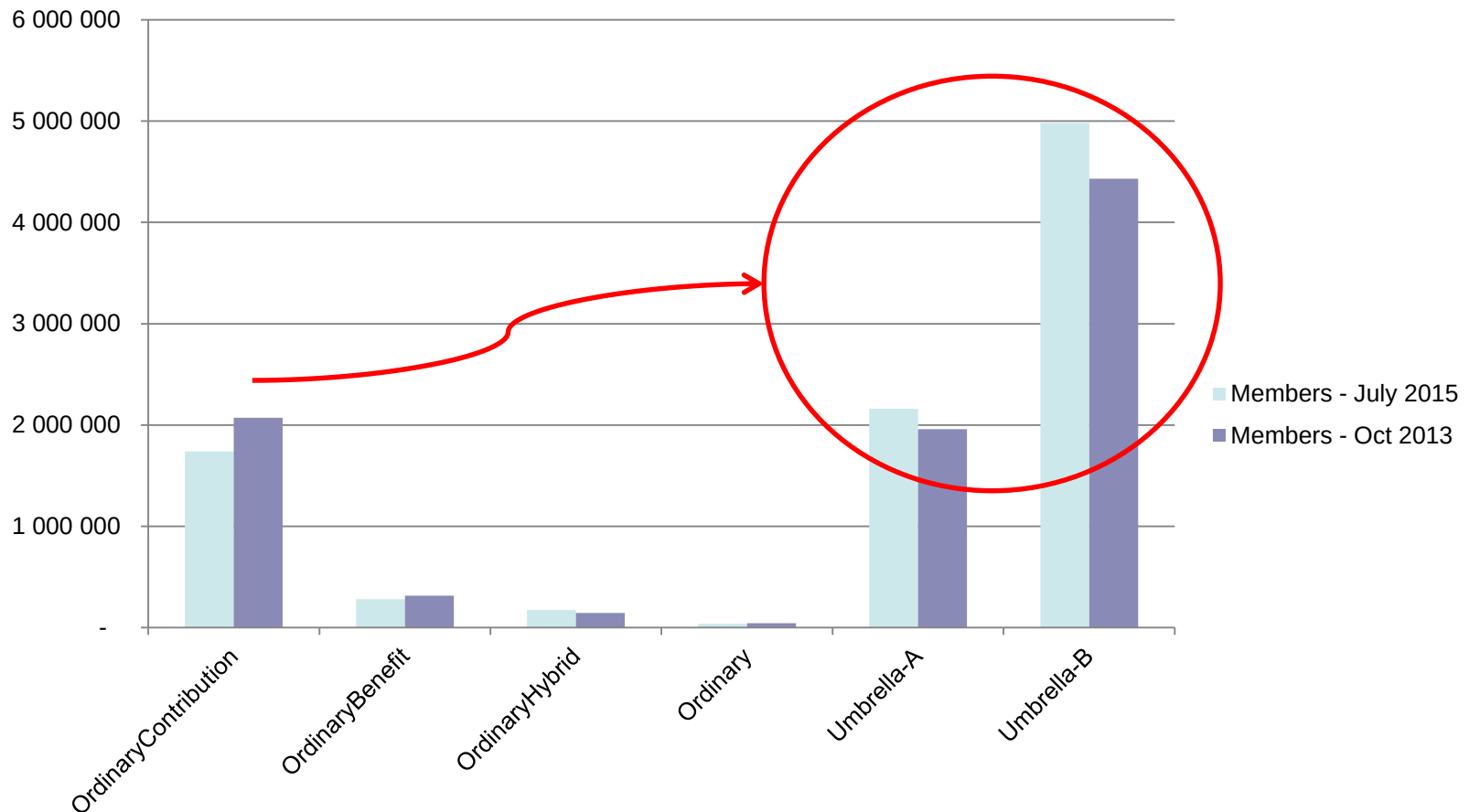
Number of funds (excl RA)



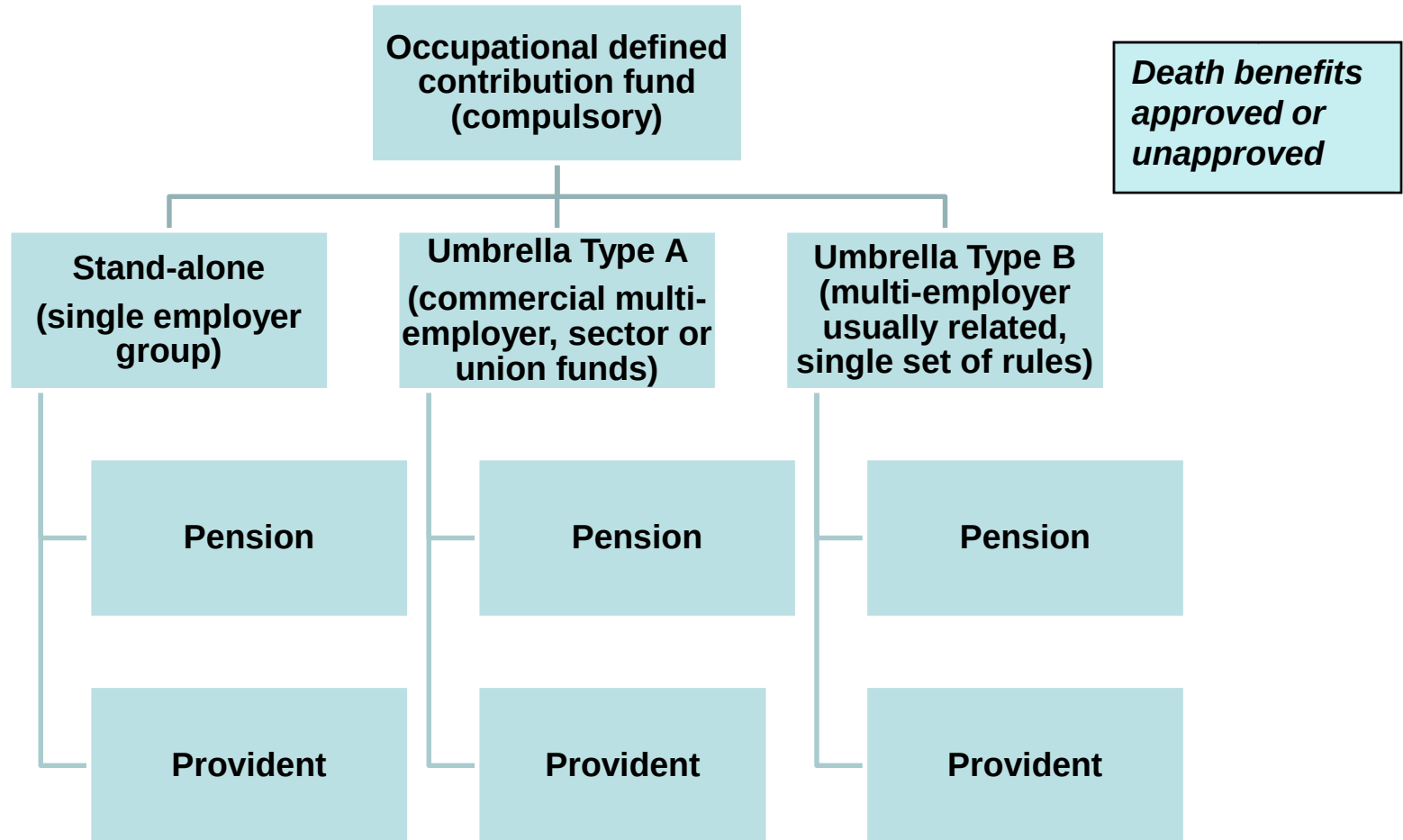
Assets (excl RA)



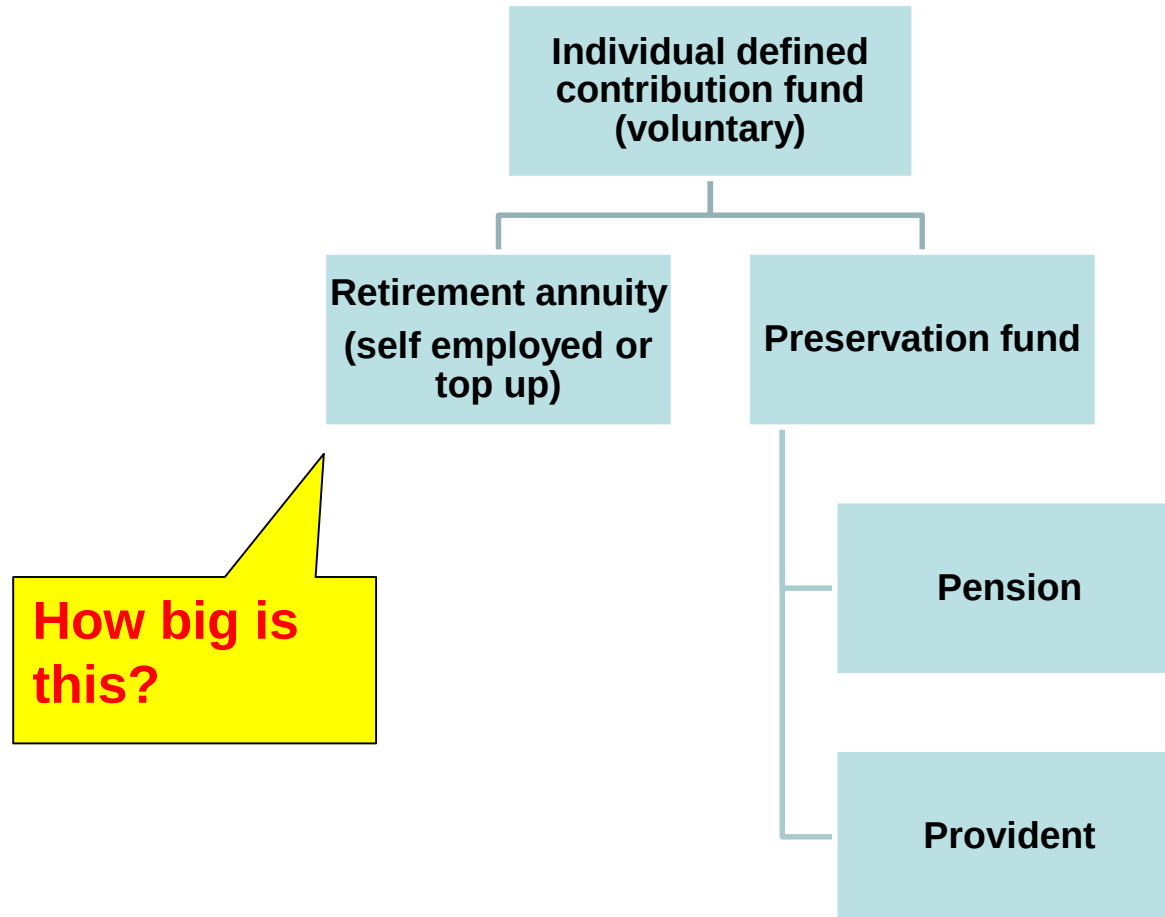
And by membership (excl RA)



Traditional retirement funding options



Traditional retirement funding options



RA and GRA funds ...

- Retirement Annuity Funds are large – occupy many of top spots on Top 100 funds lists by members/assets
- 62 active funds hold over 4 million records worth > R420bn

BUT

- *No separate records of “group RA” recorded by FSB*
- *Small numbers of employers participate*
- *Suspected less than R3 billion in AUM*

But due to

- Retirement reform – T-day aligns the different fund's tax regimes and better levels the playing field

	Pension	Provident	Retirement annuity
Member tax deduction	Yes – up to 7.5% of RFI	No	Yes – up to 15% of non-RFI (and some rand minimums)
Employer tax deduction	Yes – up to 20% in practice	Yes – up to 20% in practice	Indirect 11(a)
Contributions	EE/ER	EE/ER	EE
Retirement benefit	Up to 1/3 cash, balance annuity	Up to 100% cash, balance annuity	Up to 1/3 cash, balance annuity
Withdrawal benefit	Yes – cash or preserve	Yes – cash or preserve	No – preserve until retirement unless meet criteria

But due to

- Cost pressures, especially in smaller fund segment

Description 2013	Fund Count	Costs / Income * 100	Costs / Contribution * 100	Total Members	Total Assets (Million)
Funds With Members < 20	486	8.67%	54.81%	2 566	4 083
Funds With Members < 50	198	5.82%	25.05%	6 381	3 824
Funds With Members < 100	172	5.05%	19.87%	12 435	7 611
Funds With Members < 200	216	4.68%	18.55%	31 744	16 932
Funds With Members < 500	224	3.99%	12.48%	105 936	38 242
Funds With Members < 1000	223	3.99%	12.48%	33 362	69 302
Funds With Members < 5000	223	3.99%	12.48%	88 337	276 287
Funds With Members < 10000	223	3.99%	12.48%	18 198	239 515
Funds With Members > 10000	223	3.99%	12.48%	352 596	1 205 026
Total funds sample	2 203				

We cannot ignore that:
~50% of RSA employers have
less than 50 employees
(30% less than 20)

But due to

- Economic situation – employers focus on core business, limit time and resources to running funds



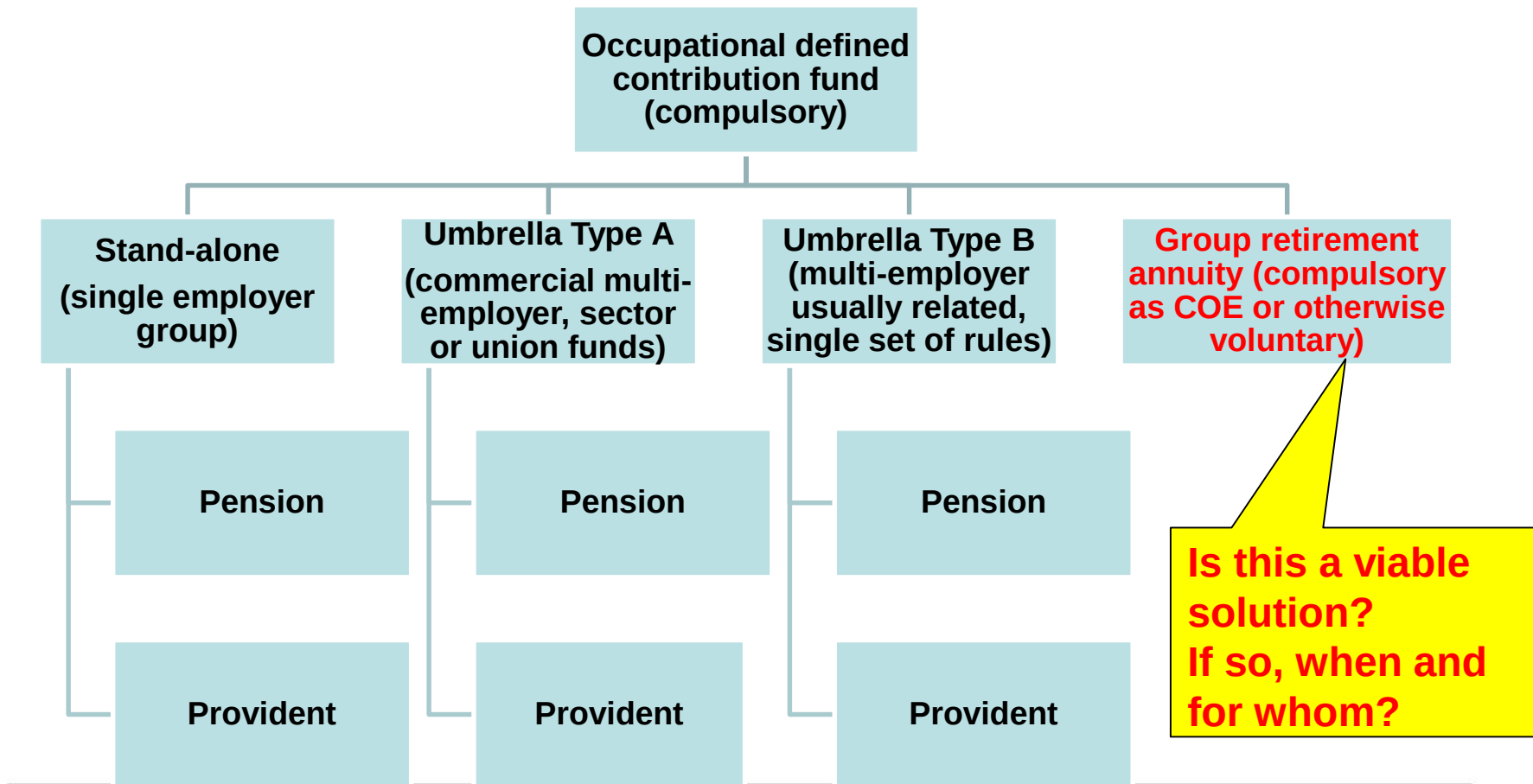
But due to

- Increasing regulatory / compliance burden pushing trustees to consider reduced roles, e.g.:
 - TCF
 - FSLGA Act – extending personal liability trustees/ER
 - higher governance budget required
 - fit and proper standards for trustees
 - POPI
 - RDR
 - retirement reform e.g. new default regulations....

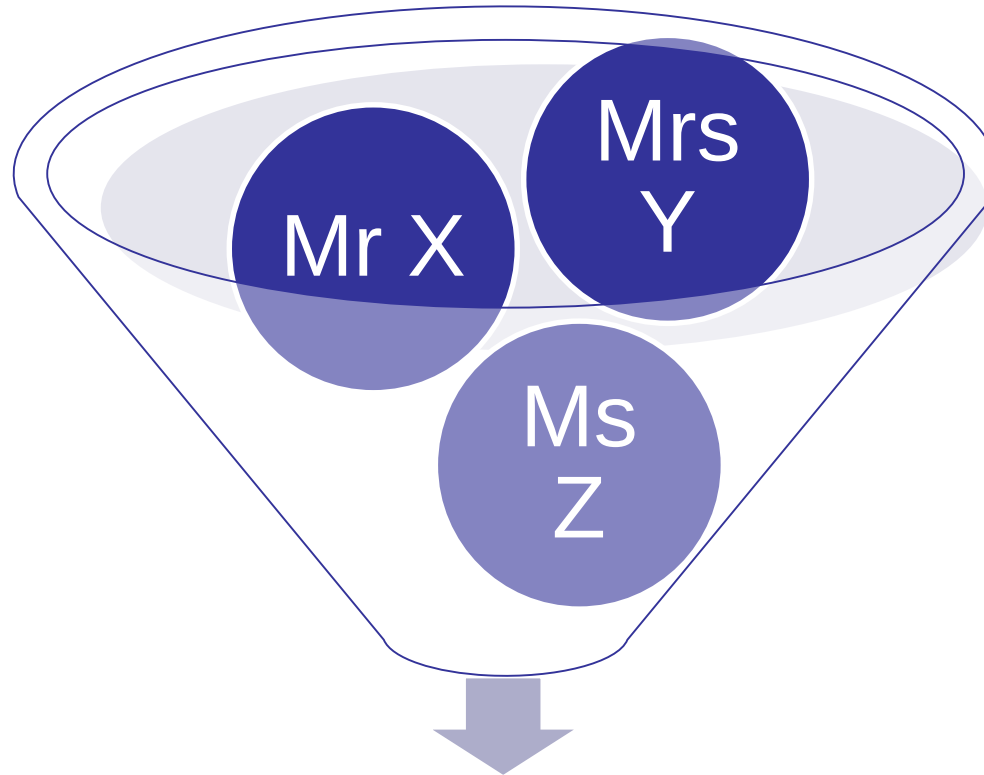
But due to

- Service provider positioning, e.g.:
 - closure of stand alone administration services forcing the umbrella discussion
 - increasing flexibility/complexity of umbrella
 - asset managers positioning to combat rise of umbrella fund's in-house asset management
 - marketing and media
 - indications by National Treasury around a preference for umbrella funds (albeit with improved governance)
 - fees and/or commission structures

We see the rise of a new debate



A group RA is = sum of parts



Risk benefits –
unapproved and
paid direct

Single contact point for administration:
Collection of contributions
Negotiations
Communication distribution etc

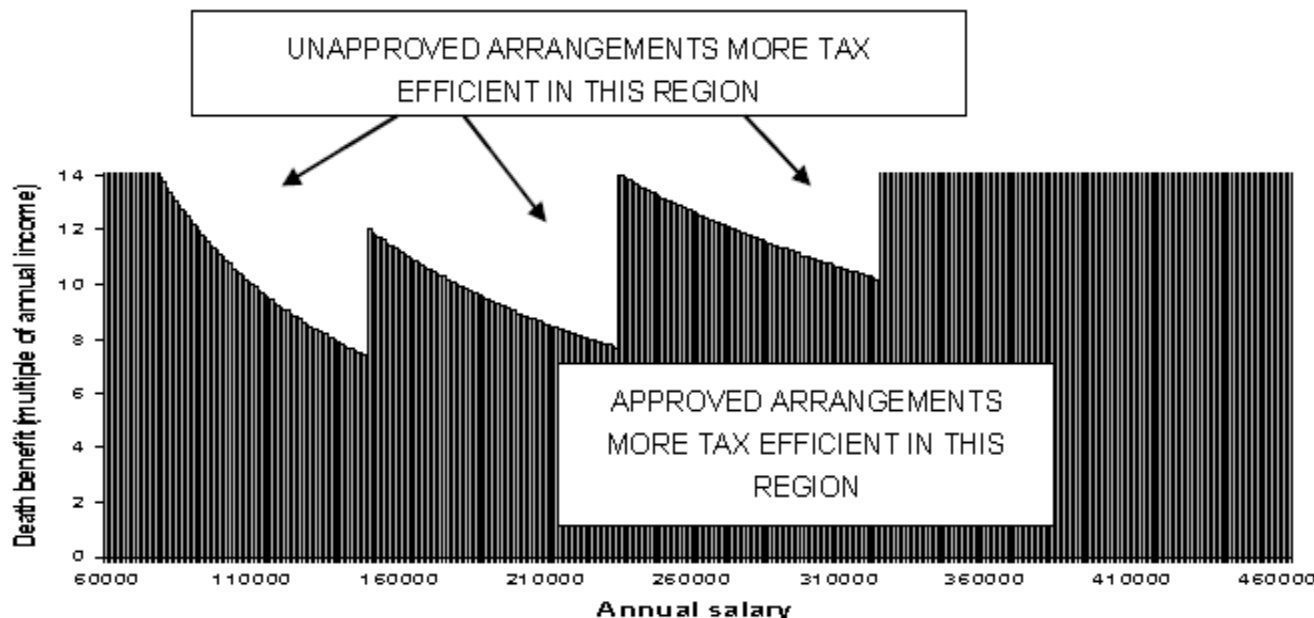
Unapproved vs approved death benefits - not a trivial decision

Table 7: Examples of tax treatment of risk benefits provided through retirement funds

Taxpayer	Individual earning R78 000 p.a., benefit of 5 times salary on death		Individual earning R750 000, benefit of 5 times salary on death	
	Outside fund ('unapproved')	Inside fund ('approved')	Outside fund ('unapproved')	Inside fund ('approved')
Employee taxpayer (premiums)	Premiums taxed at the marginal rate of 18%	Premiums tax free	Premiums taxed at the marginal rate of 40%	Premiums tax free
Employee taxpayer (benefits)	Benefits tax free in the hands of recipients	Benefits taxed at average rate of 2.9%	Benefits tax free in the hands of recipients	Benefits taxed at an average rate of 30.7%

Graph 1: Tax efficiency of approved vs. unapproved arrangements

Allocation via
s37C vs NOB
form



Stand alone vs. umbrella vs. GRA

	Stand alone	Umbrella	Group RA
Tax incentivized	Yes – pension or provident	Yes – pension or provident	Yes – as for individual RA
Provider chosen by	Not applicable	Employer	Employer
Protections: -- Creditors -- Contributions	Protected (s37) ER liable (s13)	Protected (s37) ER liable (s13)	Limited EE to sue
Employee Representation	At least 50% member elected trustees	Trustees - no Manco – yes, if applicable	Trustees – no No manco

Stand alone vs umbrella vs GRA

	Stand alone	Umbrella	Group RA
Retirement benefit	As per pension or provident	As per pension or provident	As per pension
Retirement date	Contributions cease NRA Benefit on election	Contributions cease NRA Benefit on election	No specific age
Withdrawals pre-retirement?	Yes	Yes	No
Risk benefits	Fund or employer owned - multiple providers	Fund or employer owned – limited or multiple providers	Employer owned – multiple providers OR Individually sourced
Investments	Life policies Unit trusts Segregated	Life policies Unit trusts Segregated	CIS Linked life policies
Costs	Wholesale	Typically wholesale	Retail

Stand alone vs umbrella vs GRA

	Stand alone	Umbrella	Group RA
Administration	13B - typically daily priced	13B - typically daily priced	13B LISP – daily priced
Investment choice	Yes, at trustee discretion	Yes, within limits imposed by trustees	Yes, within limits imposed by provider/advisor
Contribution limits	No min No max	No min No max	Min applies No max
Continue post resignation	No	No	Yes
Participation	Compulsory	Compulsory	Voluntary (but could include in COE)
Portability	Full	Full	Limited to RA

Pro's & cons of GRA's – member view

Advantages	Disadvantages
No need for manco/ trustees	Forced preservation ** - no access to cash on retrenchments
Participation may not be compulsory	Cannot transfer to retirement fund
Employee can continue saving after leaving employment	Little influence over GRA
Same tax treatment as other funds *	No risk benefits
No fixed NRA (although COE's are still likely to have a cut-off date)	Requires admin and potentially engagement
Forced preservation **	Choices must be made

* From 1 March 2016

** Which makes it unattractive to employees, but does potentially improve pension outcome if contributions continue. It is, in our view, unlikely that forced preservation is implemented in occupational schemes in the near future meaning this discrepancy will remain

Pro's & cons of GRA's – ER view

Advantages	Disadvantages
No need for manco/ trustees	Forced preservation **
Less resources spent on EB's	Cannot transfer to retirement fund
Less risk (funding level, legislation)	Little influence over GRA
Less admin when employee leaves	No risk benefits (or ER admin to arrange)
Employee can continue saving after leaving employment	Not practical to implement with large groups of employees
Participation not compulsory	Participation not compulsory (bad for broadening the net and perhaps cross-subsidy)
Same tax treatment as other funds *	Min contributions may exclude lower income workers

So which is better?

Stand alone or umbrella or group RA? It is clear that:

- *Current numbers only tell half the story*
- *And have been influenced by several factors not explicitly linked to appropriateness of solution to solve problem:*
 - *Drive to reduce number of funds*
 - *Increasing regulatory/compliance burden*
 - *Cost pressures*
- *Above comparison tables don't give a clear answer*
- *In fact, there is no clear definition of "better"*
- *And there is a lot of noise*

So which is better?

Suggest that we go back to basics of benefit design:

- What problem are we trying to solve?
- For who?
- Within what constraints?

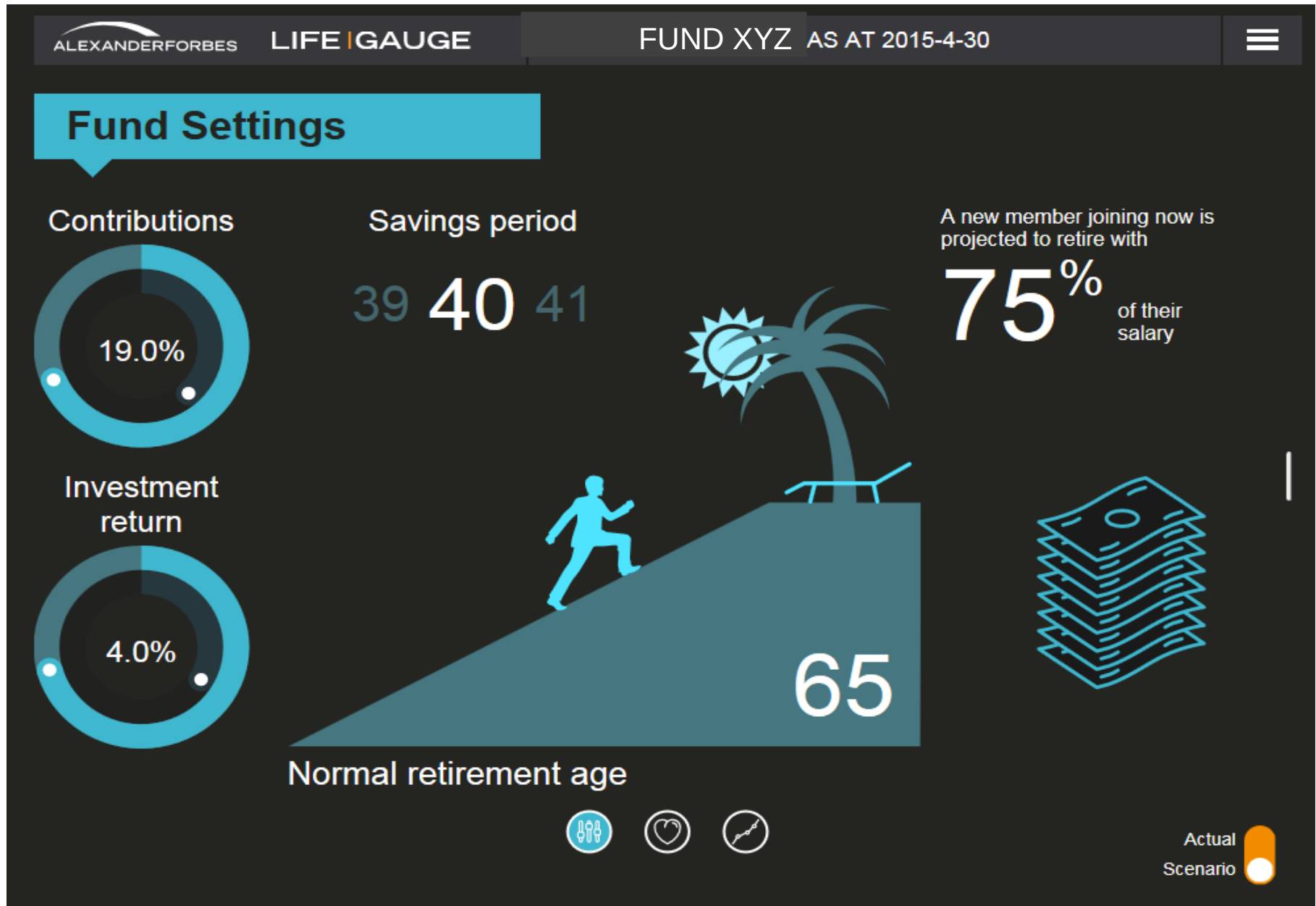
No matter which type of fund we choose

If we are going to get individuals engaged with their own financial well-being:

- Stakeholders must amplify the interest of the member throughout their financial journey, beyond simply retirement savings
- We have to engage in a language that touches an individual in what matters most

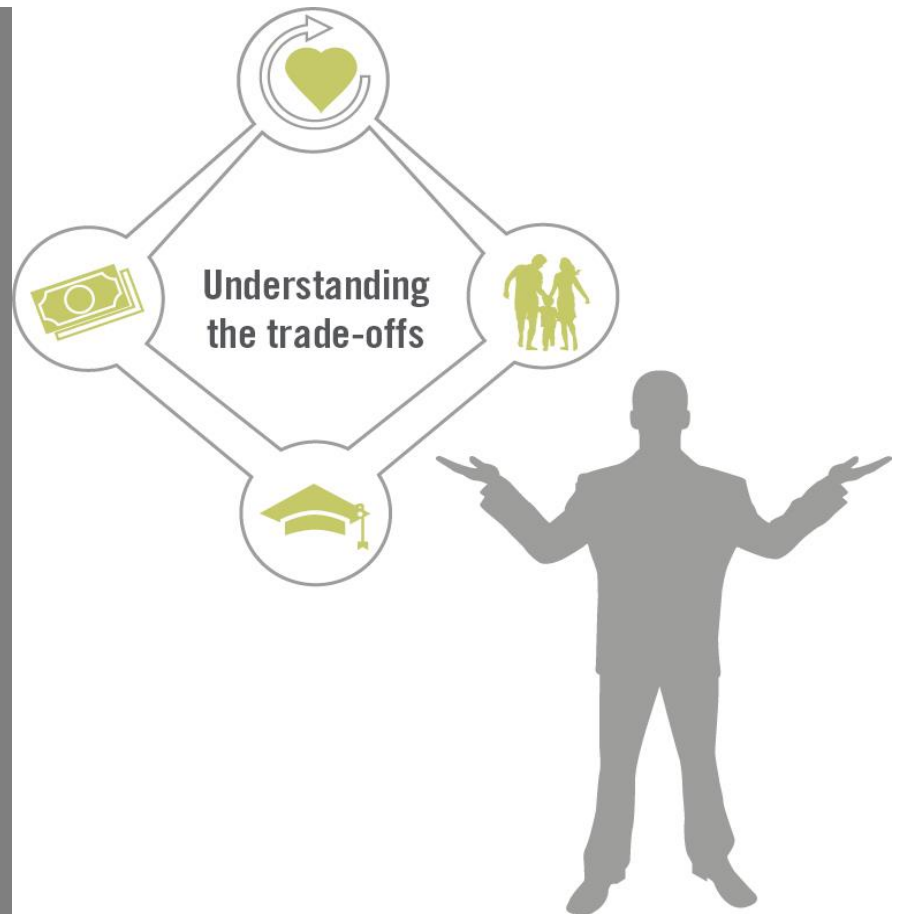


Our choices should help their outcome:



We will need to change our conversation...

- Truly understand the demographics of our funds
- Individual's real needs given their priorities and limited resources
- Consider benefits as trade-offs for what families really need



We need to rethink where best to engage

- “I see my employer as the natural source for assistance...”
- Consider where the better locus for engagement is
- ...and this is what leads us to the workplace



So we agree

- An individual's overall financial well-being is the aim
- An important component of this is being able to retire, maintaining pre-retirement lifestyle as far as possible
- The vehicle chosen should support these aims
- We cannot ignore the employer as a locus

Our choices/decisions must be based on assessment of whether it increases or decreases the likelihood of and extent of positive outcomes - in aggregate and at individual level

Issues to consider in your choice:

Retirement income objective

- Overall cost and value assessment
- Administrative requirements on the employer
- Employee demographics
- Financial literacy, capability and well-being
- Tax
- Preservation of savings
- Combination with other products (e.g. TFSA)
- Communication channels and content
- Group life assurance (and other risk benefits)
- Investment choices

Conclusion – horses for courses but many horses in the race



Each employer to weigh these up to arrive at the most appropriate arrangement for employees



Both as a group and individually

**Ethical and well
considered professional
advice will assist.**