

SANLAM EMPLOYEE BENEFITS

Executive summary 2005 Sanlam Mini-Survey



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Introduction

Sanlam Employee Benefits takes pleasure in publishing the findings of its 2005 Sanlam Mini-Survey. This survey provides continuity between Sanlam's Biennial Surveys, which will be conducted again in 2006. The Mini-Survey provides insight into some of the pressing issues currently facing retirement fund trustees and members, in addition to constituting a benchmark against which all interested persons can measure the extent to which their funds are aligned with these issues.

At the 2005 Sanlam Symposium, retirement fund trustees will get an opportunity to participate in a discussion on the development of an appropriate legislative framework for retirement funds. An electronic audience survey will be held in which trustees can participate and cast their vote on practical matters of this nature.

I would like to thank those consultants and fund representatives who participated in the survey for taking the time and the trouble to complete the questionnaires. Your contributions have made the compilation of this publication possible as a service to the retirement industry.

I would also like to thank my colleague Shaun Woodman, as well as Kobus Hanekom, our associate and partner from Simeka Consultants & Actuaries, who assisted in reviewing the questionnaire, studied the results and helped to prepare and formulate our commentary on it.

Deon Booysen
Executive Head Client Solutions: Sanlam Employee Benefits

1. Survey sample and methodology

A total of 109 telephonic interviews were conducted from 18 - 26 April 2005.

Respondents to the survey were required to have hands on knowledge regarding the fund and included principal officers, consultants, human resource managers, company managers and others. In some cases, in order to obtain answers to all the questions, more than one person related to the fund was interviewed. The sample consisted of a spread of fund sizes:

- 19 funds with less than 100 members
- 26 funds with 100 to 200 members
- 26 funds with 201 to 500 members
- 37 funds with 501 or more members

The research was conducted under the SAMRA (South African Marketing Research Association) Code of Conduct and as such all information gathered during the survey was treated in strictest confidence. In addition, only the aggregated results of the study were reported on. Participation in the survey was therefore anonymous.

2. Allocation of death benefits in terms of section 37C

In its discussion paper on pension fund reform, the National Treasury pointed out that "the principle that the management board should have such a responsibility seems to be welcomed by stakeholders" and that "the management board is perceived, in effect, to be performing a valuable social service by exercising its investigatory and distributive functions". The results of Sanlam's 2005 Mini-Survey support the task team's finding as follows:



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Thinking ahead

- 90% of the respondents believe that section 37C fulfils an important and a useful social function.
- 78% (v 15%) believe that “justice” will not be done if section 37C is scrapped.
- Even though the task of the trustees is very onerous, respondents gave trustees 4 out of 5 on average for the level of fairness and justness of their decisions.

Compliance with the expressed wishes of the deceased member

Possibly the most important recommendation of the Treasury task team is to the effect that “trustees should be obliged to comply with the expressed wishes of the deceased member unless, in their opinion, there are compelling reasons why they should not”.

In order to develop satisfactory criteria that will enable a board of trustees to give effect to this recommendation, we believe that the scope of section 37C should be narrowed down considerably, with consideration being given to the following:

A compelling place to begin the debate would be to limit persons who qualify as dependants to the deceased’s spouse and children. At present, any person who had been factually dependent or legally dependent on the deceased (among others) can qualify as a beneficiary. As a result, the trustees are compelled to investigate the personal circumstances of every potential dependant. For section 37C to operate effectively, we would have to draw the line much narrower as suggested above.

- Respondents voted 3.8 out of 5 on average to limit the persons whose personal circumstances the trustees must investigate and make provision for, before benefits can be paid to the nominees, to only the spouse and children.
- An average of 4 out of 5 were in favour of developing criteria to determine the level of dependency and therefore the level of maintenance required by each dependant. Sanlam has, for example, been using the principles applied by our courts in motor vehicle accident cases to great effect in the Sanlam Benefit Calculator.
- 3.8 out of 5 were of the view that once the spouse and children’s “defined maintenance needs” had been met, the trustees should be able to distribute benefits to those persons nominated by the deceased member.

Process requirements

The Treasury task team also recommended that difficulties with the process, which are evident in section 37C, should be minimised in new legislation. The single biggest problem appears to be members’ apathy and neglect in nominating beneficiaries and reviewing them regularly. One of the process requirements they address is that members should be required to regularly make and update beneficiary nominations.

- Participants rated the following proposal as an improvement to the current system (4.5 out of 5): Members must complete forms in which dependants are identified and beneficiaries nominated, and they must update this information regularly.
- Participants voted 4.2 out of 5 in favour of dependants being required to complete prescribed forms and submit them to the trustees in order to support and file their “defined maintenance claims” with the trustees.



Employee Benefits

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Discretionary trusts

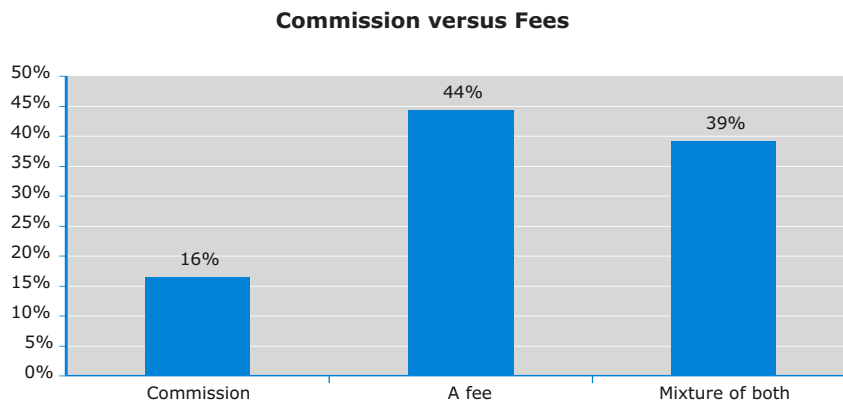
Payment into a discretionary trust can be an ideal solution in many situations. For example, if the benefit payable to a spouse and minor children will only be enough to last for a few years, it would be desirable for the member or the trustees to determine that the benefits should be paid into a discretionary family trust established for the benefit of the surviving spouse and children.

- Participants voted 4.2 out of 5 for members to nominate or trustees to pay benefits to a discretionary family trust established for the benefit of the member's dependants.

3. Commission versus fees

Retirement fund management has become very complex and the potential for personal liability is such that the services of a consultant or an industry professional are considered by many to be essential. Commissions payable in respect of typical employee benefits products are paid as and when contributions are received and do not contain an "upfront component" as is the case with retirement annuities. We asked trustees for their views.

- In response to the question as to whether they believed that consultants/brokers added value on the whole, a positive response of 3.7 out of 5 was obtained.
- Respondents rated service levels at 3.7 out of 5 and their satisfaction with the remuneration paid to consultants and brokers at 3.5 on average.
- The issue of remunerating consultants/brokers by way of commission or fees was responded to as follows:
 - commission 16 – yes
 - a fee 43 – yes
 - mixture of both 38 – yes



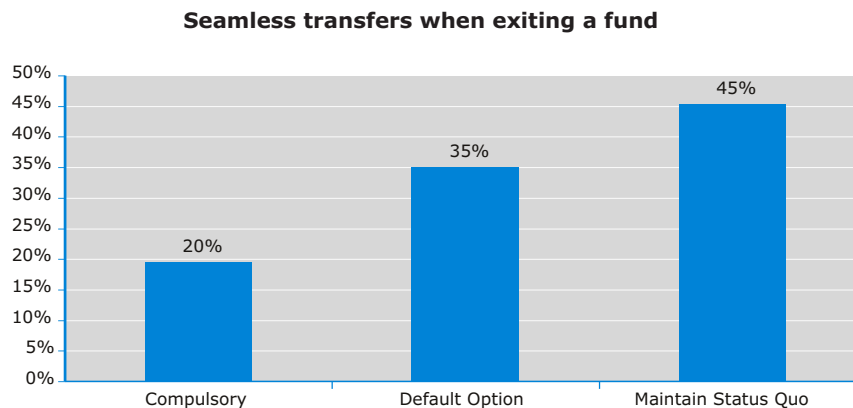
- Only 63% of respondents have a service level agreement with their consultant/broker in terms of which his/her ongoing services are specified.
- However, 80% believe that a service level agreement is a good idea.

4. Seamless transfers on exit from a fund

In its discussion paper, the National Treasury recommended that, on withdrawal, the fund may not deduct any expenses from the member's benefit nor may any party reward, directly or indirectly, any person for inducing the member to transfer his/her savings to the transferee fund. The only way to achieve this is for trustees to take proactive steps to put appropriate alternatives in place at withdrawal and retirement.

During the last 15 to 20 years, the industry has shifted from purchasing a prescribed pension for retiring members, as defined in the rules, to allowing members total freedom to purchase an annuity of their choice with an insurer of their choice from an intermediary of their choice. No doubt, for many this level of flexibility and choice was desirable and allowed them to select the very best product for their needs. However, for many others this level of choice presented them with more of a problem than a benefit. Essentially, the same principles apply when membership terminates on resignation, etc. However, the survey results show that trustees are not convinced that drastic action is required.

- 48% believe that trustees should play a greater role in selecting and negotiating appropriate annuity products or preservation funds for affected members.
- The trustees' view on future action was that the recommended products or funds should be dealt with as follows:
 - compulsory 19
 - default option 34
 - maintain status quo 44

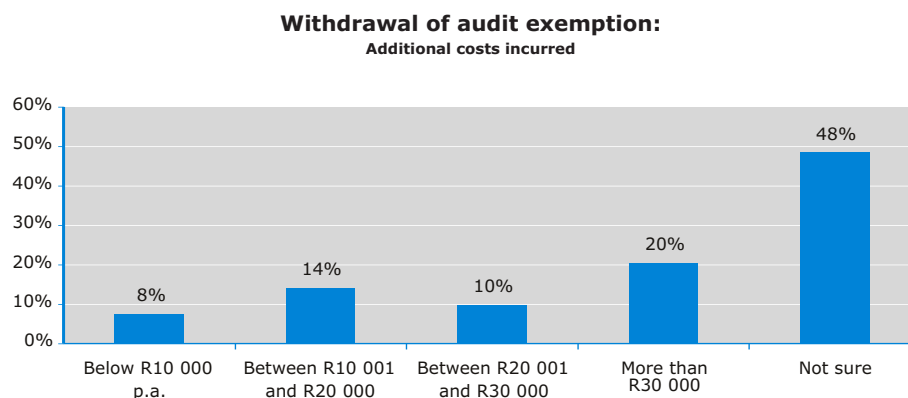


- Only 42% claimed to be familiar with the likely costs that a member incurs when benefits are transferred to a preservation fund. Of those who responded, the average of take-on administration costs was estimated at 5.9%. The cost of commissions was also estimated at 5.9%
- 46% would be prepared to pay for an industry professional to assist in developing an appropriate strategy and negotiating favourable transactions in the interest of members.

5. Withdrawal of the audit exemption

For many years, retirement funds invested in policies of insurance only were exempted from a full audit because it was felt that these funds were subject to the disciplines and controls of the Long-term Insurance Act. If the audit exemption is withdrawn as proposed, many smaller funds will have to pay between R15 000 and R30 000 to be audited. This will be a significant addition to the compliance costs/overheads of these funds and the cost of compliance will therefore reduce members' retirement benefits. As a result, a high percentage of funds will have to re-evaluate their existence or migrate to an umbrella fund where they should benefit from economies of scale.

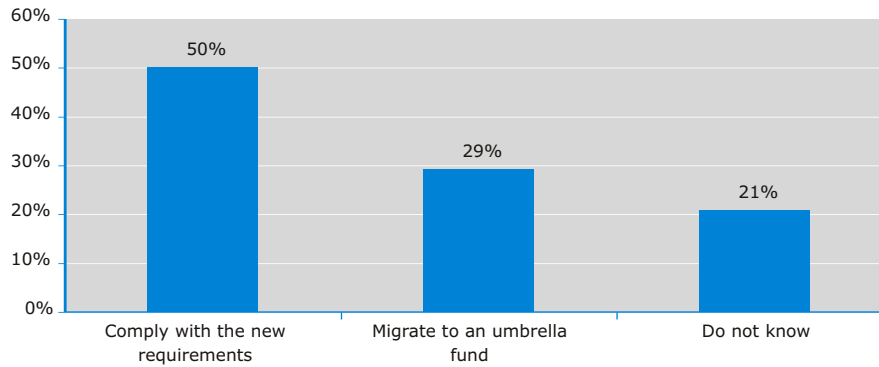
- 92% of the respondents said they were not aware of funds that suffered losses as a result of enjoying the audit exemption.
- 73% had not investigated the cost of compliance as at April this year.
- The additional cost to funds were estimated as follows:
 - Below R10 000 p.a. 7
 - Between R10 000 and R20 000 13
 - Between R20 000 and R30 000 9
 - More than R30 000 19
 - Not sure 45



- Participants represented the following size of fund:
 - Smaller than 100 members 17
 - 100 to 200 members 24
 - 200 to 500 members 24
 - 500 members and more 34
- Their fund's likely decision was reflected as follows:
 - Comply with the new requirements 48
 - Migrate to an umbrella fund 28
 - Do not know 20

Withdrawal of audit exemption:

Compliance of funds



- 44% believe that smaller funds should be given the choice to rely on the disciplines and controls in the Long-term Insurance Act and not be compelled to do an audit.
- 42% believe that all funds should be subject to the same controls irrespective of the cost.

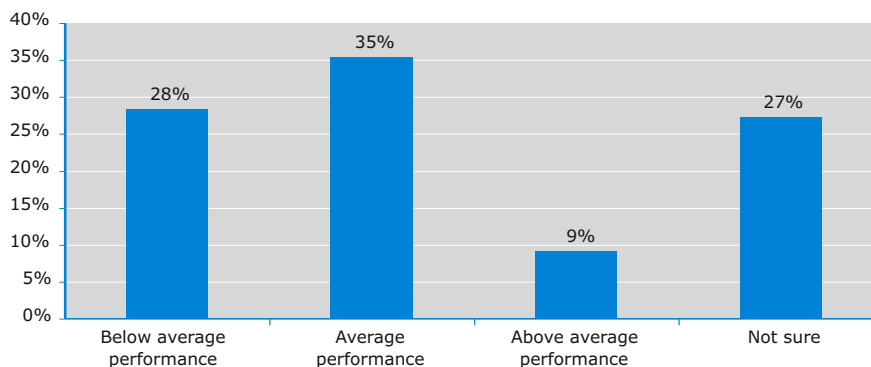
6. Investments: Financial Sector Charter

The National Treasury task team recommends that funds be required to state in writing whether they intend to invest a proportion of their assets in socially responsible investments (SRIs). The task team recommends that up to 10% of a fund’s assets should be invested in SRIs.

- 94% of the respondents have not done a survey among members to determine their needs regarding SRIs.
- Only 6% indicated that their members requested access to SRIs.
- Participants’ expectations of the investment returns on SRIs are as follows:

- Below average performance 28
- Average performance 35
- Above average performance 9
- Not sure 27

Expectations of investment returns on SRIs



- The level of investment in SRIs that participants will be comfortable with is 7.9%.
- The level of investment in SRIs that participants expect that their members will be comfortable with is 9.8%.
- 96% had no demand for shareholder activism from their members.
- 92% had no demand for compliance with any other aspects of the Financial Sector Charter.

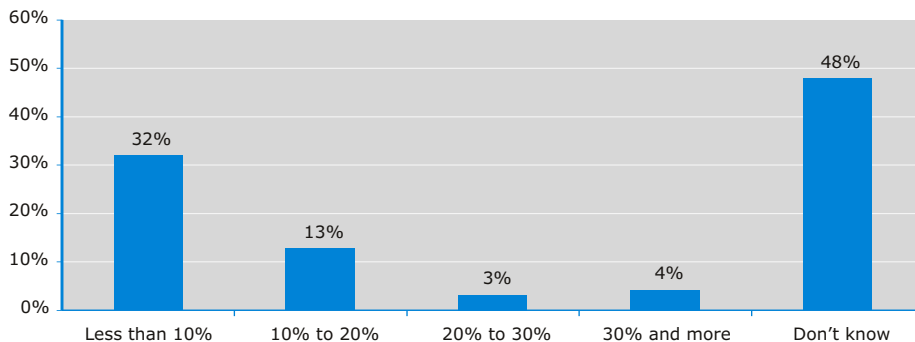
7. Risk benefits: approved or unapproved

The National Treasury is recommending a packaged option where a retirement fund not only makes provision for retirement saving, but also provides death and disability benefits. One of the main advantages of including risk benefits in the rules of the fund is that it offers certain tax benefits.

We asked participants if they knew how much cheaper the first 2 x annual salary death benefit would be if secured in terms of an approved benefit – that is, benefits payable in terms of the rules of the fund – compared with risk benefits secured in terms of a separate scheme. Their responses were as follows:

- Less than 10% 30
- 10% to 20% 12
- 20% to 30% 3
- 30% and more 4
- Don't know 45

Risk benefits: cost of approved benefits



The National Treasury wants to ensure that a minimum percentage of the total contributions paid are allocated to retirement provision and therefore suggests an arrangement in terms of which risk premium increases will not automatically reduce the amount available for retirement provision.

We asked participants which benefits they thought the majority of members would be inclined to protect when confronted with a choice:

- Retirement savings 65
- Risk benefits 16
- Not sure 10



8. Conversion of defined benefit funds

Respondents were asked to indicate whether their funds had been converted from a defined benefit (DB) to a defined contribution (DC) arrangement. Of the participants, 47% indicated that they had converted.

9. Build-up to retirement

The contribution rates of a DB fund usually included an allowance for fairly punitive withdrawal conditions, and surpluses from this source were often used to enhance retirement benefits. This is not the case in a DC fund. As a result, where the contribution rates are left unchanged, one could expect poorer retirement benefits on average.

- 13% indicated that actuarial input was obtained to determine the new employer and employee contribution rates.
- 26% of the funds continued with the original contribution rates.
- 61% either did not know if any calculations were performed, were not involved or did not reply.

Despite the above response, 66% of the funds confirmed that the aim of the new DC fund was to provide broadly the same benefits. Therefore it is worrying that only 13% of the respondents obtained actuarial advice when setting this aim.

10. Purchasing income at retirement

At retirement, a member of a DC fund has to decide how to utilise his/her savings to provide for retirement. There are basically three options:

- A linked life annuity
- A level annuity
- An inflation protection annuity

According to the National Treasury discussion paper on retirement fund reform, a member who retires at age 65 needs approximately 13.8 times his/her final salary as a lump sum in order to purchase an annuity equal to his/her final salary. If a member takes one-third in cash and purchases an annuity to replace two-thirds of his/her final salary, the member would still need 13.8 times final salary as a lump sum at retirement to purchase full inflation protection.

- Only 28% of the respondents had statistics on the size of the lump sums relative to the final salary available at retirement.
- It appears that a number of the responses citing 1/3 were incorrect, which is more than likely the proportion of the final amount that may be taken as a lump sum at retirement.
- The largest response was 10 times, with an average of 4.44 times. Even ignoring the incorrect responses, the payouts fall short of the 13.8 stated above. This would imply that the retirement benefits also fall short of being able to provide full inflation protection.

In a DC environment, the income of a member is affected by changes in interest rates and mortality rates in that they impact on the cost of providing an annuity. In a DB environment, these costs fall on the employer.



- 40% of respondents were aware of the impact of these changes.
- 57% indicated that the impact had been communicated to members.
- 51% also indicated that they had advised their members to obtain advice on how this impact affected them.

Unless this impact is shown to members, it is unlikely that any remedial action will be taken to offset the subsequent reduction in their retirement provision. This is rather worrying, particularly in cases where members still have time to address the situation.

Part of the communication to members would be to illustrate what members would be able to purchase with their current retirement savings. When asked, only 43% indicated that they had considered including an annuity factor on their member benefit statements.

If the above results are indicative of the general state of play in DC funds, there is a real need for communication to members about the risks of a DC environment. Without this consultation, many members will retire on wholly inadequate pensions when in many cases appropriate communication would have assisted members to address the situation. Trustees of DC funds should carefully consider whether they are fulfilling their fiduciary duties if these issues are not communicated to members.

11. Administration service and death and disability research

Sanlam contracted an independent market research company, BDRC, to perform a qualitative and quantitative market analysis of the fund and risk administration service needs in South Africa. This is the second of a series of regular surveys to be conducted by BDRC, the first having been conducted in 2001/2002. What is clear is that there have been the following market shifts:

- New competitors have emerged.
- Traditional competitors have gone through transformation.
- New products have been developed.
- Market needs have changed.

The objective of the survey was to ascertain the criteria used (and the relative importance of these criteria) by trustees in choosing a fund administrator or a provider of death and disability benefits. Furthermore, the survey also analyses these trends and attempts to predict evolving/potential future needs.

The survey included:

- Employer organisations with more than 100 members (HR manager, principal officer, finance manager, director, etc.)
- Intermediaries, typically senior consultants (50/50 split between product providers and independents)
- A broad spectrum of industry sectors
- All geographic regions
- Primarily DC funds



Survey Results

1.1. Fund Administration

80% or more respondents ranked the following top 10 service delivery criteria for fund administration as being “crucial”:

Rank	Fund Representatives	Intermediaries
1	Accurate reconciliation of data	Accurate reconciliation of data
2	Accurate benefit statements	Accurate benefit statements
3	Security/confidentiality of fund data	Security/confidentiality of fund data
4	Understanding of the fund	Speed of response to queries
5	Knowledgeable/experienced staff	Knowledgeable/experienced staff
6	Able to move quickly when necessary	Turnaround times for processing
7	Adherence to service level agreements	Understanding of the fund
8	Turnaround times for processing	Adherence to service level agreements
9	Proactive notification of problems	Problem solving capability
10	Speed of response to queries	Proactive notification of problems

From this list, the following items have shown significant increases in their level of importance over the last two years:

- Understanding of the fund (fund representatives and intermediaries)
- Adherence to service level agreements

Three other criteria that were ranked as being of lesser importance have also shown a significant increase in importance:

- Cost (now ranked as crucial by 71% of fund representatives)
- Flexibility to negotiate fees (but still only ranked as crucial by 52% of fund representatives)
- Ability to handle member investment choice (but still only ranked as crucial by 48% of the fund representatives and 57% of the intermediaries)

In general, the industry is underperforming the criteria that are most important to the respondents and outperforming the criteria that are of lesser importance. It would probably not be far from the truth to say that the industry as a whole is not really focusing on getting the basics right, but rather seems to have its attention on the delivery of “frills”.



The fund representatives are expressly requesting significant improvements in the following areas:

- Faster benefit statements
- Fund communication
- Delivery times
- Timely payouts
- Fast response to queries
- Accuracy of data
- Electronic access to information

The feeling is that in the next two years there is likely to be more pressure for:

1. Electronic communication (fund representatives and intermediaries)
2. More member education (fund representatives)
3. Greater choice of investments (fund representatives)
4. Faster turnaround times on queries/claims (intermediaries)

1.2. Death and Disability

Approximately 60% of respondents indicated that their death and disability benefits are being re-brokered annually, with a further 10%-12% doing this every 2-3 years.

In excess of 50% of respondents ranked the following service delivery criteria as being "crucial":

Rank	Fund Representatives	Intermediaries
1	Financial stability	Speed of claims processing
2	Consistency of claims assessment	Consistency of claims assessment
3	Speed of claims processing	Cost
4	Experience/track record of underwriter	Financial stability
5	Cost	Product tailored to client's needs
6	Application of PPR	Experience/track record of underwriter
7	Product tailored to client's needs	Reasonable proof-free limits
8	Reasonable proof-free limits	Application of PPR

From this list, the following items have shown significant increases in their level of importance over the last two years:

- Consistency of claims assessment
- Experience/track record of the underwriter
- Application of PPR
- Reasonable proof-free limits

In general, there is a much closer match between the service delivery expectations of the respondents in relation to what the underwriters are providing, compared with the relative underperformance of fund administrators in relation to their client expectations.

Approximately 60% of fund representatives did not expect their needs with regard to death and disability benefits to change in the next two years. Among those who do, the impact of Aids is again the most frequently mentioned.

In contrast, as with the previous survey, most intermediaries expect an impact on benefits and costs as a direct result of Aids. Their view is that this will increase innovation around flexible risk benefits, HIV/Aids specific products, etc.

Several market changes have developed in fund administration over the last two years, including:

- The market appears to have become more price-sensitive (cost competitiveness and flexibility to negotiate fees).
- There is an increase in member involvement in their retirement planning (member choice, flexible contribution percentage, member access, etc.).
- Administrators are struggling to meet the basic service delivery expectations (accuracy, turnaround times, adherence to service level agreements, etc.).
- There are higher expectations of the individuals handling the administration of the fund (proactive contact, faster response times, competency levels, understanding of clients' funds, etc.).

