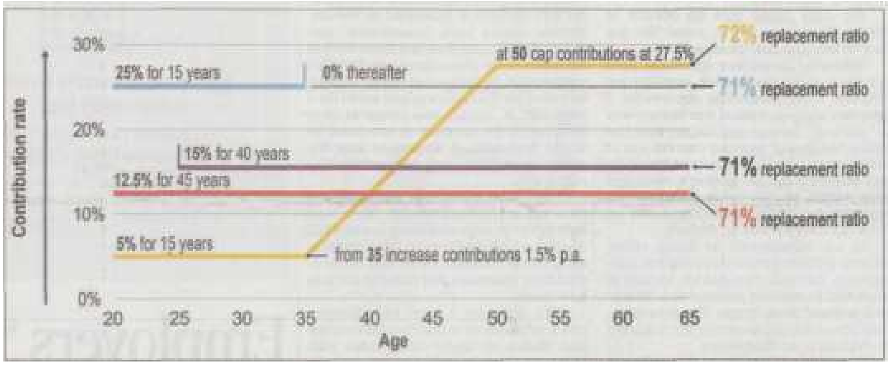
â– INCREASING YOUR CONTRIBUTIONS FROM YOUR MID-30s CAN MAKE UP FOR LOW SAVINGS RATE EARLIER

How cash-strapped young adults can retire financially secure

Retirement fund members can take advantage of higher tax breaks later in life to make up for low contribution rates when they were young and had other financial commitments. **Bruce Cameron** reports on the findings of the latest Sanlam Benchmark retirement survey.



As of March 1, you can claim more of your retirement fund contributions as a tax deduction against your taxable income or **remuneration. This** makes it possible to be more flexible about the amounts you contribute. You could contribute less when you are younger, earning less **and** trying to establish yourself, and increase your contributions later in your working life to the maximum allowed, and still achieve a replacement ratio (percentage of your income paid as a pension) similar to what **you** would have achieved **if you** had **contributed at the** same **rate over your working life. However, thanks to the power of compound interest, if you contribute a high rate early on in life, you wont have to contribute at all later in life, as this graph shows. Remember, contribution rates include your and your employer's contributions.**

Young adults who are unable to contribute large amounts to their retirement savings can still retire financially secure provided they gradually increase their contribu-tions as they get older.

However, in order to implement this strategy, your retirement fund will have to allow you to adjust your contributions as your circumstances change. Many funds do not allow this.

Many younger members of retirement funds struggle to contribute as much as they should to their funds, because they have pressing financial commitments, such as a home loan and raising children. This is one of the findings of the latest annual Sanlam Benchmark survey, which was released this week.

But Willem le Roux, the head of invest-ment consulting at retirement consultants Simeka Consultants, says this need not be a train smash if you have a well-structured retirement plan.

He says the new tax incentives for retirement fund contributions, which were introduced on March 1, enable you to save more for retirement. You can now deduct contributions made by you and your employer up to 27.5 percent of your annual taxable income. This allows you to struc-ture your contributions so that you allocate more of your income to meeting expenses when you have a young, growing family and, as you get older, allocate more of your income to retirement savings, particularly if your income grows above the inflation rate in the later stages of your career.

For example, you could save five percent of your income for the first 15 years of employment. This is less than the average total member and employer contributions of 14 percent for members of stand-alone retirement funds and 13.5 percent for mem-bers of umbrella funds (funds for the employees of more than one employer).

MORE ON THE BENCHMARK SURVEY ON RAGES 2 AND 3

To make up for the low contributions earlier in life, at age 35 you will have to start increasing your retirement fund con-tributions until they reach 27.5 percent of your total income at age 50, and maintain that contribution level until 65, when you retire. This should provide you with an ini-tial income in retirement equal to 72 per-cent of your final salary. This replacement ratio is one percentage point higher than the ratio you would have achieved if you and your employer had contributed 12.5 percent for 45 years, or 15 percent for 40 years.

Le Roux warns that, when structuring their contributions in this way, high-income earners will have to take account of the R350 000 annual cap on tax deductions for retirement fund contributions.

He says that, in order to allow members to adjust their contributions during their working lives, funds will have to provide tailor-made investment strategies for each member. This introduces complexity for members and fund administrators. Porta-bility (the ability of members of defined-contribution funds to transfer their sav-ings from fund to fund when they change jobs) also adds to the complexity.

He suggests that the solution for most members is to link contribution levels and investment choices to their age.

The complexity associated with flexible contribution rates "cannot be left to mem-bers with no support", and this is why it is important for funds to have default contri-bution rates, investment strategies and annuities (pensions). Members require advice and support when selecting an annuity at retirement, he says.

The challenge to adjusting contribu-tions as members grow older is that, according to the Benchmark Survey 75 per-cent of funds do not allow flexible employer and member contributions.

Viresh Maharaj, the chief marketing actuary at Sanlam Employee Benefits, says funds that do not allow flexible contribu-tions need to set contributions at levels that will be sufficient to enable members to create retirement wealth, or "members are being set up for failure".

DEFAULT CONTRIBUTIONS

Maharaj says default contribution levels, which are intended to provide you with a minimum targeted income in retirement are better than leaving the choice entirely to you. The reasons for this are:

â™Where funds allow members to decide their contribution levels, members are often not aware that they have the option to contribute more, or procrastinate in taking advantage of this opportunity.

The difference between average total contributions and the maximum tax-deductible contribution of 27.5 percent is 9.87 percentage points for stand-alone funds and 10.89 percentage points for umbrella funds.

Increasing the contributions to the maximum of 27.5 percent could increase your fund value over 20 years by an aver-age of 56 percent if you belong to a stand-alone fund and 66 percent if you belong to an umbrella fund, assuming an average annual return of 10 percent.

â™Members can sabotage their ability to build up sufficient retirement capital. On average, members' contributions are typi-cally based on 80 percent of their total cost-to-company package. But if members are allowed to select the proportion of their retirement contributions when structur-ing their cost-to-company package, contri-butions as a percentage of pensionable earnings drop to 73 percent for members of stand-alone funds and 67 percent for umbrella fund members, the survey shows.

Maharaj says this suggests that mem-bers reduce their pensionable earnings in order to maximise their take-home pay, because this will reduce their retirement fund contributions. So, although you may be contributing, say, 15 percent towards retirement, this may be 15 percent of 63 percent of your cost-to-company pack-age, which will negatively affect your abil-ity to save enough for retirement.

â™¦ Reducing your pensionable pay usu-ally results in a reduction in your group life assurance benefits, the impact of which you will fully realise only if you need to claim.

Le Roux says the biggest problem with leaving it up to members to decide how much to contribute to their funds is that most members do not save enough for retirement or do not preserve their retire-ment savings. As a result, they:

â™¦ Have to lower their standard of living in retirement.

â™¦ Invest their retirement savings in a living annuity, so that they can draw down a higher pension than they would be able to do with a guaranteed annuity But this results in them quickly depleting their cap-ital, leaving them dependent on their fam-ily and friends and the state.

â™¦ Have to delay retirement and work longer, which allows them to remain invested in higher-risk growth assets, such as equities, for longer.

How cash-strapped young adults can retire financially secure

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The road to a happy retirement - lessons for you and your fund

The latest Sanlam Benchmark survey of retirement funds and their members contains valuable information for both those of us trying to save and the funds that help us do so, writes **Bruce Cameron.**

Only 50 percent of stand-alone employer-sponsored retirement funds and one third of participating employers in commercial umbrella funds actually target the minimum income that you should receive in retirement after a full working life of contributing to your fund, according to a startling finding of Sanlam's annual Benchmark survey of retire-ment funds.

And even when retirement fund trustees decide on default invest-ment strategies, which affect 80 per-cent of members of all funds sur-veyed, only 37 percent of parti-cipating employers in umbrella funds and 75 percent of trustees of stand-alone funds believe that the strategies they have in place will enable you to reach the targeted retirement income level over the long term.

In other words, the investments may not provide the returns required to meet the targeted pen-sion at retirement.

Another reason why we as mem-bers do not save enough to provide an adequate pension in retirement is that two-fifths of retirement funds do not align how much you con-tribute to your retirement savings to the targeted retirement income level, the survey shows.

If your retirement fund's consult-ants and trustees don't make this a foundational principle, they cannot structure strategies to achieve this goal for you, Viresh Maharaj, the chief marketing actuary at Sanlam Employee Benefits, says.

These strategies include:

â™¦ Setting the level at which you contribute;

â™¦The investments made, and default investments that suit your stage of life; and

â™¦The pension (annuity) you need at retirement, he says.

The failure to set a retirement target compounds problems that members inflict on themselves, such as withdrawing their savings before retirement when changing jobs.

The survey shows that only 77 percent of stand-alone funds and 68 percent of umbrella funds pro-vide members with information about the consequences of not pre-serving their retirement savings.

Maharaj says that retirement funds and how we, as members, con-tribute to them, can be compared to

Advice

Many of us as drivers use a GPS device or the GPS on our smartphones to help us navigate when we don't know how to get to our destination.

Viresh Maharaj, the chief marketing actuary at Sanlam Employee Benefits, says advice is the navigation system you need to reach your desired retirement outcome.

He says the Sanlam Benchmark research revealed a real advice gap. Pensioners indicated that close on three-quarters of them first received retirement planning advice only within 10 years of retirement.

"This is potentially one of the key contributing factors to the poor retirement outcomes experienced, as high-quality financial advice has been shown to make a material difference to retirement outcomes. "The pensioners themselves illustrate this point. While a core group of pensioners highlighted saving earlier as the key tip for building retirement wealth, the sample containing pensioners with higher retirement incomes cited starting to plan earlier as the key enabler of wealth creation," Maharaj says.

motor vehicles and where and how we drive them.

Like a motor vehicle, a retire-ment fund is an intricate set of interconnecting systems that all have to work together to get you to your destination, he says.

In practice, retirement fund systems are not connecting effi-ciently, Maharaj says.

First, you - or your retirement fund's consultants and trustees - need to know where you are going, and then you need to set the right contribution level to achieve your target, he says.

ENOUGH FUEL

If your fund does not have a con-tribution strategy aligned to a minimum targeted retirement income for its members, it is like planning to drive from Johannes-burg to Durban without knowing if you have enough petrol to get there.

The role of retirement fund con-sultants and fund trustees should be to set a stated minimum target income that you should receive as an initial income in retirement and to understand the impact of the dif-ferent strategies on the complex sys-tem of retirement funding.

The Benchmark survey shows the average employer contribution is 10.36 percent of members' salaries for stand-alone funds and 9.54 percent of their salaries for umbrella funds, and the average member contribution is 7.27 percent for stand-alone funds and 7.07 per-cent for umbrella funds.

The average total contribution is therefore 17.63 percent for stand-alone funds and 16.61 percent for umbrella funds, the survey shows.

It also shows that 47 percent of stand-alone retirement funds and 40 percent of umbrella funds are reviewing contribution rates as a consequence of the recent changes to the Income Tax Act and the increased limit - 27.5 percent of tax-able income or remuneration up to R350 000 a year - for contributions to retirement funds.

South Africa's poor retirement savings situation is exacerbated by the fact that even if funds set retire-ment income targets, most members do not understand these targets, because the industry uses jargon. For example, the targets are often a percentage of your pensionable salary, which is typically less than your total salary, as it excludes allowances not included for the pur-poses of calculating your retirement fund contributions.

Maharaj says the average mem-ber does not understand that if your fund targets an income in retire-ment of 75 percent of final pension-able salary and your pensionable salary is 20 percent less than your income with allowances, your tar-geted retirement income is only 60 percent of your last total pay cheque (75 percent of 80 percent).

The Sanlam Benchmark survey shows that if you want to be a wealthy pensioner, you need to save more than your contributions to a retirement fund.

In interviews, 63 percent of mem-bers classified as affluent pension-ers, who had contributed to an employer-sponsored retirement fund, indicated that they had also contributed separately to a retire-ment annuity fund.

ROAD SIGNS

Continuing the analogy of driving a vehicle, Maharaj says we use road signs to help us get from point A to point B. These include direction markers, stop signs, traffic lights and road markings.

He says that, in a similar manner, communications from funds to their members should act as a series of signs that help members make better deci-sions in order to get them from day one of employment to day one of retirement.

PRESERVATION

If you drive from point A to point B, with possible stops along the way, you will reach your destination. But if you go round and round a traffic circle, you won't get anywhere.

Maharaj says members who cash in their retirement savings are like drivers who go round and round a traffic circle indefinitely. Unfortu-nately, many South Africans will not reach their destinations, because they fail to preserve their retire-ment savings when switching jobs.

Risk cover

Every journey has its share of bumps, and some journeys end in disaster. Features such as seatbelts and airbags are necessary safety measures for drivers and passengers. Group life assurance, which covers death and disability, acts as a safety feature for retirement fund members.

However, Viresh Maharaj, the chief marketing actuary at Sanlam Employee Benefits, says that, on average, group life assurance offered by retirement funds or employers does not provide enough cover for its members, given the typical age profile and fund values of the South African employee base. He says a large number of members do not have any additional life cover beyond funeral cover.

The Sanlam Benchmark survey shows that the average total cover is 6.44 times annual salary for stand-alone members and 6.42 times annual salary for umbrella fund members.

Statistics South Africa's research shows that the average retirement fund member supports 3.5 dependants from their salary, with some blue-collar workers supporting more than 10 dependants.

Should the breadwinner die or be disabled, the group life cover payout at this level would be spread across too many mouths to make a material difference to the lives of the member's dependants.

Maharaj says that while the cost of group life assurance has been dropping because of competition and lower claims, premiums may now have bottomed out. As a result, funds will have to pay more attention to costs and how their group life assurance is structured.

He says that, currently, only 29 percent of stand-alone funds and 32 percent of umbrella funds offer flexible risk benefits that let you choose your level of cover. The most popular type offers you a core amount of cover and lets you decide how much more cover you want above that minimum.

A small number of funds use the more modern lifestage approach, where either the cost of cover or the level of cover varies in line with your age.

A hybrid approach is one where the core cover varies depending on your age and where you can increase the cover to certain limits that depend on your age. The rationale for such an approach is that younger people require more cover, because they have young children as dependants. As you age, your retirement savings should grow and your children should move closer to independence, so the amount of cover you need can be reduced.

Maharaj says group life cover must also allow for changing family models in South Africa, whereby couples are having children later in life and grandparents are having to take care of grandchildren.

Costs

Your vehicle has running costs, including for fuel, repairs, servicing and wear and tear. Retirement funding also has costs. Funds have to be administered, the assets have to be invested and trustees often use consultants to advise them.

The costs of running your motor vehicle are easy to understand. Against this, 48 percent of the stand-alone fund trustees and principal officers and 57 percent of the umbrella-fund-participating employers who responded to the survey say it is difficult to compare the costs of retirement funds, and 21 percent of stand-alone fund respondents and 19 percent of umbrella fund respondents say "it is very difficult to do so".

This means it is difficult for principal officers, trustees and employers to shop around for the best deals and to compare products.

The Sanlam Benchmark research showed an inverse relationship between fund size and the cost of administration. Funds of more than 10 000 members pay costs of 0.48 percent of members' salaries, on average, compared to 1.85 percent for stand-alone funds with fewer than 500 members and 0.44 percent for umbrella funds with fewer than 500 members.

The average cost of a stand-alone fund with fewer than 500 members is therefore 98 percent higher than the comparable umbrella fund.

When expressed in rands, the average cost of saving in a retirement fund is R54 per member per month for a stand-alone fund and R40 for an umbrella fund ,with large stand-alone funds paying R33 per member a month.

Stand-alone funds with fewer than 500 members pay an average of R113 per member a month against R49 for umbrella funds. In this segment, stand-alone funds are 130 percent more expensive than the comparable umbrella funds.

Viresh Maharaj, the chief marketing actuary at Sanlam Employee Benefits, says that while serious effort has gone into reducing costs overtime, and more effort is required, it is unhealthy to fixate on costs.

He says focusing solely on costs distracts from the other ways in which value can be added to the retirement funding system, such as encouraging members to save more and to preserve their retirement savings.

Investments |

Engines propel a car forward. The better the engine, the better the car. Investments are the engines of wealth creation in retirement funding, as they deliver the growth that results in the power of compound interest, Viresh Maharaj, the chief marketing actuary at Sanlam Employee Benefits, says.

Some of the world's most exciting vehicles now use more than just one type of engine to achieve the right performance from the right sources at the right time. In a similar vein, funds can make use of active and/or passive investment strategies and these are no longer viewed as mutually exclusive in a portfolio, Maharaj says.

An active investment strategy is one in which a fund manager makes the investment decisions, while a passive strategy is one that tracks an index, such as the FTSE/JSE All Share Index.

If you are given a choice of retirement fund investments, you need to make considered choices, as they can have a significant effect on your retirement funding, Maharaj says.

For example, when you are younger, you need to be aggressively invested in equities to provide the best returns. But you should move to more conservative investments as you get older to protect your wealth.

He says the Sanlam Benchmark research shows umbrella funds use both passive and active investment management.

Funds have default investment strategies for members who do not select their own investments.

The survey shows that seven percent of stand-alone funds and 5.4 percent of umbrella funds invest exclusively in passive portfolios for their default investment strategies; 54 percent of stand-alone funds and 17 percent of umbrella funds invest exclusively in active portfolios in their default investment strategies; and 34 percent of stand-alone funds and 47 percent of umbrella funds invest in both in their default portfolios.

In default choices offered to members, 60 percent of stand-alone funds and 52 percent of umbrella funds were lifestage portfolios, which gradually lower the risk-return profile as you age, and 25 percent of stand-alone funds and 17 percent of umbrella funds were invested in balanced funds, which invest across the asset classes without taking individual members' investment risk exposure into account.

Nine percent of stand-alone funds and 26 percent of umbrella funds make use of smoothed-bonus investments as part of their default portfolio.

The road to a happy retirement - lessons for you and your fund
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Employers 'must do more to teach their staff sound financial habits'

BRUCE CAMERON

Your first few weeks of employment and how your employer motivates you are likely to determine how you plan for retire-ment, Kobus Hanekom, head of strategy, governance and compliance at retirement fund consultants Simeka, says.

"Day one of employment should be seen as day one of retirement," he says.

Hanekom says that there is no better time to teach sound financial habits to young employees than in the first week or two of employment.

His advice follows the realease of the latest Sanlam Employee Benefits Benchmark retirement survey, which shows that only 20 percent of retirement fund members estimate that they will have sufficient savings for a financially secure retirement.

Hanekom says retirement fund mem-bers "will never be more ready to focus, pay attention and learn new habits than when they receive their first pay cheque. If employers do nothing else this year, imple-menting this strategy will be a great start and will make a significant difference."

If you do not save enough for retire-ment, it will not only impact on you, but on your entire household and even the com-munity in which you live, says Sanlam actuarial specialist Mayuri Reddy

She says the advice retirees interviewed for the survey would give to younger peo-ple is: "Save, start planning and invest from a young age."

When a focus group of young South Africans was asked about their saving habits, they indicated they tended to react to specific developments in their lives and did not follow a clear plan.

The view of financial planners is that many people don't save for retirement because "there is always something that tends to get more attention, such as small children, a house, a car or the good things in life that they want to buy, and they only look at retirement when they are 55".

Hanekom says that when you reach age 55 and decide to save more for the last 10 years, it is too late.

To compound the problem, the survey shows that a real advice gap exists. Nearly three-quarters of the pensioners surveyed said they received advice for the first time within 10 years of retirement.

Viresh Maharaj, the chief marketing actuary at Sanlam Employee Benefits, says that lack of proper advice is one of the key contributing factors to poor retirement outcomes. He says fund members appreci-ate financial advice and the need for guid-ance, given their lack of understanding.

The survey reveals that 48 percent of stand-alone retirement funds and 58 per-cent of umbrella funds say they have a for-malised advice strategy in place. However, of these, 35 percent of stand-alone and 52 percent of umbrella funds consider offering factual information as sufficient.

"[Factual information] does not qualify as financial advice and is not nearly as effective," Maharaj says.

Only 29 percent of stand-alone funds and 27 percent of umbrella funds provide actual financial advice.

He says the lack of advice is highlighted by the fact that more than two-thirds of the pensioners surveyed indicated that they did not preserve their retirement savings when changing jobs.

Many did not even understand the tax implications of not preserving their sav-ings or the negative effect on their retire-ment-savings nest egg.

Maharaj says technology has a key role to play in enabling better outcomes for retirement fund members as it can provide advice at lower costs.

For example, robo-advice, which is still in its infancy in South Africa, could be used successfully to provide advice to more members, particularly when combined with well-structured defaults on invest-ment choice and modern member commu-nication services.

Employee wellness

Wellness programmes should not be defined merely in terms of healthy living relating to things such as exercise, weight management and healthy eating, Jocelyn Hathaway, the chief operating officer of Sanlam Employee Benefits, says.

She says the traditional view of defining wellness has resulted in a lack of attention being paid to a critical area of the psychological well-being of employees: financial wellness.

"Financial stressors potentially play a far greater role in influencing employee psychological health and stress levels than the actual health stressors themselves, which are the traditional targets for employee wellness programmes.

"In the increasingly competitive business context, the success of companies is directly dependent on the ability of staff to deliver on their responsibilities, to innovate and to create wealth.

"Stress and ill health hamper the ability of staff to execute on their deliverables."

Hathaway says the benefits of comprehensive wellness programmes are:

â™¦ Employees can lead physically, mentally and financially better lives; and

â™¦ Employers benefit through improved productivity and reduced absenteeism.

She says that the Sanlam Benchmark survey shows that 48 percent of employers have wellness programmes, but these are mainly of a traditional nature.

The research also reveals that 87 percent of respondents believe that it is the employer's responsibility to enable good retirement outcomes for their employees.

She says employers are well positioned to positively affect the financial wellness of their employees, and this is also in their own best interests. Levers that employers can use include: providing appropriate funding mechanisms that allow lifetime wealth creation, such as retirement saving; structuring these mechanisms to channel financial behaviour towards better decision making; providing financial literacy education; and reducing financial stress by proactively engaging with employees about their financial pressure points.

PENSION CALCULATOR

The online versions of these articles on our website, www.persfin.co.za, include a link to **Sanlam's Day** One **Member Tool,** a calculator that can help you determine the percentage of your total pay package you will receive as a pension in retirement (your replacement ratio).

Employers 'must do more to teach their staff sound financial habits'

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