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insights

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In case you missed it…

Insights from Sanlam Benchmark Survey 2023

1. Economic Background to the Survey

The Sanlam 2023 Presentation and the full survey report issued afterwards recognise that retirement funding in the South Africa of 2023 faces serious challenges and that relatively few employed people will be able to look forward to financial security in retirement and the leisure in which to enjoy it. This is nothing new, and it builds on the Alex Forbes analysis that suggests that only 6% of retirement fund contributors will be able to retire comfortably.

The Two-Pot system taking effect on 1 March 2024 is part of the policy response to address the underfunding for retirement, along with tax harmonisation, T Day, Retirement Benefits Counselling (RBC), default regulations (for investment and retirement), and other policy changes already rolled out in the past decade.

Although the Covid pandemic is officially over, the lingering effects of financial loss, business interruption and the closure of small businesses due to lockdown restrictions are still being felt in the economy, which has had only minimal growth in the last few years. The lack of investor confidence in South Africa has been compounded by South Africa being grey-listed by the Financial Action Task Force and by Eskom's failure to supply reliable energy to businesses and domestic consumers.

Unemployment, especially among South Africa's youth, remains at an unacceptable rate, even when based on conservative estimates.

As a result, many households now find themselves in immense debt which is exasperated by the ever-increasing cost of basic necessities such as food, power, accommodation, and services. Such immediate financial demands may leave little money in the family budget to use for savings toward retirement.

2. Results of the Sanlam Survey

The Sanlam survey was taken over 500 full-time employed people and found that 75% of these employees were in an occupational retirement fund, while 25% were not. It is, therefore, likely that those who were not members of a retirement fund as a condition of employment had minimal savings of any kind to fund their retirement.

Sanlam's chief executive, Kanyisa Mkhize said that 30% of individuals were unsure about how much to save, 47% lacked clarity about which retirement product to invest in, and 48% failed to include future medical aid contributions in their financial planning. Further, 40% said that they would be happy to opt out of their current retirement fund and use the money to meet more immediate financial demands.

The survey also found that 63% of South Africans were currently anxious about their finances, with 87% saying they felt financial stress. For 58%, this was affecting their physical and/or mental well-being. Debt management is the first step to implementing a coherent financial plan, and employers are, no doubt, seeing the adverse impact on productivity in the workplace.

Ms Mkhize said that the biggest financial concern for South Africans was the fear of running out of money during retirement and the risk of facing unexpected financial challenges such as significant medical expenses, without sufficient savings to fund such emergencies.

This is a well-founded fear based on the Alex Forbes statistics, and RBC should become a more meaningful part of a fund's governance and communication policies after the Two-Pot system comes into effect in 2024.

3. How will the Two-Pot, or Two-Component System address the problem?

3.1 How the Two-Component System will work

During June 2023 National Treasury published draft legislation that is specifically designed to preserve savings for retirement, while at the same time providing some financial relief for cash-strapped households. The latest draft of the legislation refers to two "components".

Essentially, the system would provide for retirement savings to be divided into two components, with one-third allocated to the savings component which could be accessed once each year while the employee is in service, (subject to the restrictions contained in the legislation) and the remaining two-thirds allocated to the preservation component, which would have to be preserved until retirement.

Members leaving service prior to retirement would not be allowed to access any assets in the preservation component but might have limited access to assets in the savings component, provided that they had not withdrawn any amount from the savings component in the year in which they left service.

This would prevent the current 'leakage' where members typically leave service, access their full benefit and use it to meet immediate financial needs. Most employees change jobs several times in the course of their working life and if the withdrawal benefit is not preserved it can mean that little is left at retirement.

Allowing access to the savings component would also prevent members from resigning from their jobs in order to access their retirement savings for an unexpected emergency.

The Sanlam report contains a model of a fairly typical female employee who enters a retirement fund at age 20, changes jobs 7 times in the course of her working life before reaching age 50 and withdraws her retirement savings each time she changes jobs. On the assumption that she contributes at the rate of 11% of her salary, which increases annually by 3%, and that the investment return on her contributions is 11%, if she makes no further withdrawals after age 50, she will have R2,7 million at retirement.

Notably, the broad rule of thumb is that an employee should have 15% of earnings being invested towards retirement funding over their working life to achieve the same standard of living post-retirement as they enjoyed pre-retirement.

The Appendix to this publication shows how the contribution levels are below the desired contribution rate (after allowing for insurance and other costs), and these statistics do not factor in contributions usually being based on basic salary and not total earnings.

In the Two-Component environment, using the same assumptions on contribution rates, investment return, salary increases and job changes, the same individual, even if she withdrew the annual permissible amount of the savings component, would reach retirement with R8,6 million rand.

If she did not make any withdrawals from the savings component during her working life, the modelling in the Sanlam report indicated that the amount available at retirement would be R19 million.

3.2 Are there any drawbacks to the Two-Pot system?

Despite the advantages outlined above, there are a few potential problems:

- The date of implementation is 1 March 2024, and the legislation will probably only be passed in November 2023. Administrators will have to scramble to have systems in place and the necessary rule changes registered by the Financial Sector Conduct Authority by that date.
- Members over 50 will be able to access their savings component. Given that members rarely change employment after reaching the age of 50, under the old system the retirement savings of such members would typically be preserved until retirement. Under the new system, members over 50 will be entitled to the annual withdrawal from the savings component which could result in them reaching retirement in an even worse position.
- The examples from countries such as Chile and Australia which allowed limited access to retirement savings during the Covid pandemic are not encouraging. An article in the Sanlam report showed that a total of a quarter of the assets in the pension system were withdrawn over a two-year period. The assets withdrawn were primarily used for consumption spending, emergency spending to survive, and repaying debt, with the remainder ending up in the household current and savings accounts.
- The increased workload on administrators in processing the annual access to the savings component by certain members will drive up costs. How these costs are allocated and minimized will become an important factor.

4. Are there any ways to promote members' long-term financial stability?

4.1 Communication

It is important to communicate to members that the Two-Component system should not be regarded as a licence for members to access retirement savings unless they have real and pressing needs. It should be emphasised that the annual withdrawal from the savings pot should be for emergency use and not, for example, to fund an overseas holiday or the purchase of a luxury vehicle.

Administrators and trustees of course have no control over how withdrawals from the savings component will be used, but any communication to members should stress that a withdrawal from the savings component will be heavily taxed. The next version of RBC is going to be significant.

Since compulsory counselling by funds was introduced on 1 March 2019, there has been little or no impact on benefit leakage. With early access as well as compulsory preservation, fund members are going to have to become more involved in making decisions that go beyond whether to pay tax on their benefit.

4.2 Debt Counselling

The Sanlam survey mentioned that many South African households face immense debt. The latest Eighty20/XDS Credit Stress Report for the fourth quarter of 2022 showed an increase in the amount of South Africans applying for credit, with more than 800 000 new entrants over the period.

These new entrants took out R9.3 billion in new loan value which was an increase of 10% over the same period for the previous year.

Many South Africans are over-indebted. This means that they are unable to service their current debt as they have accumulated debt which exceeds their income. It is difficult to commit to any long-term financial goals for retirement savings if a member is heavily indebted.

A spokesperson for COSATU said recently that the introduction of the Two-Component system would be welcomed by South Africans who had become indebted over the Covid period and due to the rise in the cost of living. However, using the savings component to repay household debt will ultimately diminish the amount available for retirement funding.

Debt affects the emotional and psychological state of employees, and some employers attempt to address the problem by incorporating debt awareness into part of an overall wellness programme.

However, targeted debt counselling which will assist in placing the debtor under debt review would be a more useful and effective approach.

The debt review process is a formal legal procedure which protects the consumer in terms of the National Credit Act.

4.3 Selecting an Appropriate Annuity at Retirement

Even members with adequate savings at retirement risk financial problems later if given inappropriate advice at retirement. At present, the majority of retirees select a living annuity at retirement. ASISA statistics indicate 94% of all annuities bought are living annuities, which carry heavy ongoing fee structures.

The benefits of a living annuity lie in the flexibility it offers since the retiree can select the level of income he or she requires and if any capital is left on the death of the retiree, it will go to his or her beneficiaries rather than cross-subsidize the annuitants who live longer than anticipated.

However, the risk is of the capital diminishing and of the retiree eventually running out of money. Living annuities carry several risks that need to be considered carefully i.e. longevity, sequence and investment risks.

Further, the structure of the living annuity contains many costs and fees which are not considered, and the ongoing fee structure benefits the financial advisor recommending the product and the organisation providing it.

However, these costs and fees contribute heavily towards diminishing the value of the capital available to fund the full length of the member's retirement. The rule of thumb is that for the living annuity capital to be sustainable, the pensioner (annuitant) should not draw more than 5% per annum.
What is seldom advised is that this "maximum drawdown" should include the annuity costs; being primarily asset management, platform (administration), and advisor costs.

Typically, the pensioner will be doing well to get away with a cost structure of 1.5%, 0.5% and 0.5% respectively for the main components. In this "high road" example the product support receives a Rand for every Rand the pensioner receives. Too often the pensioner draws 5% not realizing the costs will cause the money to run out.

Depending on the circumstances of the individual, it is often appropriate that a guaranteed life annuity will ultimately offer greater security and value for a retiring member.

The default regulations to the Pension Funds Act require members to be provided with retirement benefits counselling three months prior to retirement. Unfortunately, this period is too short and the retirement counselling on offer is sometimes perfunctory and of little value.

Ideally, counselling should start at least 7 years before the date of the member's retirement.

Providing members with appropriate and intensive counselling, on the products available at retirement would enable retiring members to make an informed choice at retirement and optimise their chances of enjoying a financially secure and comfortable retirement.

APPENDIX

The table below illustrates:

- average contribution rates in relation to administration costs and the cost of risk benefits;
- the benefits typically provided by retirement funds in South Africa;
- the normal age of retirement which significantly impacts the quantum of the member's benefit at retirement;
- investment trends, indicating the majority of members will be in the default portfolio chosen by the trustees of the retirement fund.

	Sanlam Benchmark Survey
Contribution Rate	Average employer contribution (10.45%) Average member contribution (7.08%)
Administration and Operating Cost	Admin fee as a fixed cost per member (36%) As a % of the member's salary (44%) As a % of the total asset value of the fund (3%) (Average admin fee: 0.45% for all funds surveyed; for funds with below 500 members cost = 0.63%. Fixed cost = R 55.29 per member per month)
Disability Insurance Benefit	Average cost 1.0% Average income benefit 76% Cost 1.21% of salaries
Death Benefit	Average lump sum is 3.35 x Cost 1.61% of salaries (increase from 1.51% due to Covid) Increase in flexible risk benefit options
Normal Retirement Age	Average: 63.50 years
Individual member investment choice	Number of members invested in default on average (84%) Multi-managed portfolios as default (61%) Most popular performance benchmark is CPI related (47%)

Should you have any questions regarding the above, please contact your consultant to assist you.