

Pension Lawyers Association Conference 2005

# **Costs of Saving for Retirement Options for South Africa**

**Presentation by: Rob Rusconi**

**SEI Investments**



# Anatomy of research

## South African costs

- International context
- Methodology
- International costs
- Collective investments
- Occupational funds
- Individual policies



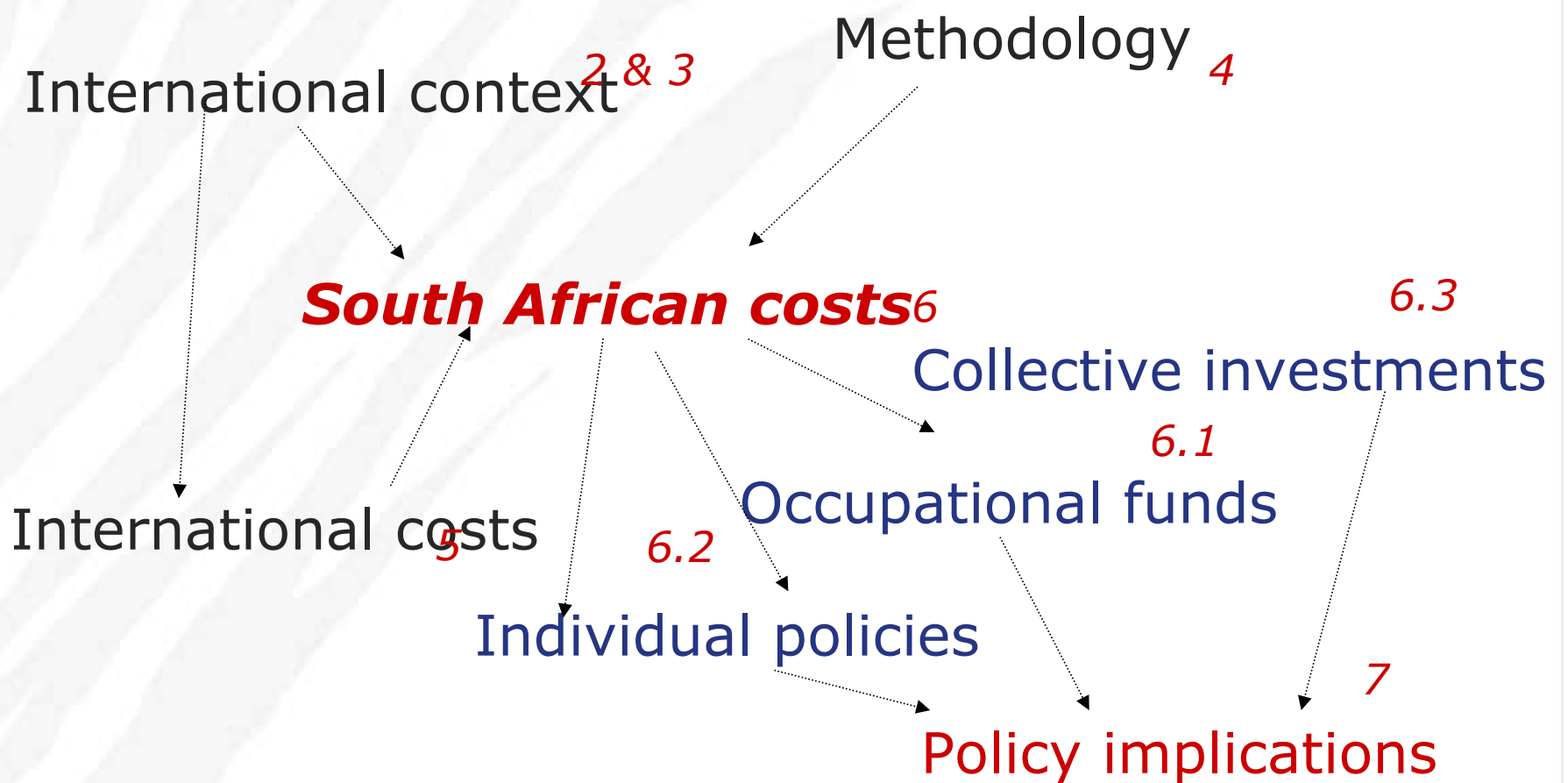
# Anatomy of research cont.

## Policy implications

- Occupational funds
- Collective investments
- Individual policies

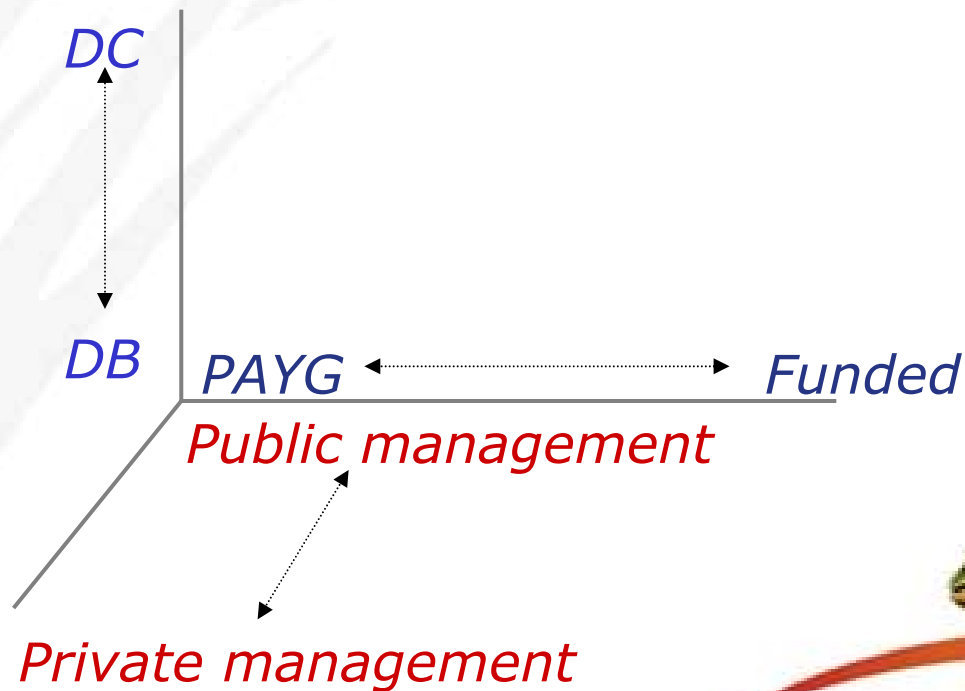


## Anatomy of research



## International context

- A large variety of systems exist

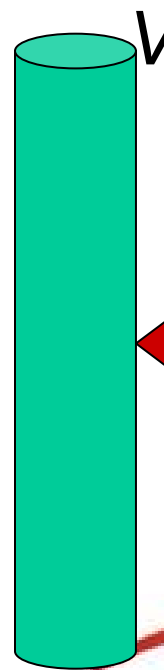
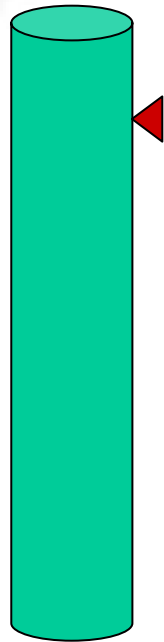
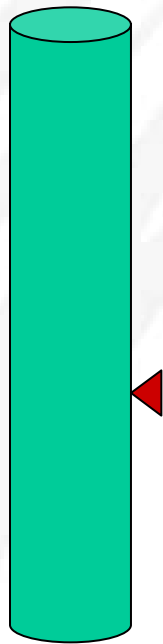


*Ref: pages 12 - 13*



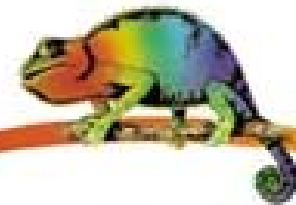
# International context

- A large variety of systems exist  
*Redistribution Compulsory saving*



*Voluntary saving*

*Ref: pages 13 - 16*

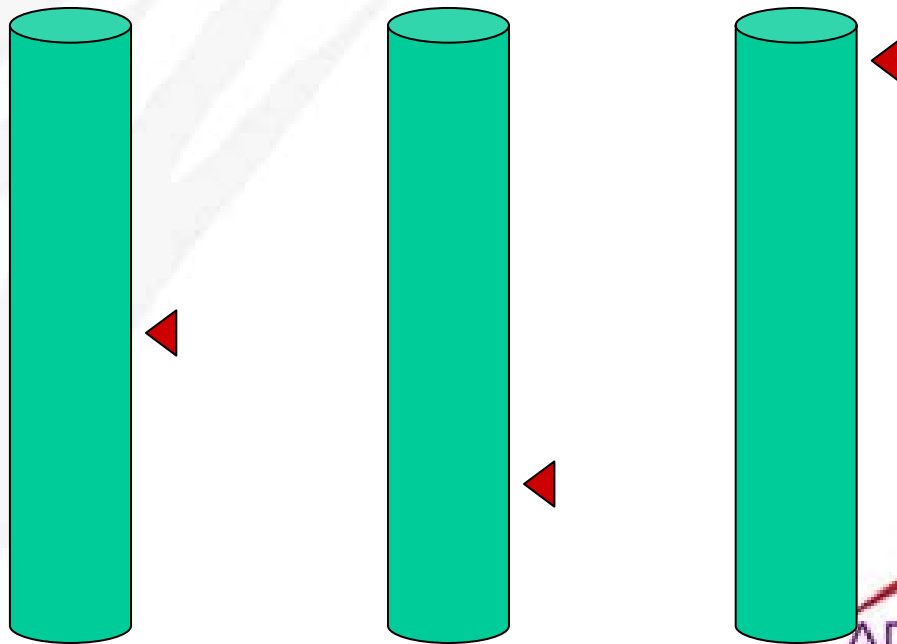


**ADAPTING TO CHANGE**  
*the only constant in life is change*

# International context

- A large variety of systems exist  
(and SA is skewed to private sector)

*Redistribution Compulsory saving Voluntary saving*



*Ref: page 44 - 45*



# International context

- A large variety of systems exist...
  - ... with a common problem

Population over sixty years old

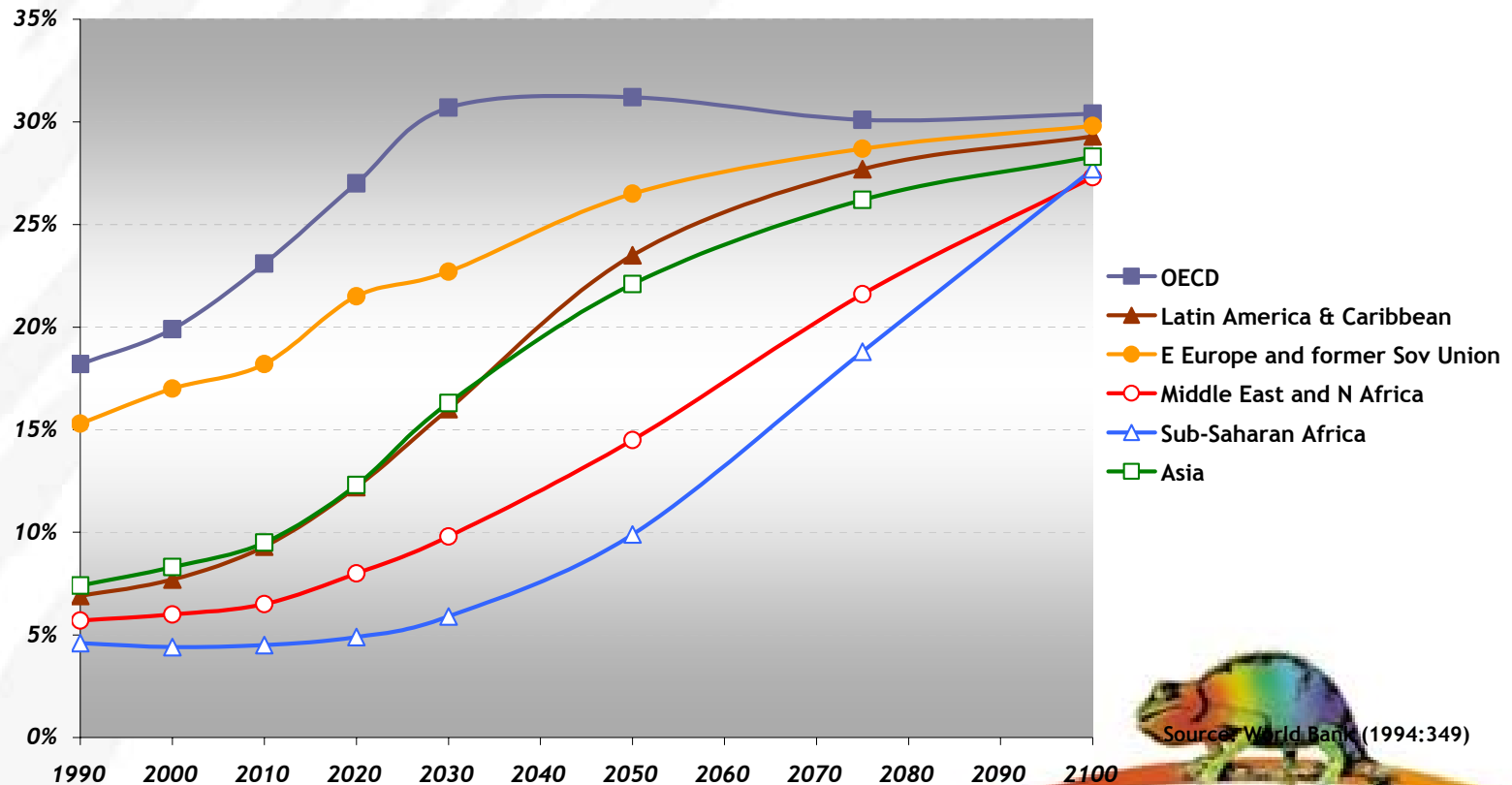


Figure 1

Source: World Bank (1994:349)



## Measures of lifetime cost

- Reduction in yield
- Charge ratio



# Measures of lifetime cost cont.

## Individual assumptions

10 yrs	Term to retirement
10.00%	Contribution percentage
R 24,000	Starting salary
R 0	Starting fund level

## Model assumptions

7.00%	Salary growth (annual)
10.00%	Investment return (annual)
5.00%	Inflation rate (annual)

## Charges assumptions (actual)

R 0	Initial fixed
0.00%	Initial % of 1st year contribution
R 6.00	Regular fixed (monthly, 1st month onwards)
3.50%	Regular % of contribution (1st yr onwards)
2.00%	Regular % of accumulated fund
R 0	Final fixed
0.00%	Final % of accumulated fund
7.00%	Inflation of fixed deductions

## Charges assumptions (shadow)

R 0	Initial fixed
0.00%	Initial % of 1st year contribution
R 0	Regular fixed (monthly, 1st month onwards)
0.00%	Regular % of contribution (1st yr onwards)
3.45%	Regular % of accumulated fund
R 0	Final fixed
0.00%	Final % of accumulated fund
7.00%	Inflation of fixed deductions

Ref: pages 48 - 51



## Results: occupational funds

- Shortage of data
  - Information used from a variety of sources
  - Data often undisclosed
  - Heterogeneous measurement methods



## **Results: occupational funds**

- Major cost areas
  - Asset management
  - Administration
  - “Other costs”

*Ref: pages 72, 73*



## Results: occupational funds

- Estimated lifetime charges (core)
  - Charge ratio 17% - 27%
  - Reduction in yield 1.05% - 1.65%
- Evidence of a wide range
  - sensitive to size of fund
  - significant 'random' variation

*Ref: page 84*



## Results: individual life RAs

- Estimated lifetime charges
  - Charge ratio 27% - 43%
  - Reduction in yield 1.50% - 2.85%
- Considerable variety between providers
  - levels
  - patterns

*Ref: pages 90, 97*



## Results: mutual fund RAs

- Estimated lifetime charges
  - Charge ratio 22% - 33%
  - Reduction in yield 1.20% - 1.95%
- Much more competitive industry
  - transparency
  - consistency



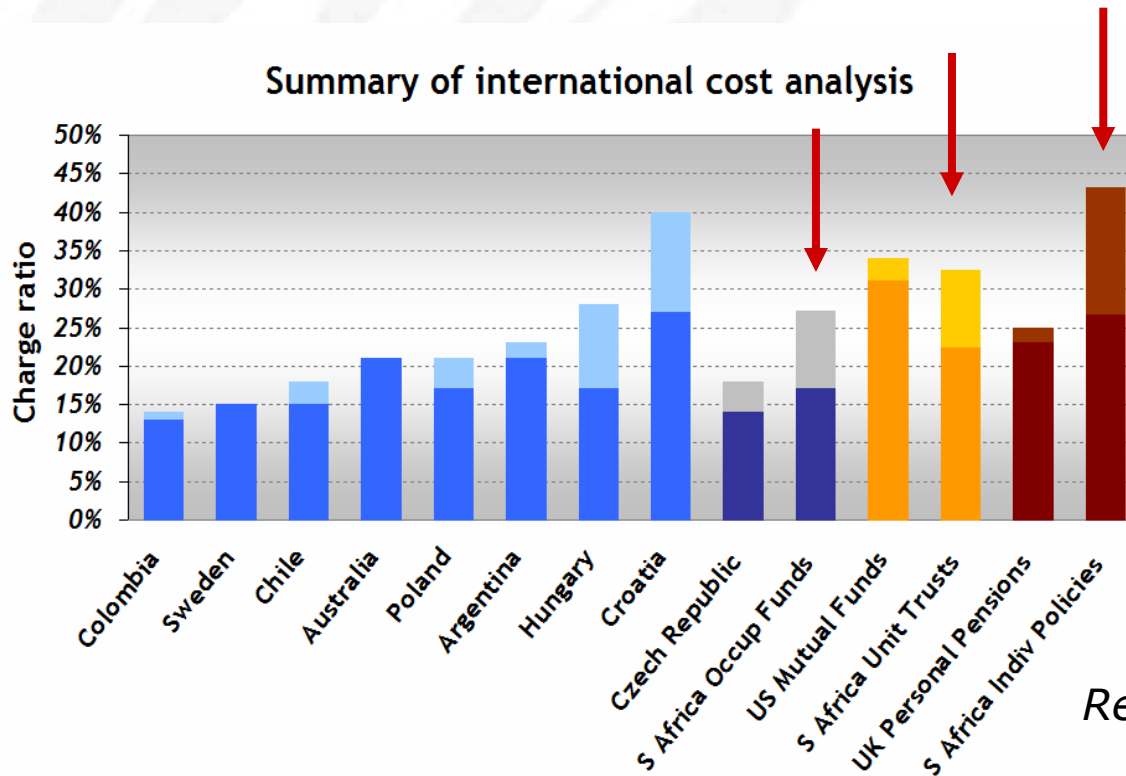
## **Results: mutual fund RAs cont.**

- With some reservations on retirement saving

*Ref: pages 103, 104*



# Results: comparison



Ref: pages 67 & 107

- Costs are on the high side...  
... perhaps understandably





## Policy implications

- Transparency ✓
  - consistent methodology
  - minimum disclosure
- Closure of channels x
  - each serves a purpose



## Policy implications cont.

- Charge ceilings 
  - consider implications very carefully
- New class of products 
  - assess alternatives
  - in the context of South African needs

*Ref: pages 111 - 115*



## Further research required

- Better data
- Deeper analysis
- Better comparisons
- Charges in the context of policy
- Lifetime saving patterns

*Ref: pages 116 - 118*



## Final thoughts

- This is just a start
- Fees are not everything...
- ... but they make a substantial difference



# Prototype cost analysis tool

## MODEL FOR COMPARING RETIREMENT FUND CHARGES

The purpose of this sheet is to compare the charges of two retirement fund providers in a consistent manner. Inputs are represented by blue text, outputs by red. Notes are added to cells marked with small red triangles. Some providers charge in more than one way. Include all charges in the inputs section. Where faced with a charge structure not supported by this model (eg performance based fees) seek suitable independent advice.

Fund inputs	
Number of members	2,500
Total pensionable payroll	R 75.0 m
Assets	R 250.0 m
Contribution rate	12.00%

Providers	
Provider 1 name:	Alternative 1
Provider 2 name:	Alternative 2

Charge details: Alternative 1	
Rand per member per month	R 55.00
Percent of contributions	5.00%
Percent of payroll	0.00%
Percent of assets	0.00%

Charge details: Alternative 2	
Rand per member per month	R 25.00
Percent of contributions	0.00%
Percent of payroll	0.00%
Percent of assets	0.50%

Outputs: Alternative 1	
Equivalent total charge expressed either as:	
a percentage of contributions	22.77%
or alternatively as:	
a percentage of assets	0.80%

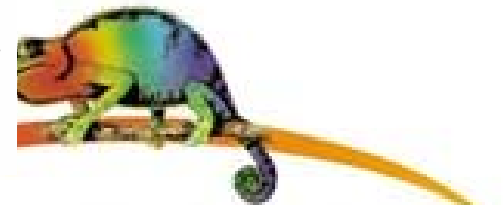
Outputs: Alternative 2	
Equivalent total charge expressed either as:	
a percentage of contributions	22.38%
or alternatively as:	
a percentage of assets	0.78%

This calculation requires a number of assumptions. Assets are assumed to grow evenly at a rate of 10% per year and cash inflows, excluding asset growth, is assumed to equate to cash outflows. Payroll grows evenly at a rate of 7% per year. The contribution rate and charges themselves are unchanged for the duration of the year. All charges are payable monthly at the end of the month.

Disclaimer: This is a simplistic model aimed at assisting trustees to compare the charges levied by different providers. The authors cannot accept any liability for the results produced or for the use to which these results are put. As with any comparison of two providers the fees are not the only criteria that should be taken into account. Other factors like the range of services provided and the quality of the service should also be considered.

Model produced by Rob Rusconi

Version 1.0 March 2005



**ADAPTING TO CHANGE**  
*the only constant in life is change*