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

South African costs

International costs

Methodology

Collective investments

Occupational funds

Individual policies

Policy implications

2 & 3

4

6

6.2

6.1

6.3

7

Pension Lawyers Association Conference 2005

Adapting to change
the only constant in life is change
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
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

Figure 1

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

Summary of international cost analysis

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

Ref: pages 67 & 107
Policy implications

• Transparency
  – consistent methodology
  – minimum disclosure

• Closure of channels
  – 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 (e.g., performance-based fees) seek suitable independent advice.

<table>
<thead>
<tr>
<th>Fund inputs</th>
<th>Providers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of members</strong></td>
<td>Provider 1 name: Alternative 1</td>
</tr>
<tr>
<td>2,500</td>
<td>Provider 2 name: Alternative 2</td>
</tr>
<tr>
<td><strong>Total pensionable payroll</strong></td>
<td></td>
</tr>
<tr>
<td>R 750.0 m</td>
<td></td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td></td>
</tr>
<tr>
<td>R 250.0 m</td>
<td></td>
</tr>
<tr>
<td><strong>Contribution rate</strong></td>
<td></td>
</tr>
<tr>
<td>12.00%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Charge details: Alternative 1</th>
<th>Charge details: Alternative 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rand per member per month</strong></td>
<td><strong>Rand per member per month</strong></td>
</tr>
<tr>
<td>R 55.00</td>
<td>R 25.00</td>
</tr>
<tr>
<td><strong>Percent of contributions</strong></td>
<td><strong>Percent of contributions</strong></td>
</tr>
<tr>
<td>5.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td><strong>Percent of payroll</strong></td>
<td><strong>Percent of payroll</strong></td>
</tr>
<tr>
<td>0.00%</td>
<td>0.00%</td>
</tr>
<tr>
<td><strong>Percent of assets</strong></td>
<td><strong>Percent of assets</strong></td>
</tr>
<tr>
<td>0.00%</td>
<td>0.50%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Outputs: Alternative 1</th>
<th>Outputs: Alternative 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equivalent total charge expressed either as:</td>
<td>Equivalent total charge expressed either as:</td>
</tr>
<tr>
<td><strong>a percentage of contributions</strong></td>
<td><strong>a percentage of contributions</strong></td>
</tr>
<tr>
<td>22.77%</td>
<td>22.38%</td>
</tr>
<tr>
<td>or alternatively as:</td>
<td>or alternatively as:</td>
</tr>
<tr>
<td><strong>a percentage of assets</strong></td>
<td><strong>a percentage of assets</strong></td>
</tr>
<tr>
<td>0.80%</td>
<td>0.78%</td>
</tr>
</tbody>
</table>

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 simple 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 Flusconi

Version 1.0 March 2005

Adapting to change
the only constant in life is change