ACTUARIAL
SOCIETY
OF SOUTH AFRICA

QUANTIFYING RISK, ENABLING OPPORTUNITY

An industry player's perspective

ASSA RMC Conference 2013

Anton Gildenhuys - Sanlam

Retirement reform (first four papers)

- Enabling a better retirement income
  - Happy with outcome of the consultation process
- Preservation, portability and annuitisation
  - Strongly support the principles
  - Main concern: practicality of preservation proposals
- Incentivising non-retirement savings
  - Excited about the idea – early days though
- Simplifying tax treatment of retirement savings
  - In broad agreement
  - DB fund complexities mainly in the GEPF

Retirement reform (first four papers)

- Enabling a better retirement income
  - Happy with outcome of the consultation process
- **Preservation**, portability and annuitisation
  - Strongly support the principles
  - Main concern: practicality of preservation proposals
- **Incentivising** non-retirement savings
  - Excited about the idea – early days though
- **Simplifying** tax treatment of retirement savings
  - In broad agreement
  - DB fund complexities mainly in the GEPF

Charges in South African retirement funds

- We're in full support of initiatives that will:
  - Improve the net benefit to clients
  - Minimises unintended consequences
- Nature and level of charges critical in this
- Concerned about:
  - The central themes in the paper
  - The significance and direction of proposed interventions

Three parts to this paper

- What we read
- Our perspective
- Unpacking two specific themes

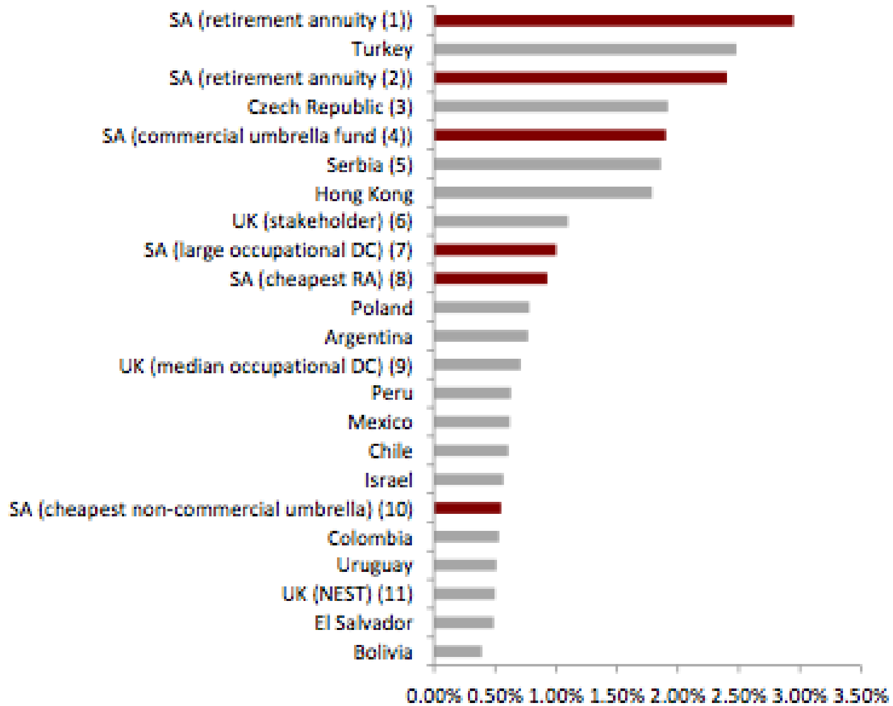
Part One: What we read

Main theme in the paper

- Market forces failing:
  - Asymmetry of information: clients not price sensitive
  - Product complexity, intermediation, charge shifting and other methods used to increase price
  - Result: imbalance in sharing of value between capital providers and consumers

Comparison to other dispensations

Figure 2: Estimated 40-year annual *RiY* for various South African plan types in an international context



Source: Hernandez and Stewart (2008), unless otherwise indicated.
International comparisons are difficult for many reasons, see text for details.
All figures probably exclude trading costs.

A bit outdated

Where's the others?:

- Australia,
- New Zeeland

Comparison to other dispensations

- Our charges are relatively high
- Some recognition given to differences:
  - Fragmentation
  - Preservation
  - Participation (compulsion)
- However, analysis and recommendations revolve on how to address “market failure”

Direction of proposed solution(s)

- Improve comparability of products:
  - Standardised charging structure
  - Improved disclosure
- Improve portability of products: retirement fund exchange
- Fund based solution:
  - Encourage consolidation
  - Fund governance
- Auto-enrolment
- “Effective intermediation”: RDR extended to group retirement space

Response to “failing market” – ensure effective competition

Additional themes: Charge shifting

- Between "recurring" and "initial" charges:

Figure 3: Effect of initial charges on retirement fund accumulations after 40 years for a regular contributor

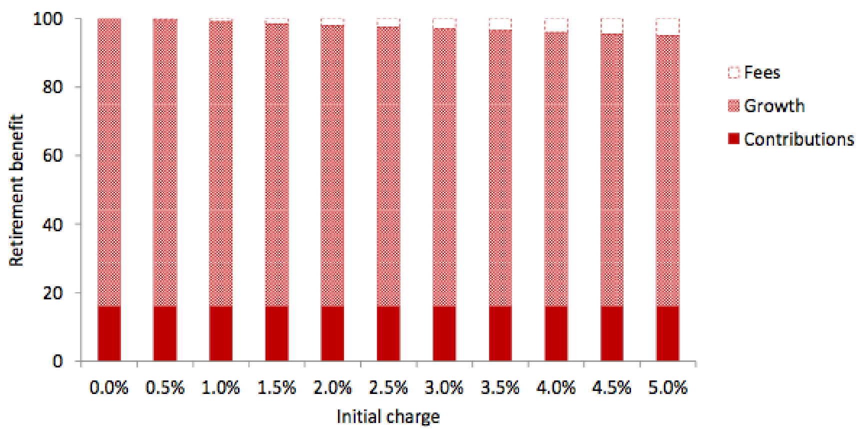
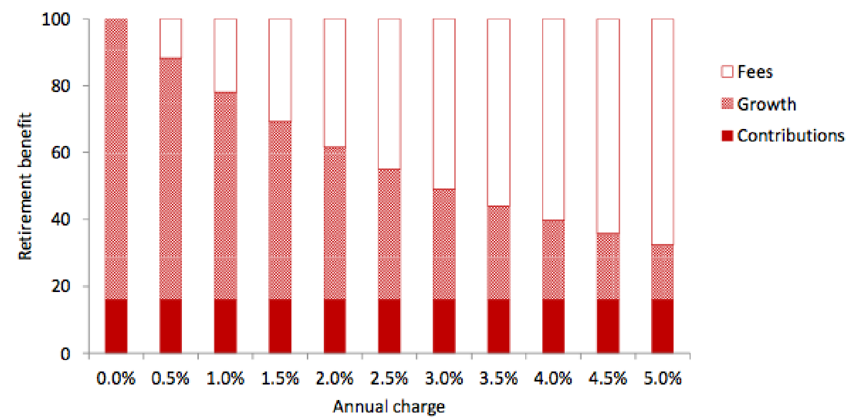


Figure 4: Effect of recurring charges on retirement fund accumulations after 40 years for a contributor



- Between recurring charges themselves:
  - Guarantee charges, performance fees, asset management charges, platform fees, administration fees, and adviser fees

Additional themes (2)

- Active vs. passive investment management:
  - Zero sum game
  - After fees, clients worse off
- Guarantees and smoothed bonus funds:
  - Policyholder carries the risk
  - “In principle, there is no reason why retirement funds could not elect to smooth returns within the fund, rather than purchase an insurance policy which does so outside the fund.”

Part 2: Our perspective

Market is effective

- Ineffective market characterized by:
  - Excessive profits
  - Lack of improvement in consumer value
- Average industry VNB margin:

Big 5 insurers	2007	2008	2009	2010	2011	2012
VNB total (in R'million)	3 764	4 114	3 069	3 028	3 802	4 752
PV of NUB premium total (in R'million)	127 985	139 319	134 199	135 439	135 128	152 228
VNB margin	2,94%	2,95%	2,29%	2,24%	2,81%	3,12%

Risk Discount Rate (Sanlam)	10.8%	9.8%	11.9%	10.9%	10.7%	9.3%

- Impact of profit motive

Evidence of improving value

- Evidence of improving value:
  - Reduction in retail charges

Starting at R1000p.m, 25 years	PV of charges	RIY
2004 charging structure	R64 780	2.8%
2013 charging structure	R45 987	2.1%
Reduction	29% (or 3.7% p.a.)	25% (or 3.1% p.a.)

  - Reduction in EB charges

Year	RIY
2010	2.01%
2011	1.90%
2012	1.70%
2013	1.65%

Comparisons to other dispensations

- Impact of differences underestimated
  - Preservation:
    - Assets under management in industry
  - Compulsory/voluntary
    - Cost of distribution
    - Persistency
  - Fragmentation
    - Average assets under management
  - Nature of incentives
    - Co-contribution or tax incentives

KiwiSaver model

- Auto-enrolment:
  - Employer 3% contribution
  - 8 weeks to opt out

Close to compulsion

- Fees:
  - Distribution – RDR approach
  - Admin: $3 p.m.p.m.
  - Asset management: 50bps – 150bps

Distribution outside product
Investment fees similar

- Higher ave. AUM:
  - Kick start contribution from state
  - Full preservation
  - Single provider per client only (transfers allowed, with a fee)

High average AUM/member

- Tax credit system:
  - 50c / $1
  - Inland revenue exchange (voluntary)

Redistributive incentives

Levers to reduce charges

- Market is already working well
  - Keep as cornerstone of solution
- Government intervention:
  - Address structural issues that market cannot solve by itself
  - Intervene once-off. Set the "rules of the game"
  - Avoid:
    - Participation
    - Need for constant involvement to keep the system stable
  - Take account of other changes:
    - Rest of retirement reform
    - TCF
    - Intermediary remuneration review
- Gradualist approach
  - Prioritise changes to be made (for all regulatory reform)
  - Give market time to respond

Structural issues (1)

- Reduce cost in the value chain:
  - Distribution: auto-enrolment
  - Administration: already highly effective:
    - Davies (p.52 of Charges paper)
    - Compass study
  - Asset management: disclosure (already under way)
- Rely on the profit motive for:
  - Continuous efficiency improvement
  - Innovation

Structural issues (2)

- Grow average AUM per member:
  - The lever that is often under estimated
  - Put more in: Compulsion / Auto-enrolment
  - Leave it there: Preservation
  - In not too many baskets: Reduce fragmentation
    - Proposals on consolidation (how?)
    - Address nature of preservation proposals

Part three: Unpacking two specific themes

We disagree with a number of specific themes

- Views on active vs. passive investment management
- The importance of advice
- SARS as an exchange
- Risk benefits as part of the charges debate
- The power of the client
- The structure and role of platforms
- Commercial umbrella considerations
- The need for retirement annuities
- And two more…

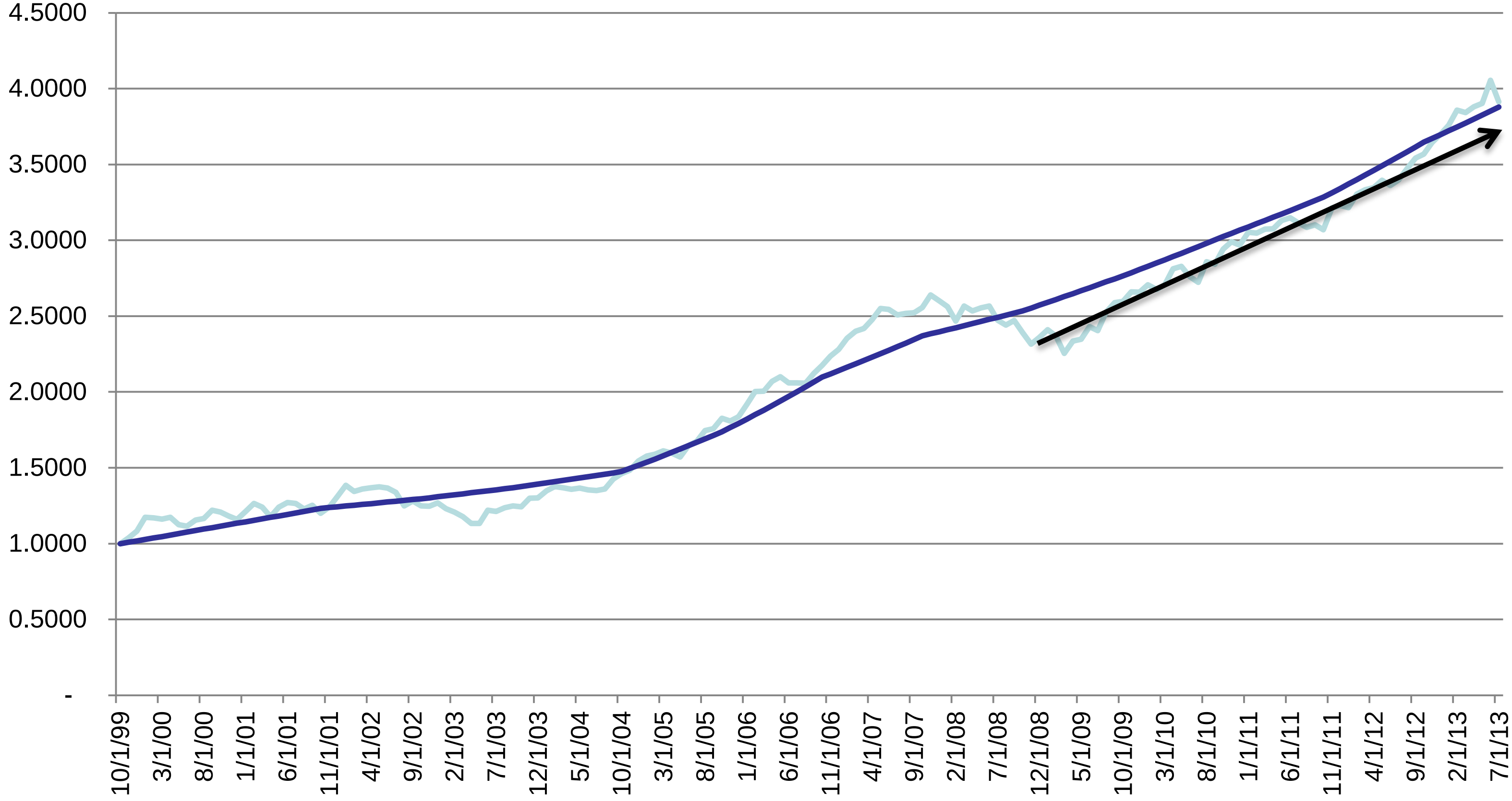
Our view of guarantees and smoothed bonus funds

Guarantees and smoothed bonus funds

- SAM vs. charges paper
- Smoothed bonus funds:
  - Management actions:
    - Role of Statutory Actuary,
    - Professional guidance
    - Legislation
    - The Board
- Tail events
- “Little evidence of shareholder support, despite recent volatile investment market conditions”:

ASSA should respond…

Need for shareholder support?

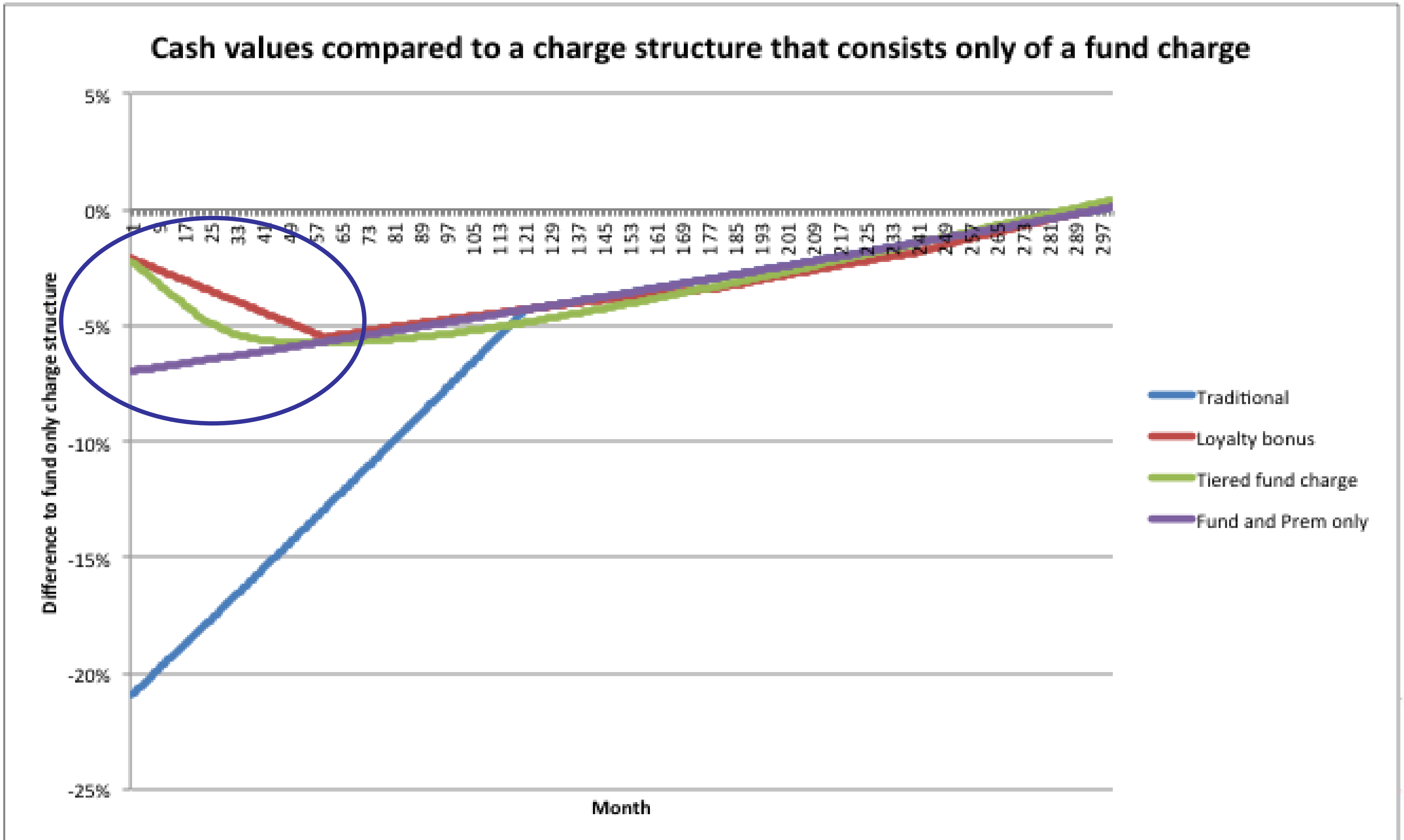


The risk of radical intervention…

Charging structures – client perspective

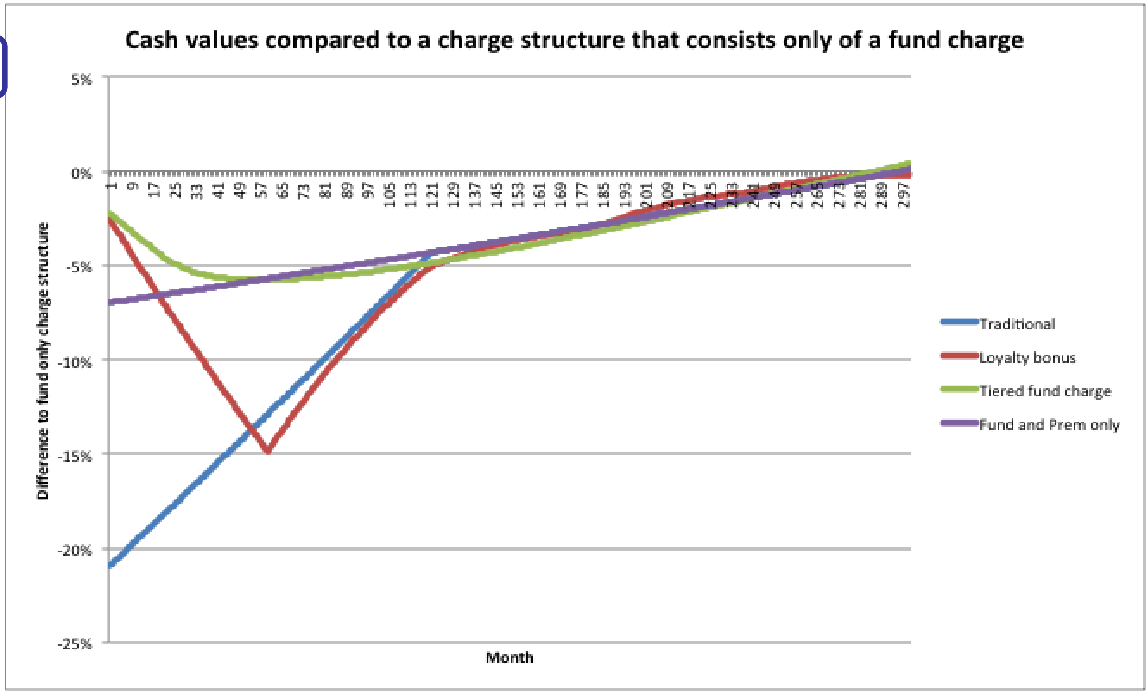
	A Traditional	B Loyalty bonus	C Tiered fund charge	D Fund and premium charge only	E Flat fund charge
Fund management charge	1,50%	3,50%	-	1,50%	2,05%
Premium charge	5%	0%	0%	7%	0%
Policy fee (p.m.)	10	10	10	0	0
Early termination charges					
Month 0	15%				
Month 120	0%				
Loyalty bonus (% of fund extra)					
Loyalty bonus month					
60		0,0%			
120		5,0%			
180		10,0%			
240		16,0%			
300		23,0%			
Fund charge (p.a.)					
Fund charge range					
R -			5,00%		
R 10 000,00			3,00%		
R 15 000,00			1,75%		
R 60 000,00			1,50%		
R 200 000,00			1,50%		
RIY	2,2%	2,2%	2,2%	2,2%	2,2%

Charging structures – client perspective



Loyalty bonus structure – Similar to Reg 5

	Traditional	Loyalty bonus
Fund management charge	1,50%	10,00%
Premium charge	5%	0%
Policy fee (p.m.)	10	10
Early termination charges		
Month 0	15%	
Month 120	0%	
Loyalty bonus (% of fund extra)		
Loyalty bonus month		
60		5,0%
120		40,0%
180		70,0%
240		105,0%
300		143,0%
RIY	2,2%	2,2%



Charging structure – Provider view

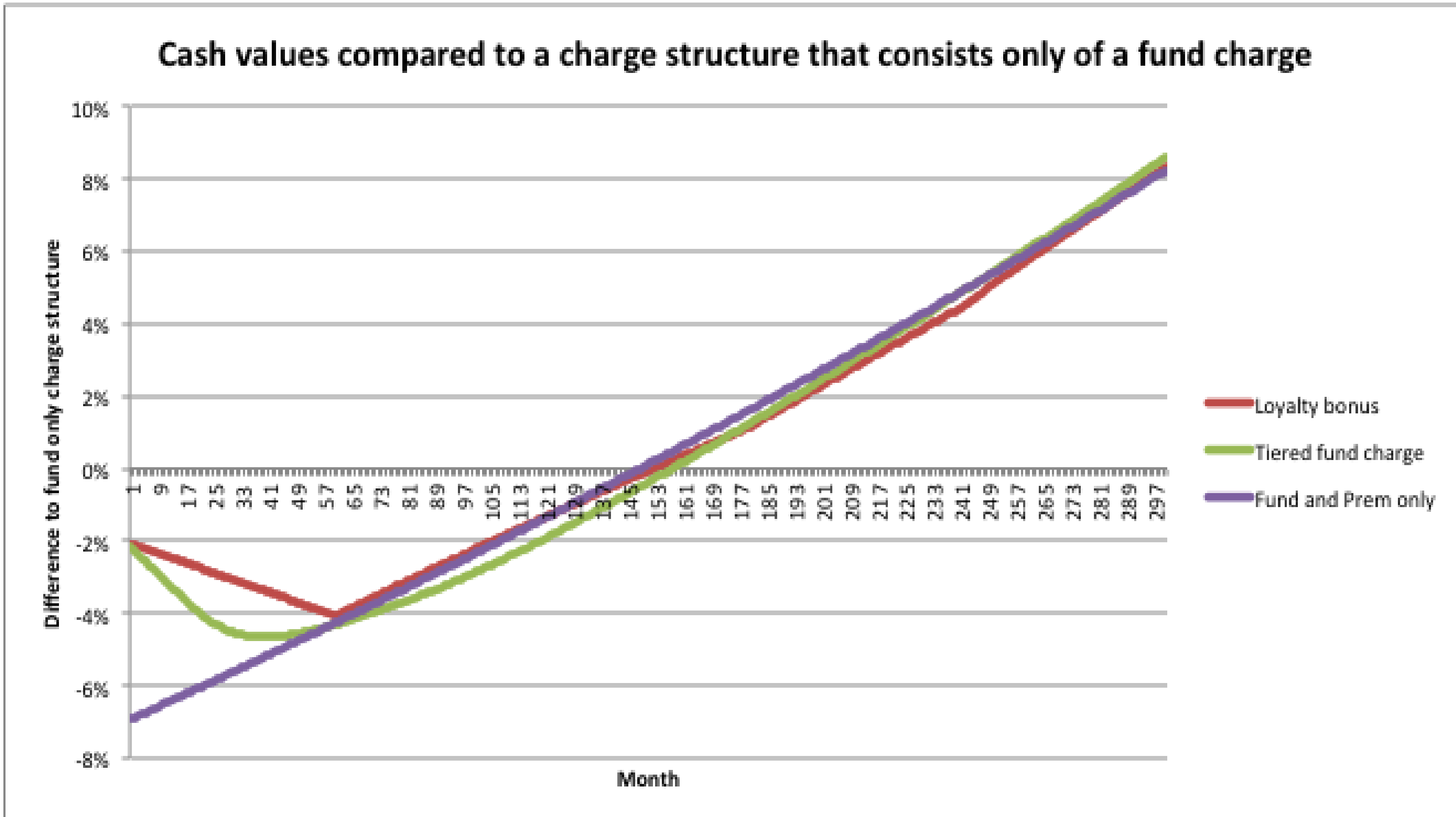
- Same RIY:

	Tiered fund charge	Flat fund fee
Expected present value of charges	10 308 533	8 421 858
Expected present value of expenses	(9 571 136)	(9 715 273)
Expected present value of profit	737 397	(1 293 415)
Expected present value of premiums	38 886 633	38 886 633
Margin	1,9%	-3,3%

- Same profitability – fund fee = 2,65% (RIY = 2,8%):

	Tiered fund charge	Flat fund fee
Expected present value of charges	10 308 533	10 363 173
Expected present value of expenses	(9 571 136)	(9 624 561)
Expected present value of profit	737 397	738 613
Expected present value of premiums	38 886 633	38 886 633
Margin	1,9%	1,9%

Charging structure – Realistic view of alternatives



Promoted portability and ruthless standardisation

- Who is going to do the hard yards? After 5 years:
  - most of the expenses, little income
  - existence lump sum: new fund fee only of 1,95% (acquisition expenses incurred again)
- Pricing for worse persistency. Transfers from 2% to 10% after year 5.
  - Tiered fund charge: RIY 2,2% -> 2,8%
  - Flat fund fee: RIY 2,8% -> 4,5%
- Not what they taught in Economics 101:
  - There will always be a mismatch in incidence of charges and expenses
  - Exacerbated in current business model

Conclusion

Trust the market

- Market in South Africa is very effective
- Small number of structural changes -> Big impact on outcome for consumers
- Add auto-enrolment to other reforms, then give the market time to respond
- This way:
  - Change is done in a sustainable way
  - Unintended consequences are minimised

Thank You!

Questions?