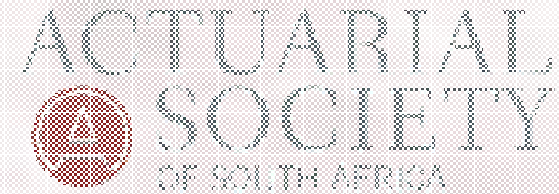




Retirement Fund Reform for Dummies

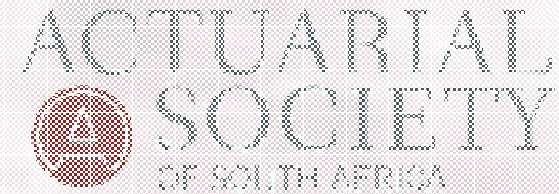
David Gluckman

My Guiding Principles



1. Paper aimed at policymakers not actuaries
2. Aimed for light read that is both entertaining and thought-provoking
3. Tried not to exceed 20 page limit
4. Chose to avoid arguments that have been well made by others
5. Tried to steer clear of promoting own business interests

Being a Dummy is Good Not Bad!



1. First principles reasoning is very powerful
2. Don't be intimidated by actuarial models
3. Place national interests above ego

Humans v Computers

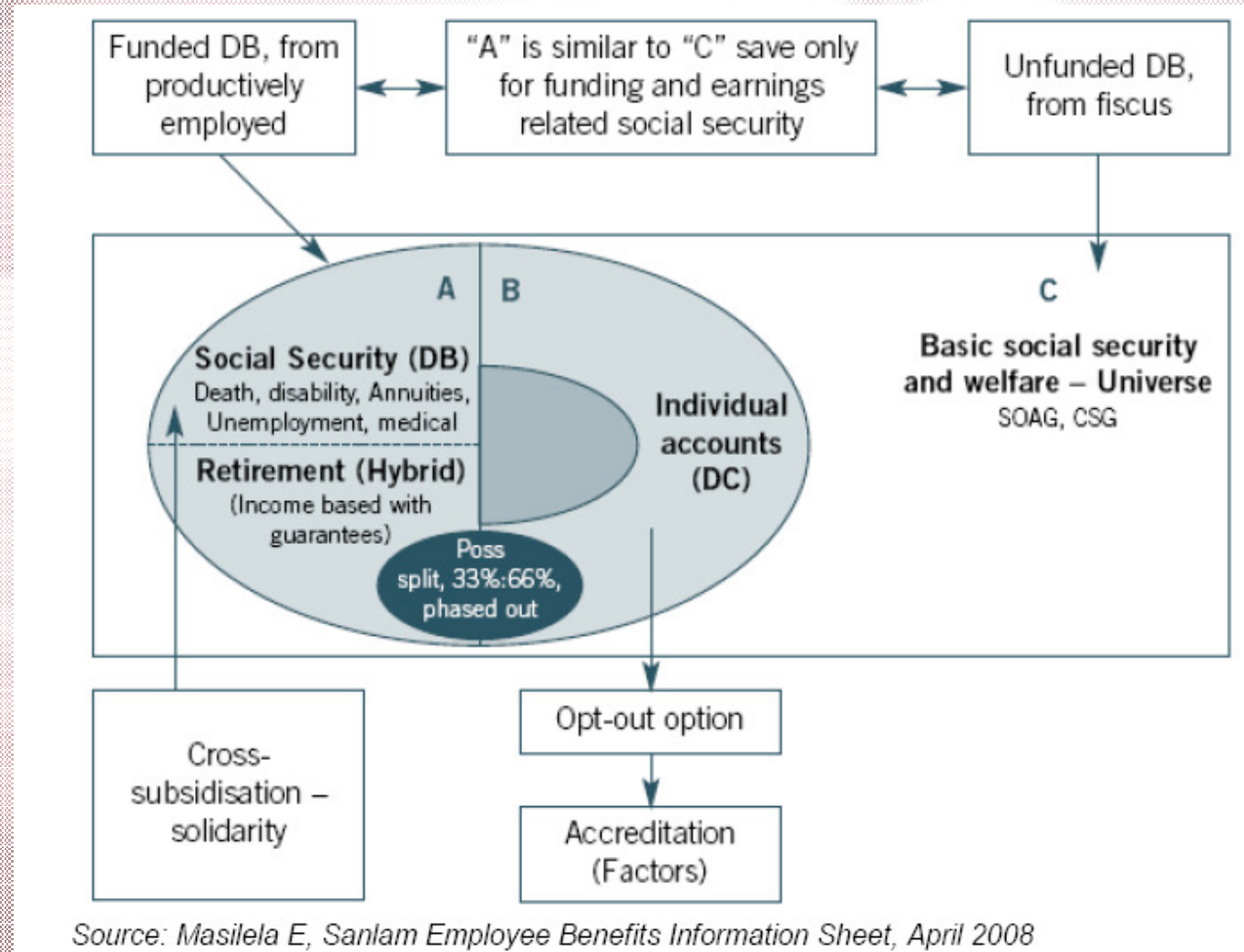


- 100 – 200 billion positions in 3 minutes
- Never makes a calculation error
- Never tires
- Immune to psychological pressure



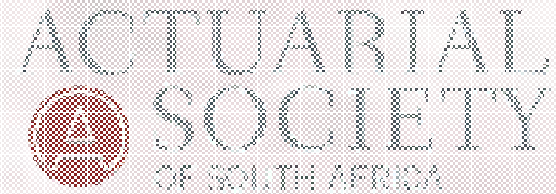
- 100 – 200 positions in 3 minutes
- Prone to human error
- Tires
- Subject to psychological pressure

The Model in a Nutshell



Transition

Gluckman's Law



Net Utility raising from retirement fund reform

equals

Gross Utility raising from retirement fund reform

minus

Cost of Transition

The Devil is in the Detail

Section 4 Conclusion on page 33

4.1.4 This research has not dealt with the important issue of transitional arrangements. This will be the reality for at least 30 years before the first cohort of new-entrants to the workforce retire having only belonged to the national scheme their whole life.

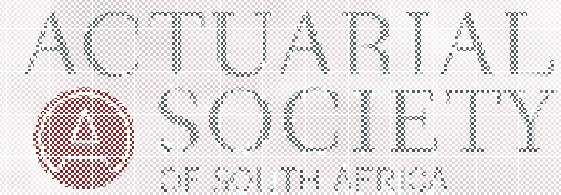


Main Transition Options

Commence new system,

1. but leave all accrued savings in current funds
2. and compel transfer of all accrued savings to new dispensation

Potential Cost of Paid-up Benefits

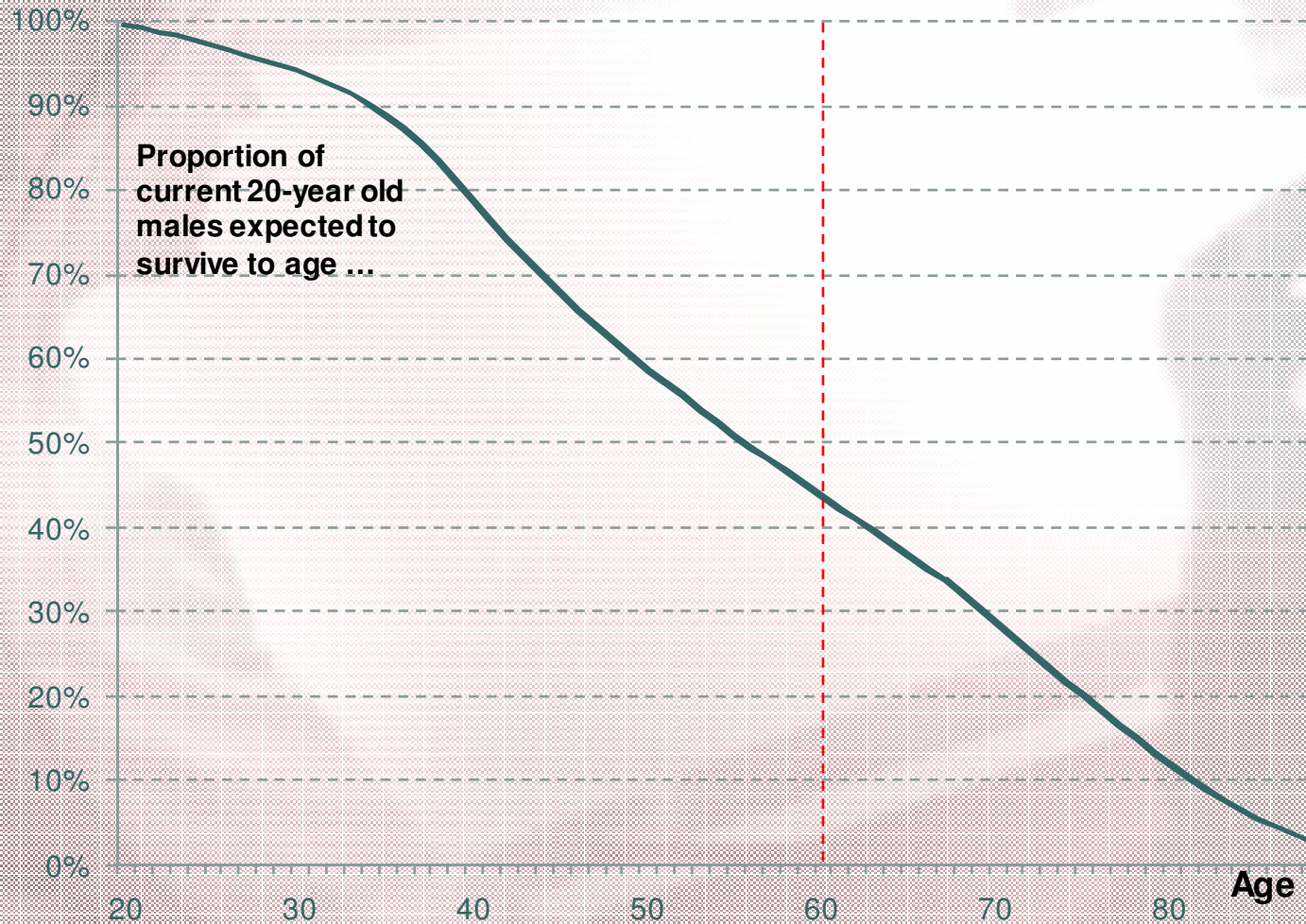
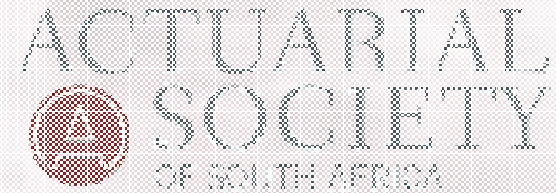


| Salary Band | # Members | Average Liability | Total Liabilities (R'million) | Unclaimed Benefits Risk Factor | Estimated Cost of Unclaimed Benefits if Made Paid-up (R'million) |
|---------------------|------------------|-------------------|-------------------------------|--------------------------------|------------------------------------------------------------------|
| <60k | 943,600 | R 30,840 | 29,101 | 25% | 7,275 |
| R60k - R120k | 247,000 | R 142,450 | 35,301 | 10% | 3,530 |
| R120k - R180k | 105,000 | R 295,116 | 30,990 | 0% | 0 |
| R180k - R500k | 91,000 | R 415,474 | 37,808 | 0% | 0 |
| >500k | 12,600 | R 1,001,788 | 12,623 | 0% | 0 |
| Sample Total | 1,400,000 | R 104,159 | 145,823 | | 10,805 |

Source: Analysis by Southey & Duck 2007 (data reworked)

Should Retirement Fund Reform be a Priority?

Many will not make it to retirement

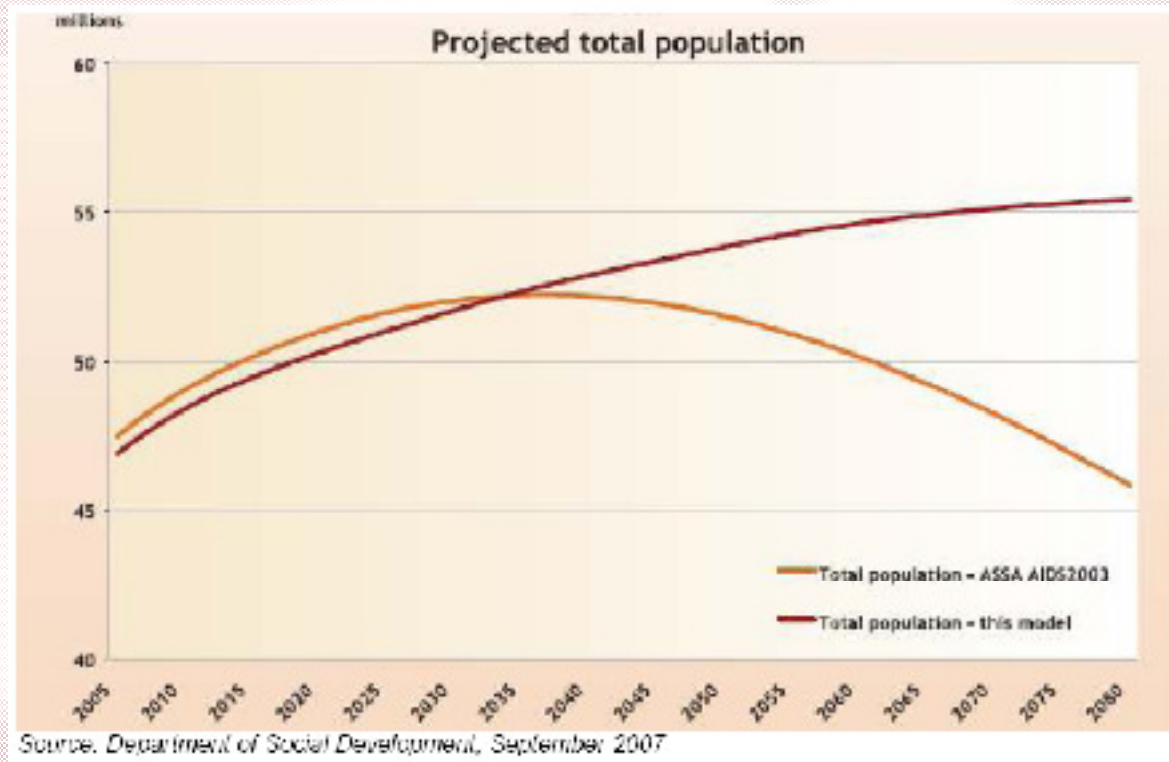


Some respondents did not think that they would reach old age, for many, what came to mind when asked to think about old age is: *"I think of death"*

"My main worry is HIV and sugar diabetes, but I don't think I will reach the age of 70" (35-45 year old female)

Source: ASSA2003 model, whole SA population, standard assumptions

The Impossible Task of Modeling Over 75 Years



“immigration will be positive and one of the strongest drivers of total population growth, but modeling immigration with confidence is difficult because one needs to make assumptions not only on the numbers but on the age, gender and socio-economic standing of immigrants”.

Social Grants & Risk Costs

1. These are urgent priorities for the majority of the population
2. What can be afforded with 3% allocation?
3. Model these costs first to inform the retirement funding discussion
4. Recognise there are overall cost constraints

Job Creation is a Priority

International comparisons – labour force and unemployment rates

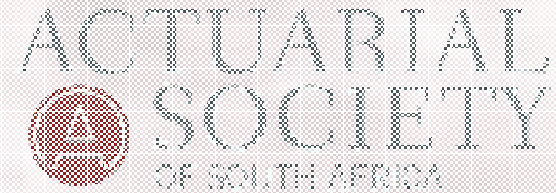
| Country | Year | Labour Force (000s) | Unemployment Rate |
|---------------------|-------------|---------------------|-------------------|
| Argentina | 2006 | 11,052 | 9.5% |
| Brazil | 2004 | 90,982 | 9.1% |
| Chile | 2005 | 6,315 | 6.9% |
| Czech Republic | 2005 | 5,175 | 7.9% |
| Hungary | 2006 | 4,247 | 7.5% |
| Korea | 2005 | 23,711 | 3.7% |
| Mexico | 2006 | 43,216 | 3.2% |
| Philippines | 2006 | 35,804 | 7.3% |
| Poland | 2006 | 16,937 | 13.8% |
| Singapore | 2006 | 1,881 | 4.5% |
| South Africa | 2007 | 16,984 | 25.5% |
| Turkey | 2005 | 24,566 | 10.3% |
| Average | | | 9.1% |

Source: *Fruf für die Welt (Frye 1)* 2008 based on research published in 2007 by the International Labour Organisation.

‘... our high rate of unemployment remains our greatest economic challenge ...’

Trevor Manuel
2008

Key Dummy Takeaway



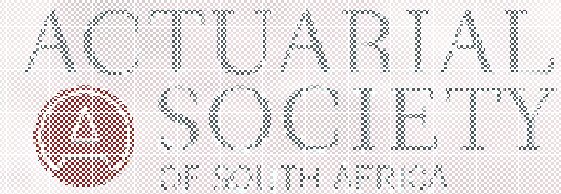
“Given the very high transition risks as discussed in Section 2 above, it would be ill-advised to accept these transition risks and costs to implement a new dispensation that we cannot model with confidence, that will at best produce net utility far into the future (and maybe not), and that potentially takes our ‘eye off the ball’ as to other more pressing priorities”

What Reform Can Work?

“Let us therefore brace ourselves to our duty, and so bear ourselves that if the British Empire and its Commonwealth last for a thousand years, men will still say, ‘This was their finest hour.’”

Winston Churchill, British Statesman and Prime Minister, 1940

Retirement Funds Offer Reasonable Value-for-money



| | Charge Ratio | | Reduction in Yield | |
|---------------------------------|--------------|-------|--------------------|-------|
| | Low | High | Low | High |
| Retirement funds (narrow range) | 17.0% | 27.1% | 1.04% | 1.65% |
| Retirement funds (wide range) | 13.4% | 30.4% | 0.81% | 2.36% |
| Individual policies | 26.7% | 43.2% | 1.50% | 2.80% |
| Unit trust products | 22.3% | 32.5% | 1.20% | 1.95% |

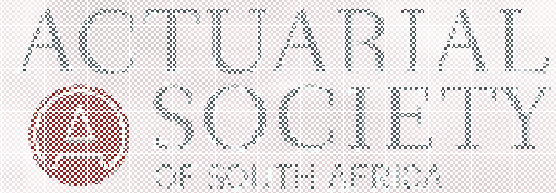
Source: Rusconi RD, 2005

Especially larger funds ...

| Plan Size | Employer-sponsored defined contribution | Employer-sponsored defined benefit | Retail |
|-----------|-----------------------------------------|------------------------------------|--------|
| Small | 15% | 21% | 28% |
| Medium | 12% | 16% | 22% |
| Large | 5% | 7% | N/A |

Source: Rusconi RD, 2005

Solidarity At Work



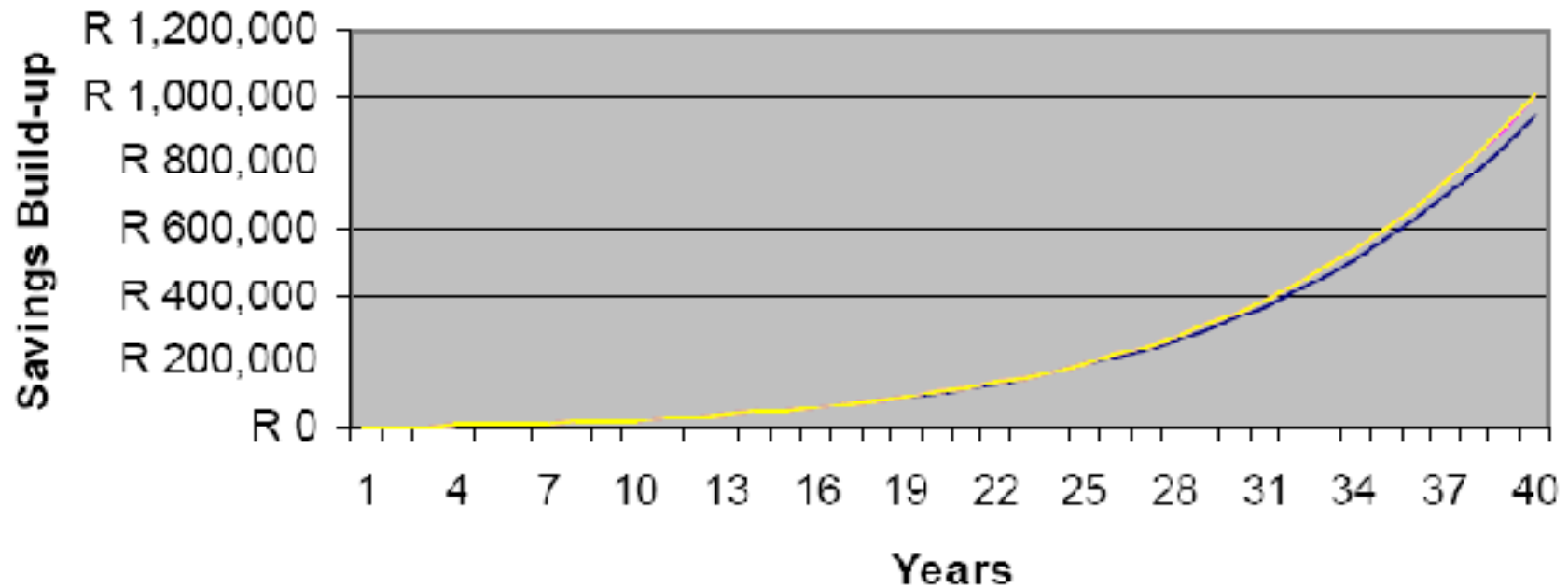
“South Africa’s retirement funds are civil society treasures”

Anthony Asher, 2007

***“In group schemes,
sophisticated members of the group will act as buyers for all,
while communal pressures or regulatory intervention
can prevent exploitation of the weak or naive”***

Anthony Asher, 2007

“Charges, Charges, Charges”



- Reduction in Yield of 1.3% throughout
- Reduction in Yield of 1.3% for first 5 years thereafter 1%
- Reduction in Yield of 1% throughout

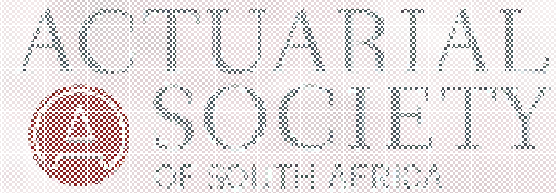
Source: Own calculations

Consolidation is Vital

| Number of Members and Pensioners | Number of Funds | Percentage of Total | |
|----------------------------------|-----------------|---------------------|--------------|
| | | By Funds % | By Members % |
| 1-20 | 7 354 | 54,8 | 0,4 |
| 21-50 | 2 019 | 15,1 | 0,8 |
| 51-100 | 1 206 | 9,0 | 1,1 |
| 101-500 | 1 829 | 13,6 | 5,0 |
| 501-1000 | 429 | 3,2 | 3,7 |
| 1001-5000 | 434 | 3,2 | 11,7 |
| 5001-10000 | 58 | 0,4 | 5,1 |
| 10001+ | 91 | 0,7 | 12,2 |
| | 13 420 | 100,0 | 100,0 |

Source : Financial Services Board, 2005

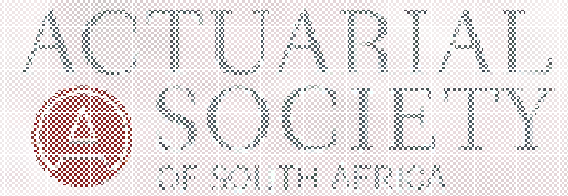
Some Examples of Quick Wins



1. Single retirement funding vehicle
2. Use taxation as a lever to drive desired outcomes
3. Optimal use of “power of defaults” (soft compulsion) e.g. preservation
4. Industry agreed total expense ratios
5. Enhance *effective* competition
6. Deregulate commission

Who Is The Real Dummy?

Contact details



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