GETTING TO GRIPS WITH THE "SANDWICH GENERATION"

About a year ago we trained a board of trustees up on the West Coast on the allocation of death benefits. We discussed the typical scenarios where a deceased is survived by a spouse and two minor children, when one of the trustees pointed out that, this example is very far from typical. In their community, he said, a more typical scenario would be that the deceased is survived by an elderly parent living in his home, a spouse and a number of adult unemployed children (doing piece work of some kind) also living in his home, possibly with a child of his or her own.

HOW DEATH BENEFITS ARE ALLOCATED TO CHILDREN

The traditional approach in terms of which the needs of children are assessed for the purposes of allocating death benefits is as follows. The trustees would determine the age at which the children in the household would typically leave school and begin to fend for themselves. This "end of school going term" is normally between ages 18 to 26. In the allocation process the trustees then aim to provide each child with support up to the end of school going term. Children beyond that age are typically only considered once the basic needs of the minor children are provided for, assuming that these major children were not dependent on the deceased for another reason - such as unemployment. The unemployed children are often allocated an amount if the total benefit is sufficient to allow this. Their monthly needs are determined (based on the level of income in the household) and multiplied with the number of months that it would reasonably take for them to find employment. This would typically be assumed to be 12 to 24 months. This approach however has its limitations and will not necessarily address the needs of all the persons who were dependent on the deceased in such a household.

THE YOUTH UNEMPLOYMENT RATE

The sad truth is that the position of this community in the west coast is not unique. Elsewhere in the country the young who cannot find work also tend to stay at home and continue to be dependent. Many South Africans do not only carry the burden of their unemployed children, they also have to take care of their aging parents – hence the concept of a sandwich generation. (In more affluent households we find a similar but not less problematic development where employed children continue to stay at home primarily for reasons of convenience and lifestyle.) But how widespread are these developments and what is the rate of change?

The unemployment rate amongst the youth is 48% according to Stats SA. Clem Sunter points out that the youth (aged 15-24) currently account for 20% of the total population (10 million), whilst the young (aged 0-14) is 30% of the population (16 million). He also highlighted population growth statistics and pointed out that the makeup of our society is likely to change in future. According to the 2015 Sanlam Benchmark Survey 24% of pensioners still have child dependants and 58% have adult dependants.

The Pension Funds Act requires that death benefits be allocated to the dependants of the deceased "as may be deemed equitable by the board". With the shift that is evident and predicted in the structure and needs of our society, further shifts are also likely to take place over time in the practices and benchmarks we consider "equitable".

THE NEW NORMAL

The sandwich generation will continue to break new ground and test the levels of our creativity in the years to come.

To accommodate the levels of youth unemployment, we no longer recommend the use of age 18 as the end of school going term. Trustees allow children a few more years, at least up to age 21, to find jobs. Secondly when calculating the "unemployment assistance allocation" the trustees allow a longer period for unemployed major children to find a job. How best to deal with more distant relations and others who were also enjoying some level of support in the household of the deceased is more difficult to determine and is done on a case by case basis.

This is merely a start. We will also engage with the regulator and with industry bodies to make appropriate adjustments to the Act. We have to find ways to reflect and do justice to the changing needs and the long term realities of the communities we serve.

Kobus Hanekom
Head: Strategy, Governance and Compliance

The unemployment rate amongst the youth is 48% according to Stats SA. The young who cannot find work tend to stay at home. They may do piece work of some kind but they continue to be dependent. Many South Africans do not only carry the burden of their unemployed children, they also have to take care of their aging parents – hence the concept of a sandwich generation.

UNDERESTIMATING THE BENEFIT OF SAVING FROM DAY ONE MAY BE MORE COSTLY THAN YOU THINK

"It is so overwhelming when people start to talk to me about stuff like that. I don't know what it means so I always just think OK I'll get it one day. I think like I've got lots of time before I retire." – young member focus group, Sanlam Benchmark Survey 2015

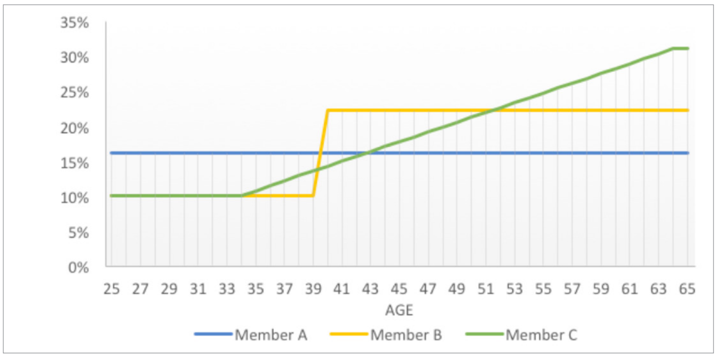
Saving for retirement is a long term investment and many young members feel that because retirement is such a long way away they can live a little and start saving the desired contribution rate later in life. When starting out one's career it's exciting to receive that first pay cheque and it's difficult not to dream about and experience some of life's luxuries your money can buy. For many young members the quest is to maximise take home pay. They will pay attention to any other needs when they get to them.

If this is your way of thinking, you may fall into the category of people that underestimate the concept of compound interest and the effect it has on your retirement savings. Starting to save effectively for retirement from Day One will not only have an enormous impact on your lifestyle after retirement, it will also have a very positive impact on your cash flow and lifestyle during the later part of your career.

To illustrate this, we look at 3 members aged 25 who have just embarked on their careers and plan to save for retirement at age 65 which is 40 years into the future. All three members wish to retire on the same lifestyle and therefore target the same income at retirement. Member A works towards a Projected Pension Ratio (PPR) of 75% i.e. to retire on a pension income that will replace 75% of his Total Guaranteed Package (TGP) less his retirement contributions, while the other two members delay saving effectively for retirement for some time in the future.

- **Member A:** This member makes the recommended contribution rate of 16% of his TGP from Day One.
- **Member B:** This member contributes at the minimum contribution level (10% of TGP) for the first 15 years in order to increase his take home pay, and will then increase his contribution amount once off and continue to contribute at the increased rate until retirement in order to have the same level of income at retirement as member A.
- **Member C:** This member also contributes at the minimum contribution amount, but only for 10 years, after which he will increase his annual contribution amount by a fixed amount each year until retirement in order to have the same level of income as member A.
- The first 2% of contributions are allocated towards operational expenses and risk benefit insurance premiums.

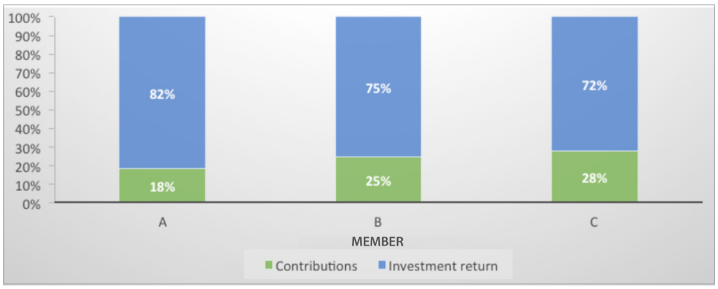
Many young members feel that because retirement is such a long way away they can live a little and start saving the desired contribution rate later in life. We calculate the cost of such a strategy.



The graph shows that at age 40, member B has to increase his contribution to 22% of TGP, which is more than double the percentage he was saving during the 15 years he maximised his take-home pay.

Member C begins increasing his contribution percentage from age 35 by 0.7% per year. At age 43 he has to start contributing more of his salary per year than member A and at age 52 he begins contributing more than member B. His final contribution rate just before retirement is 31% of TGP. This amount is much higher than the current total tax free contribution rate, so this member would need to contribute at an even higher rate to reach the target income.

The cost of delaying effective retirement savings is shown in the bar chart. Over the 40 year period, member A only contributes a total of 18% of his final fund value at retirement. The balance of his retirement benefit will be the growth he earned on his investment. Member B ends up contributing 25% of his total fund value and member C 28%.



WHERE DOES THE SMART MONEY GO?

The charts show how expensive retirement becomes if you decide to "live a little" during your twenties and early thirties to maximise your take-home pay. The smart thing to do is to get used to making an effective contribution from Day One so your money can work harder for longer. Lifestyle will always be important – not just in your twenties. Plan B and C will require you to tighten your belt at some future time when it may be even harder for you to contribute more. In addition of course, what is that old saying again about the security of having "money in the bank".

Ryan Campbell-Harris
Actuarial Analyst

THE DAY ONE STRATEGY IN ACTION

Last year we reported on a study done by Prudential in the USA in which they concluded that our brains are not hard wired to save for retirement and that when confronted with a short term need such as the need to buy new shoes, the shoes will win every time.

Looking at the map of Europe, I am beginning to wonder whether this is a general truth. Almost without exception, the countries in the cold north are financially better off than the ones in the warm south. Is it possible that not only the plants and the animals but also the humans living in the northern countries - where it freezes over in winter - are hard wired to prepare for winter? Is it possible that they are endowed with a greater sense of urgency and purpose as a result? In the warm south, if you cannot get around to something today there is always tomorrow – right?

THE 2015 SANLAM BENCHMARK

When we studied the 2015 Sanlam Benchmark Survey results the one thing that stood out is the contrast between the attitudes and behaviours of the young compared to the retirees. It is as if the young interviewed were more apathetic about their retirement plans than we have come to expect whereas the retired persons interviewed were comparatively more disciplined and prepared.

The young member focus group (23 to 35): This group was included in the survey this year to explore qualitatively, issues around their financial well-being. The results were a little alarming. Especially as it became apparent that the single members and the childless couples are easy spenders who believe that "spending on me" is a reward for hard work. Securing the future is not a big priority *"I have considered saving but my deductions are crazy from work, we have benefits, our pension is a lot of money I believe. It's good for the future but I just don't think it's realistic [saving] with my current standard of living. OK yes I will have a nice pension fund when I decide to resign or whatever but then I want money now."*

The pensioner group: This group is in surprisingly good shape. Of those who took a lump sum benefit in cash almost 40% reduced their bonds and 35% reduced their short term debts. Just under 80% was living in their own home which is fully paid. Almost 60% has no debt. Of those that have debt, only 5.8% of their income on average goes towards servicing debt.

These groups were both reasonably representative of the funded population. What they had in common is the advice they offered on how to improve the savings culture. *"If they can find a way to simplify it and find a way to stress the importance of it. As a 19 or 20 year old you don't grasp the importance of it until you're maybe a bit older."*

It appears that our natural sense of purpose and urgency to provide for our futures falls short. We have to implement additional structures and disciplines to assist and guide South Africans to provide for their retirements, such as the Day One strategy.

THE DAY ONE STRATEGY

This is a method to get in front of and get the attention of employees at that point in their careers when we have the most leverage to change behaviour and teach new habits – on Day One of their employment with you. At that point we connect with them in a way and in a language they understand - with a short but powerful audio visual message. Then they participate and run the projected pension calculator so they can see for themselves what their projected pension ratio is and how to improve it.

In the pilots we ran during 2014, HR reported that they feel much more involved and able to assist. Members who experience both the old and the Day One induction strategies report that they feel more informed and empowered to take charge of their retirement plans. More importantly, however, they have more positive feelings about their employer and their fund and are more convinced that their best interests are served.

As an employer you can make a significant difference in the futures of the South Africans that you employ. If you do nothing else this year take the next logical, but relatively painless step and implement one or more member guidance and support strategies.

Freddy Mwabi
Actuarial Specialist

The results of the young member focus group (23 to 35) in the 2015 Benchmark Survey were a little alarming. Especially the single members and the childless couples are easy spenders who believe that "spending on me" is a reward for hard work. Securing the future is not a priority.

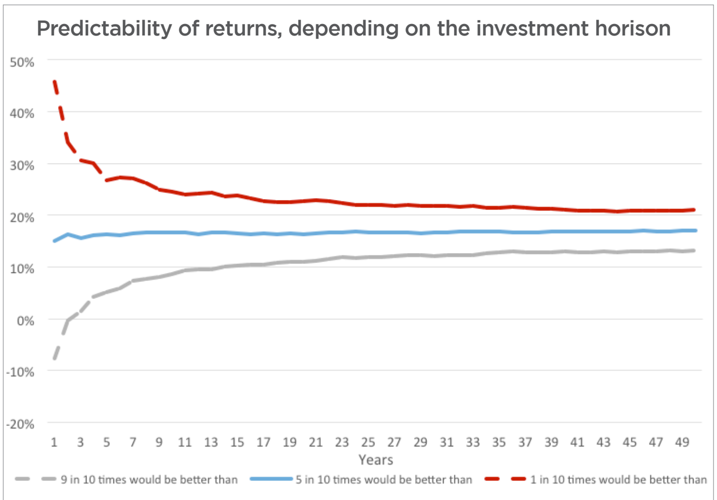
WHAT EVERY MEMBER SHOULD KNOW ABOUT LONG TERM INVESTING

"I think if they can simplify it, especially for the younger person, it all seems like gibberish sometimes. If they can find a way to simplify it and find a way to stress the importance of it. As a 19 or 20 year old you don't grasp the importance of it until you're maybe a bit older." – young member focus group, Sanlam Benchmark Survey 2015

As a client you may have heard me say *"the secret to investing is addressing the right risk at the right time"* on more than one occasion. You may also have heard me say that the "right risk" to address for a young member, is that of insufficient investment returns over the long term as this has the biggest impact on a member's ability to retire in a dignified manner. The question is how to get the message across to our younger members whose energy and attention is elsewhere? Consider this angle.

To get the best return over the long term you have to invest in an aggressive portfolio such as a lifestage strategy. When you do this you need to know that the market is volatile and that it will go negative from time to time, as most keen investors would attest to. This is the nature of the market but despite this behaviour it will still give you the best return over the long term. You may think of the old saying that goes "if you can't take the heat, stay out of the kitchen". However, the nice part about long term investing is that once you put your assets in the proverbial oven / the market, you are free to leave. In fact the longer you stay away the better. Here is why.

The chart below shows the predictability of investment returns, based on a simple statistical model using recent market returns.



Predictability of returns, depending on the investment horison

The blue line shows the middle of the road return for an investor with an investment horison of one to 50 years. The grey dotted line shows a kind of "worst case" – 9 in 10 times, the outcome would be expected to be better than this. The red dotted line shows the "best case" – only 1 in 10 times could the investor expect to perhaps do better than this. What this graph tells us is that the longer the investment horizon, the smaller the spread between the worst case and best case. So the longer the term of your investment, the more likely you are to get a good positive return. The shorter the term, the greater the risk of loss.

Over one or two years the expected returns in the model varied between -10% and 40%. The longer term returns only varied between 13% and 21%, which is a great result for any long term investor. In reality the returns may vary even more greatly, as was seen in the global financial crisis in 2008, where returns were almost -50% over a year. Nonetheless, as the investment term lengthens, the expected returns still converge to a narrower range. South Africa's long term history shows that the returns on shares have been around 7% above inflation. Therefore, based on our current level of inflation, a long-term average return of around 13% per annum appears reasonable.

In a nutshell, an aggressive portfolio offers the best possible return over the long term. Yes, during the shorter term the returns are volatile, but an investor only runs the risk of losing his money should he terminate the investment at that time. One might say that when you are invested for the long-term, the short-term volatility and risks are more in the nature of background noise – unless of course you terminate and crystallise your losses at that time.

If we return to our image of the heat in the kitchen you may think of the kitchen as too hot (if the returns are that unpredictable) and that you will get burnt. However, your long term investment loves the heat. All you have to do is get your investment in the oven and leave it to do what it does best. The hard work is to decide on an appropriate strategy, then all you need to do is forget about it or at least leave it until the time comes to consider your phasing options six years before retirement. So make as though your retirement fund credit is a paint job at the back of your house and rather go and catch up with your friends. It appeals to the lazy genes in all of us – right?

Willem le Roux
Head: Investment Consulting

PRINT