Secure Tomorrow

Minet

Aon | Global Network Correspondent

MINET THOUGHT LEADERSHIP

Minet is a trusted pan-African advisor that meets the uncertainties of tomorrow by delivering risk and human capital solutions today. As the largest Aon Global Network Correspondent, Minet has access to a network of over 50,000 colleagues in 120 countries as well as to proprietary data, research and analytics which enable us to manage and secure the risks of tomorrow and provide clients with an unrivaled advantage. For more information, please visit www.minet.com

Risk. Reinsurance. People.

ARE RETIREMENT FUNDS STILL RELEVANT TODAY OR IS THERE A BETTER ALTERNATIVE?

January 11th, 2022

The concept of retirement funds may seem simple to many because one may view it as merely an individual saving. The reality is that there is a lot more to it. Saving for one's retirement should unavoidably be an involving exercise during one's working life. For many people, retirement benefit constitutes the largest pool of money they have at any given time in their lifetime. Retirement Funds have come under a lot of pressure over the years as members are not able to achieve their desired financial outcomes. Experts have debated on what some of the leading factors resulting from this could be and there is no definite, no one correct answer or solution to the problem. This gives rise to the question of whether retirement funds are worth the trouble at the end of the day?

The main objective of a Retirement Fund is to serve as some secure source of income at retirement. However, it is extremely difficult – if not impossible – for an individual to maintain the same standard of living once they have retired. The hope is that a retired member could continue to lead a decent life at least. The most common yardstick to determine whether a member has successfully achieved a desirable retirement outcome is by using a Net Replacement Ratio ("NRR"). An NRR is the ratio of a member's pension in the year after their retirement compared to salary in the year before retirement. For example, if a member's pension in the year after retirement is P6,000 and their salary in the year before retirement was P10,000, then this equates to a NRR of 60% (P6,000/P10,000).

It is assumed that a retiree does not require the same level of income as an employed individual and that an NRR of 70% or more is sufficient, taking into consideration that there are lower work-related expenses, less debt repayments and fewer financial dependents to support. So how does one ensure that their retirement objective is achieved and whose responsibility is it? I would like to be quick to point out that a 70% NRR is a very ambitious target, as very few people get to achieve or beat it, particularly in Botswana

Many retirees often find themselves in financially compromising positions due to their failure to plan adequately for their retirement. Although Fund Administrators will attempt to educate members as often as possible, the 2018 Sanlam Benchmark Research Summary confirms that less than 20% of individuals can maintain their standard of living after retirement. I believe that this is no coincidence because of some fundamental flaws in the approach that individuals take in their retirement journey that goes beyond the responsibilities of the Board of Trustees, Investment Managers and Fund Administrators. Nevertheless, as stakeholders in the retirement industry, we can play a pivotal role in aiding individuals and empowering them to make sound financial decisions in preparation for retirement.

In South Africa, the new regulations - in terms of the Pension Funds Act - requires that members have access to retirement benefit counselling before receiving a withdrawal, which is one of the key elements to improve retirement outcomes for members. The current approach to retirement counselling - industry wide - may be cryptic, as it has not evolved over time to address the current problems faced by retirees which include high debt levels, low real returns, expensive cost of health care, and the increasing need to provide financial support to dependents such as grandchildren.

The Retirement Funds industry needs to adopt a holistic approach to pre-retirement consulting where the focus is on establishing the financial wellness of an individual, by placing emphasis on diversifying one's retirement portfolio or developing multiple income streams for retirement.

While saving for retirement during the accumulation phase is extremely important, your plan of action on how you convert other assets in your retirement pool to income will play an even bigger role in ensuring a smooth transition to retirement. My interaction with hundreds of members through pre-retirement consultations has made it clear that most individuals focus on short term investments and pay little to no attention to what should happen in retirement. Most people are poorly informed regarding their current retirement benefits, projected levels of income at retirement, and the various options available due to a lack of interest in the topic, which causes a problem in their ability to plan adequately.

Globally, market forces are making it more difficult for members to achieve their retirement goals and this has added a lot of pressure on the Board of Trustees who find it close to impossible to come up with ways to mitigate against the investment risks which members are exposed to. Trustees are forced to respond by increasing retirement ages (an almost impossible feat to achieve) as no employer is ever willing to carry an employee who is not as productive to the business, longer, continuous revision of investment strategies, and bargaining with employers to increase retirement contributions. In my view, these interventions barely come to fruition as Trustees have little to no control over them. What we need to do is to focus on the factors we have control over and develop tailor-made financial plans that are reviewed annually that take into consideration things like estate planning, insurance, debt management and other investments, well within 20 years of retirement. I believe technology and modern financial tools can play a very big role in assisting with monitoring a member's retirement journey by providing the right analytics to assist a member to make informed financial decisions geared towards retirement.

The biggest mistake one could make, is to retire whilst still in vast debt. The 2019 Bank of Botswana Household Indebtedness Survey indicates that household borrowers, aged between

30 to 50 years old, account for 60.7% of the overall credit market, while those aged 50 years and above account for 18.7%. Individuals within 10 years of retirement are encouraged to refrain from taking long term or large debt as this will ultimately force a member to settle any outstanding debt using their cash lumpsum at retirement.

An improved healthcare system affects longevity (people tend to live longer), which affects annuity pricing as it ends up being expensive for the pensioner who lives longer and therefore ends up earning a meagre annuity. There is too much monopoly by the main insurance companies and there are very few competing annuity products in the annuity market, while available assets in the bond market are limited. Since the 2008 financial crisis, annuity prices have dropped by almost half due to the decline in interest rates, while the cost of living has increased, thus putting pressure on a retirees' NRR and subsequently on their standard of living.

With continuous education, eventually an individual can ensure that history does not repeat itself where the current generation needs to take care of our grandparents, who did not have retirement plans in place. Currently the Government of Botswana has an old age pension allowance for citizens who are 65 years old and above amounting to P530.00 per month, which is not enough to support an individual in today's economic environment.

Retirement has the potential to be a relaxing and fulfilling stage of life. As with any major change, it presents a new set of challenges that need to be addressed accordingly. With the assistance of the Board of Trustees, the Fund or its service providers must take into account the following considerations, in order to ensure that an individual is in an improved position when they retire:

1. Provide a comprehensive view of the life one wants to live once they reach retirement age and provide a breakdown of the actual cost of living for budgeting purposes.
2. Train an individual to understand the investment choices they make in their personal capacity, and the impact or value they will have at retirement.
3. Discuss the tax benefits and implications preserving commutable pension benefit at withdrawal prior to retirement.
4. Train on how annuities work and the projected monthly pension at the time of retirement.
5. Assess the cost of specialised health care if necessary or simply making a saving provision for medical aid cost during employment.
6. Assess the need for specific insurance covers to assist with covering costs in the case of a possible loss
7. Engage an accredited financial adviser through the assistance of a Fund Administrator to provide an overview and recommendations to better your retirement outcomes

The factors listed above, focus on the member being proactive and engaged in its financial planning journey with the understanding that retirement funds alone will not be sufficient due to the current cost of living. Therefore, one should ideally focus on determining his/her expected standard of living by making provisions for the many years prior to retirement.

In addition, it is important that individuals be informed about the possible changes in their lives, which will affect their financial, social, and psychological wellbeing. There is a precedence amongst many Batswana that one must retire with a big retirement home and a new car, which is counterproductive in retirement. Although we unfortunately cannot control many external factors, we do have control over our approach towards retirement and we can therefore ensure that what we plan for is what we will achieve by taking a more holistic approach to consulting at least 20 years prior to retirement.

According to the 2021 Non-Bank Financial Institutions Regulatory Authority (NBFIRA) Annual Report, as of 31 March 2021, there was a total membership of 246,541 active members and 15,639 pensioners. This means that at least 11% of Botswana's population has a retirement arrangement in place. But then, what will the remaining 89% of Botswana's population do when they reach retirement age? Is there an alternative to retirement funds? And are they still relevant? My answer is ABSOLUTELY! There is no alternative, the only option is to change our mindset about retirement, and plan adequately to ensure that a retirement fund will work for you.

"*Growing old is not an option. We don't have a choice. But we do have choices that will greatly affect our quality of life for the rest of our life*." - Henry K Hebleler

Samuel Sono | Minet Botswana

References:

2018 Sanlam Benchmark Survey, New challenges for trustees Helping members improve their retirement outcomes | https://www.financierworldwide.com/public-pension-pressure#.YYiXcmBBxPY | https://www.nbfira.org.bw/sites/default/files/NBFIRA%20ANNUAL%20REPORT%202021%20%2B%20.pdf (2021 NBFIRA Annual Report) | https://www.alexanderforbes.co.bw/download/afbotswana/media/Newsletters/18335-NL-2019-08.pdf | https://www.investopedia.com/articles/retirement/07/life_cycle.asp | https://www.bankofbotswana.bw/sites/default/files/publications/HOUSEHOLD%20INDEBTEDNESS%20SURVEY%20REPORT%20-%202020.pdf (2019 Household Indebtedness Survey Report) | https://www.morganstanley.com/articles/retirement-challenges