

# Managing member retirement expectations – Mind the gap

Date: 27 February 2017

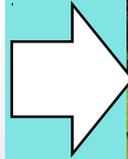
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Presented to: Botswana Pension Society

## Disclaimer

This presentation was presented by Mosimanegape Molefi in his personal capacity to contribute towards the theme "Majority of members in Botswana retirement funds retire with insufficient incomes. Where/What is the solution" on Monday 27<sup>th</sup> February 2017 to the Botswana Pension Society. The presentation was designed solely for discussion purposes. It should not, in any way, be construed as individual member advice or used for any other purpose. The author shall not be liable for any loss, damage or liability of any nature incurred by any party and resulting from the information therein. For any further discussion he can be reached via the contact details provided at the end of this presentation.

# Important to realise that members have expectation of a lifestyle in retirement



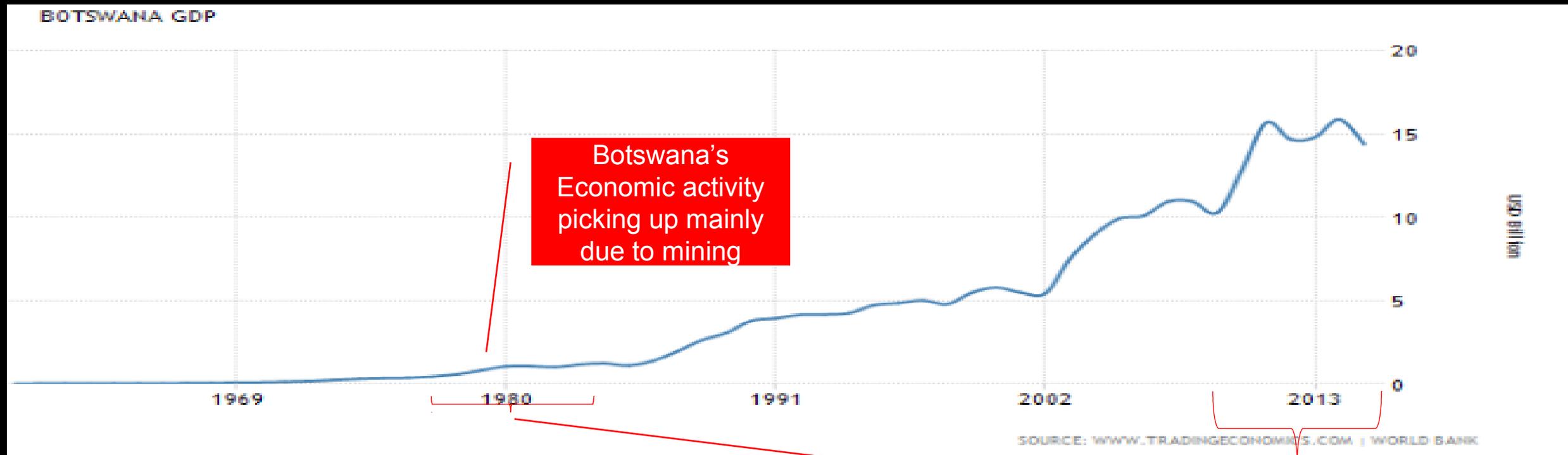
Member expectations

Pensioner reality???

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# Botswana recent retirees context and economic history



GDP data source: Trading Economics

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# Back to the Retirement journey- retirement prioritisation

Priority of retirement planning and need for retirement info/advice

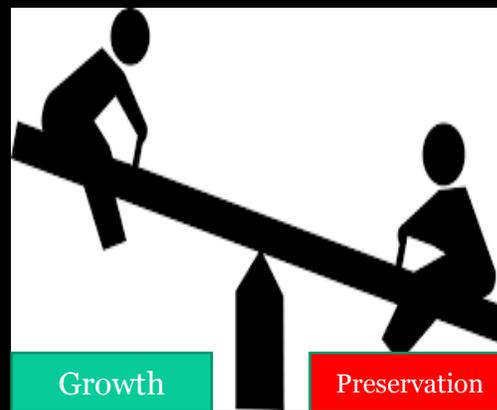
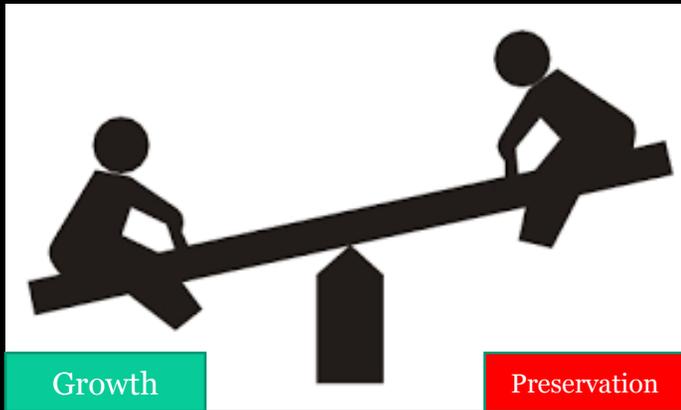
Starting work

Accumulation Phase

Capital Preservation

Annuitisation and/or encashing

Managing available income



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# Pre-Retirement (mis)advice and (mis)information a global issue

- Pre-retirement information is important but not availed enough – according to a study by HSBC **27%** of pre-retirees never received advice or information about retirement
- We need to appreciate that forms of advice are formal and informal including family & friends, professionals, media, books and online
- Informal forms of advice and information are mainly as a result of:
  - Insufficient advice from formal sources
  - View that advice and information from formal sources is too complex
  - Heuristics: Natural tendency for members to compare their benefits against each other
- Informal advice or information creates risks for members and their beneficiaries as each individual's retirement circumstances are unique!

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# Retirement information “the Member’s Lens” – why it is becoming more important

## Shift from DB (risk for ER) to DC (risk for EE):

- Defined Benefit/Final salary schemes – (relatively) easier for members to comprehend level of income at retirement e.g. your pension is x% of salary at retirement

Defined Contribution – not so easy from a member’s perspective to appreciate level of income in retirement, a range of variables involved:

- Investment performance
- Level of regular contributions + additional contributions (AVC’s)
- Term to retirement

More information required by members i.e. greater transparency required on the part of trustees and service providers for members to make informed retirement planning decisions



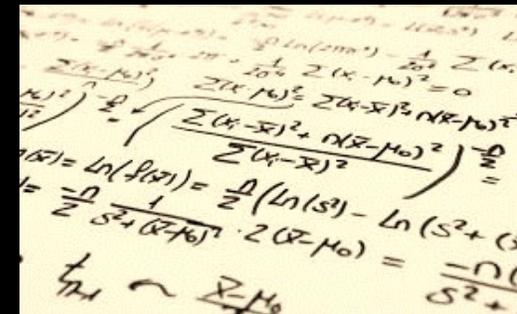
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# Member communication needs to be regular, accurate, timely and simplified

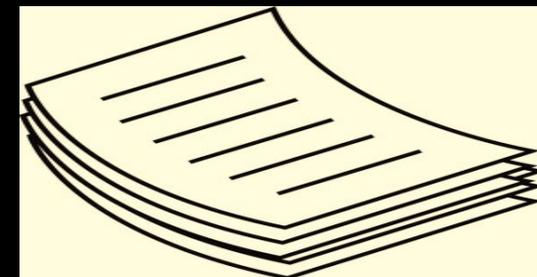
## Some maths??:

- Expected Replacement ratio i.e. Ratio of expected gross income @ retirement: gross income before retirement – gives an idea of lifestyle pre/post retirement
- Doesn't sound so technical, does it?
- Would need an idea of the two levels of income –income at retirement a huge unknown especially many years before retirement!



## Typical information and additional info

- Member benefit statements – usually contains level of accumulated funds and historical performance
- Some additional forward-looking information: Projection of expected pension pot
- Additional forward-looking information+: level of expected retirement income



# Assumptions and member data accuracy critical

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# Spotlight on membership records

- Accuracy of data important for both the accumulated pot and expected projected pot
- Member records - important that these parameters are accurate:
  - Demographic profile – age (determines term to retirement), sex and marital status (determines life expectancy in retirement)
  - Salary info i.e. salary amount + level of contribution
  - Investments including prior transfer values (growth of accumulated funds + future contributions)
  - Confirmation of existence for pensioners
- Risks of inaccurate membership data:
  - Mismatch between expected income in retirement and reality
  - Not saving early (and hard) enough for retirement e.g. if contribution data was recorded inaccurately
  - Potentially inappropriate decisions at retirement (e.g. at the pension conversion stage)

Inaccurate member records not only a member expectation risk but also a trustee decision risk i.e. poor data may lead to inappropriate conclusions and decisions

Administrators usually keep membership records on behalf of the trustees but trustees are ultimately responsible for ensuring that accurate member records are kept – do you know the extent of the accuracy of your membership data?

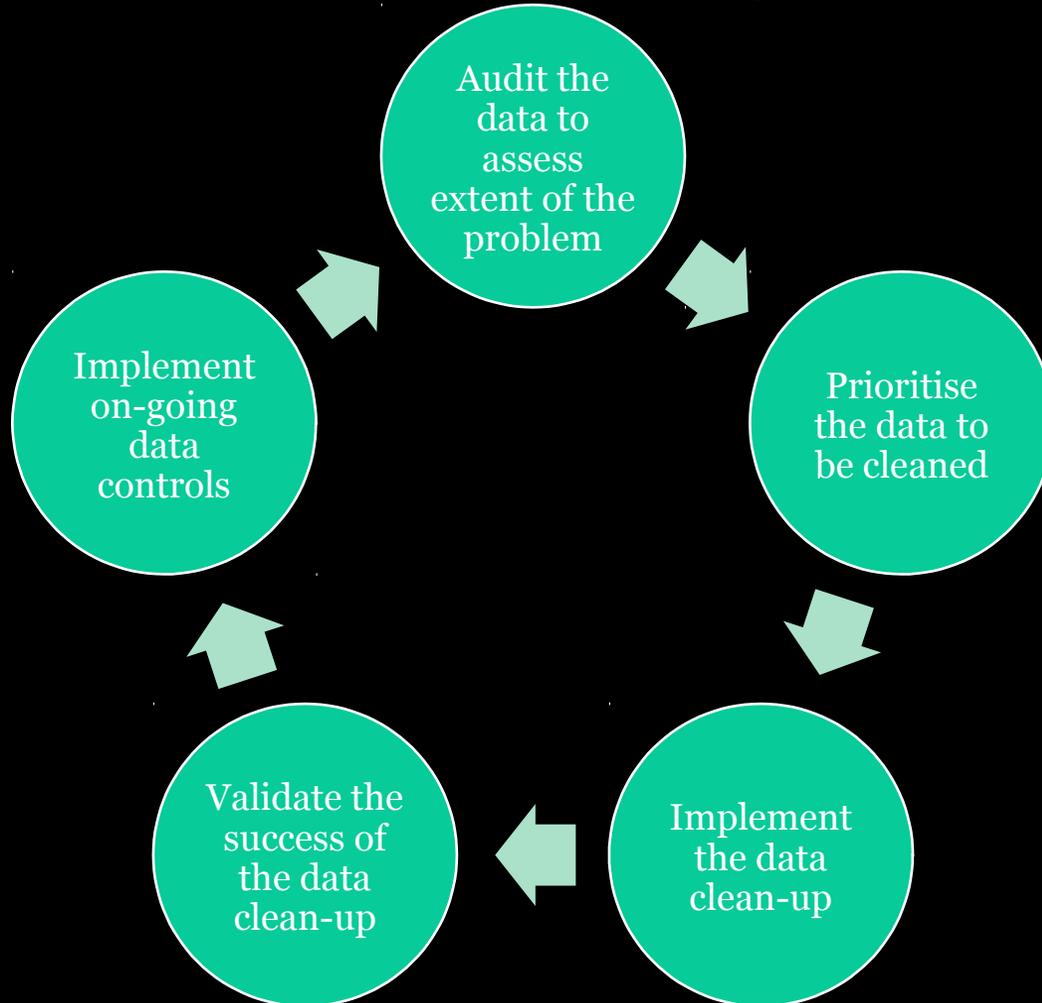
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# Improving the quality of membership records

## Potential solution – Data Management cycle



Note: the current administrator may have gone through the data management exercise. However, having an independent review of the exercise may remove any potential conflicts of interest.

The following specific circumstances may trigger the need for a data management exercise:

- Where the fund has previously converted from DB to DC
- Where there has been data migration
- Where there has been a change in data controls

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# Spot Light on Member pension pot Projection assumptions



$$= f(\text{expected investment performance, contributions})$$

Expected investment performance two approaches:

- Simplistic – **deterministic** i.e. one set of assumptions
- More complex – **stochastic**/probabilistic/statistical

In both, context of the assumptions is important as future performance may not replicate the past

Some sensitivity analysis?

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# Spot light on Pension/annuity conversion assumptions



$$= f(\text{life expectancy in retirement, pot size, type})$$

**At retirement** already too late to change pot size:

- Type of annuity needs to be appropriate to member's circumstances (e.g. choice between single or joint life, indexed vs level, with/out guarantee term)
- Role for providers to use appropriate life expectancy and bond yield assumptions
- Once locked-in cannot be changed

**Before retirement:**

- Improves members understanding of how much income to expect vs current income
- May encourage members to start saving early e.g. though AVC's

Context of key assumptions important here as well. Key ones are life expectancy and bond-yield.

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# Advantages and risks of Pension projections and conversion assumptions

- Advantages of pension projections & conversion assumptions:
  - Gives members an idea of how much their retirement pot/income could be
  - May encourage members to start saving early (and hard enough)
  - Members expectations could reduce to align with reality
- Risks of inappropriate pension projection & conversion assumptions:
  - Potentially inflated member expectations of size of pot/income at retirement
  - Not saving early (and hard enough) for retirement
  - Incorrect prioritisation of competing needs

**Key message: projection/conversion assumptions are only useful if they are appropriate and their uncertainties understood!**

**Important for trustees to be aware of key assumptions used and their sensitivities – similar to poor data, inappropriate assumptions increase decision risks**

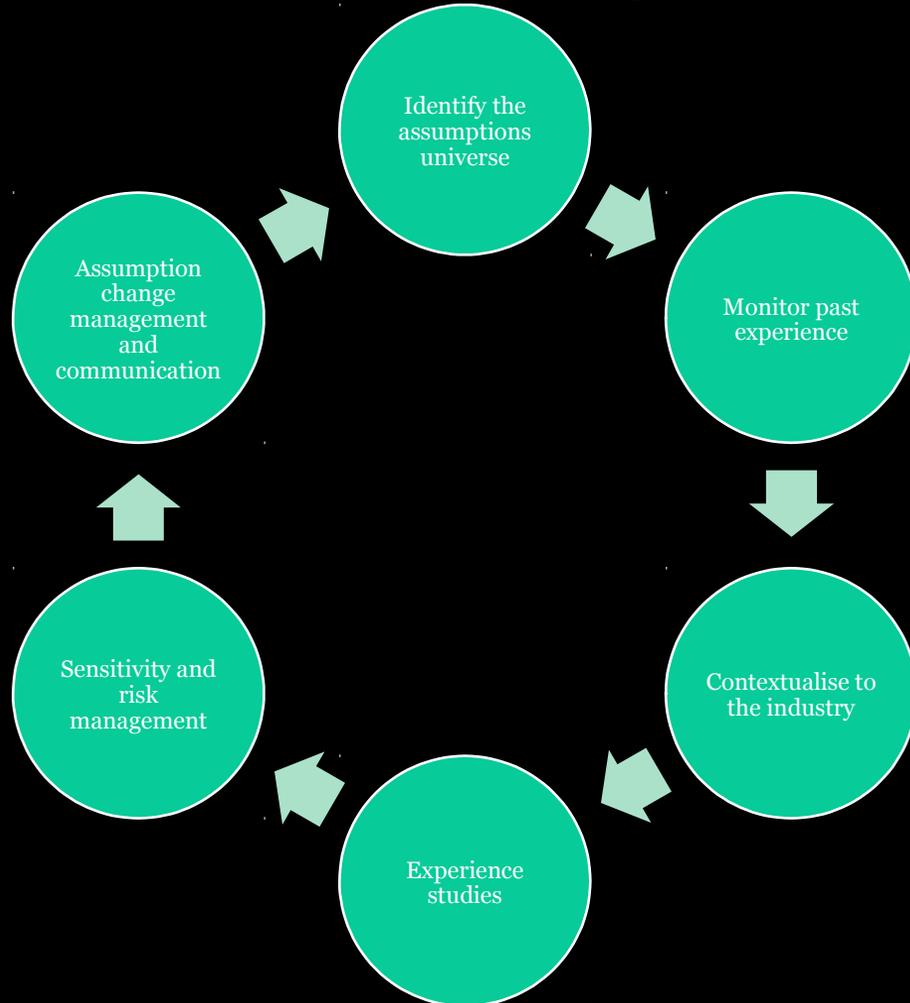
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# Improving the quality of assumptions

## Potential solution – Assumption Management Framework



A formal assumptions framework assist to counter against the risks of use of inappropriate assumptions

It is important that people, processes and systems are aligned to support the framework

The following are examples of areas where a formal assumption framework would improve transparency and improve “challenge”:

- Expected investment returns pre-retirement
- Longevity assumptions in retirement – longevity is becoming more unpredictable and longevity risk is becoming topical!
- Bond-yield assumptions for expectation of annuitisation

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# Summary – bridging the information gap– a joint effort

Pension fund members	The pension fund industry
<ul style="list-style-type: none"> <li>• Appreciate the fact that needs and priorities change pre and post retirement</li> <li>• Be realistic: establish own retirement needs early</li> </ul>	<ul style="list-style-type: none"> <li>• Educating the members on different life stages and implication on retirement planning</li> <li>• Ensure member records are accurate</li> <li>• Use appropriate assumptions for projections and annuitisation</li> <li>• Provide customised, appropriate and accurate illustration of potential accumulated savings and income in retirement</li> <li>• Consider the effectiveness of communication methods to avail the information in a timely manner</li> </ul>
<ul style="list-style-type: none"> <li>• Start saving early to maximise likelihood of achieving the set retirement goals, while understanding the risks</li> <li>• Avoid the tendency to “encash” some of the pension pot when changing jobs</li> </ul>	<ul style="list-style-type: none"> <li>• Demonstrate the importance of saving early enough for retirement – i.e. “what-if” retirement planning scenarios</li> <li>• Communicate the key risks quantifiably if possible</li> <li>• Provide enable platform for members to understand the impact of “encashing” benefits when changing jobs</li> </ul>
<ul style="list-style-type: none"> <li>• Regular review of accumulated savings and consider other avenues of saving for retirement (e.g. use of some of “windfalls” such as annual bonus to an AVC)</li> </ul>	<ul style="list-style-type: none"> <li>• Avail the investment performance information in a timely manner using the right platform</li> <li>• Avail means for members to easily invest additional voluntary contributions</li> </ul>

# Thank you

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