By Shaun Levitan and Robert C. Merton

RETIREMENT FUNDS

Focus on meaningful information

Don't allow yourself to be fooled by notions of a 'pot of money'.

The current investment practice in South Africa is to provide members of Defined Contribution (DC) plans with the value of their account on a regular basis. The statement provides the member with both the account balance at the beginning and the end of the period, along with the investment return on the member's assets.

This information is clearly important but it is not meaningful. In fact, providing this information might actually be dangerous.

Suppose Lindiwe, aged 55, receives her statement and it reveals an accumulated fund balance of R1m. Lindiwe is thrilled to have R1m in her account. For many years, she has believed that R1m is the target and she believes she is on track for a great retirement.

The reality is that knowing her account balance provides Lindiwe with no insight into her likely standard of living in retirement. She currently has a potentially false sense of comfort over her retirement finances.

Suppose Lindiwe instead received a statement from her retirement fund that revealed the following:

- She has sufficient accumulated savings right now to receive a monthly real income of R6 100 a month increasing annually with inflation when she retires at age 65 for the rest of her life;
- Her future contributions towards retirement savings are likely to result in a further R1 100 (real) a month increasing annually with inflation; and
- She is therefore on track to receive approximately R7 200 a month (in real terms) when she retires and this will increase annually in line with inflation.

These calculations are technical but can easily be done in a transparent manner. Providing this information to an individual changes the statement from referring to a 'pot of money' to that of a stream of income at retirement. It recognises that retirement income is actually the goal because the role of a retirement fund is to maintain our standard of living in retirement.

Only Lindiwe is in a position to decide whether this income of R7 200 will be sufficient. However, she has now been empowered with meaningful information that allows her to answer questions such as whether she should be contributing more, whether she should work longer or whether she should take on more investment risk.

By treating our retirement account in the same way as a bank account, we teach members to focus on the incorrect measure from their earliest interactions with their retirement provision. South Africa has among the lowest preservation rates in the world when members move jobs. This is a symptom of a system that holds out the 'pot of money' to members on an ongoing basis. If the primary focus were on their retirement income, then the desire to access the funds would likely be far lower. At the very least, the implications of accessing funds would be immediately understood.

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Presenting information to Lindiwe in the way described above did not require a significant education exercise on the part of the trustees. We already think in terms of consumption. It provided her with the information needed to understand her financial situation. The fund credit is clearly a very important piece of information but it is not meaningful.

Before spending millions of rand and hundreds of hours on educating members on financial concepts, we should try to interact with them meaningfully. ■

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