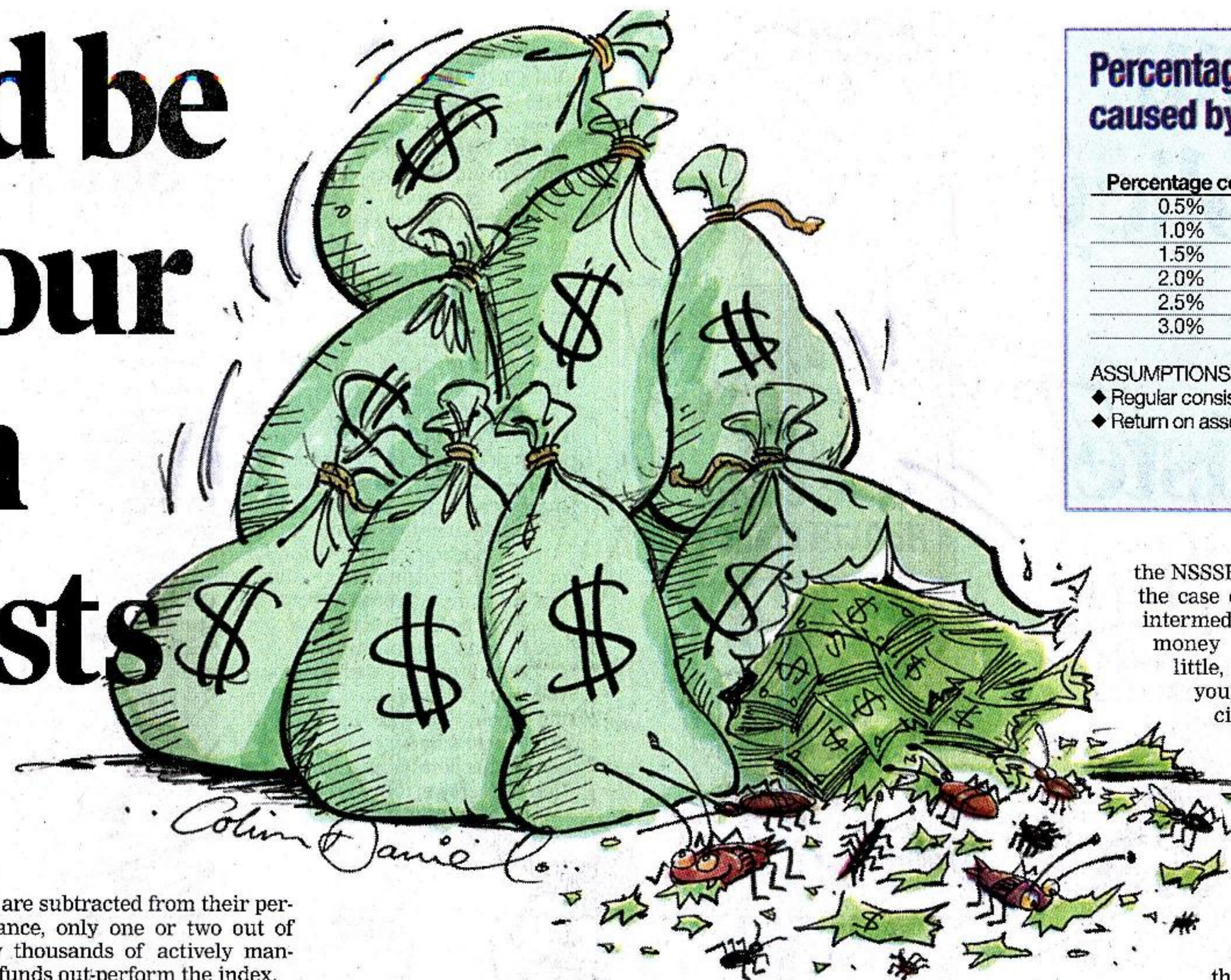


Funds should be protecting your savings from ravages of costs



‘Charges, charges, charges’ are a determining factor in the ability of people to retire financially secure, David McCarthy of the Tanaka Business School at Imperial College in London concluded in his presentation at a seminar on the recently published Sanlam annual retirement survey.

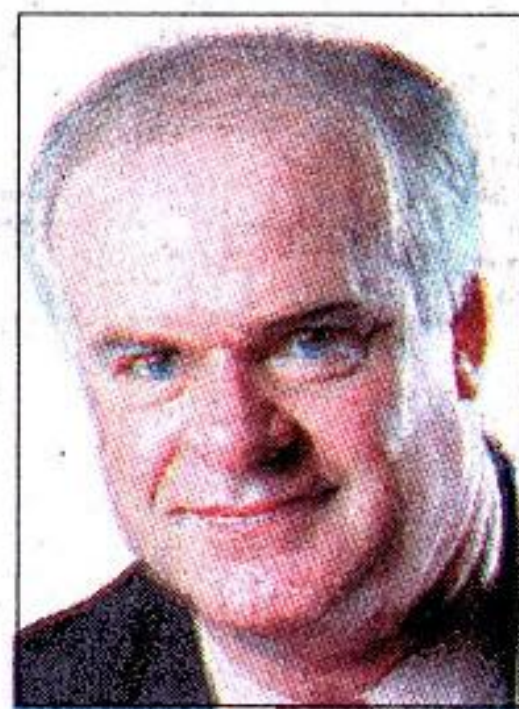
He pointed out that a 1.5-percent charge will reduce your end benefit by as much as 30 percent.

And yet very few of us take investment costs seriously enough, while product providers do everything possible to befuddle us over costs. And the costs can be significant. Look at the table on this page to see by how much your end benefit can be reduced by asset management costs alone.

What is even worse is that many retirement fund trustees, particularly those who are involved with products such as umbrella funds, retirement annuity funds and preservation funds, seem to think that costs are not important.

Retirement fund trustees have a fiduciary duty to act in the best interests of their funds and, ultimately, the fund members. This means ensuring that, among other things, money is wisely and cost-effectively invested.

The question is whether most trustees, particularly those who are appointed to manage the affairs of industry-provided products, pay enough attention to costs.



Life with Cameron
Bruce Cameron

Methinks not, on the basis of the evidence I see.

COSTLY ACTIVE MANAGEMENT

The first question I must ask is why more retirement funds do not have a substantial portion of their investments in passively managed index-tracker portfolios (funds).

These are investment portfolios that simply track indices, and do not require armies of expensive analysts and the other services that go into what are called actively managed portfolios.

Research here and overseas has shown time and again that over both the long and the short term active managers on average do not out-perform the appropriate indices. And over the long term, once all the

costs are subtracted from their performance, only one or two out of many thousands of actively managed funds out-perform the index.

This failure on the part of most retirement fund trustees to recognise the issue of costs worries me. This is one of the reasons why over the past two weeks Personal Finance has been involved with exchange-traded fund (ETF) index-tracker product provider Satrix in holding seminars in Cape Town and Johannesburg.

The seminars were based on research by Rob Rusconi, the independent actuary who blew the whistle on the high costs of life assurance retirement savings products. He was asked by Satrix to take its Satrix 40 product apart and to publish the results.

Rusconi's research shows that with a tracker fund, you will at least not under-perform the market, and that the costs involved with most but not all index-tracker funds have very little impact on what you will receive at retirement.

Instead of using passive asset management, we too often have retirement funds, particularly industry-provided umbrella funds, being driven into the expensive arms of multi-managers.

Multi-managers claim they can

overcome the problem of the variation in performance of active managers. They argue they can select the best asset managers and blend them together to give you the best results. But based on the evidence, multi-managers definitely do not seem to be able to provide sustainable superior performance. Add to this their charges, which, combined with the underlying charges of the selected active managers, counter any value they may bring.

And then the multi-managers normally tell you about the pre-cost results, instead of your after-cost results. The other con they often perpetrate is to show only selected performance periods in which they may have done well.

UMBRELLA FUND FILAWS

What worries me even more is the way that consultants are driving retirement funds into umbrella funds, particularly funds provided by the consultants' employers.

An umbrella retirement fund is a fund provided by a financial services company for a number of "participating employers" that do not have the time or the expertise to

manage a stand-alone, cost-effective fund for their individual employees.

A few years ago, I sharply criticised the Sanlam retirement fund survey, because, in my view, it was designed to push the sale of Sanlam's awful Wizard Umbrella Fund. Simply put, Wizard was a rip-off.

Since then, I am pleased to say, Sanlam's retirement survey has become a lot more meaningful and its umbrella fund offering has improved dramatically.

So it saddened me to attend a media conference recently at which Old Mutual also presented a retirement survey. It was déjà vu. The survey, which at best could be described as very thin, was clearly designed to push Old Mutual products, particularly umbrella funds.

For example, who can take a survey seriously that asks intermediaries: "Do you favour umbrella funds" and "Do you favour the government's proposed National Social Security Saving Fund (NSSF)"? Of course, the intermediaries favoured umbrella funds and not

Percentage reduction of long-term savings caused by asset management fees

Percentage cost	Reduction over number of years			
	10	20	30	40
0.5%	2.3%	4.7%	7.0%	9.5%
1.0%	4.6%	9.3%	14.1%	18.9%
1.5%	6.9%	14.0%	21.2%	28.4%
2.0%	9.2%	18.7%	28.3%	37.9%
2.5%	11.5%	23.3%	35.3%	47.4%
3.0%	13.8%	28.0%	42.4%	56.8%

ASSUMPTIONS:

- ◆ Regular consistent contributions that increase by 7% a year; and
- ◆ Return on assets of 10% a year.

SOURCE: ROB RUSCONI, TRES CONSULTING

the NSSF. Why? Because in the case of umbrella funds intermediaries earn lots of money for doing very little, at the expense of your retiring financially secure.

Once intermediaries sign up an employer (not you, the member) with an umbrella fund, most administrators pay the intermediaries three percent of all contributions for as long as you contribute.

With very few exceptions (Sanlam is now one of them), the intermediaries have no further obligations. Intermediaries do not collect the contributions, they do not have to report back to the employer and they most definitely have no obligation to the members.

The NSSF will partially close this jam factory.

If Old Mutual wants us to take its surveys seriously in future, it should approach umbrella fund members and ask them, among other things, whether:

- ◆ They approve of the rights they lose on becoming members of an umbrella fund;
- ◆ They feel the product supplier should insist on member/employer committees that must be kept informed about their fund;
- ◆ An intermediary, who provides them with no advice, should be entitled to receive a percentage of their contributions, or whether the intermediary should be merely paid a

one-off fee by the administrator;

- ◆ Umbrella fund (and other occupation fund) trustees are doing their fiduciary duty in selecting an expensive multi-manager rather than a low-cost index-tracking fund; and
- ◆ They are aware of the total costs involved in the umbrella fund and the effect these costs will have on their end benefits.

NECESSARY REFORMS

Better still, Old Mutual and others should reform their own umbrella funds by:

- ◆ Appointing independent trustees who will have the right to select the best service providers. By an amazing coincidence, most of the trustees of financial service retirement products agree that the fund sponsor (the financial services company) provides the best services, including asset management, administration, and group life and disability risk assurance cover. This is even when the charges are above average, particularly with multi-manager asset managers.

- ◆ Not paying ludicrous commissions to intermediaries. At the very least, intermediaries should be made to work for the money by reporting back to member committees at least every six months about the status of their funds and providing individual advice to members, whose money they are taking.

- ◆ Halting the vast investment choices available to members at significantly inflated costs. Research has repeatedly shown that most members do not understand the choices, are not given proper advice, and often make the most conservative and dangerous choices out of fear of making the wrong choice.

- ◆ Using investments such as ETFs to improve performance and reduce costs.