

Understanding the costs of transfer

The decision whether to transfer/convert from an underwritten ("old generation") to a non-underwritten ("new generation") retirement annuity is dependent on whether the investor recovers the early termination charge paid to transfer/convert before the retirement date. The point at which the investor has recovered the early termination charge fully is called the breakeven point. As long as the breakeven point is before the intended retirement date the transfer/conversion will be value enhancing. If the breakeven point occurs at a point after the intended retirement date then the transfer/conversion will not be value enhancing and should be avoided unless there are other push factors encouraging a member to leave a fund such as repeated poor administration or client service, the unavailability of appropriate investment options or a lack of transparency with regards to fees.

Some of the factors that influence the decision are:

1. Early termination charge applied at transfer/conversion
2. Costs incurred on current platform
3. Costs incurred on new platform
4. Years to retirement

The rest of this document explains these factors in more detail in an attempt to assist intermediaries and clients to understand the effect changes to these factors will have on the final decision.

1. Early termination charge applied at transfer/conversion

This is the charge that is levied by the long-term insurer for cancelling the underwritten policy before its contractual maturity date. This charge results from costs incurred upfront and only recouped over the term of the policy. Since the policy is terminated prematurely, the balance of the costs cannot be recouped over the term of the policy by the insurer any more. This results in a termination charge levied by the insurer to offset the outstanding costs.

A charge will also be levied if the investors stops or reduces his/her monthly contribution. This charge may be lower than the charge levied for transferring/converting the lump sum amount. According to legislation the charge cannot be more than 30% of the market value for policies that were issued before 1 January 2009 and cannot be more than 15% for policies that were issued after 1 January 2009. The charge for policies issued after 1 January 2009 has to reduce to 0% over a term of not more than 10 years. How the charge is calculated is the intellectual property of the long-term insurer. The charge levied by the insurer is not negotiable.

The charge will reduce the starting value of the investment on the new generation platform. The higher the charge the more likely it will be that the transfer/conversion will not in the investor's best interest.

2. Costs incurred on current platform

These are the costs levied by the administrator of the underwritten policy. There are various descriptions for these fees on the different platforms.

The underwritten section of the PPS Retirement Annuity consisted of two product types namely Legacy (pre 2000) and Stratus (post 2000). The costs for the Legacy products are very difficult to quantify due to the fact that it had an insurance element. The costs for risk and investments were rolled into one premium making it very difficult to isolate the savings portion of the retirement annuity contribution.

The Stratus product has gone through several fee changes over the last 10 years. Both the quantum and fee naming conventions have changed. The types of costs associated with this product currently (as at December 2010) are as follows:

- Plan charge = normally R12 per month
- Fixed administration charge = Fund dependent varies from 1.3% to 2% p.a.
- Variable administration charge = Size dependent sliding scale
  = For Debit orders the fee starts at 3% p.a. for amounts below R500 000 and reduces to 2.7% p.a. for amounts above R1mil
  = For Lump sums the fee starts at 1.6% p.a. for amounts below R500 000 and reduces to 1.3% p.a. for amounts above R1mil.
- Asset management charge = Fund dependent varies from 0.24% to 2.00% p.a.
  Performance fees may also be added to this fee
- The advice fees are included in the administration charges

These fees were obtained from SanQuote Version 8.0.709.26023.

Loyalty bonuses are paid based on the investment period. The loyalty bonuses only reduce the Fixed and Variable Administration charges. The scale for bonuses is:

Years from start	Rebate
5	25%
10	50%
15	60%
20 and every 5 years thereafter	65%

The reduction-in-yield (RIY) is one number that encompasses all of the above, but ignores the impact of various practically relevant costs. The following needs to be kept in mind when using the RIY number for comparison purposes:

- The RIY is only valid for investments with a fixed term. New generation products do not have RIY because they are open ended.
- The RIY is calculated over the whole term of the investment. The actual fee paid during the term may differ vastly from the RIY, especially if loyalty bonuses are weighted towards the end of the term.
- The total ongoing costs paid during the first five years of the investment can be calculated by adding up the costs listed above.
- The RIY does not take into account any additional costs for switching (i.e. changing the underlying manager) or reducing or stopping recurring contributions during the term of the investment.

There are several other types of fees levied on the older Stratus products. Some of these fees have been renamed to the charges above and others have been removed. Some of the fees levied on the older Stratus products are:

- Policy charges: this is basically the same as the plan charge above.
- Fund management fees: this fee is a combination of the asset management charge and fixed administration charge above.
- Service: this fee is normally 0.5% p.a.
- Marketing fee: this fee is normally 0.48% p.a. or 0.6% p.a.

The fees for the Sanlam administered section of the PPS Retirement Annuity can be obtained from Sanlam. These fees are quoted in the policy document and monthly statements. Investors can also ask Sanlam to calculate the specific costs associated with their retirement annuities. Please note that this may be a time consuming process.

The higher the costs of the current retirement annuity the more likely it will be that a transfer/conversion will be value enhancing.

3. Costs incurred on new platform (PPS Investments)

Generally fees can be divided into the following three main categories:

- Advice fees:
  These are the fees paid to intermediary for providing financial planning services (e.g. which funds to invest in, how much to contribute to maximise the tax deduction)
- Administration fees:
  These are fees paid to the administrator for providing client service and administration (e.g. buying and selling units at the various management companies, providing statements)
- Asset management fees:
  These are fees paid to the asset management company for managing the underlying funds selected (e.g. buying and selling shares)

The fees applicable to PPS Investments (all fees below exclude VAT):

- Advice fees:
  - 0% initial advice fee on section 14 transfers into the new section of the PPS Retirement Annuity Fund.
  - Up to 1.5% negotiable initial advice fee on Intra-fund Conversions into the new Section of the PPS Retirement Annuity Fund.
  - Up to 3% negotiable initial advice fee on new recurring contributions.
  - Up to 1% p.a. negotiable ongoing advice fees.
- Administration fees:
  - 0% initial administration fees on all lump sums and recurring contributions.
  - Ongoing administration fees are calculated using a size dependent sliding scale and deducting the manager rebate from this fee.
  - Example: R1,000,000 invested 100% into the Coronation Balanced Plus Fund Ongoing administration fee = 0.6% - 0.4% = 0.2% p.a.
  - The maximum ongoing administration fee is 0.55% p.a. and the minimum is 0%.
  - Please note that the ongoing administration fee for investments into the PPS Multi-Managed Funds is 0% p.a.
- Asset Management fees:
  - 0% initial asset management fees on all funds.
  - Ongoing asset management fees are fund dependent. These fees range from 0.65% for a cash fund to 3% p.a. for equity funds.
  - Some funds may also levy a performance fee (the performance fee has been included in the 3% above).

The higher the costs of the new retirement annuity the less likely it will be that a transfer/conversion will make sense.

4. Years to retirement

The number of years to retirement is an important input when considering a transfer/conversion. The longer the investor has to retirement the more time he/she has to make up the transfer/conversion charge and other possible costs. It is important to use the investor's actual retirement age and not the age specified on the current retirement annuity product. Often investors retire later than the term selected when they bought the underwritten retirement annuity product.

As mentioned above the years to retirement has to be longer than the breakeven point for the transfer/conversion to be in the best interests of the investor.

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