

Fine-tuning the employee benefits system

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This was the conclusion of former UK cabinet secretary Lord O'Donnell after releasing an exhaustive piece of research on Wellbeing and Policy from the Legatum Institute in March 2014. His observation applies equally to other spheres of life. The work that we do as a financial services industry and the role we play in employee benefits are cases in point.

We have to ask ourselves the question: if the financial services industry were designed from scratch to meet what people need for their life satisfaction, what would it look like? Similarly, what would happen if we designed employee benefits this way?

Last year we invited you to join us at the table to shift our approach to employee benefits design from a fragmented to an interconnected one. All of this was based on the key objective of helping individuals to manage their physical, mental and financial health.

We remain committed to this objective and believe that all stakeholders still have a critical role to play in achieving this. But often the link between individual wellbeing and what each stakeholder values is fuzzy. Why does getting it right for the individual matter?

Since releasing [The bigger picture](#), we've realised from our interactions with various stakeholders that it's easy to lose our focus on the bigger picture. It's easy to slip into the details and focus on fixing this cog or that widget, rather than getting the whole engine to serve a higher purpose. And when we do look at the big picture, it's often to pat ourselves on the back. After all, in 2013 the World Economic Forum ranked the South African financial system as the third most developed in the world. That's pretty impressive.

But as Lord O'Donnell's report showed, it matters what you measure. If improving lives is what we're after, then we might not have so much reason for celebration.

Take, for instance, the fact that according to the United Nations Development Programme's latest Human Development Report, South Africa ranks 121st out of 186 countries on the basis of its score on the human development index. This is 42 spots lower than if we rank the same 186 countries on the basis of income. This shows how wide the chasm between human development and income can really be.

To address the concerns raised by [The bigger picture](#) about why this really matters, in this narrative, we zoom out to look at two important aspects of the bigger picture. First, how do employee benefits fit into the bigger picture of the South African system of social protection? Second, how do they fit into the bigger picture of an individual South African life?

In [The bigger picture](#), we will paint the bigger picture for South Africa as a whole. Painting this picture requires wrestling with some key questions:

- > Where do employee benefits fit into the broader South African economy?
- > How does South African culture affect how we spend, save and insure?
- > How has the role of stakeholders changed over time in relation to retirement funding?
- > What is the role of each stakeholder and what benefits accrue to them if we get the system to work for individuals?

Answering these questions is not easy, but in wrestling, with them, we realise how significant our work in employee benefits actually is.

Having understood the bigger picture for South Africa, we turn to the bigger picture for individuals in '[The way forward](#)'. Here we put forward some suggestions for potential solutions, but as we step back in among the cogs and widgets, we ask that you remember the bigger picture.

['The employee benefits system and its inter-dependencies'](#) sought to understand why South African employee benefits were not fulfilling their potential and discovered that the core reason was the fragmentation between stakeholders. This narrative seeks practical ways to address the fragmentation in employee benefits in pursuit of individual financial health. While these are just a first foray into solving these issues, we believe that it is important to start testing the boundaries and challenging conventions. We invite you to take this journey with us – do you think these solutions will work? Do they go too far, or not far enough?

Improving outcomes for individuals requires improvements within the employee benefits framework and beyond. What this means is that we have to acknowledge that simply preparing an individual for retirement is not enough. We need to engage with their entire journey and help them to achieve financial health both today and in the future. We propose a number of solutions across the chain of employee benefits design and implementation. Critically, we need to constantly weigh up the roles of design and human behaviour, as getting either of these wrong can completely upset the process. We can't ignore either of them.

So, in [The way forward](#), we lay out our solutions according to a three-step process: design, implementation and monitoring. Each of these processes is critical and each is iterative. What we present here is not the end of this exploration, but the beginning.

We hope that our suggestions start a chain reaction. Question them, analyse them, use them. But most importantly, measure them. A key insight from our work for Benefits Barometer 2014 is the critical nature of that final step – we have to monitor what we do; we have to measure our success.

As we seek to work together to find solutions for employee benefits, we seek to improve the lives of individuals, expanding their access to things which will increase their life satisfaction. We need to improve our results in each part of the puzzle, but we also need to remember that getting each piece right matters only to the extent that it contributes to the bigger picture.

Last year we invited you to the table. This year we invite you to tuck into a platter of suggestions. Tell us what you think: good, bad, needs more salt?

Executive summary

The bigger picture

Employee benefits matter. They matter because when a breadwinner is unable to earn an income, these benefits may be the only financial buffer that stands between a household and destitution. And that matters for all South Africans.

The employee benefits system analysed why the current system is failing and identified that the key issue is the fragmentation of an interconnected system. To fix this, all stakeholders need to work together – employers, the government, the financial services industry and, most importantly, members and their dependants, who are primarily represented by trustees and unions.

Since then, we have realised that many stakeholders don't fully understand the implications of the failing system. They don't see the bigger picture. We need to build a better case for why they should care. In this section, we will paint the bigger picture.

> [Why it matters?](#)

Employee benefits are the primary financial source of social protection for working South Africans. As such, getting employee benefits right is an important component in getting social protection right. When done correctly, social protection allows for a more inclusive growth path that involves full participation from all South Africans.

> [What is the context?](#)

Many South Africans rely on their families and communities to protect them from shocks. These informal, often non-financial arrangements sit outside the formal social protection system and are often ignored by stakeholders in this system. To properly understand the importance of social protection, which includes employee benefits, we need to have a wider understanding of how South African households spend, save and insure against the risks they face.

> [How has it changed?](#)

In the shift from defined benefit (DB) to defined contribution (DC) funds, many of the risks associated with retirement funding have shifted from the employers to fund members. More importantly, with employers stepping away, financial services companies now assume a more central role.

Financial services companies need to focus on how they can help fund members and their fiduciaries to shoulder the additional burdens they now face. Perhaps we need to consider new ways of approaching retirement funding, one of which is based on the principles used in a DB fund.

> [Who's responsible?](#)

Both social protection and employee benefits are subject to the risk of fragmentation if key stakeholders fail to engage. Returning our focus to employee benefits specifically, we examine the stakes held by the government, employers, custodians for households (trustees and unions) and the financial services industry. Each has a role to play and benefits to derive in making the system work.

The way forward

Getting people to care. The great challenge that surrounds retirement funds is that for the bulk of an individual's working life, the average individual has little interest in taking on the complex task of thinking through their retirement funding dilemma.

What is uppermost in their minds – and this is true for families in all income brackets – is how to solve that perennial financial conundrum: finding the right balance between meeting their consumption needs of today; building the appropriate cushions to cope with financial shocks in the future (including retirement); and somehow managing to improve their standard of living.

To get South African workers to take their retirement plans seriously, it's as important that we help individuals maintain a stable financial journey through life as it is to secure stability at the end. This requires improvements within the employee benefits framework and beyond.

Starting with the employee benefits framework, we propose that stakeholders examine each of the three key steps: design, implementation and monitoring. We need to take an iterative approach to this process, constantly seeking to improve our ability to achieve meaningful outcomes for individuals.

Having made our suggestions for employee benefits within the current context, we then turn to the journey for the individual and we dare to dream what that journey could look like in the future.

Design

The heart of the matter

Benefit design is often a combination of legacy issues and market conventions. As such, it may well have little relevance to members in a particular fund. But by prioritising meeting individual needs within a group scheme, employers together with their funds can make a significant difference in employees' lives. This requires having a sound understanding of what members need, how these needs change over their life cycle and the cost implications.

What's the point?

Funds need to have targets. By having targets, members can find out at any time the extent to which they are adequately covered for retirement and whether shortfalls exist. But what the target should be is a complex issue, as needs vary widely. More importantly, savings targets don't address the quality of protection individuals have in the course of their financial journey. In an ideal world, we need to design a multi-tiered target framework.

The journey on autopilot

Defaults have become increasingly popular, especially among regulators, who have realised that they can counteract behavioural biases to improve both individual and societal outcomes. However, to use defaults effectively, we need to understand the conditions in which they are appropriate and what constitutes a good default.

Mind the gap

To address the fragmentation we identified in Benefits Barometer 2013: '[The employee benefits system and its inter-dependencies](#)', one of the key steps is to examine the links between employer policies, legislation and insurance policies. Gaps can arise between disability, incapacity and sick-leave policies, but can also arise elsewhere. Closing these gaps can be costly, but leaving them unaddressed could have severe consequences for individuals.

Implementation

At what cost?

Costs are an increasingly contentious concern for clients of the financial services industry, especially given the effects they can have over the long term. Knowing whether costs are reasonable requires an understanding of what types of services add value and what types can destroy value. It also requires understanding of how different pricing structures will affect individuals in different circumstances and the range of ways that the effects of costs can be measured. We propose a new model for both consulting and asset management costs to address the upside-down value chain.

Coping with the complexity

Rising medical costs have led to schemes implementing a range of measures to control these costs. Unfortunately, this increases complexity for the individual and often results in higher out-of-pocket expenses due to difficulties in understanding how their medical scheme covers expenses. While communication and education could offer partial solutions, technology also makes it possible for experts to absorb the management of that complexity.

Stop the presses! We need to talk

Despite the plethora of research on how good communication can help individuals make better choices, most employee benefits communications follow a tick-box approach designed to appease regulators or protect fiduciaries. By embracing research on how individuals respond to various forms of communication, we can design new material that can actually help members. We look at two specific applications: investment choice and projection statements.

Failure to launch

Conventional approaches to financial education are failing, because the focus has been more on teaching fundamentals and less on behavioural issues that affect individuals' resistance to learning or change. New research is helping us to identify more effective, if somewhat unconventional, strategies. The employer has a key role to play in facilitating this, but we need to demonstrate why their investment will meet its objective and provide a financial benefit. We also provide suggestions on what to do when the employer is not an appropriate conduit.

Monitoring

Measuring success

Whatever is done for individuals, in both design and implementation, needs to contribute to better outcomes. Knowing whether the situation for individuals has improved requires developing and using our ability to measure what is working and what isn't. An expanding range of tools allows us to monitor retirement funds, investment strategies and medical aid selections.

The journey - not just the end game

Many employed South Africans face significant financial challenges but will never be in a position to engage with a financial planner. We explore how we could address these challenges by taking advantage of emerging research on decision making and financial literacy. We address the issue of how we can get individuals to engage and what will incentivise them to care.

The issue

In Benefits Barometer 2013: The employee benefits system we identified that most people were making it to retirement with insufficient savings. To untangle why, we examined different sectors and found that different issues drive dynamics in different sectors. Issues which might bring one sector to its knees were totally trivial in another. In this section we provide introductory summaries of last year's issues chapters and salient updates on any changes. We also change the categories slightly and introduce high employee turnover as an additional issue.

FINANCIAL SERVICES INDUSTRY