WHAT OPTIONS EXIST FOR DEFINING A TARGET?

The replacement ratio is one of the more widely used targets for South African funds. Defined as the ratio of income in the year after retirement to the income (usually pensionable income) in the year before retirement, South African boards of trustees use replacement ratios as a way to determine whether fund members are achieving adequate outcomes.

Replacement ratios originated in defined benefit (DB) funds because of how benefits were calculated:

Accrual rate **x** *final salary* **x** *number of years of service*

The pension benefit accrual rate usually varied around 2% and the resulting pension benefit replaced between 60% and 80% of the member's pre-retirement income, based on between 30 and 40 years of service.

Replacement ratios can be difficult measures for individuals to understand. Wealth-earnings ratios provide individuals with the multiple of current pensionable salary they would need for an adequate retirement income[6]. Wealth-earnings ratios share many similarities with replacement ratios, but interpretation of the outcome on the part of the member is made much easier with the use of multiples rather than percentages. This means that members with multiple retirement savings vehicles could easily work out the total collective outcomes of these funds to work out whether they will achieve an adequate income level.

6 Moore & Mitchell (1997)