RETIREMENT REGULATIONS – MY VIEW

CAPE TOWN: Ryk van Niekerk recently wrote about his experience of retirement planning when he left his previous employer to join Moneyweb. His frustration with independent advisors and the regulation of retirement investments was pretty obvious to all. I am reasonably convinced that he must have received massive support from a range of Moneyweb readers and I am sure that his article probably reinforced some people's views that retirement advisors are useless and that this industry is filled with sharks. Naturally he is talking to his market as Moneyweb is aimed at those who want to do things themselves but this does not mean that there is only one answer to this debate.

DANGEROUS ARTICLE TO WRITE

A person in my position who decides to engage with someone in Ryk's position in a public forum like Moneyweb can rightfully be accused of gross stupidity. It is a bit like SA playing the All Blacks in New Zealand on a rainy day in the middle of winter with only 10 players vs. their 15. I am certainly not holding all the aces here! In fact I might be better off criticising the FSB because they probably won't read my article. I am hoping that Ryk and his colleagues are reasonable people and will see that this is a real issue that must be debated because real people are going to read his article and some of them will follow his lead. This could lead to some very sad outcomes and that is something that must be addressed. As we learnt from the property syndication debacle, too many advisors remained silent whilst people did things that we felt were wrong and it cost many investors their retirement savings.

LESSONS FROM THE PAST

In the USA you can take advantage of the massive flexibility that Ryk requires from his retirement investment. This means that you can invest in a range of different instruments with minimal restrictions. Sadly this freedom comes at a very real cost. Many of you might recall a rather large company called Enron which imploded dramatically through corporate fraud. What you might not know is that the company employed thousands of honest, very bright and financially sophisticated people who had enormous faith in their employer. They had so much faith (and freedom) that they used their retirement vehicles to buy Enron shares. Some of them even had 100% of their retirement money in Enron shares. When the company collapsed, these people lost their jobs and their retirement capital. With the benefit of hindsight, we could easily criticise these people as fools but what if you worked for Google and could buy shares in the company via your retirement fund in the early days – surely you would have been tempted?

We could argue that you should not have all your retirement money in shares; you should have some invested in bonds too. If you worked for Chrysler as a mechanic all your adult life, you might have felt secure in buying Chrysler bonds which were yielding about 8% p.a. Sadly, when Chrysler went south, you would have lost your job and all your money just as those who invested in Enron did. Why would South African investors be any different? Surely prudent regulation that is implemented in a rational fashion would be better for most investors?

WE ARE NOT AS SMART AS WE THINK WE ARE

Private and professional investors make more incorrect investment decisions than correct ones. Sadly, their erroneous decisions usually cost them a lot more than they make from their good decisions. A study called Quantitative Analysis of Investor Behaviour by Dalbar Inc. & Lipper shows that

all types of investors tend to “cost” themselves 58% per year of their potential returns over a 20 year period. This means that when average unit trusts generate an annual return of 12% per year, investors are only getting 5% per year. In a South African context, if this is happening to your retirement money then you are guaranteeing that your capital is being eroded by inflation.

Sadly, even those who we expect to know better (e.g. Corporate Financiers, Accountants, Financial Journalists and Traders) often turn out to be the worst investors because they feel that their expertise gives them an edge over the market. Increased knowledge about finances often leads to increased confidence in one’s own abilities but not necessarily increased skill.

THERE IS INNOVATION IN THE RETIREMENT INDUSTRY

I think the comment by Ryk that there is no innovation in the retirement industry is totally wrong. There are many independent firms who are driving the product providers to reduce costs, improve transparency and offer more alternatives. As an example, we worked with one of SA’s largest unit trust companies to create indexed retirement solutions which are by far the cheapest in the industry. A private investor can now get a retirement fund for a total annual cost of 0.75% + VAT per year with no transaction costs or initial fees. Another product provider is working on a comparable solution at a cost of 0.5% + VAT per year.

WHY COST IS IMPORTANT

It is highly debatable whether any stock broking portfolio can beat an indexed solution over a long period of time on a pre-cost basis. If you then include the effect of costs, it is almost guaranteed that Ryk’s portfolio will underperform the index an 18 year period. Naturally the stock broker would not have told him this but I am sure that a good advisor would have told him the truth even if Ryk did not want to hear it. This is the real crux of having an advisor vs. an order taker. A great advisor will tell you what you need to know, not what you want to hear. A bad advisor will agree with you and make you feel better about your decisions just to ensure that the deal is done.

RETIREMENT CAPITAL IS NOT THE PLACE TO TAKE EXCESSIVE RISK

History shows that investors do have a 20% chance of beating the market over a long period of time. Those that manage to get this outperformance will usually get much higher growth than the index so it is worth taking the chance. My concern is that you should not take the risk with your precious retirement money. If you are not one of the fortunate 20% of people who get the outperformance, the opportunity cost of underperforming is massive. If you strongly believe that you have the skills and experience to beat the market, you should use your additional savings to that the risks. This gives you two horses in the race.