A RETIREMENT ARRANGEMENT: A WIN-WIN SITUATION

A retirement arrangement is a plan used to set aside money for retirement and it is in most cases the only savings plan for retirement for many people. It is a benefit, in the case of occupational retirement arrangements, which has employer and employee relationship. It is beneficial for an employer to establish a retirement arrangement for its employees.

The benefits to the employer are: (1) Retention strategy, (2) Attract new talent, (3) Reduce Employee turnover, (4) Good corporate citizen, where the employer either private sector and public enterprises, assists the state to achieve its legal and constitutional obligation to improve the welfare of the Namibian people, (5) Minimize or eliminate the cost implications to the employer for the recognition of past service in the absence of a retirement arrangement.

The benefits to the employee are: (1) Saving for retirement, (2) Tax benefits, (3) improved financial security. Therefore, it is prudent for an employer to establish a Retirement arrangement for its employees, be it a stand-alone Retirement Fund or participate in an umbrella Retirement Fund.

Pillars of Retirement Funds

The Retirement Fund system is structured on three pillars, which are: (1) Public pension system, which is a National Pension Fund, usually mandatory and defined benefit in nature. In the case of Namibia, the Social Security Commission has a mandate to establish the National Pension Fund as provided for under section 34 of the Social Security Act 34 of 1994. (2) Occupational schemes (Employer sponsored schemes) are usually prefunded. They are either defined benefit or defined contribution fund type. This article is focused on this second pillar. (3) Voluntary individual savings, which are Retirement Annuity Funds.

Employer Sponsored Schemes

It is imperative for an Employer to establish a Retirement Fund for its employees. This will be part of the Employees benefits referred to as a deferred salary or compensation. By so doing, the Employer is assisting its Employees to plan for post-retirement. The employees contribute a certain percentage of their salary to a Retirement Fund, in addition the Employer also contribute a certain percentage on behalf of the Employees either to match the employee contributions or contribute a higher percentage depending on the benefit design and affordability.

The Employer can consider establishing a **stand-alone Retirement Fund or participate in an umbrella Fund**. To determine which scheme is appropriate the following factors, but not limited to, are considered: the size of the payroll, number of employees, the benefit design etc. If the Employer’s payroll is small and has few employees, and would wish to establish a stand-alone Fund, the cost of managing the Fund might be high and ultimately affect the net retirement savings, which would affect the Retirement Benefit. This might also result in a lower Income Replacement Rate (IRR) in Retirement. Even though the IRR differs from person to person depending on the individual needs and lifestyle, the average targeted IRR is 70% to enable the retiree maintain the same standard of living in retirement.

However, the appropriate solution for an Employer with a small payroll and few members is an umbrella Fund. The benefit, amongst others, of joining an umbrella Fund is the economies of scale that allows a greater allocation of net contributions towards members' retirement savings. The adverse is that, despite being afforded an opportunity to establish an advisory (management) committee, the participating employer has no control on the appointment of service providers and the top governance structure. Therefore, to make an informed decision whether to establish a stand-alone Fund or join an umbrella Fund, the Employer will need to engage a Retirement Fund expert for an advice, this will be different to each employer depending on the unique circumstances and needs. It is worth noting that Retirement Funds require good corporate governance, efficient operations, and sound investment strategies.

Furthermore, the Employer would need to consider whether to establish a **defined benefit (DB) fund or a defined contribution (DC) fund**. The difference between the two is mainly centered on who bears the risk between the employer and the employee. In a DB scheme, the Employer bears risks such as Investment risks; longevity and inflation. This will result in an open-ended liability arrangement for the Employer, a risk any Employer would have less or no appetite at all. Whereas, in a DC scheme the employee bears the above-mentioned risks, in addition there is a very high level of uncertainty about the level of income they can expect in retirement.

In the UK parliament, there has been considerations to introduce a Defined Ambition (DA) fund in addition to the DB and DC. The design of the DA fund is meant to allow the Employer and the Employee to share the risks, hence it is also known as the risk-sharing Fund. However, the House of Commons in the UK Parliament published a research briefing on 28 October 2019 where they stated that the implementation of the DA was put on hold by the government, for an alternative framework for collective defined contribution schemes. Risk-sharing is not new, and it is done in another way referred to as a hybrid scheme. A hybrid scheme has a combination of the characteristics of a DB fund and DC fund.

After an Employer, has considered whether they will be establishing a stand-alone Retirement Fund and whether it will be DB or DC scheme, they will also need to consider whether it will be a **Pension Fund or** a **Provident Fund**. The difference is the annuitization (monthly pension) and the tax treatment. The most basic difference is that in a Pension Fund a member, on reaching retirement, receives one-third lump sum benefit and the remaining two-thirds of the benefit is used to establish a monthly pension payable for a lifetime. Whereas, in a Provident Fund the whole benefit is paid out as a lump sum at retirement. The terminology pension fund is usually used interchangeably with Retirement Fund, however pension fund is a type of a Retirement Fund.

Macro-economic benefits to the Namibian economy when an Employer establish a retirement fund:

1) It creates savings that can be used for essential investment in commerce and industry.
2) The investments made by the retirement fund industry lead to the employment of large numbers of people.
3) Many retirement funds often invest a part of their assets in social responsibility programs, such as the provision of housing for members.

It is evident from the above that, the establishment of a pension arrangement has benefits for the Employer; the Employees; commence and industry, and the state.

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