Everything you need to know

What are Smoothed Bonus Portfolios?

In smoothed bonus portfolios, investment returns are smoothed by way of regular bonus declarations. This results in stable and dependable investment returns, lessening the roller-coaster ride that investors in market-linked portfolios might experience – consider the global financial crisis during 2008 as an example. These bonus declarations are based on the returns achieved on the portfolio's underlying investments. However, some returns are set aside during periods of strong market growth to be used to boost returns during periods of weaker performance.

Smoothed bonus portfolios are often used as an end phase in lifestage. Many members are risk averse, especially those closer to retirement. These members have worked hard for many years to build up their fund value and do not want to risk seeing their savings reduce due to market downturns.

Benefits of Smoothing

- Smoothing reduces the exposure to short-term market volatility
- Smoothing lessens the risk of investing in or disinvesting from the market at the wrong time due to circumstances beyond a member's control, for example retirement or retrenchment

Positive, Real Returns

- Bonuses are declared monthly in advance, net of the guaranteed premium
- Sanlam guarantees that the monthly bonus, net of fees, cannot be negative
- Sanlam's Smoothed Bonus Portfolios have outperformed inflation significantly over the long term, thereby providing real returns

Why is smoothing beneficial for retirees?

As members typically have little choice over when exactly they retire, exposure to the market – even in a balanced fund (the green line) – may be undesirable. Take Joe as an example, if he was invested in an average balanced fund and retired 6 months later, when Jane does, his retirement savings would be substantially smaller, due to market movements.

But if invested in a smooth bonus product (the blue line), both Jane and Joe would have some capital protection. Jane is in a far better position when she retires due to this capital protection.

Guarantees

- The book value is the value that is guaranteed to be paid out for benefit payments (death, disability, resignation, retrenchment and retirement) regardless of market conditions. The book value is the net contributions accumulated at the bonus rates.

- There is no limit on the amount of benefit payments at book value.

- All guarantees are backed by the financial strength of Sanlam Life.

  - Solvency cover of 187% on 30 June 2020 and a Standard & Poor (S&P) credit rating of zaAAA.

  - The resilience of the Sanlam share price during the sub-prime crisis shows the market's confidence in Sanlam and its management

What are the costs associated with a smoothed bonus portfolio?

Insurers are required to hold a specified amount of capital in order to provide the guarantees underlying the smoothed bonus portfolio. The insurer may sometimes be required to provide financial assistance to the portfolio. An example would be if the portfolio becomes significantly underfunded. Financial assistance is often in the form of an interest free loan from the insurer's shareholder fund to a smoothed bonus portfolio.

To compensate for the fact that a portion of the insurer's capital is tied down by offering these portfolios (and that money loaned to a portfolio may never be recovered), insurer's charge a guarantee fee / capital charge in addition to the normal asset management fee.

These fees vary between insurers. The guarantee fee also differs significantly between those portfolios with partially vesting bonuses and those with fully vesting bonuses.

Are there other costs?

There are some that argue that there are other costs as well, mostly relating to asset allocation, smoothing and disinvestment conditions.

Most smoothed bonus portfolios tend to have an asset allocation similar to a moderate balanced fund. In a strong bull market, these portfolios will therefore underperform more aggressively invested portfolios. It is important that member communication creates realistic return expectations for members. These portfolios do not try to compete with aggressive market linked portfolios.

One of the consequences of smoothing is that bonuses often lag market returns. When there is a market downturn these portfolios often still declare strong bonuses based on the surpluses built up before the downturn. After exceptionally bad downturns, these portfolios could be in deficit. Bonuses could take a while to recover to more normal levels as the portfolio tries to strengthen its funding position. Some members complain about low bonuses when investment returns pick up, forgetting the relatively good bonuses received during the downturn.

Although these portfolios provide valuable guarantees on benefit payments, other exits, such as termination or investment switches will occur at the lower of book and market value. These portfolios are therefore not suited to members who regularly wish to switch between portfolios. During a market downturn the smoothed bonus portfolio could be underfunded. Members might therefore receive a lower value on switching than anticipated or they would have to wait until the portfolio is fully funded. For those members who do not intend switching out of the portfolio before exiting their retirement fund, this is not an issue.

Funding levels and disclosure

- Sanlam discloses whether its portfolios are fully funded (or what the funding levels are if underfunded) on a monthly basis

Unique Features

- Sanlam allows book value to be ceded on section 14 transfer i.e. when transferring from and to the same portfolio it is not seen as a termination; book value is transferred even if the portfolio is underfunded
- Sanlam guarantees to vest 10% of the Stable Bonus Portfolio's non-vested account annually

Who should invest in a smoothed bonus product?

- Members close to retirement who want to protect a portion of their retirement fund savings
- Members who require the volatility of financial markets to be smoothed over time, allowing them to plan more confidently for retirement
- Members who do not want to see negative monthly returns
- Members who want comprehensive guarantees on benefit payments

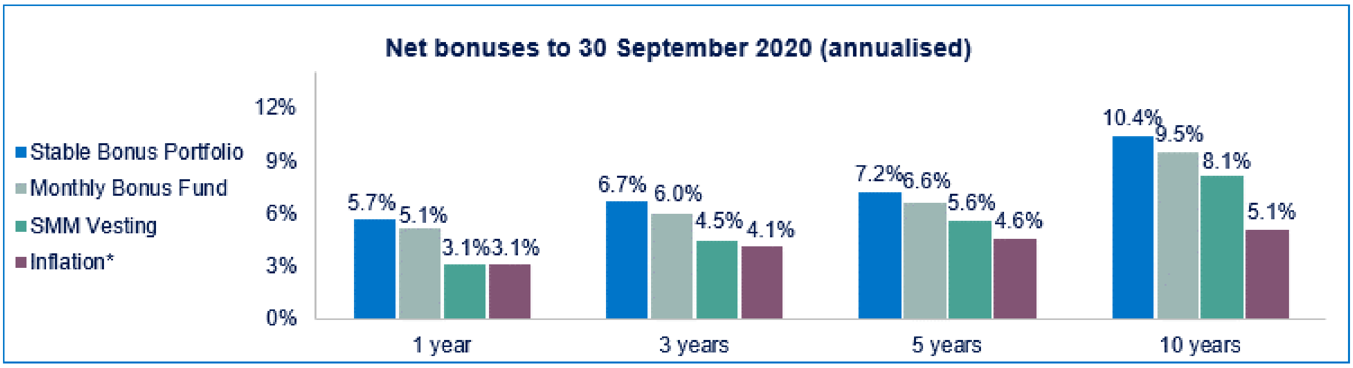
Important considerations for choosing a smoothed bonus portfolio

When considering a smoothed bonus portfolio for your members, it is important to remember that the various products on offer differ between insurers. In particular investigate the following:	
Bonus formula	Does the insurer disclose the bonus formula used, or does the insurer operate on a black box approach with complete discretion? A publicly disclosed bonus formula allows potential clients to understand the insurer's smoothing methodology and likelihood of zero bonuses during a downturn.
Management philosophy	It is important to understand the insurer's management philosophy, including: • How the insurer determines and reviews the portfolio's asset allocation, including the use of stochastic modelling of returns and hedging. • Their practice of closing severely underfunded portfolios. • Principles regarding removal of non-vested bonuses. Most of this is set out in a Principle and Practices of Financial Management (PPFM) documentation available on an insurer's website. Some insurers have significantly enhanced their management of these portfolios in recent years, to the extent that funding levels have remained much higher during the 2008 Global financial crisis than in 2003.
Vested and non-vested pool	For those portfolios offering vesting and non-vesting bonuses, some insurers guarantee to transfer 10% of the non-vested pool at the end of each calendar year to the vested pool. This will prevent the non-vested pool from becoming too large and watering down the guarantee provided. Other insurer's use their discretion in deciding the portion to transfer or consider a fixed portion of the amount invested to be non-vesting. Some insurers do not allocate the full contribution by a member to the vested pool. It is important to realise that these portfolios therefore do not guarantee the return of a member's original capital invested.

Limitation on benefit payments	Some insurers contractually limit the amount of benefit payments paid at book value. This is a significant restriction when a Fund expects a large number of exits, for instance during an industrial accident or restructuring.
Financial strength	Any guarantee is only as good as the institution providing the guarantee; consider the insurer's financial strength. Also consider the funding level of their current portfolios – any funding level below 80% would be a cause for concern.
Transparency regarding funding levels	Some insurers disclose monthly whether their portfolio is fully funded, or show the funding level on their website if underfunded. Some merely confirm the funding level range at the end of a quarter / year. Others say nothing at all.

Why choose Sanlam Smoothed Bonus Portfolios?

Comparison with inflation and other Smoothed Bonus Portfolios



REAL RETURNS	1 year	3 years	5 years	10 years
Stable Bonus Portfolio	2.6%	2.6%	2.6%	5.3%
Monthly Bonus Fund	2.0%	1.9%	2.0%	4.4%
SMM Vesting	0.0%	0.4%	1.0%	3.0%

* CPI Inflation up to 31 August 2020

Performance during market downturns

Our product range has shown its worth during the 2008 and 2020 Global Financial Crisis, expertly navigating the difficult market conditions, providing peace of mind to retirement fund members.

Compared to previous downturns, these portfolios have recovered in a very short period of time. This did not happen by accident – we were helped by the governance and decision making processes of our Asset-Liability Committee (which was formalised after 2003), good asset allocation decisions and the use of hedging techniques. In a sense, we paid our dues during 2003 and today we can see the benefit of what was learnt.

- Sanlam's Asset-Liability Committee provides a strategic framework for the management of Sanlam's Smoothed Bonus business. This includes determining the strategic asset allocation and the setting of benchmarks and risk parameters for our asset managers. The committee is headed by Sanlam's Statutory Actuary.

- Our unique management philosophy has resulted in:

  - An excellent bonus history compared to that of our peers. As an example, the Stable Bonus Portfolio had only 3 months of zero bonuses during the 2008/2009 crisis (Nov 08, Mar 09, and May 09) and one month in 2020 (April 2020).

- Portfolio funding levels that did not deteriorate to the levels seen during the 2003 downturn. There was therefore no need to open new pools or change our investment strategy during the subprime crisis.
- We were ideally positioned to benefit from the market recovery during 2009.

If you would like further information on Sanlam's Smoothed Bonus Portfolios:

call us

Danie van Zyl
Head: Smooth Bonus Centre of Excellence
Tel: +27 21 950 2853
E-mail: Danie.vanZyl@sanlam.co.za

Lorraine Loubser
Assistant
Tel: +27 21 950 2985
E-mail: Lorraine.Loubser@sanlam.co.za