FINANCIAL ADVISERS HATCH RETIREMENT PLANS

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The formula for retirement planning used to be simple: contribute each month to the national pension plan and begin collecting pension checks when you reach retirement age. The public pension still exists, but the process got a bit more complicated when private alternatives sprung up earlier this decade.

Concerns over the national pension fund's long-term solvency made people more aware of the need to consolidate their long-term financial security independently. As a result, more Egyptians are now turning to private retirement plans, which promise better returns and greater flexibility compared to the public pension plan, according to Omar Radwan, the head of regional asset management at HC Securities, a Cairo-based investment bank. "By letting go of a small portion of a current salary, you can make a huge amount of savings," he says.

Radwan illustrates his point using a hypothetical example. If a person invests one pound today, and assuming an average return of 9.5 percent per annum, the payout will be LE 17 in 30 years. Taken on a larger scale, contributing even a modest amount over the years can result in a comfortable nest egg.

The important thing, however, is starting early. Too many people wait until they are nearing retirement before thinking about what options exist, analysts say. "You should start investing when you start working because it gives the longest period of time to enhance returns," advises Dalia Shafik, vice president for asset management at EFG-Hermes.

This is particularly important for private retirement plans, many of which take stakes in the stock market, where a long-term strategy is necessary to recoup periodic losses that result from sudden downturns in the market. But market volatility is the price to pay for potentially lucrative gains, which can be far more than on bank deposits tied to interest rates, says Shafik.

The possibility of returns exceeding 100 percent per year is enticing, though certainly not guaranteed. By contrast, the national pension's rate of return for someone making the average wage is only 3 percent, according to a 2005 World Bank study.

The monthly payout of the public pension is calculated as a percentage of the individual's average salary for the last two years prior to retirement, with annual adjustments made for inflation. While the annuity is usually enough to cover basic living expenses, many retirees also rely on their personal savings, support from family members and – if they have any – real estate investments.

The notion that a single public pension would be sufficient was already supplanted elsewhere by a more pragmatic approach that also relied on private plans, explains Ahmed Marwan, chairman of Cairo-based investment bank Sigma Capital. "In the US and Europe, you have a system where each individual working makes a contribution to social security, and when you retire, the government gives something back. That's the social safety net. On top of that, you have pension funds established by companies themselves, and people contribute. In the US, it's a 401K, and again, the principle is to put a little bit in today and to eventually get something back."

Looking back a decade, the market was ripe for alternatives to the public pension, recalls Mohamed Mowafi, the former head of financial advisers at Allianz Egypt, a subsidiary of Germany's Allianz SE. "One of the main concerns among people in Egypt is [saving for] retirement, but [at the time], there was no real plan available, which is why insurance companies thought of penetrating the market."

In 2001, Allianz offered the first private retirement plan in Egypt. It was a hybrid product that combined insurance and investment, devoting a portion of a client's premium into an investment fund, with the remainder paying for insurance coverage. "We wanted to offer different investments, other than conventional products such as timed deposits that fluctuate 25 to 100 basis points above LIBOR," Mowafi says, referring to the benchmark London Interbank Offer Rate. "So we decided to allocate premiums into different investment funds managed by a well-known company, EFG-Hermes."

Other insurance companies followed, including France's AXA, American Life Insurance Company (Alico) and Egypt's Commercial International Life (CIL), each selling products structured along the same lines. The insurance segment of these plans typically covers death, accident and disability. Clients can vary the amount of insurance coverage, but doing so affects the investment payout because the premium is split between the two. Greater insurance coverage results in a smaller investment return, and vice versa. "If you'd like to increase the investment, then you will decrease the insurance," explains Mowafi. "So if your main focus is to make money, then you will decrease the insurance coverage."

A portion of the premium income is given to a professional asset manager who invests in equities and fixed-income assets. Think of them as mutual funds with added insurance benefits. Some funds seek steady returns in fixed-income securities, while others try to eke out higher gains by taking on a bigger portion of equities, though with the downside of more risk.

The size of Allianz's funds has increased considerably in the last five years, according to Shafik of EFG-Hermes, which is responsible for handling the company's retirement fund portfolio. "When the plans were first introduced, they were small and not growing very fast. But now the flow is increasing every month, which means more people are signing up, and there are probably higher contributions as well."

She argues that part of the success of the various private insurers offering retirement plans is a sound marketing strategy. Insurance companies have forged agreements with banks to sell their retirement plans. Bancassurance, as it is known, offers a new contact point with customers, Shafik says. "I think bancassurance has been an effective channel because people are more comfortable with their bank and are more inclined to at least listen to them [than an insurance salesperson]."

At maturity, which may be before retirement age, a fund's payment is disbursed as a lump sum or as a 25-year annuity, Mowafi says. There are no capital gains taxes in Egypt. However, the contributions to the plan are not tax-exempt either. You contribute to the fund from you post-tax salary, meaning you have already paid income tax.

The taxability of these funds is perceived as a drawback when compared to another private retirement plan known as an "end-of-service savings plan" (ESSP), which allows for tax-free contributions up to 20 percent of the individual's pre-tax salary. First introduced to Egypt four years ago, ESSP is a defined contribution plan – similar to a 401K – in which employers often provide matching funds, essentially doubling the employee's contribution to the fund.

In order to become vested in the plan, employees must stay with a company for an agreed number of years, explains Sherine Fadl, head of operations at Beltone Financial, a regional investment bank that currently manages ESSPs worth a total of LE 35 million. If they leave the company before the agreed upon period they may forego the company's contribution to the fund.

The asset manager meets with the company to determine the company's appropriate level of risk, Fadl explains. There are also quarterly presentations to clients to give an update on the fund's performance and offer an outlook. At those meetings, the asset manager will listen to participants, and even consider revising the investment guidelines if there is consensus.

A common request is for greater equity when the market is bullish. While it is possible to alter the equity stake, the fund must retain a conservative approach. “If they ask for 100 percent equity, then we have to explain that this is a retirement fund. There is a limitation,” Fadl notes.

A number of Egyptian companies have created private retirement funds for their employees as part of their loyalty incentive packages. The funds, which come in many different flavors, are managed by a third-party investment specialist in charge of investing and administering the program. “We were approached by several companies and institutions to help them invest money that they had collected in a private pension fund,” says Radwan of HC Securities. “They agree with their employees to contribute a small amount, let’s say 5 percent of their monthly salaries, which are put into a fund. And this fund is basically a retirement fund. We work here on managing these assets whether in fixed-income or equity. We should have different strategies when allocating the money, but the idea is that with time, when someone retires, they collect a portion of the fund.”

While fund managers do not usually set a requirement in terms of the minimum number of employees a company must have, they often set a minimum capital requirement due to the steep administrative costs. Private funds must be managed and administered separately – unlike mutual funds, which pool together a lot of investments to drive down costs.

Therefore, it isn’t likely that private plans will be available to small companies anytime soon. Of course, they are also out of reach of many workers who cannot afford to give up any additional part of their income, even recognizing the long-term benefits.

But analysts are upbeat about the future of private plans. They stress that this industry is still in its infancy, and a booming stock market that generates big returns will fuel enthusiasm. “You see young employees paid well, and with big savings, and they have the luxury of thinking about retirement,” says Radwan. “This particular class of people is increasing in numbers, and in purchasing power, and their savings are increasing dramatically.”

Increasingly, Egyptians have come to accept that the government will not be able to provide for them in their golden years. The public pension plan is seen more as a relic of a bygone era when the government pledged to support citizens from cradle to grave. In its stead is an ethos that stresses individual responsibility. “The concept of self-reliance is growing,” says Marwan. “Whereas, historically, you work and the government takes cares of you, today you have to do something to supplement what the government is doing.”

EARLY DEPARTURE

When selecting a retirement fund, it is important to read the fine print regarding the policy for distributing the accrued amount in case of death before the fund’s maturity. In most retirement funds, the contributions and their earnings are treated like any other asset, and are paid to the family in accordance with Egyptian inheritance law. The investor also has the option of naming a beneficiary, or a group of beneficiaries, upon investing in a fund.

Where funds include a life insurance policy, the individual has two options. “The first is for the person to opt to receive the greater of the two amounts, either the insurance or the investment. Usually, it’s the insurance,” says financial adviser Mohamed Mowafi. “The second option is for the person to pay slightly higher premiums and receive both amounts.”

As far as end-of-service savings plans (ESSPs) go, the amount paid in case of an untimely death depends on the arrangement made by the employer. “It is essential to understand exactly what the contract says,” Mowafi stresses. In some cases, the contract will allow the family to collect the entire amount paid by the employee and the company during the period worked, plus any profits. In other cases, the family of the deceased employee will only collect the amount the employee paid, and any profit accrued on that amount.