SA retirees in living annuity 'crisis'

Thousands of elderly have had pensions halved in six years

By LAURA DU PREEZ

About 70% of the population aged more than 85 are women. Picture: Inganathi Williams

● Startling new estimates show that about 59 000 people — more than 20% of all retirees drawing a pension from the favoured South African pension product, the living annuity — are now drawing half the income they were receiving six years ago in after-inflation terms.

The estimates are the work of Deane Moore, an actuary and CEO of Just South Africa, a company that provides retirees' least-favoured choice of pension — the annuities that guarantee your income.

However, the Association for Savings and Investment South Africa, which represents life and investment companies that provide living annuities, has labelled Moore's estimates "dangerous".

Nine out of 10 retirement fund members choose to invest their retirement savings from an employer-sponsored retirement fund or retirement annuity in investment-linked living annuities at retirement.

These pension products allow you to choose the underlying investments, but you take the investment risk and the risk that you may outlive your savings' ability to provide an income.

Each year, Asisa publishes the average rate at which pensioners are drawing an income from the R330-billion invested in living annuities — this year the average rate was 6.62% of the capital a year as a pension.

Gloomy figures

But Asisa's rates fail to show how many retirees are drawing dangerously high percentages of their capital or who have hit the maximum rate at which a pension can be drawn — 17.5%. Once you hit the maximum, your income declines in real (after-inflation) terms each year.

The most recent details from 2011 were published in a 2012 Treasury discussion document titled "Enabling a Better Income in Retirement".

Moore used these figures to calculate the likely rate at which those who were on pension in 2011 are now drawing an income from their living annuity investments.

He found that:

- An estimated 50% of the 2011 retirees — about 139 000 people — will probably see their income decline in real terms within the next five years unless they earn relatively high returns of more than 12.5% a year (before fees) over this period;
- The 69 500 clients who were drawing more than 12.5% of their capital as a pension in 2011 will have reached the maximum drawdown limit of 17.5% if they earned returns in line with retirement fund averages and increased their pensions in line with inflation.

They would also have drawn from their capital, rather than just the returns, over the past six years;

- About 59 000 of these investors have seen the rand value of their income halved in real (after-inflation) terms over that period, and the other 10 500 have seen the rand value of their income reduced by 33% in real terms; and
- About 22 600 retirees who had been drawing between 10% and 12.5% in 2011 would also have reached the maximum drawdown rate of 17.5% if they took inflation-linked increases in their pensions over the past six years.

Crisis still not clear

Taryn Hirsch, a senior adviser at Asisa, says life and investment companies that offer living annuities only provide the industry body with data about the total policies on their books and do not provide data about individual policyholders.

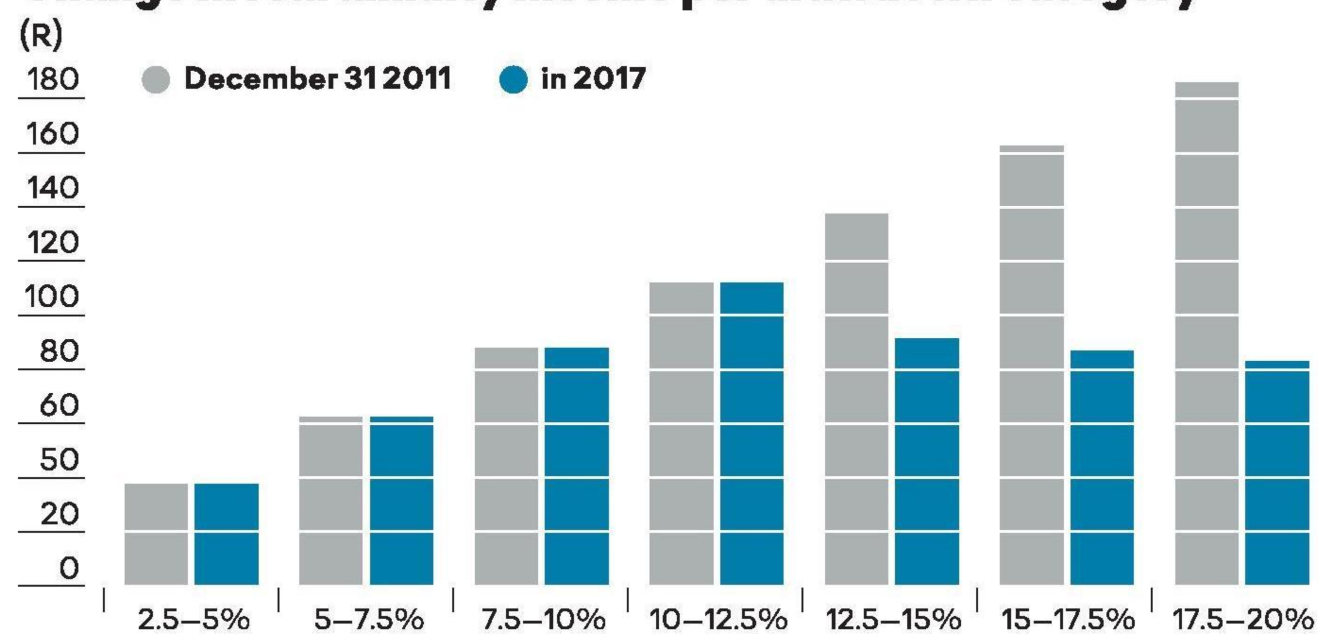
Asisa aggregates this data to determine the average drawdown rates. Hirsch says the detailed 2011 data was provided to the Treasury at its request.

It is not possible to extract deeper trends from the pooled data and it would be misleading to say retirees are heading for disaster, Hirsch says.

She points out that:

- Living annuity policyholders may well have more than one living annuity;
- Policyholders who have several living annuity policies use them for different funding purposes;
- Retirees can on death bequeath their remaining investments to beneficiaries. Younger beneficiaries who inherit policies may draw down the maximum income;
- Terminally ill policyholders may withdraw the maximum income;
- Policyholders may place their retirement fund capital in living annuities with a view to buying conventional annuities at a time when conventional annuity rates are higher; and
- Retirees may be invested in other retirement savings products.

But Moore says the "crisis of unsustainable retirement income" will become visible in the decade between 2020 to 2030 as more living annuitants start to live beyond their average life expectancy.



The graph shows the average annual pension drawn after investment returns were added and charges deducted if the fund value was R1000 at the start of the year. The drawdown is calculated for the mid-point of the range ie 3.75% for the first drawdown range and 16.25% in the case of the 15–17.5% range. The values are expressed in real (after inflation) terms.

Graphic: Ruby-Gay Martin Source: JustSA

Women hit worse

In its 2012 document, the Treasury said its calculations suggest that the vast majority of South African living annuitants are exposed to a substantial risk of falls in real income as they age.

Financial advisers have highlighted the problems with living annuities at recent Financial Planning Institute events and a number of advisers have joined a new organisation, the South African Independent Financial Advisors' Association, which focused on living annuities at its first two meetings this year.

Moore says the crisis will affect women much more severely than men as 70% of the population over the age of 85 are women. The average life expectancy for those who retire at age 65 is 18 years for men and 22 years for women, with 50% of men and women living beyond these ages.

Only a small minority will be able to leave a legacy

● Most retiring pension fund members choose to use an investment-linked living annuity to provide an income in retirement often because they believe they will leave a legacy for their children or heirs.

However, the myth that living annuities will enable you to leave a legacy should be bust, says Deane Moore, the CEO of Just South Africa.

It is only the 31% of living annuity investors who draw an income of less than 5% of their living annuity investments who have a high probability of leaving some legacy to beneficiaries, he says.

Everyone else should focus on preserving their income.

Most people shun guaranteed annuities, which provide a guaranteed income for life regardless of how long you live, because the remaining capital you invest remains with the life assurer when you die, or if you select a guaranteed period for which the income will be paid to you or your heirs, at the end of that period.

Earlier this year, Sygnia launched its For-Life living annuity, offering underlying investments in Just's Lifetime Income asset class. Investments in this asset class provide a guaranteed income for life that can never be reduced regardless of what happens in investment markets or how long you live, Moore says.

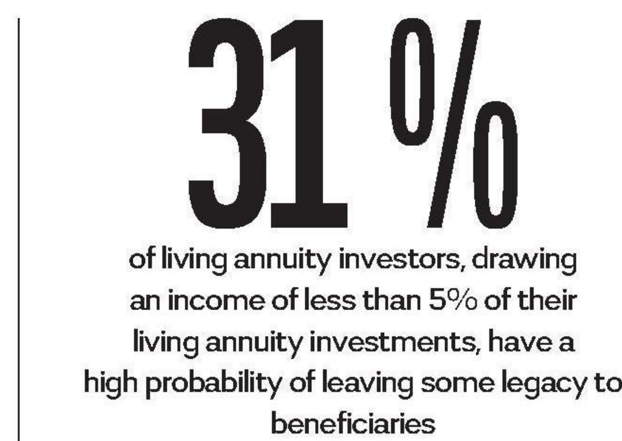
The initial income guaranteed depends on your health, lifestyle and income as it would if you were buying a separate guaranteed annuity policy.

Over your lifetime, the Lifetime Income Fund provides an annual return between equities and bonds, and the return increases the longer you live, Moore says.

You can split your living annuity investments between the Lifetime Income asset class to guarantee your essential expenses for life and other unit trust funds aimed at delivering long-term growth and potentially a legacy for your heirs.

Just is currently in discussions with other living annuity providers to get its new asset class listed on more investment platforms.

Pieter Koekemoer, head of personal investments at Coronation Fund Managers, says that Just's product is the most exciting development in the retirement fund industry to address the risk of longevity that asset managers cannot address with traditional investments.



At a recent Morningstar conference for financial advisers, Jaco van der Walt, the head of the FirstRand Investment Management Office, says living annuities are complex investment drawdown accounts that are dangerous tools in the hands of the uninformed.

He says they contain a huge amount of risk that retirees — especially less-affluent pensioners — are often unable to bear.

The only way of dealing with the risk to your income that you face in a living annuity if you live a long time is to take on higher investment risk, Van der Walt says.

However, many retirees do not have the ability to take that risk.

Van der Walt says that he is pleased to see guaranteed annuities being rolled up in living annuities and says advisers need to engage with product providers so that guaranteed annuities can be made more affordable.

This way, people can be offered real solutions to the problem of how to secure an income in retirement rather than being "sold dreams", he says.

David McCarthy, a South African actuary who worked on the National Treasury's income in retirement discussion document, says that a product that tries to offer some kind of compromise between the risk of outliving assets, leaving something to heirs, and investing in long-term higher-risk-return assets, is clearly welcome for retirees.

According to McCarthy you should always look for transparent, uncomplicated annuity products and make sure you can afford the fees.

Q&A

Your money questions answered

Q: In your article "Choose someone to carry out your will, literally" (November 5), it says that one should negotiate the executor's fee and put this plus the name of the executor in your will. But this doesn't seem right because the executor might only be required to wind up an estate many years after the will is compiled, making any fee mentioned in it completely eroded by inflation. Elsewhere in the article it says an executor's fees are regulated at 3.99% of the estate's value, so what is the point of putting an agreed fee in your will?
Jon Abbott

A: Harry Joffe, head of legal services at Discovery Life, says the Estate Duty Act tariff only regulates the maximum value and no minimum is specified. This means that an executor cannot charge more than 3.99% (inclusive of VAT) but can always charge less. Unless you negotiate a fee upfront, your estate will be charged the maximum fee.

Executor's fees specified in the will should always be a fixed percentage of the estate, not a rand value, so this would remain relevant even if the estate is wound up many years after you made your will. For example, the executor could agree to charge 1.75% plus VAT of the assets in your estate.

Q: We read with interest the article "A capital gains tax hack for retirement" (October 22). Our situation is similar to the one mentioned. My wife and I hold a 50% interest each in a CC whose sole asset is rent-producing industrial buildings. What will the tax situation be when we sell the buildings? We have owned the buildings for 35 years, the assets do not exceed R10-million and we hope to sell for R5-million. We are now 76 and 74 and selling because of ill-health. We were both substantially involved in the operations of the business.
Small business owners

A: Daniel Baines, a legal manager at PWHarvey & Co, replies: In order to qualify for the R1.8-million CGT exclusion for small business owners, you need to be, as you are, over the age of 55 and have been actively involved in the business for a period exceeding five years. However, you also need to be selling "active business assets" which specifically excludes an asset held to derive income mainly from rental income.

You may, however, use other means to reduce your CGT. Other expenses incurred, such as transfer costs (including attorney's fees), transfer duty, estate agent commission on the sale of the building and improvements made to the building, can be added to the purchase price of the building to reduce the capital gain.

If you have an interest in a CC, you must sell your entire interest in order to be able to qualify for the R1.8-million exclusion; you cannot merely sell the asset within the CC. This answer only deals with the CGT implications; there may be other tax implications.

Q: I am 71 and married by antenuptial contract. My wife and I purchased our home in 2004 in my wife's name with no encumbrances or bonds. My wife passed away in June and the smallholding is too big for my unmarried son and me. My wife left all her assets to me. I need to know the tax implications before selling and purchasing a smaller property. Is the estate liable for any capital gains tax on the proceeds of the sale? My wife and I purchased our current property for R478 000 in 2004 and the municipality valued it at R717 000 in 2013. I expect to sell the property for approximately R1.6-million. From the proceeds of the sale I intend buying a home for me and my son for approximately R1.5-million. Would it be prudent, given my age, to have the property registered in his name as he will ultimately inherit this asset — would it save paying transfer fees? What tax implications will this have?
Property owner

A: Louis van Vuren, CEO of the Fiduciary Institute of South Africa, replies: In the absence of all the information required, I can make some generic comments, but not give specific advice. When you die you are deemed to have disposed of all your property to your deceased estate, potentially leading to capital gains tax on those deemed disposals.

It seems that the property was your and your wife's primary residence, meaning the deemed disposal of the property to the deceased estate will not attract CGT.

Even if the property was not the primary residence, the Income Tax Act provides for roll-over to a surviving spouse free of CGT.

If you sell the property after it has been transferred to you, the difference between the sale price and the base cost will be subject to capital gains tax in your hands. The base cost is the purchase price plus allowable expenses (mainly capital improvements, but not normal maintenance).

If the executor sells the property in the course of the administration of the spouse's deceased estate, the same will apply in the deceased estate, and you will receive the cash after the CGT and other costs have been paid. The municipal valuation is immaterial.

If the property is registered in your son's name, it will be regarded as a donation at market value and potentially subject to donations tax. If you did not make any other donations during the tax year, the first R100 000 will be exempt from donations tax and the rest will be taxable at a flat rate of 20%.

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