Press release
6 April 2016

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THE ANNUITY REVOLUTION IN SOUTH AFRICA

Labour unions and the National Treasury agree on the urgent need to improve the value for money of retirement solutions, but disagree on next steps. Deane Moore, CEO of Just Retirement South Africa, shares this sense of urgency: "The time has arrived for annuities to be revolutionised to improve customer outcomes. Living annuities only provide good value if you die early. Conventional guaranteed annuities require the poor and ill to subsidise the rich and healthy. And with-profit annuities have been subject to opaque insurer discretion."

National Treasury and the labour unions

National Treasury published a series of papers between 2012 and 2015 on the shortcomings of the annuity market in South Africa and the need for retirement reform. They highlighted that:

- Most people who purchase living annuities face a significant risk of outliving their assets. Their annual drawdown rate is too high for their life expectancy and there is no longevity protection for those who live longer than expected. There are high charges for financial advice and investment choice, even though many people choose a conservative asset strategy and do not exercise active investment choice.
- The relatively poor and sick who have shorter than average life expectancy and purchase conventional guaranteed annuities subsidise the rich and healthy who live longer, unless their annuity rates take account of their specific income, health and lifestyle factors in determining their annuity income.

(see appendix for direct quotes)

In response, National Treasury has initiated a programme of retirement reform, which includes draft default annuity regulations. However, its attempt to introduce tax harmonisation and compulsory annuitisation for provident fund members met with opposition from labour unions. The insurance industry has a role to play in demonstrating that its annuities provide compelling value for money for individuals.

Living annuities are actually dying annuities

Ironically, for most people, living annuities only offer good value for money if they die early.

For those who die early, the capital that remains in the living annuity is paid out to beneficiaries. However, the typical purchaser of a living annuity makes several mistakes which significantly reduce the income available to them in retirement:

- They draw a level of income from their living annuity, which is greater than the guaranteed income they would receive from a with-profit annuity that targets inflationary increases, and therefore is not sustainable throughout their lifetime.
- They invest in a conservative investment portfolio, which generates worse returns in the long term than if they were invested in a with-profit annuity.
- They have bad luck. If investment markets fall, living annuity holders should reduce their drawdown to avoid depleting their assets, but many can't afford to do this. As a result, they have fewer assets to benefit from a recovery in the investment markets when this happens.

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- They fail to convert to a guaranteed annuity or with-profit annuity when they become ill or reach the age of 80, and get trapped in a living annuity where the maximum drawdown is capped at 17.5%. In a guaranteed annuity or with-profit annuity, when life expectancy falls below six years, the annuity payment each year as a percentage of the purchase sum becomes greater than 17.5%.

It is extremely disturbing that living annuities are still marketed by many insurers as 'one-size-fits-all' retirement solutions. Unfortunately, regulations also incentivise advisers to recommend living annuities, because they can earn up to 10 times more remuneration from selling and providing advice on a living annuity than a guaranteed annuity. Even if an adviser can see that an aging client would be better off in a guaranteed annuity or with-profit annuity than being capped in a living annuity, their remuneration stops if they recommend a conversion, and they receive no remuneration for going through the administration of converting their client.

Naming these products 'living annuities' rather than 'dying annuities' was marketing genius, but they will leave many South African retirees who live beyond the age of 80 destitute and dependent on the generosity of their children or the State Old Age Pension.

Conventional guaranteed annuities have required the poor and ill to subsidise the rich and healthy

Conventional guaranteed annuities are provided by insurers that offer one price for all annuitants who are the same age and gender. With these insurers, the poor and ill, who are expected to have shorter life expectancy, subsidise the rich and healthy.

It is not fair that someone who has had to pay higher premiums for life cover, to reflect a higher risk of dying, is treated by insurers as if they will survive to the same age as standard lives once they receive retirement income. They should, instead, receive a higher annuity income over a shorter life expectancy.

South Africa does not yet offer the same level of consumer protection as the UK does, where the Association of British Insurers' Code of Conduct on Retirement Choices requires that conventional guaranteed annuity providers make the following statement during the sales process: "We do not offer a rate based on your health or factors that affect how long you might live, such as medication you take, where you live, your occupation and whether you smoke. This is known as an enhanced annuity and if you are eligible for this type of annuity, another provider could offer you a much higher level of income."

Just Retirement plays a significant role in championing consumer outcomes in any market in which it operates. We offer enhanced guaranteed annuities that provide higher income to those who are relatively poor and ill, and those who have higher risk lifestyle factors, so that everyone is treated fairly.

Paternalistic and opaque with-profit annuities

With-profit annuities should represent the most cost effective way of simultaneously guaranteeing income for life and targeting annual increases in line with inflation. Unlike conventional guaranteed annuities, they invest a significant portion in assets that are expected to grow in line with inflation, such as equities. In the long term, company profits and dividends are expected to grow in line with inflation, whether this is expected or unexpected inflation. However, current with-profit annuities have a number of shortcomings:

- some are opaque, with annual increases determined by the insurer, and no clear link to investment performance;
- others claim to be transparent, but provide no details of the investment portfolio which is managed by in-house asset managers.

Time for a revolutionary new approach to annuities

Just Retirement's ambition is to start an annuity revolution. Moore argues, "there is no 'one-size-fits-all' product for every individual, but rather building blocks: known expenses need to be covered by income that is guaranteed, no matter how long the person lives; and surplus assets can be invested for a rainy day or for beneficiaries." These different needs are met by different products – it is sub-optimal to force an individual into one product for both needs.

Just Retirement's Enhanced With-Profit Annuity

Just Retirement is launching a world-first Enhanced With-Profit Annuity as an optimal solution to provide the guaranteed income a retiree requires to cover known expenses:

- retirees receive a guaranteed income for life that can never decrease, regardless of what happens to investment markets or how long they live;
- this guaranteed income takes into account their specific health and lifestyle factors, so everyone is treated fairly;
- annual increases in their guaranteed income are linked to the performance of best-of-breed investment managers, chosen by independent investment professionals;
- any adjustments to increases are determined by independent professionals - Just Retirement retains no discretion.

Part of a holistic solution

An Enhanced With-Profit Annuity is the ideal partner product for a flexible, low cost living annuity, in which surplus assets can be invested and withdrawn when needed to meet unexpected medical or other expenses in retirement. The combination of essential guaranteed income and surplus assets will differ for each individual.

"We cannot respond to the challenges laid down by National Treasury and the labour unions with deafening silence," says Moore. "Just Retirement is pleased to respond with a world-first product seeking to address the specific issues raised, and to enhance the toolkit of advisers seeking to improve customer outcomes in retirement."

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APPENDIX:

Summary of National Treasury's conclusions on the shortcomings of the annuity market in South Africa

National Treasury published its conclusions on the shortcomings of the annuity market in South Africa and the need for retirement reform in a series of papers between 2012 and 2015. In particular, the following direct quotes are taken from the paper 'Enabling a better income in retirement,' SA National Treasury, 21/9/2012

Living annuities:

- "Most South African retirees who purchase living annuities face a substantial risk of outliving their assets"
- "Average charges of living annuity policies are high"
- "Part of these charges – in particular platform fees and part of fees for financial advice and investment management – represent the implicit and explicit costs of providing investment choice, which relatively few living annuitants use."

Guaranteed annuities:

"Large players in the annuity market rate individual purchasers only by age and sex… expensive for the poor and the sick, who may either subsidise the rich and healthy if they purchase annuities, or may be excluded from the market entirely."