A new living annuity that offers you investments in an income-for-life “asset class”, together with investments in traditional asset classes such as equities, bonds and cash, may offer retirees the best of both ways to provide an income on a single platform.

Research shows that most people who at retirement have to buy a pension with their retirement fund savings want the security of an income for life, which you get when you buy a guaranteed annuity from a life company.

Despite this, most South Africans buy an investment-linked living annuity, which does not provide any security against the risk of outliving your capital. This is because most people do not understand the value of buying a secure monthly pension that is paid regardless of how long you live.

Just, a newcomer in the annuity market, has teamed up with Sygnia, a financial services company that has been disrupting the retirement market by introducing low-cost, index-tracking products.

From March 1, Sygnia will offer retirees a new living annuity called Sygnia ForLife, in which retirees can select, along with other funds on the Sygnia platform, the Lifetime Income Fund, which provides an income for life.

The Lifetime Income Fund is a unitised fund priced and managed by Just, which used to be called Just Retirement until a recent name change by its United Kingdom-based parent company.

Since 2015, Just has been providing annuities for South Africans that are priced to take their state of health into account. The annual pension increases are linked to the performance of independent asset managers.

Deane Moore, the chief executive of Just, says the Lifetime Income Fund on Sygnia’s ForLife living annuity offers an initial income at retirement that is higher than the rate, or percentage, that the Association for Savings & Investment South Africa recommends as capable of sustaining an income for life.

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

He says the benefit of surviving each year outweighs the cost of the guarantee on the income.

You can decide how much to invest in the Lifetime Income Fund and how much to allocate to traditional asset classes (equities and bonds) to enhance your savings so they will generate more income in future, or so you can leave a legacy to your children.

You can also choose whether automatically to phase your savings into the fund over a period.
As is the case when you take out a guaranteed annuity, your investment in the Lifetime Income Fund terminates when you die.

However, as with any guaranteed annuity, you can choose an option that provides an income until either you or your spouse dies, or you can buy a guarantee on the period for which you will receive the income - for example, a guaranteed income for 10 years.

If you die before the guarantee period ends, a lump sum equal to the income stream will be paid to your heirs.

Sygnia’s software can help your financial adviser to determine the trade-off you should make between the Lifetime Income Fund and other investments, by showing you the risk of your investments not providing the income you need.

Sygnia’s software is based on an award-winning paper presented at last year’s Actuarial Society of South Africa’s convention by John Anderson and Steven Empedocles.

Living annuities popular

Although South Africans have traditionally preferred living annuities over guaranteed annuities, many underestimate the risk that their living annuity investments will not provide them with the income they need, forcing them to live on less or rely on their families. Although they may have bought a living annuity so that they could leave their children a legacy, they can end up having to depend on their children for support.

Anderson says that, over the past 15 to 20 years, there has been an increase in the number of retirees choosing a living annuity over a guaranteed annuity, with the result that more people are at risk of running out of money in retirement.

Anderson says product providers have in the past launched hybrid annuities, but these have not been popular because, among other things, some of them forced retirees to convert their living annuities to guaranteed annuities when their savings could no longer sustain a certain income level, while others required retirees to convert to a guaranteed annuity when they reached a certain age. In addition, the guaranteed annuities in hybrid products have often been costly inflation-linked ones.

The income guaranteed by the Lifetime Income Fund will increase over time in line with investment market returns.

Moore says the fund aims to grow the income in line with the inflation rate, but the increase is not guaranteed or fixed, as it would be if you bought an inflation-linked guaranteed annuity.

The investment required to buy a pension with an increase that targets the inflation rate, but where the increase is linked to investment market returns, is typically 30 percent lower than the cost of a pension guaranteed to increase in line with inflation. With the Lifetime Income Fund, the returns are linked to the returns earned by Sygnia’s Skeleton Balanced 70 index-tracking fund.

The investment will be available from March 1 to living annuitants who invest in the Sygnia living annuity using a financial adviser.

Anderson says the Sygnia ForLife living annuity will in future be made available to retirement funds as their default annuity.

The Lifetime Income Fund may also in future be made available through Sygnia’s robo-adviser (internet-based advice offered through an online app).
You can switch providers

If you buy a living annuity, you do not have to stay with the same product provider throughout your retirement; you can switch your annuity to another provider.

Just chief executive officer Deane Moore says that if you invest in the Lifetime Income Fund and switch from the Sygnia ForLife living annuity to another product provider, you may be able to switch your underlying investments in the Lifetime Income Fund, depending on the investment platform.

However, currently you can make an initial investment in the Lifetime Income Fund only through a Sygnia ForLife living annuity.

Case studies: how a guaranteed income can improve your lot

You may think you will not earn the best return from a guaranteed annuity, but this is the wrong way of thinking about your income in retirement.

You need to be concerned about the returns you earn when you are saving for retirement, but in retirement you need to consider the best way to convert your savings into the income you need to live on, and, if you can afford it, the bequest you will leave your heirs.

Guaranteeing part of your income may allow you to invest the balance of your retirement savings more aggressively, improving your income and the potential to leave a legacy to your heirs, John Anderson, a portfolio manager at Sygnia, says.

Sygnia is launching a ForLife living annuity in which you can invest in a unitised Lifetime Income Fund, which provides an income for life in the same way that a guaranteed annuity bought from a life assurer does.

The company tested its Lifetime Income Fund in the real-life case of a 75-year-old who has been retired for 10 years and has R2.5 million in a living annuity in a moderate-growth portfolio, from which he draws an annual income of R312 000. A man aged 75 can expect to live for 12 years, and in this case his investment will, in all likelihood, not sustain the income of R312 000 a year for that period.

Your investment in a living annuity is subject to the performance of the investment markets, which may not deliver the returns you need and may not deliver them each year in the order you need, to ensure your living annuity grows sufficiently while you withdraw an income. This risk is known as the sequencing of returns.

By law, your withdrawals from a living annuity must be between 2.5 percent and 17.5 percent of the amount invested. The limit of 17.5 percent means you cannot deplete all the capital in your annuity; instead, your income will decline each year once you reach the maximum withdrawal rate of 17.5 percent, while your capital is likely to erode, unless you earn very high returns.

Sygnia calculated that the 75-year-old’s family would probably have to contribute R300 000 to supplement his income if he lived for 12 years.

But, if he transferred some of his living annuity investments into the Lifetime Income Fund, the man could maintain his income of R312 000 - partly from the guaranteed annuity and partly from the balance - and it is likely that the remaining investments would be sufficient for him to leave a small legacy of R62 500.

In addition, if he lived beyond the age of 87, he would still receive the guaranteed income.

In another case, a 60-year-old with R3.5 million to invest planned to withdraw only 2.5 percent of her capital - an annual pension of R87 500.

By converting part of her investment to a guaranteed income, she was able to increase her income by 60 percent to R140 000 and make her pension more secure, even if she lived longer than expected.

You have to invest a minimum of R200 000 in a Sygnia ForLife living annuity and R20 000 in the Lifetime Income Fund.