



Quantifying Risk, Enabling Opportunity.

Hybrid Annuities

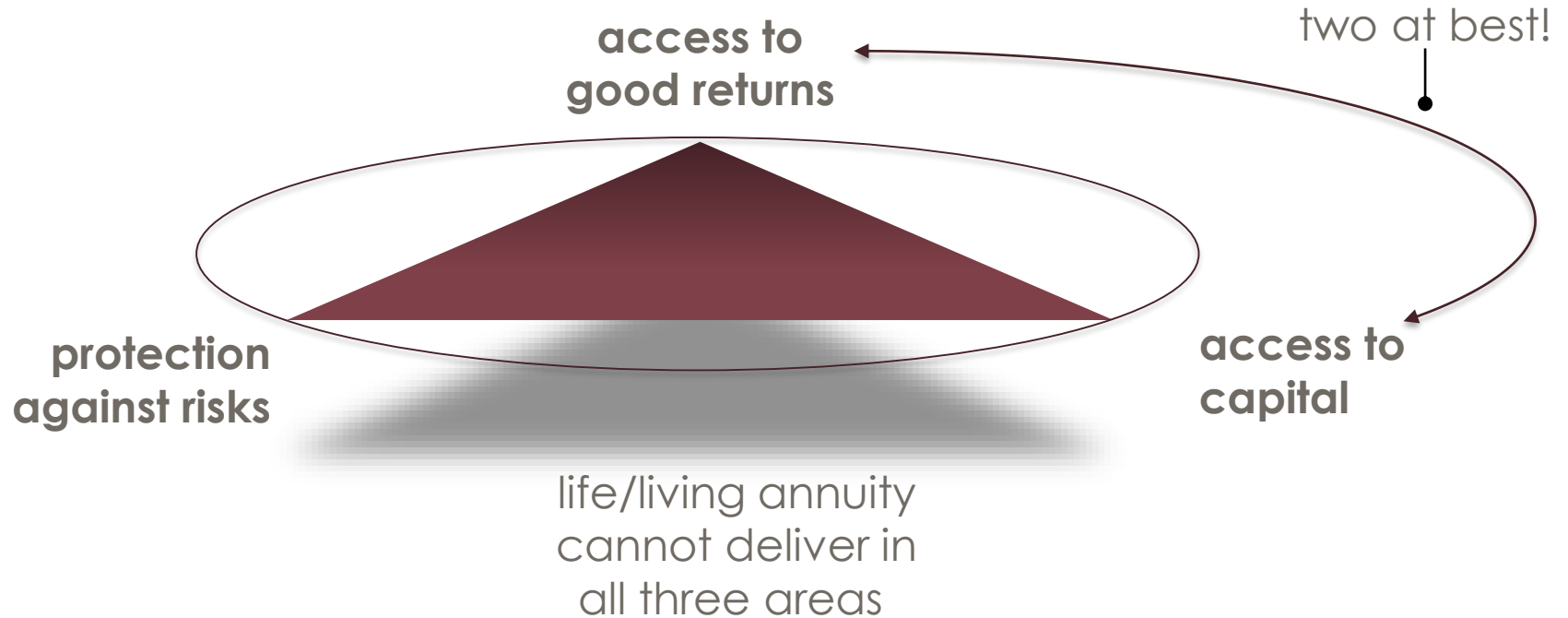
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Retirement trilemma



Partial annuitisation: Background

- Widely accepted that partial annuitisation is **more optimal** for pensioners
- Life and living annuities have **advantages and disadvantages**
- Local and international research
 - **Immediate annuitisation** is more optimal than deferred annuitisation
 - **Improves sustainability** for a given expected **capital legacy**
 - Consume more income with **less risk**

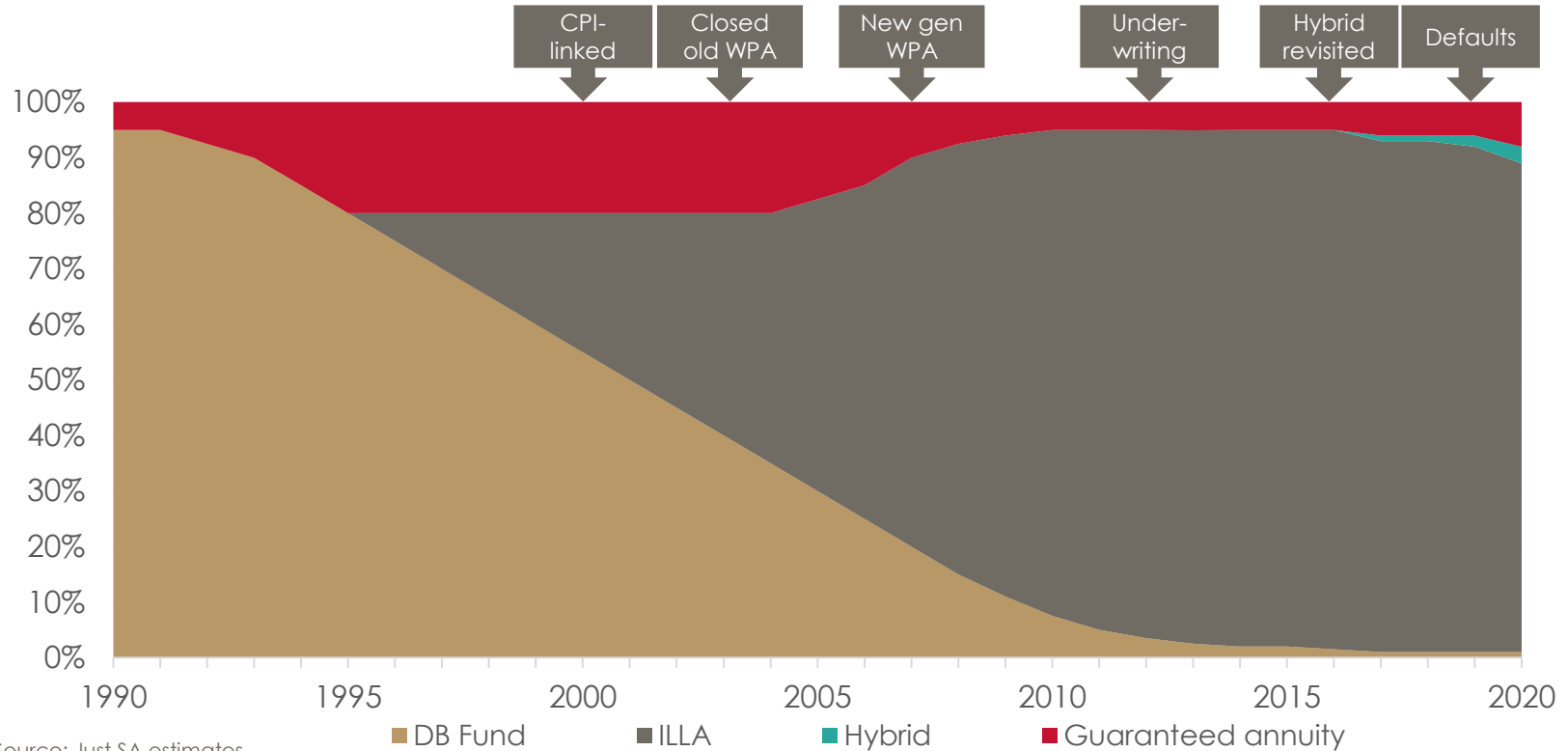
Partial annuitisation: How to split?

- Amount to allocate to lifetime income component?
 - **Personal circumstances** (risk profile, fund credit, discretionary savings)
 - Need for **advice**
 - **Safety first:**
 - Cover essential expenses
 - with income legacy for financial dependant
 - Inflation protection
 - **More aggressive** asset allocation on balance

Partial annuitisation: The landscape

- Developed in **International markets**/already offer a blended approach
 - Social security safety net; plus
 - DC Private provision
- **SA landscape**
 - Little/no social security
 - The **great risk transfer**
 - DB funds closed;
 - 90%+ invested in living annuities
 - Average drawdown % above sustainable levels = unfolding crisis

Annuity market development in South Africa



Regulatory framework

Definitions

1. Splitting/partial annuitisation **at retirement** possible
2. Hybrid products enable partial annuitisation **after retirement**
3. **Hybrid products = Single products = combination** of features from:
 - a) **Guaranteed life annuity**
 - i. Income for life; or
 - ii. Survival credits
 - b) **Living annuity**
 - i. Flexibility
 - Annual Drawdown %
 - Investment choice
 - ii. Capital legacy on death of main member

Regulatory framework

- **Insurance Act** makes provision for “**non-linked**” and “**linked**” annuity benefits
- **Income Tax Act** defines **Living Annuity**
 - **Value of annuity** determined solely by reference to the value of assets
 - **Amount of annuity** is determined in accordance with the method or formula prescribed (currently **2,5% and 17,5% drawdown limits**)
 - **Full remaining value may be paid as lump sum** if below a certain threshold (currently **R125,000**)
 - Amount of annuity **is not guaranteed**
 - Benefits payable to **nominated beneficiaries/estate on death**
- **Prudential Communication 1 of 2021** deals with transfers of “linked” annuities

Regulatory framework: Partial annuitisation

	Allowed	Not allowed
At retirement	Split between in-fund and different products with different insurers (living or guaranteed)	
After retirement	Full transfer of living annuity to different insurer (Single living or guaranteed annuity only)	Split of living annuity to other insurers (living or guaranteed annuities or combinations)
	Split of living annuity within same insurer	

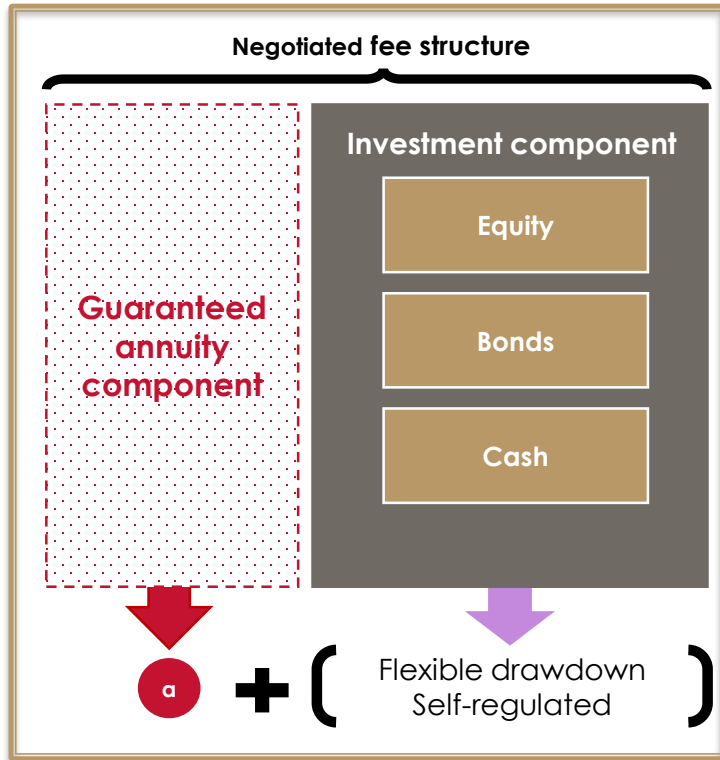
Regulatory framework: Commission/advice fees

	Guaranteed annuity	Living annuity
Upfront	<p>Max 1,5% + VAT</p> <p>Practice = max</p>	<p>Max 1,5% + VAT</p> <p>Practice* = 1,0% average</p>
Ongoing	Not allowed	Not allowed by <u>insurer</u>
		<p>Self-regulated</p> <p>Practice* = 0.6% p.a. average</p> <p>Paid by <u>separate entity</u> (LISP) to adviser based on agreement with client.</p>

Source: Warren Matthysen, 2019, How much does it cost to retire, ASSA Convention

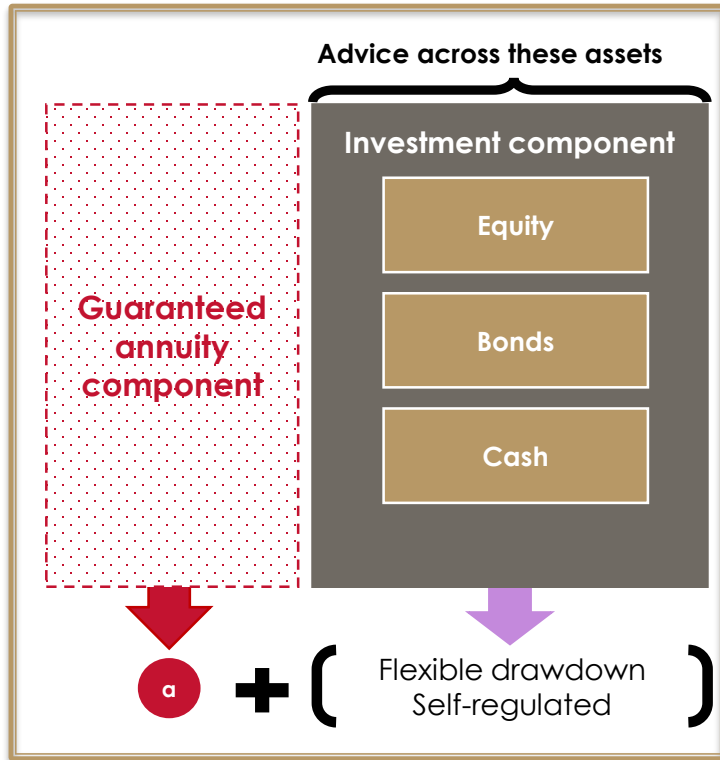
Product Structures

Hybrid products: In-fund



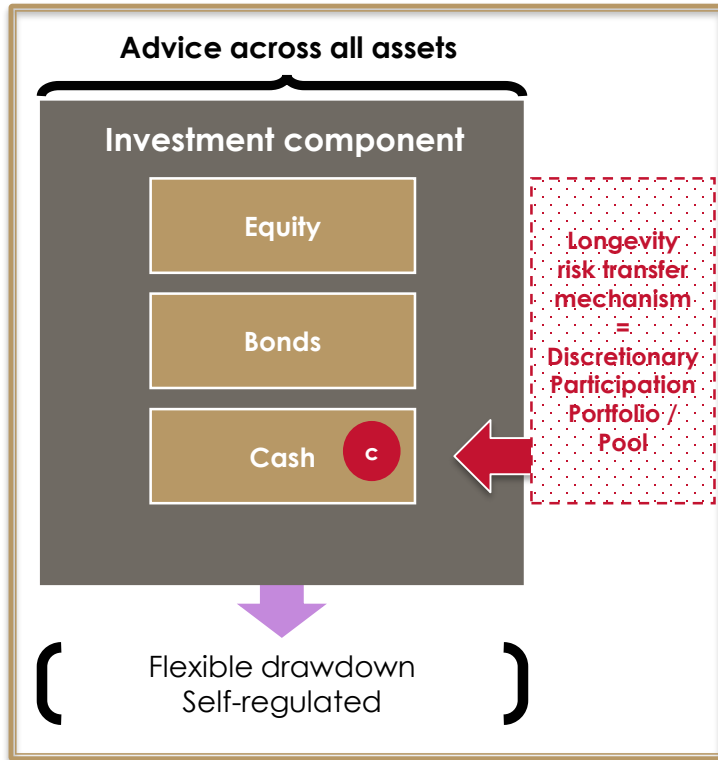
1. Wrapper = retirement fund
2. Requires rule amendments
3. Not transferable
4. Drawdown self-regulated
5. Subsequent guaranteed annuity tranches possible
6. Institutional fee structures negotiated with stakeholders via SLA

Hybrid products: Life annuity #1



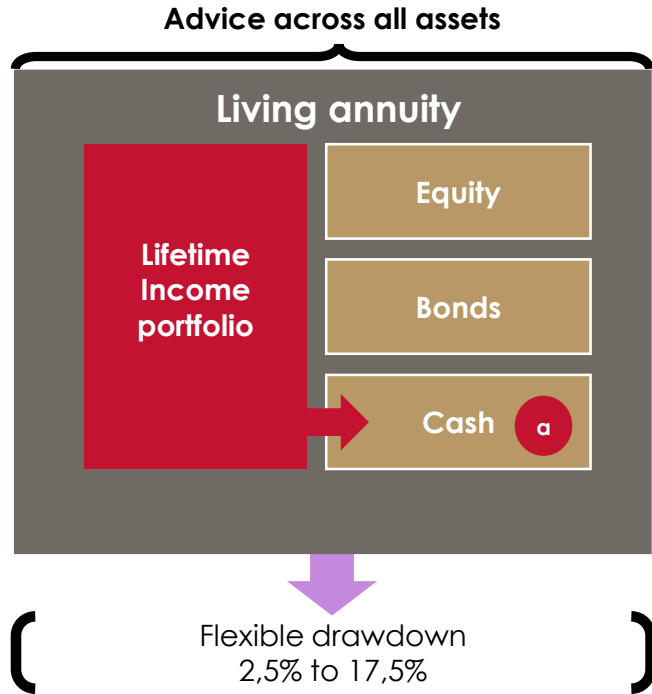
1. Wrapper = conventional life annuity
2. Requires non-linked life license
3. Not transferable
4. Drawdown self-regulated
5. Subsequent guaranteed annuity tranches possible

Hybrid products: Life annuity #2



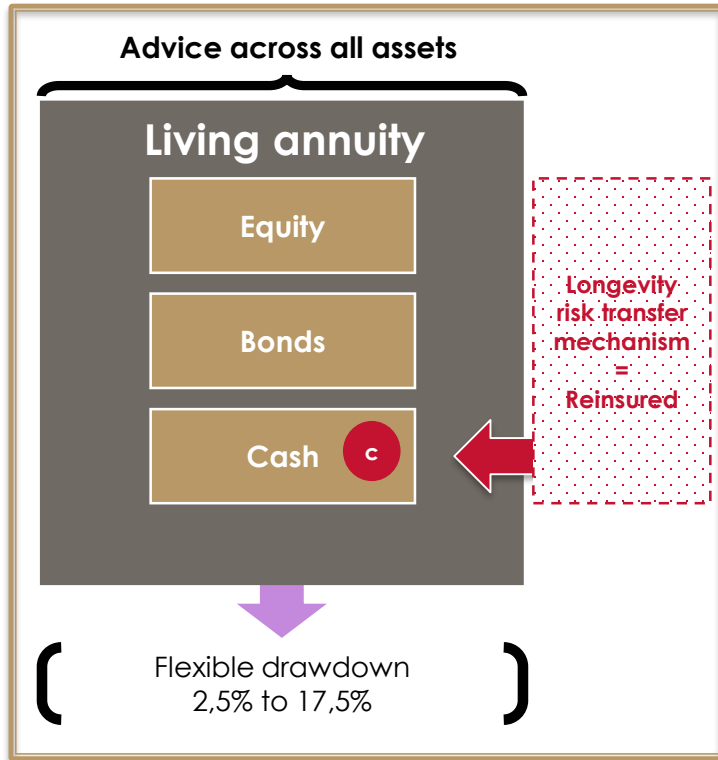
1. Wrapper = conventional life annuity with Discretionary Participation features
2. Requires non-linked license with DPP and PPFM
3. Not transferable
4. Drawdown self-regulated
5. Can increase risk transfer % over time

Hybrid products: Living annuity #1



1. Wrapper = living annuity
2. Requires linked life license
3. Transferable (provided transferee will accept lifetime income portfolio).
4. Subsequent tranches possible
5. No upfront commission payable on subsequent tranches

Hybrid products: Living annuity #2



1. Wrapper = living annuity
2. Requires linked life license
3. Transferable (provided transferee can replicate structure or replace reinsured portion with guaranteed annuity).
4. Can increase risk transfer % over time

Summary

	In-fund	Life #1	Life #2	Living #1	Living #2
Type	In-fund	Guaranteed life annuity		Living annuity	
Life license	n/a PFA	Non-linked		Linked	
Lifetime income offered	In-fund guaranteed annuity	Guaranteed Life Annuity	Survival credits only. Not guaranteed.	Guaranteed Life Annuity	Survival credits only. Not guaranteed.
Transferable	No			Yes, subject to transferee acceptance	
Ongoing advice	Negotiated by Trustees	Investment component	All assets		

Further considerations

1. Advice frameworks

- a) Paradigm shift required to incorporate “Safety First” approach
- b) Training on new products and tools

2. Client communication

3. Fees

- a) No additional charges compared to standalone components

4. Regulatory change

a) Default regulations

- i. Hybrid living annuities can apply for exemption 37(2)(g)
- ii. FSCA Conduct Standard on Living Annuities in an annuity strategy (Draft)

b) Industry lobby for **splitting after retirement**

c) **Consolidation** of retirement accounts

Conclusion

1. Industry **innovation** overcomes regulatory hurdles
 - a) Enables partial annuitisation after retirement
 - b) Removes conflict of interest for advisers
2. Improved outcomes for pensioners
 - a) Partial annuitisation is **more optimal** for pensioners than either/or.
 - b) Improves sustainability** for a given expected capital legacy
 - c) Consume more** with less risk

Questions