BRENTHURST WEALTH MANAGEMENT

INVESTMENT REPORT

BRENTHURST
THE HOME OF WEALTH

www.brenthurstwealth.co.za

NOVEMBER 2012 • ISSUE 213

In this issue

JHB: +27 11 799 8100
CPT: +27 21 914 9646
PTA: +27 12 460 0340

Global Markets AND SA ECONOMY

INCOME CHOICES AT RETIREMENT

BRENTHURST WEALTH

You have just retired and now have to use at least two-thirds of your accumulated retirement savings balance to buy products that qualify as annuities to comply with the Income Tax Act – part of mandatory annuitisation in South Africa.

But which product to buy? Should you opt for guaranteed payments from a conventional guaranteed annuity product, purchased from an insurer, which will guarantee you an income until the day you die? Or should you invest your money in a living annuity, which is linked to an investment portfolio where you can draw down money, choosing a percentage between 2.5% and 17.5% annually?

Earlier this year in June, the Association for Savings & Investment South Africa (ASISA) released a survey in which they found that in 2011 alone living annuities attracted new inflows of R23.9bn. In total, the ASISA study showed, South Africans had R155.2bn of their retirement savings invested in some 278 000 living annuities at the end of last year.

The study was the first of its kind as living annuity providers only had to start providing an annual status report to ASISA since the *ASISA Standard on Living Annuities* came into effect in 2010.

REASON FOR CONCERN

The main concern with living annuities has been, and still is, that policyholders will draw down too much income, erode their capital, and create a situation where there is a generation of impoverished retired citizens who outlive their capital stores. This concern has already led to government reducing the drawdown rate a number of years ago. The drawdown rate can be reviewed once a year on the anniversary date of the policy.

According to Peter Dempsey, deputy CEO of ASISA, the average income drawdown level in 2011 was 6.99%. In September National Treasury released a discussion document titled *Enabling a better Income in Retirement*. Also using ASISA numbers the paper shows that the median living annuity policy has a drawdown of between 7.5% and 10% per year and that the average policy has a drawdown rate of 9.05% annually – significantly higher than the 6.99% in the ASISA study. These rates are before fees, which may add up to 2% to these values each year.

Simply put, the performance of the underlying investments should be your chosen drawdown rate plus inflation plus whatever percentage of your capital is going to fees to keep the capital level at the same real level. This obviously increases as you increase your selected drawdown level.

Although Dempsey believes the average drawdown rate is lower than expected Treasury remains concerned about living annuities and suggested some regulatory changes to:

- Increase competition
- Reduce the amount of financial advice they require and
- Reduce their costs.

But are living annuities inherently a bad product, which should be avoided? To answer this, lets first take a simplified look at the options open to retirees.

THE OPTIONS:

To comply with the law South African members of pension funds and holders of retirement annuities have to use at least two-thirds of their accumulated balances to buy products that qualify legally as annuities. Members of provident funds may withdraw their entire retirement balance in cash when they retire, but can purchase annuities if they wish.

THERE ARE TWO MAIN TYPES OF PRODUCT THAT QUALIFY AS ANNUITIES :
THE CONVENTIONAL LIFE ANNUITY AND THE PHASED-WITHDRAWAL PRODUCT OR LIVING ANNUITY.

1) CONVENTIONAL GUARANTEED ANNUITIES

Conventional annuities provide an income for life, guaranteed by an insurance company or a pension fund, regardless of how long the purchaser lives.

Niel Fourie, Public Policy Actuary at Actuarial Society of South Africa, explained the concept on RSG radio in a program on the topic, stating that conventional guaranteed annuities work on the insurance principle where some policyholders (those who die earlier) subsidize the others (who live longer).

Some of the general options include an inflation-linked guaranteed annuity where the amount increases annually in line with the inflation rate; payments may increase in line with investment returns (with-profit); at a fixed rate or another option is a level annuity where payments do not increase over time. There are also options for your spouse to receive a lower, regular amount once you pass away until he or she also passes away. After that any capital that still remains belongs to the insurer.

According to the National Treasury paper evidence suggests that about 90% of conventional life annuities sold are “level” annuities and that today only about 20% of retirees choose conventional guaranteed annuities.

2) LIVING ANNUITIES

Fourie explains that a living annuity is linked to an investment portfolio, but that as you can choose what percentage to draw down on your capital, you could soon sit without an income if the capital is depleted.

The major reason for the popularity of living annuities seems to be that annuity purchase behavior is driven strongly by short-term considerations. Often retirees don’t have enough capital saved to provide for a retirement income from a guaranteed annuity that is on par with what they are used to. A living annuity then offers the option to draw down a higher percentage.

One positive of a living annuity is that if you die before your capital is depleted, the balance can be left to your family. With longevity rising especially amongst the middle and upper class, the chances of this happening, however, diminishes.

WHICH TO CHOOSE?

Both of the broader product categories – guaranteed or living annuities – have their advantages and disadvantages.

For longevity protection and certainty, guaranteed annuities are a good product choice.
Treasury does highlight that since annuity income may be paid for 30 years or more, people who buy these run the "small" risk that the company guaranteeing their payments could become insolvent. Any capital that is left when you die and your spouse has also passed away (if spousal protection was chosen) will belong to the insurer and subsidize policyholders who outlive their capital.

If you have a larger amount with which to purchase an annuity, say around R2m and more, a living annuity can be the right product for you if you understand the complexities and manage it correctly.

This is also the obvious choice if you believe that the capital amount is enough to outlast you and you would like to leave the remainder to your family (although a back-to-back guaranteed annuity where a lump sum death benefit is payable is also an option).

In addition, living annuities are even more attractive when it is used in conjunction with other assets to supplement an income, such as discretionary investment portfolios, cash or rental properties.

The tax treatment of both products entail that either the insurance company (guaranteed annuities) or individual (living annuity) pays tax on the income earned by the assets, but that the policyholder does pay income tax at the standard rate on the regular or drawdown payment.

GET GOOD ADVICE, CONSIDER WISELY

In the discussion paper National Treasury bemoans the fact that while the retirement system provides a strong support structure (including a savings obligation) during an employee's working life, this support structure is withdrawn for the vast majority at retirement and you are left to your own devices to make the choice.

Whether you decide to settle on a guaranteed annuity or take the risks associated with a living annuity, one thing is clear: Make sure you understand the difference and have a financial services adviser that you trust and that could provide you with some scenarios on what would be needed to maintain the standard of living you envisage – if possible. If you do opt for a living annuity remember that every time you consider raising the drawdown rate without a guarantee of returns to sustain your capital level, you run the risk of outliving your money and possibly becoming dependent on others or the state – a scary and sobering thought at the very least.

CONCLUSION:

Much of the recent media coverage of this issue has been unbalanced and did not provide a proper perspective of the myriad issues involved in making the correct choice. A living annuity when properly used as part of an overall investment portfolio offers the chance for a lifelong portfolio which can generate- inflation adjusted income over the lifetime of the investor.

Another important distinction between the two general types of annuities is that with a traditional (guaranteed) annuity the investor will only require investment advice once.

With the living annuity the investor will require on-going advice for as long as the product is in existence.

BRENTHURST RECEIVES TOP HONOURS

The Financial Planning Institute (FPI) has recently introduced the FPI Approved Professional Practice™ brand which makes it easier for consumers to identify financial planning practices that adhere to the highest standard of professionalism.

The Approved Professional Practice™ accolade is only bestowed upon a practice once certain rigorous criteria have been met, which includes amongst others that at least 60% of the planners are Certified Financial Planners™ and at least one CFP™ professional is a key individual.

Brenthurst Wealth Management (Pty) Limited is therefore proud to announce that we have recently been awarded top honours by the Financial Planning Institute of South Africa (FPI) as an Approved Professional Practice (APP), of which we are one of only five financial planning companies countrywide to have been given this accolade. Kindly refer to the following link: **http://www.fpi.co.za**

BRENTHURST WEALTH FINANCIAL PLANNERS:

MAGNUS HEYSTEK I BRIAN BUTCHART I JOHAN BURGER I RENEE EAGAR ISONIA DU PLESSIS I JANA GOUSSARD I MAGNUS L HEYSTEK I RICHUS NEL

INVESTMENT STRATEGIST:

MAGNUS HEYSTEK
magnus@heystek.co.za
+27 83 692 8635

INVESTMENT ADVISORS:

BRIAN BUTCHART CFP ®
brian@brenthurstwealth.co.za
+27 82 335 5117

JOHAN BURGER CFP ®
johan@brenthurstwealth.co.za
+27 82 732 8655

SONIA DU PLESSIS CFP ®
sonia@brenthurstwealth.co.za
+27 83 260 4055

RENEE EAGAR CFP ®
renee@brenthurstwealth.co.za
+27 83 233 9373

INVESTMENT ADVISORS:

JANA GOUSSARD AFP™
jana@brenthurstwealth.co.za

RICHUS NEL
richus@brenthurstwealth.co.za

MAGNUS (JNR)HEYSTEK
magnus1@brenthurstwealth.co.za

TAX & ACCOUNTING:

GAVIN BUTCHART
gavinb@brenthurstwealth.co.za

MARKETING:

SUE HEYSTEK
sue@brenthurstwealth.co.za

RECEPTION JHB:

ANTJE MOUTON
reception@brenthurstwealth.co.za

CLIENT SERVICE (JHB /CPT / PTA):

ESMERIE LOOTS
esmerie@brenthurstwealth.co.za

YOLANDI BURGER
yolandi@brenthurstwealth.co.za

SUZEAN HAUMANN
suzean@brenthurstwealth.co.za

CELESTE PHAKHATI
celeste@brenthurstwealth.co.za

ALLIE SIKHOSANA
allie@brenthurstwealth.co.za

ERNA MARÉ
erna@brenthurstwealth.co.za

CHRISTOFF POTGIETER
christoff@brenthurstwealth.co.za

ROZANNE HEYSTEK
rozanne@brenthurstwealth.co.za

BRENTHURST WEALTH MANAGEMENT (PTY) LTD

JOHANNESBURG: Building 3 Prism Business Park | Cnr Fourways Boulevard & William Nicol Fourways | Gauteng SA
Tel: +27 (0) 11 799 8100 | Fax: +27 (0) 11 799 8101 PO Box 10150 Fourways East | 2055 Gauteng South Africa

PRETORIA: 157 Banket Rd| Waterkloof | Pretoria | SA
Tel: +27 (0) 12 460 0340 | Fax: +27 (0) 12 346 8453

CAPE TOWN: Tyger Waterfront I Waterfront Terraces Block 2 I Waterfront Road I Carl Cronje Drive I Bellville| W Cape
Tel: +27 (0) 21 914 9646 | Fax: +27 (0) 21 914 6515 Postnet suite 275 P/Bag X22 |Tygervalley |7536|Cape Town SA

Brenthurst Wealth Management (Pty) Ltd. is an authorised FSP in terms of the FAIS Act, 2002(FSP No 7833) .
Brenthurst Wealth Management (Pty) Ltd. is an associate of the Stonehouse Capital Group