RE: COMMENTS ON THE PROPOSALS TO EXPAND THE ACCESS TO “LIVING ANNUITIES”

SAIT welcomes the opportunity to comment on the proposals to expand the access to “living annuities” as part of Government’s response to the effect of COVID-19 on the economy and individual South Africans.

1. BACKGROUND

1.1 Introduction

1.1.1 At retirement, individuals have certain options available regarding permissible withdrawals of contractual “retirement interest”. In the case of pension funds and individual retirement annuities, up to one-third of available savings may be withdrawn as a lump sum while the two-thirds balance must to be paid out via an annuity.

1.1.2 Annuities can be in the form of guaranteed annuities or a living annuities. Guaranteed annuities generally provide benefits until the death of the recipient and/or the spouse. Living annuities operate more like a savings account with benefits solely based on fund accumulations.
1.1.3 Living annuities in particular, have the following characteristics:

- The total value of the annuity must be linked to the value of the assets or “retirement interest” used to purchase the annuity;
- The drawdown level chosen by the recipient must be set as per Government regulation (currently between 2.5 per cent and 17.5 per cent);
- Once the total value of the assets or savings falls to a level established through Government regulation, the total amount may be withdrawn as a lump sum;
- The amount of the annuity cannot be guaranteed by the provider; and
- When the recipient dies, the remaining savings may be withdrawn by their nominee as a lump sum or continued as an annuity.

1.1.4 As a practical matter, guaranteed annuities and living annuities are very different products. In the case of a guaranteed annuity, the risk of longevity falls on the product provider. In the case of living annuities, the risk of performance rests solely with the recipient. In short, with a “living annuity”, payments are not guaranteed for life; once the capital savings are depleted, the annuity ends.

1.1.5 The effect of the COVID-19 crisis on financial markets have been a significant drop in the value of the underlying capital investments supporting living annuities. The result is that previously identified challenges have become more pervasive and their effect exacerbated.

1.1.6 The current “living annuity” structure is based on the traditional retirement model, where a person works (and saves faithfully) until they are in their 60s, whereupon they retire and primarily live off their “retirement interest” in the form of an annuity.

1.1.7 The reality for many South Africans is that they either:

- Need their entire “retirement interest” in one lump sum (the current provident fund model), due to not saving sufficiently over their working life (challenge 1), or alternatively
- Start a second career after their “retirement” and therefore do not need to draw down on an annuity until much later in life (challenge 2).

1.2 Challenge 1

1.2.1 Living annuity holders caught in challenge 1, have in the past been affected by the 1/3 limitation: Due to their “retirement interest” from a pension or retirement annuity fund exceeding R225 000 (R75 000 = 1/3) upon retirement, they could only take 1/3 as a lump sum. E.g. R300 000 in “retirement interest” would allow a R100 000 lump sum payout and a R200 000 living annuity.

1.2.2 Since the costs (asset management and administration costs) of managing a living annuity are high, the growth in a typical living annuity could easily be outstripped by the costs, resulting in a rapidly diminishing capital balance and quite soon, a retiree with no income. The value of these low-value “living annuities” are now further diminished by the drop in the financial markets, making the annuities no longer cost effective to maintain.
1.3 Challenge 2

1.3.1 Living annuity holders caught in challenge 2, have been affected by the “living annuity” drawdown regulation in that, even where their employment/business provided sufficient income, they were forced to draw down on the living annuity at a rate of at least 2.5% per annum.

2. PROPOSALS

2.1 Proposal 1

2.1.1 Referring to the “NOTICE IN RESPECT OF METHOD OR FORMULA FOR PURPOSES OF DETERMINATION OF AMOUNT FOR PURPOSES OF PARAGRAPH (b) OF DEFINITION OF LIVING ANNUITY IN SECTION 1(1) OF INCOME TAX ACT, 1962”.

2.1.2 The proposal is to temporarily allow individuals who receive funds from a “living annuity” to immediately either increase (to 20% from 17.5%) or decrease (from 2.5% to 0.5%) the proportion of the value of the “living annuity” that they receive as income, instead of waiting up to one year till their next contract “anniversary date”.

2.1.3 The stated aim is to assist individuals who either need cash flow now or who do not want to be forced to sell after their investments that have underperformed (addressing challenges 1 and 2 in the short-term).

2.1.4 It is proposed that the measures be implemented for a limited period of four months starting from 1 May 2020 and ending on 31 August 2020.

2.2 Proposal 2

2.2.1 Referring to the “NOTICE IN RESPECT OF AMOUNT OF VALUE OF ASSETS THAT MAY BE PAID IN LUMP SUM FOR PURPOSES OF PARAGRAPH (c) OF DEFINITION OF LIVING ANNUITY IN SECTION 1(1) OF INCOME TAX ACT, 1962”.

2.2.2 It is proposed that, effective from 1 May 2020, the 1/3 lump sum be increased from R75 000 to R125 000.

3. COMMENTS

3.1 Proposal 1

3.1.1 With very few exceptions, the impact of COVID-19 on financial markets has been catastrophic. As per an article published by the IMF1, “This makes the Great Lockdown the worst recession since the Great Depression, and far worse than the Global Financial Crisis”. In our view, the 4 month period as per proposal 1 should be extended to at the next 12 months to assist individuals who either need cash flow relief now or who are in the position that they can wait until the financial markets pick up again before dipping into their capital value.

3.2 Proposal 2

3.2.1 As per our understanding, the result of Proposal 2 will be that as from 1 May 2020:

- Individuals that elect to retire from pension or retirement annuity funds may withdraw their entire “retirement interest”, should the value of the “retirement interest” not exceed R375 000 as at retirement; and

- Individuals in receipt of an existing “living annuity” may commute (cash-in) a “living annuity” –
  - If the individual did not commute any portion of their “retirement interest” and subject to the terms and conditions of the “living annuity”, the total value of the “retirement interest” on the “retirement date” of the individual did not exceed R225 000; or
  - If the individual did commute any portion of their “retirement interest” and subject to the terms and conditions of the “living annuity”, the value of the “living annuity” becomes at any time less than R125 000.

3.2.2 We welcome the proposal and support the measures to assist individuals to access their “retirement interest” during this time of crisis.

End.