**Media Release**
**Actuarial Society of South Africa**
**6 March 2019**

## Three steps in the right direction for retirement savings

As of this week, South Africans who are members of a pension or provident fund will hopefully start to feel the impact of three new regulations on their retirement savings.

These so-called default regulations came into effect on 1 March 2019 and affect three important areas of retirement saving: how your contributions are invested while you are accumulating savings (Regulation 37 of the Pension Funds Act), how easy it is to leave your savings invested when you change jobs (Regulation 38) and the options you have available to convert your retirement savings into a monthly pension for life when you retire (Regulation 39). Members will also benefit from retirement benefits counselling to provide information and explain the implications of these default options.

### The significance of Regulation 39

Twané Wessels, a member of the Investments Committee of the Actuarial Society of South Africa (ASSA), says in terms of National Treasury's Regulation 39 of the Pension Fund Act, all retirement funds are now required by law to assist retiring members with solutions to enable them to convert their accumulated savings into a sustainable retirement income.

She says the aim is to make it easier and cheaper for retirement fund members to buy retirement income solutions that will help them achieve a sustainable income for life. She says the default options put in place by retirement funds could consist of guaranteed life annuities (including with-profit annuities), living annuities, or a combination of both.

Wessels says while this is the first step in what will be a long journey to enable a better later life for South Africa's pensioners, it is certainly a step in the right direction.

"The introduction of annuity strategies will go a long way in assisting South Africans with the biggest financial decision of their lives, which is what to do with their hard-earned life-savings when they reach retirement," notes Wessels.

The new regulations place a strong emphasis on the sustainability of retirement income. Wessels says it will assist in alleviating an enormous burden on the Government.

According to the South African Social Security Agency there were 3.5 million old age grants in payment at the end of December 2018 totalling about R70.5 billion for the year. "This is an enormous burden on the State, and at the same time the R1 780 per month old age grant does not necessarily provide much relief to the country's pensioners," says Wessels.

**Tough financial decisions at retirement**

Wessels says generally retirees hope to achieve two goals when retiring from their retirement funds. The first is to have sufficient monthly income to be able to meet their needs in retirement. The second is to provide for a death benefit for beneficiaries.

Individuals retiring from a retirement fund are allowed to take some (if a pension fund) or all (if a provident fund) of their savings as a lump sum. However, the reality is that the universal need for people in retirement is not a lump sum but rather an inflation adjusted monthly income. To provide such a monthly income using their accumulated savings, members have three choices: buy a life annuity, a living annuity, or opt for a combination of the two options.

She says while this sounds simple and straightforward, it is not. "Circumstances and financial needs differ from individual to individual and the choices made at and during retirement will determine whether a retirement income lasts for the rest of a person's life or whether the capital is depleted and the pensioner has to then rely on the Government grant or family support or both."

Unfortunately, according to Wessels, many South Africans who did not save enough for their retirement are opting for living annuities because of the ability to draw a higher income in the early years of retirement and because there is the hope that something could be left for beneficiaries.

Wessels says research by actuaries John Anderson and Steven Empedocles explored the question of combining a life annuity with a living annuity.

The two actuaries made the important point that basing a retirement strategy on the expectation of a death benefit is a double edged sword as the death benefit is a positive feature only as long as there is capital remaining. However, the key risk with living annuities is running out of capital. Once this has happened, the death benefit turns negative. Instead of leaving a death benefit to beneficiaries pensioners become dependent on their families or the Government.

Wessels says the majority of retirees can better meet their financial goals in retirement by allocating all or some of their savings to a life annuity and allowing an insurer to manage the various risks associated with providing a sustainable lifetime income.

"Where retirees opt to use a portion of their retirement savings to buy a life annuity and invest the rest in a living annuity, the risk of depleting capital is managed. The retiree doesn't have to draw down as much of their capital when markets have performed poorly, like we have seen over the last few years."

She adds that the insurer would be managing the risks in the life annuity, and therefore the retiree does not have to be so conservative with the living annuity assets and is able to rather invest in more growth assets that are expected to provide a higher return. A life annuity can also be structured to suit individual circumstances by ensuring the benefit is paid for a minimum period even if you die (this adds a death benefit element to it) and by making sure that a portion of the annuity will continue to be paid to a surviving spouse or partner after your death.

Wessels points out that life annuities can be considered true insurance, while living annuities are a form of self-insurance. “You can self-insure if you have enough savings to do so. For example if you have a large amount of savings you don’t have to have car insurance as you can simply use those savings to replace your car in the event of something happening to your car.”

In the case of annuities, self-insurance means having enough capital to last as long as the pensioner lives, irrespective of how long that might be or what happens to investment markets. Unfortunately, says Wessels, the majority of pensioners do not have enough savings to self-insure the sustainability of their income for an uncertain lifespan.

She says rather than trying to compare and then choose between these two fundamentally different products, for some pensioners there is merit in considering a combination of the two annuity options.

**How default options can make a difference**

Wessels says while the lack of adequate savings for retirement remains a critical problem, default annuity options are likely to enable better decisions for the savings available to pensioners.

“While retirees will still be able to use a financial adviser and opt for any of the products available on the broader market, retirement funds will from now on be required to provide quality, easy-to-access solutions supported by simple communication and guidance.”

**Ends**

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**Issued on behalf of:**
The Investment Committee of the Actuarial Society of South Africa

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