



Life annuities:

The balance between the **starting income** and **annual increases**

When they retire, most pensioners want to maintain their standard of living and protect their money against market fluctuations.

A retiree can use their retirement savings to buy a life annuity from an insurer. A **life annuity** is an **insurance policy** where the pensioner secures a **guaranteed income** for the rest of their life. They must also decide on the type of life annuity and consider the starting income of the annuity and the expected annual increases. Their choice will depend on their requirements and affordability.

Types of life annuities

With-profit annuity

A with-profit annuity's annual increase is based on the investment returns of the underlying Bonus Generating Portfolio (BGP). Once an increase is granted, the new pension amount is guaranteed. Although future increases are not guaranteed, they can never be negative. The minimum bonus is 0%, which means their annuity income will never decrease.

The starting pension is usually around 20% higher than an inflation-linked annuity. The higher starting pension is a result of investing in the BGP, which is expected to deliver higher returns than the underlying assets of an inflation-linked annuity. The BGP also targets increases in line with, or a percentage of inflation, rather than guaranteeing such increases. Generally, over the long term, with-profit annuities have been able to deliver increases in line with the expected outcome.

Although future increases are not guaranteed, the pensioner has peace of mind that the initial annuity and all declared annual increases are guaranteed for the rest of their lives.

The starting pension of a with-profit annuity can be adjusted, so the lower the inflation-targeting percentage, the higher the starting pension and the higher the inflation-targeting percentage, the lower the starting pension.

Level annuity

A level annuity provides no future increases and the pensioner will receive the same monthly income for the rest of their life. This annuity pays the highest starting income of the four types of life annuities. The pensioner usually benefits over the first 10 years, but the purchasing power of the annuity reduces over time. In an economy like ours, where there is inflation risk, the retiree should carefully consider the risks before buying this annuity.

Fixed-escalation annuity

A fixed-escalation annuity provides guaranteed future increases at a fixed percentage chosen by the retiree. For example, if an increase of 5% is selected, the pensioner's monthly income will increase annually by 5%. The pensioner has a level of protection against the reduced purchasing power of the pension, but they have no protection against high inflation rates. The lower the percentage of the fixed increase, the higher the starting pension.

Inflation-linked annuity

Future increases are based on the published inflation rate. Many retirees will be tempted by this option as the purchasing power of their annuity is maintained irrespective of the inflation level. The downside is that the starting pension is the lowest in comparison to the other annuity types, and for many, this is unaffordable.

Starting pensions of life annuities

The starting pensions of the 4 types of life annuities are compared in the table. This example is based on a 65-year-old male with R1 million retirement savings who chooses a 5-year guarantee period and a 50% spouse's pension on his death.

	Momentum Golden Income With-Profit Annuity	Inflation-linked annuity	Fixed-escalation annuity	Level annuity
Starting income Indicative quotes on 1 January 2023	R76 200 pa (2% PRI: 100% inflation targeting) R84 600 pa (3,5% PRI: 70% inflation targeting)	R61 600 pa	R77 700 pa (5% fixed-escalation pa)	R111 600 pa

Post-retirement interest rate

A unique feature of a with-profit annuity is the post-retirement interest rate (PRI).

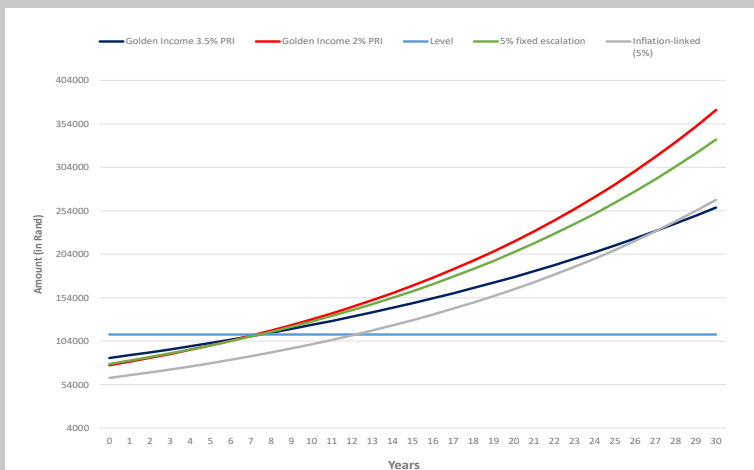
The PRI is the minimum investment return that the BGP must earn before any increase will be granted at the next policy anniversary. Returns above the PRI are used to grant the annual increase.

The Momentum Golden Income With-Profit Annuity offers a range of PRIs from 0% to 3,5% in increments of 0,5%. The PRI determines the size of the initial annuity income and the level of future increases.

- The higher the PRI, the higher the starting annuity income, but the lower the future expected increases.
- The lower the PRI, the lower the starting annuity income, but the higher the future expected increases.

For each PRI, we will show the targeted level of long-term inflation protection. The pensioner must choose a PRI based on their requirements around the level of starting annuity and the need for inflation protection of this annuity. For example, the Momentum Golden Income With-Profit Annuity with a 2% PRI, has an objective to provide increases in line with inflation. A pensioner who wants 100% inflation protection will choose this option. If this means that their starting pension is too low for their current needs, they could increase their PRI to 3,5% in this example. Their pension increases are now only expected to provide 70% inflation protection over the long term.

Expected annuity projections based on the starting pensions:



The graph highlights the path of the different annuities as increases are granted over time.

Although the main aspects when choosing between the available life annuity options are the starting pension and the expected increases, there are other details that should also be considered .

We have assumed that the with-profit annuity meets its objective and provides increases in line with an inflation rate of 5% per annum.



The table compares the four types of life annuities:

	Momentum Golden Income With-Profit Annuity	Inflation-linked annuity	Fixed-escalation annuity	Level annuity
Starting income Indicative quotes on 1 January 2023	R76 200 pa (2% PRI: 100% inflation targeting) R84 600 pa (3,5% PRI: 70% inflation targeting)	R61 600 pa	R77 700 pa (5% fixed-escalation pa)	R111 600 pa
Annual income increases	Income increases annually through declared bonuses, that are based on the smoothed performance of the underlying Bonus Generating Portfolio.	Income increases annually in line with the Consumer Price Index (CPI) rate published by Stats SA.	Income increases annually by the fixed percentage selected at inception.	No annual increases.
Inflation risk	Increases are not guaranteed and there is an inflation risk. With-profit annuities have shown over the long term that it provides pensioners with targeted inflation protection.	Increases are linked to the published CPI, so there is no inflation risk for pensioners.	The increases are guaranteed at a fixed percentage. A 5% fixed-escalation annuity is below the current inflation rate, and as inflation rises, the purchasing power of the annuity is reduced.	In an inflationary economy such as South Africa, the real value of the pensioner's income will be drastically reduced by inflation over time.
Investment risk and future returns	Pensioners share in the upside potential of the investment market. There is downside protection through a guarantee that increases can never be negative.	Pensioners do not participate in future investment performance.		
Selections required	Pensioners must choose the level of inflation protection that they want to target.	None	The level of the fixed percentage for annual increases.	None
How long the pensioner will receive an income	Income is guaranteed and will be paid for the rest of the pensioner's life, or the chosen guarantee period, whichever is longer. Their income will never decrease, and any increases will form part of the new minimum guaranteed income level.			

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