RETIREMENT INCOME CONSIDERATIONS

Investment-Linked Lifetime Income Plan

THINK WORLD CLASS

glacier by Sanlam

WHICH TYPE OF RETIREMENT INCOME PRODUCT TO PURCHASE?

No matter who we are, we all need to make certain decisions when it comes to retirement planning. These include deciding which type of retirement income product to purchase to ensure that our income needs will continue to be met throughout retirement.

Longevity risk
The risk that you, the client, may live longer than expected, which leads to your running out of a post-retirement income later in life. This risk is becoming ever more relevant given that life expectancy is increasing globally.

Investment risk
The risk that your income and capital (if the product allows for capital preservation) is negatively affected by investment returns from your underlying investment portfolio being worse than expected.

Inflation risk
The risk that the purchasing power of the income provided by your chosen product is eroded due to the level of income not keeping up with inflation.

IT IS IMPORTANT TO CONSIDER THE RISKS WE FACE RELATING TO RETIREMENT INCOME

There are a number of retirement income products from which one can choose. The most suitable one for your individual needs will depend on your expenses, and the extent to which you are willing to accept the risks outlined above. Whether longevity risk is an important consideration, will depend largely on the state of your health and your accumulated savings amount at the point of retirement.

LET'S INVESTIGATE THE INCOME NEEDS OF THREE PEOPLE

Judy Thabo Sylvia

Judy

65-year-old widow; no financial dependants; very risk averse; requires stable, consistent income that will last for life.

Savings

Retirement savings*:
R1.5 million
Discretionary savings:
R500 000

Income Needs

Judy needs the income provided by her chosen product to cover her non-discretionary expenses. She is worried that, like her mother, she might live past the age of 85.

Product Options

Judy therefore decides to buy a guaranteed life annuity which will provide her with income certainty and stability for the rest of her life

Thabo

A 60-year-old husband and father of three. His youngest daughter, 23-year-old Lindiwe is just finishing university but will be financially dependent for another five years. He is the main breadwinner and needs assurance his wife will have an income for life, should he die. He is willing to face fluctuations in income in return for exposure to growth assets.

Savings

Retirement savings*:
R3 million
Discretionary savings:
R1 million

Income Needs

Thabo predominantly needs an income from his retirement savings to cover his non-discretionary expenses. He is not too concerned about longevity risk, since he had to retire earlier due to poor health. However, he is worried about the longevity risk his wife faces, as both her parents are still alive.

Product Options

Thabo is undecided on whether to purchase an Investment-Linked Living Annuity (ILLA) or an Investment-Linked Lifetime Income Plan (ILLI) or a combination of both.

Sylvia

Is a 55-year-old successful businesswoman; retiring early to spend more time with her husband and three young children; bulk of her savings in the form of discretionary money; wants exposure to growth assets and is willing to accept both investment and longevity risk.

Savings

Retirement savings*:
R11 million
Discretionary savings:
R20 million

Income Needs

Sylvia is not worried about outliving her capital. Her focus is therefore on ensuring that she leaves any excess capital to her heirs.

Product Options

Sylvia therefore decides to utilise her retirement savings to purchase an Investment-Linked Living Annuity (ILLA).

*Constitutes savings from pension funds, provident funds, preservation funds and retirement annuities.

RETIREMENT EXPENSE PYRAMID

Your retirement income needs to cover a wide **range of expenses**. These can be categorised into basic living expenses, discretionary expenses and excess income, as shown in the retirement expense pyramid below.

Excess income/ assets
Not needed and can be passed on to next generation

Income covering discretionary expenses
Expenses likely to increase with inflation but can be reduced or delayed e.g. travel & entertainment

Income covering basic (non-discretionary) living expenses
Likely to increase with inflation (or more) and typically cannot be reduced. These include rent, medical cover, water& electricity

ILLA

If you have excess retirement savings with which you aim to leave a legacy **an ILLA may be the best match.**

Investment-Linked Lifetime Income Plan & Guaranteed Life Annuity

For the income required to cover the lower tier expenses, you should consider a product which has some form of income guarantee. The income levels should also have the potential to grow in line with inflation over the long term.

An ILLI and a Guaranteed Life Annuity provide the guarantee of an income for life, and the ILLI can also provide real income growth through exposure to an underlying portfolio of growth assets. These products are therefore suitable for covering basic living expenses and certain discretionary expenses.

A LOOK AT THABO AND HIS WIFE

Investment Profile

Age = **60**

Retirement capital = **R3 million**

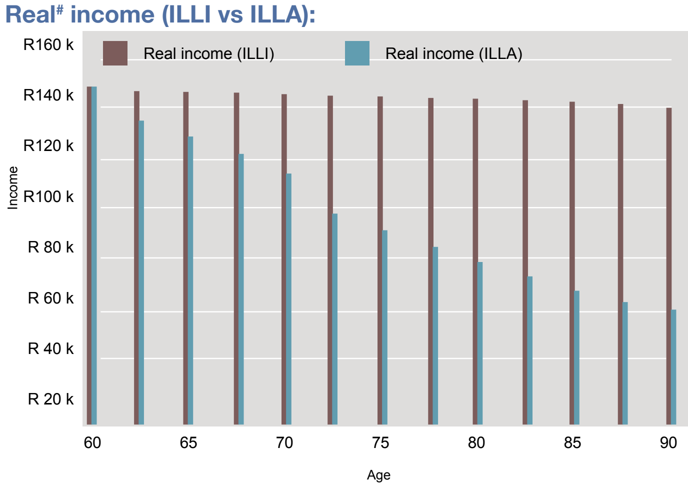
Risk profile = **Moderate**

Should Thabo and his wife take an ILLI or an ILLA?

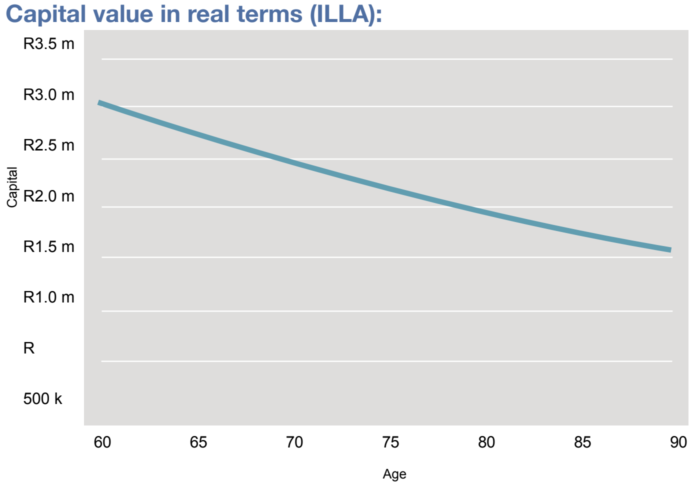
Let's consider some comparisons

The risk that the purchasing power of the income provided by your chosen product is eroded due to the level of income not keeping up with inflation.

Real# income (ILLI vs ILLA):



Capital value in real terms (ILLA):



Notes

The illustrations above were drawn for Thabo and his wife who are both aged 60. The income and capital projections are net of all fees which include asset management fees, an intermediary service fee of 0.57% and Glacier's standard administration fees for the ILLI and ILLA.

#After adjustment for inflation to reflect the purchasing power in today's money (R105 in a year's time & 5% inflation equals R100 in real terms today)

**Assuming the same investment returns under the ILLI and ILLA, as well as a constant percentage of income under the ILLA

With the same investment assumptions:

- If he takes an ILLA, Thabo's wife and other beneficiaries retain the remaining underlying capital at his death. His wife may need to apply this to purchase an income.
- If he takes an ILLI, Thabo and his wife will receive a lifelong income, and they will get a larger income increase year on year**. Income payments will cease immediately if both Thabo and his wife die outside of the guaranteed income payment term.

Comparing the aforementioned results for an ILLI and an ILLA, under the same investment return conditions, reveals the following:

ILLI	ILLA
Higher income growth	More income flexibility
Full longevity protection	Client takes on longevity risk
No capital on death	Capital on death

What is the true extent of longevity risk?

Lifespans can be longer than expected			
Chance of survival	65 year old man	65 year old woman	65 year old couple*
50% chance	85 yrs	89 yrs	94 yrs
30% chance	91 yrs	95 yrs	99 yrs
25% chance	93 yrs	97 yrs	100 yrs
20% chance	95 yrs	99 yrs	102 yrs
10 % chance	100 yrs	104 yrs	106 yrs

Source: Sanlam Internal Mortality tables * at least one surviving

The results in the table above show that people are living longer than you might expect.

This longevity risk has two important implications:

Clients living longer than expected are exposed to a greater risk that there will be **insufficient capital** in later years to provide the **required income**.

The longer time horizon compounds the eroding effect of **expense inflation** on the purchasing power of the client's income.

If Thabo and his wife want to retain a proportion of their capital, while securing an income for life and maximising income growth with the remaining portion, they can combine an ILLI & ILLA.

Advantages of combining an ILLI & ILLA

- You are guaranteed an income for life.
- You benefit from potentially higher income growth over the long term than under an ILLA only.
- The remaining capital underlying the ILLA is available to your dependants on death.
- The ILLA income percentage can be adjusted to counter worse-than-expected investment returns.

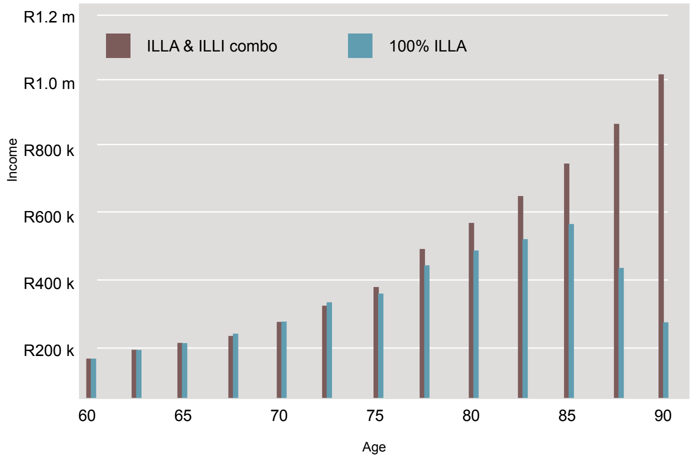
Let's say Thabo and his wife require a monthly income of around R11 500, which is approximately R150 000 p.a. before tax and they want to use a combination of an ILLI & ILLA to produce this income in the most efficient way possible, taking into account their specific circumstances. To help them decide what the most efficient split of capital between the ILLI and ILLA is, we compare the income and capital provided by the combination to what they would have received if they had invested all of their capital in an ILLA.

EXAMPLE 1

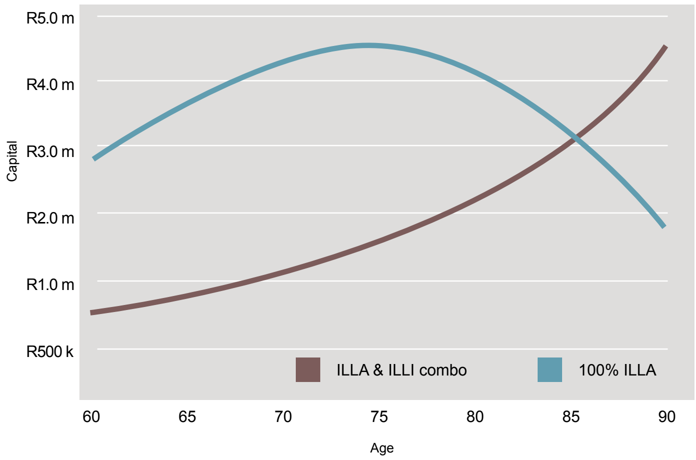
Capital allocation: 70% to ILLI, 30% to ILLA

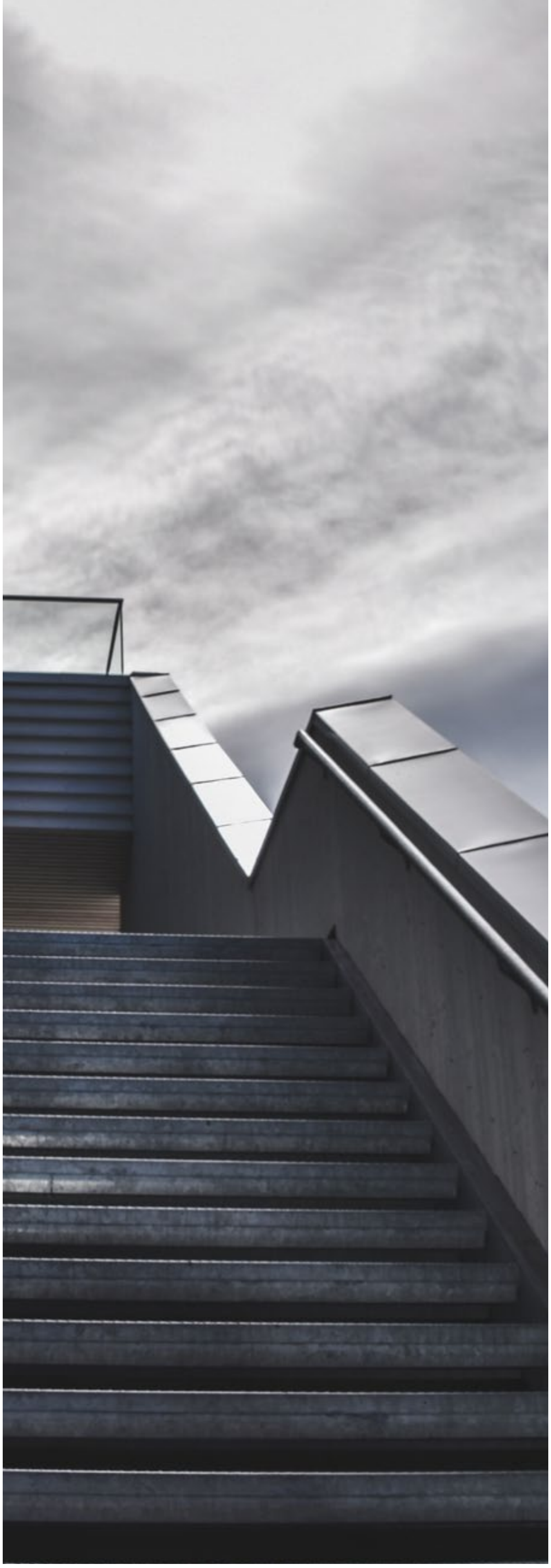
- **ILLI income:** 101 925 retirement income units p.a., which is R101 925 in year 1. They require an income of R150 000 p.a., which means they need a further R48 075 p.a.
- **ILLA income:** R48 075 p.a. which translates to an income drawdown of 5.34%. Due to the high proportion of capital allocated to the ILLI, and the greater potential income growth achieved on this income, they decide to keep the ILLA income percentage constant.

Projected income (70% ILLI & 30% ILLA combination vs 100% ILLA):



Projected capital (70% ILLI & 30% ILLA combination vs 100% ILLA):





Notes

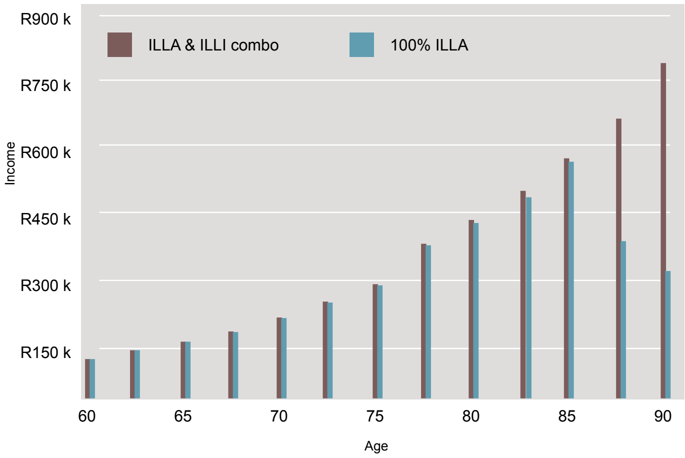
ILLI purchased on a joint-life basis, with a 15% reduction in income, 3% income acceleration rate and five year guaranteed income payment. ILLI investment strategy: moderately aggressive; ILLA investment strategy (in both cases): moderate. Income growth underlying 100% ILLA: 5.0% p.a.; income growth underlying 30% ILLA: 0% p.a.

EXAMPLE 2

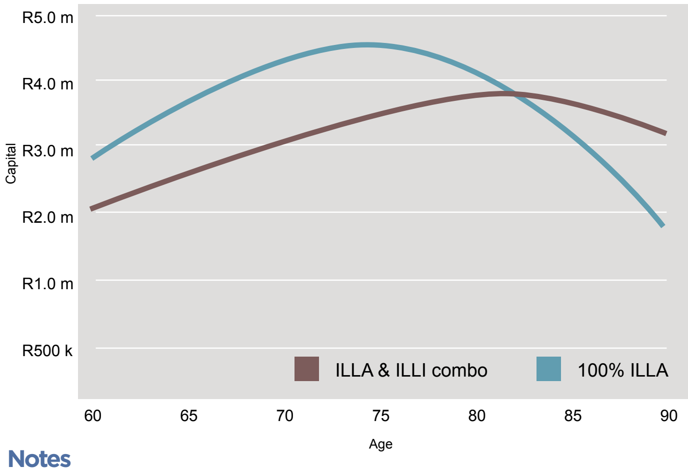
Capital allocation: 30% to ILLI, 70% to ILLA

- **ILLI income:** 43 682 retirement income units p.a., which is R43 682 in year 1.
  They require an income of R150 000 p.a., which means they need a further R106 318 p.a.
- **ILLA income:** R106 318 p.a. which translates to an initial income drawdown of 5.06%.

Projected income
(30% ILLI & 70% ILLA combination vs 100% ILLA):



Projected capital
(30% ILLI & 70% ILLA combination vs 100% ILLA):



Notes

Product parameters as previous, except income growth underlying 100% ILLA: 5.5% p.a. and income growth underlying 70% ILLA: 4.5% p.a.

Income and capital characteristics of the combination of the ILLI & ILLA

- With the addition of an ILLI, you give up capital on death in return for extra income growth.
- As time goes by, the difference in capital available on death becomes smaller.
- There is a substantial income increase in later years (compared to an ILLA only), PLUS capital remaining on death.
- The combination provides a stable real income per annum, provided that you have exposure to inflation-beating growth assets.
- With the combination, you can have a low ILLA income drawdown rate and can grow underlying capital value, which will be available to dependants on death.

How do you decide in what proportions to split your capital between the ILLI & ILLA?

- It depends primarily on your priority: longevity protection (lifetime income) or capital preservation.
- If your main priority is longevity protection, you would be better off allocating a higher proportion of your capital to the ILLI.
- If your main priority is capital preservation, you would be better off allocating a higher proportion of your capital to the ILLA.

Other things to bear in mind:

- Retirement capital is not the only source from which one can leave a financial legacy or take financial care of one's dependants after death. You could consider a life policy, which pays out a lump sum at death.
- The second life insured on a joint life annuity does not have to be one's spouse. It can, for example, also be another dependent adult.

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