Combining a living and a life annuity for best effect

By Tommy Grewar, Business Development Manager

Without a doubt, the living annuity (ILLA) is the preferred choice at retirement today, as it allows investors the flexibility to select their income level, manage the funds in which their retirement capital will be invested and thereby control their exposure to risky assets. Another attractive point is that it addresses the desire of many investors to leave a legacy by allowing investors the option to nominate benefices to inherit the proceeds (in most cases their children).

Considerations when selecting an ILLA

The unspoken critique of the ILLA is, however, the longevity risk which investors face with the grim reality that the capital may be depleted before the time and that the intended beneficiaries may now inherit the responsibility and financial burden of looking after the investor (in most cases the children looking after their parents).

The reason for this is that income drawdown often exceeds the ability of the capital to provide, or in other words, investors just draw too high an income and eat into their capital, some right off the back and others gradually over time, until there is eventually nothing left.

This places enhanced emphasis on the sustainability of income and highlights that the ILLA alone has and may continue to fail some investors over time as they fall victim to the classic retirement pitfalls of retiring too early, not saving enough before retirement, drawing too high an income and lastly but most significantly, investors investing too conservatively in their years before retirement.

Is there another way?

It is my personal belief, however, that the purpose of retirement provision is exactly that, to provide for retirement and that investors need to face the reality that leaving a legacy is often not possible and that they should not change the purpose of their retirement provision. Once this reality has been dealt with, it opens the door to the possibility of having the right discussion – which is, how to ensure your month-to-month income requirement is catered for sustainably. One of the ways in which this may be achieved is by looking at the almost forgotten and less favoured traditional life annuity which guarantees an investor an income for life. Yes, the capital is used to purchase this income stream, but is the surety of a lifetime income guarantee not worth it?

Due to the initial income from a traditional life annuity often being far less than the investor is able to accept without being willing to sacrifice their current standard of living, this investment option is dismissed in favour of the living annuity where the income level is flexible. It is dismissed either by the investor or by the intermediary – the investor not being willing to make the necessary adjustments to their standard of living and the intermediary eager to keep the client happy in an attempt to avoid the tough discussion.

Combining the two options may be the answer

The question is however, why is it always a one or the other and not a combination of the two? A guaranteed income for life on the one hand with no capital risk and then on the other hand, the flexibility of the living annuity where the investor (now with a guaranteed income provided by the traditional annuity) is now freed to a large extent to open themselves to growth assets which they were not previously open to in the first place, as they may have been too conservative. We as South Africans tend to be too conservative by nature when investing.

An often forgotten point is that, at retirement, it is possible to split the retirement provision between a traditional life annuity and an ILLA – this split will depend on the level of guarantee required. It is, however, not possible to split an existing living annuity. Therefore, if this is a route you would like to consider as an option for the investor now or even at a later stage (that is if the current life rates are not as good as you would like them to be) then plan ahead by having two ILLA’s issued at inception instead of only one. To guarantee as much of the month-to-month income as possible should be the main priority of every investor and financial planner. Allow the investor the opportunity to enjoy their retirement by taking the focus off the capital.

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