The ‘best-rate-versus-flexibility’ debate

There is a million-dollar question currently doing the rounds. In the case of a client needing a combination of traditional retirement income products, does the best guaranteed rate in the market offer the best choice of provider in the long run? Rocco Carr, Business Development Manager at Glacier by Sanlam explored this question.

When a client needs a guaranteed income during retirement, the general procedure often results in some unforeseen challenges:

- When the money becomes available (often weeks after the signing of the application form), the guaranteed quote has expired, and a new quote needs to be signed with the new rates, which might be better or worse than at date of advice.
- The company whose quote was the best at the time, might not be offering the best rate anymore, but since the request of transfer (ROT) was structured for this specific company, the process needs to continue.
- There is uncertainty as to whether your client will end up with the best guarantee in the market.

Many financial advisers believe in bespoke retirement income stream management and achieving this through combining a living annuity and life annuity. Initially it might make sense to get the life annuity signed with the company offering the best rate. There are, however, some hurdles to overcome:

- Two quotes with separate companies need to be obtained - one for the living annuity and the other for the life annuity.
- Many retirement funds are reluctant to split the amount as it results in two ROT forms, increasing the risk for error.
- The financial adviser needs to manage this entire process, complicating their admin and compliance.
- The amount of paperwork for the client is cumbersome and confusing.

Overcoming these hurdles still does not alleviate the risk that your client might not end up with the best rate in the market.

Is the effort worth the result?

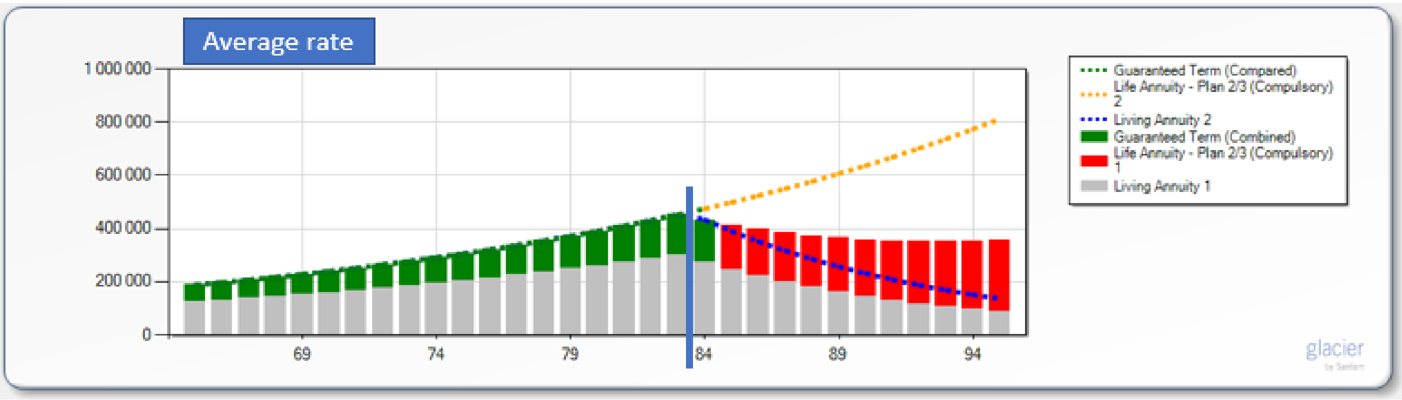
Let's look at an example where the client wants to use 30% of the available retirement interest towards a guaranteed joint life annuity.

Assumptions used in this illustration are:

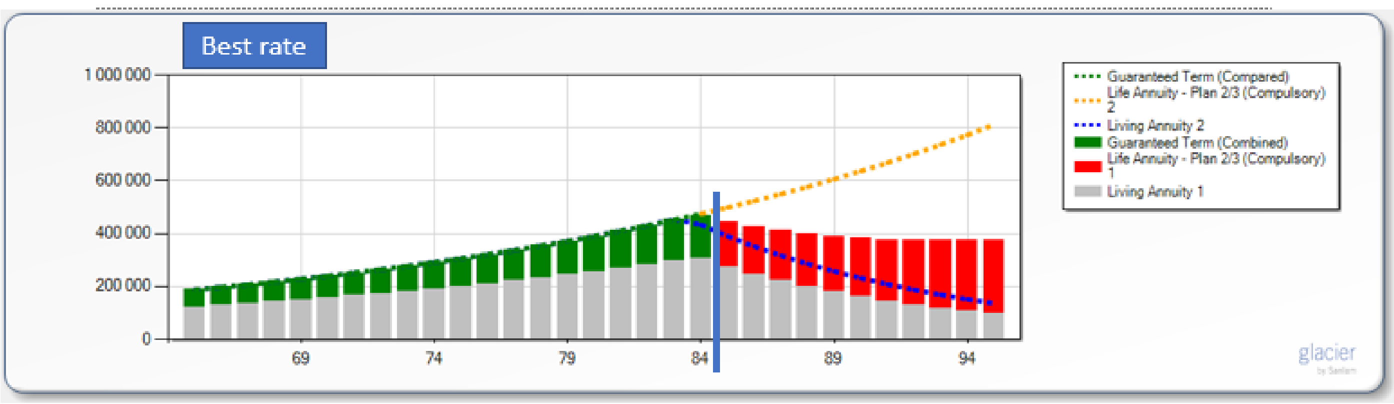
- Both lives insured (male and female) are aged 65.
- Income escalates at 5% during retirement.
- Both guaranteed annuities have a 1.5% initial fee, while the living annuity has an annual fee of 0.5%.
- A 20-year guaranteed term.
- An inflation plus 5% portfolio (multi-asset high equity) is used in all living annuity projections.

In the below two graphs (projecting future incomes) the rates of two life companies, one offering an average rate and the other offering the best rate (for that specific week) are used. The rates are used for illustration purposes below, and are dated as at 6 September 2021.

Graph 1 – Average rate in the market for the week, offering a monthly income of R5 221



Graph 2 – Best rate in the market for the week, offering a monthly income of R5 419



Source: ICE

In both cases the income from the combination of the life annuity (green bars becoming red after the guaranteed term) and the living annuity (grey bars) keeps pace with the guaranteed income until after the age of 80. With the average rate (graph 1), the living annuity income starts declining at the start of age 84 and the with the best rate (graph 2) the living annuity income starts declining only one year later at the start of age 85 (black boxes). The higher guaranteed income, based on the higher rate, therefore only buys the client an extra year.

The extra year should be weighed against simple administration, seamless future income stream management opportunities and holistic value proposition, should it happen that the provider offering the average rate performs better on these elements.

Is there something else to consider?

Let's imagine choosing the provider in the week of 6 September that offers an average guaranteed rate but who also offers:

1. The life annuity and living annuity combination on a single quote and single application form; and
2. Keeping the living annuity as a separate policy, thereby allowing for future section 37 transfers and additional guarantees; and
3. Upon a signed client request, the living annuity can be issued as two separate living annuities; and
4. An option to, during retirement, convert the living annuity to a type of combination solution that offers both the features of a life annuity and a living annuity (one conventional annuity for life); and
5. An option to secure the current rate for a fixed period, removing uncertainty about future rates.

The 20-year government bond yield can be regarded as a proxy for what could happen to life annuity rates in the future. If we consider what has happened with the bond yield during the two weeks ensuing the above date, one can assume that market uncertainty has offered an opportunity to buy a second guarantee. The below graph shows the 20-year bond yield, with the red lines crossing on 6 September, and the last date on the graph being 20 September 2021.

Source: Trading Economics

The implication of this is that if the provider offering flexibility was considered two weeks prior, it would have been possible to immediately utilise this opportunity for a second guarantee at a better rate. The opportunities offered during November 2020 and April 2021 were even more pronounced.

The choice of a flexible provider is therefore something that should be seriously weighed up against selecting the best guaranteed quote at a single point in time. Flexibility offers a good alternative to enable future income stream management, which is a very important objective of advice at retirement.

Real Income Solutions from Glacier Invest

Another option is to consider the use of two living annuities, one of which could be conservative (comprising, for example, income funds or the Glacier Invest 3% Real Income Solution). This sets the investor up to take advantage of opportunities down the line. The Glacier Invest Real Income Solutions are designed to increase predictability and consistency of retirement income, as well as to protect capital when markets are underperforming. The investor will therefore enjoy a stable performance and can move the more conservative living annuity into a new guaranteed annuity at a later stage.

Glacier Financial Solutions (Pty) Ltd and Sanlam Life Insurance Ltd are licensed financial services providers.

Glacier Financial Solutions (Pty) Ltd is a licensed discretionary financial services provider, trading as Glacier Invest FSP 770

Sanlam Multi Manager International (Pty) Ltd FSP 845 is a licensed discretionary financial services provider, acting as Juristic Representative under Glacier Financial Solutions (Pty) Ltd

The Glacier Invest Real Income Solutions include wrap fund portfolios managed by Glacier Financial Solutions (Pty) Ltd., a Licenced Discretionary Financial Services Provider, FSP 770, trading as Glacier Invest.

Glacier Invest is the discretionary fund management offering of Glacier Financial Solutions (Pty) Ltd ("Glacier"). Glacier has partnered with Sanlam Multi Manager International (Pty) Ltd, part of the Sanlam Investments Group, to optimise the investment management responsibilities

Glacier Financial Solutions (Pty) Ltd.

A member of the Sanlam Group
Private Bag X5 | Tyger Valley 7536 | Email client.services@glacier.co.za | Tel +27 21 917 9002 / 0860 452 364 | Fax +27 21 947 9210 | Web www.glacier.co.za | Reg No 1999/025360/07
Licensed Financial Services Provider | Glacier Financial Solutions (Pty) Ltd. is also a Licensed Discretionary Financial Services Provider FSP 770, trading as Glacier Invest | Sanlam Multi-Manager International (Pty) Ltd. | A member of the Sanlam Group

Private Bag X8 | Tyger Valley 7536 | Tel +27 21 950 2600 | Fax +27 21 950 2126 | Web www.smmi.com *|*Reg No 2002/030939/07
Licensed Discretionary Financial Services Provider, acting as Juristic Representative under the Glacier Financial Solutions FSP 770
Glacier International is a division of Sanlam Life Insurance Limited
Sanlam Life Insurance Ltd. | Email life@sanlam.co.za | Tel + 27 21 916 5000 / 0860 726 526 | Fax +27 21 947 9440
Reg No 1998/021121/06 | Licensed Financial Services Provider