Income strategy at retirement

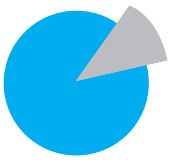
When you retire from a Pension Fund, Retirement Annuity or Pension Preservation Fund, you are legally obliged to purchase a compulsory annuity with a portion of your retirement proceeds. This will provide you with a post-retirement income stream. Provident Fund members have the option to purchase an annuity on a voluntary basis.

At retirement, your retirement proceeds are fixed, but the decisions on how to use them will have far-reaching consequences for your financial security in retirement. Of these, determining an appropriate retirement income strategy is probably the most important.

There are a number of potential threats to your income and financial security after retirement:

- Life expectancy: You or your spouse may outlive your investments and income.
- Your income may not keep up with inflation, so your standard of living will decline.
- Negative market conditions may impact on your investments and/or income.

Another important retirement decision is deciding how much of your retirement proceeds to take in cash. Taking the maximum cash benefit may not be in your best interest. You should consider the following:



The tax payable on the cash amount – a portion can be taken free of tax, but thereafter it will be taxed on a sliding scale.

If you have long-term debt like a bond, it is generally a good idea to repay it.

Beware of spending the cash on luxuries – this is still part of your total retirement provision and should be used for large or unexpected expenses and to supplement your income if required.

Life expectancy at retirement

The table below provides an indication of life expectancy at different ages. For example, out of a group of men aged 60, half is expected to live until 85. Life expectancy is dependent on an individual's specific circumstances and state of health and can vary quite significantly. If many of your relatives lived past 100, make sure your planning allows for this!

AVERAGE LIFE EXPECTANCY							
Age	**55**	**60**	**65**	**70**	**75**	**80**	**85**
Male	29	25	21	17	14	11	8
Female	36	32	27	23	19	16	12

Source: Sanlam Life (2012)

Retirement income options

There are many different retirement income options available that can help you mitigate the threats to your financial security after retirement in various ways. It is important that you understand the impact of the option you choose on your post-retirement income stream.

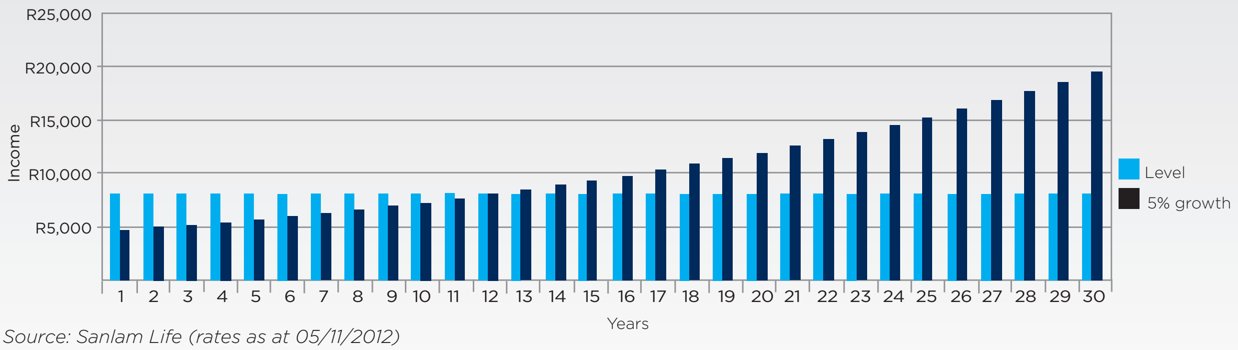
See the article "Comparison of Retirement Funds" for more information on the rules that apply to different retirement funds at retirement (available in the Retirement Fund bulletin on www.sanlam.co.za).

Guaranteed Life Annuity

A **guaranteed life annuity** provides a guaranteed income for life. A second life insured, for example a spouse, can be added at the outset, in which case the income will be paid until the last life insured dies. It is possible to select for the income to reduce (for example by 50%) at the death of the first life insured.

Generally, income ceases at death, but it is possible to select a term certain at the outset, in which case income will be paid to the life insured's beneficiaries until the end of the term certain if death occurs within the term certain. For example, if a 10-year term certain is selected, the income will be paid for at least 10 years.

The income can be a level annuity or increase every year at a fixed percentage (for example 5%). The graph below compares the income stream of a level life annuity with that of an annuity with 5% income growth per year. The example is for a male aged 60, who could expect to live for another 25 years, with a R1 million purchase amount.



Source: Sanlam Life (rates as at 05/11/2012)

Although an increasing income stream provides a lower initial income, it is crucial with a view to maintaining your standard of living after retirement, as your expenses will increase by inflation every year.

If you require a product to provide you with your only or main source of income post-retirement, you should consider an increasing guaranteed life annuity.

Inflation Linked Life Annuity

An **inflation-linked life annuity** is a special type of guaranteed life annuity that provides an income stream that is guaranteed to increase with inflation for the life of the insured. It is possible to add a second life insured or select a term certain at the outset, as for other guaranteed life annuities.

An inflation-linked life annuity provides the best possible protection for your financial security post-retirement, as you do not carry any risk in terms of longevity, inflation or investment. This is important if you do not have sufficient retirement and other funding to carry these risks yourself.

Bonus Annuity

A **bonus life annuity** (also known as a with-profit annuity) provides an income stream for the life of the insured. The annuity income is guaranteed never to decrease, but annual increases in the income are not guaranteed.

Annual increases are linked to the investment returns on a with-profit portfolio. A with-profit portfolio is a balanced investment portfolio in which the investment return is smoothed and distributed via yearly bonuses.

A post-retirement interest rate (PRI) is selected at the outset. If the investment return actually earned in a year is higher than the PRI selected, the excess is used to provide income increases. For example, if a PRI of 3,5% is selected and the investment return is 6%, the additional 2,5% can be used to provide increases. If a lower PRI is selected initially (it can even be 0%), the initial income is lower, but the potential increases in income will be higher.

It is possible to add a second life insured or select a term certain at the outset, as for a guaranteed life annuity.

This is an appropriate product if you wish to increase your potential future income, and you have sufficient other investments or income streams so that you can afford the risk of your income increasing at less than inflation.

Investment Linked Life Annuity (ILLA)

An **Investment Linked Life Annuity** (ILLA) is only recommended for investors with retirement proceeds in excess of R1 million, with significant additional sources of post-retirement income or with low life expectancy due to ill-health. It offers no protection against your living longer than expected and you have to carry both the investment and inflation risk yourself.

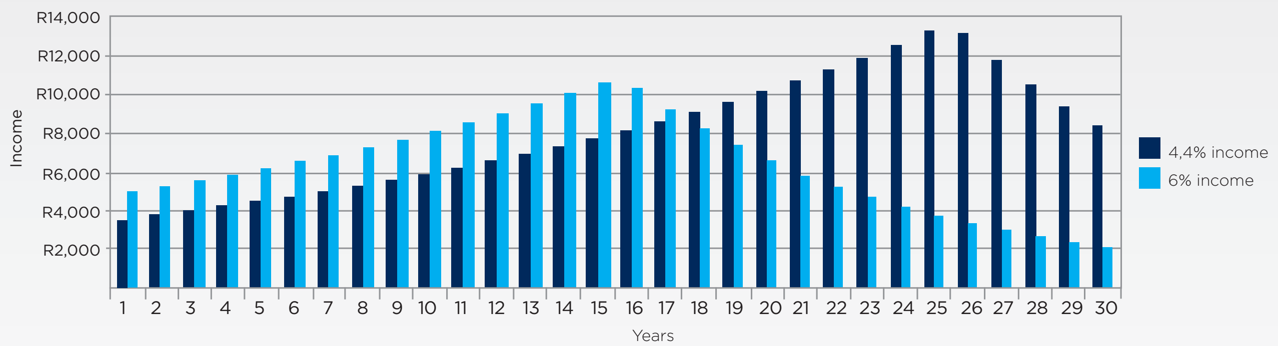
With an ILLA, a range of investment funds is available to the annuitant. The retirement proceeds are invested in the selected investment funds and used to provide an income. Between 2,5% and 17,5% of the total investment value must be withdrawn as income each year. It is possible to adjust the income annually, as long as the income remains between 2,5% and 17,5% of the investment value. If the initial level of income selected is too high and increases by inflation annually, the withdrawal percentage will at some point be capped at the maximum, after which it will not be possible to increase the income by inflation any more. The income is very likely to start reducing thereafter.

Sanlam has compiled a table of maximum recommended income withdrawal percentages for an ILLA to help clients select an appropriate level of income to withdraw given their age. The percentages in the table give an indication of the maximum percentage that should be withdrawn. The limits are set to target an income level that should not reduce in real terms (after allowance for inflation) during their life expectancy without running into the regulatory maximum drawdown rate of 17,5%. They are based on a portfolio that generates a return of 2% above inflation per year after fees have been taken into account (for example, a portfolio generating a return of 9,5% per year, if inflation is 5,5% and fees are 2% per year).

SANLAM GUIDELINES ON MAXIMUM WITHDRAWAL LEVELS

Age	55	60	65	70	75	80	85
Male	4.0%	4.4%	4.9%	5.6%	6.3%	7.3%	8.7%
Female	3.5%	3.8%	4.2%	4.7%	5.2%	5.8%	7.0%

The graph below compares the income stream from an ILLA investment of R1 million with an initial income of 4,4% per year (in accordance with the guidelines above for a male aged 60, who could expect to live for another 25 years) with the income stream if an initial income of 6% per year is selected. The income is adjusted by inflation annually and a real return of 2% per year after fees is assumed.



It is important to select an appropriate investment fund portfolio for an ILLA. The annuitant must balance earning an investment return that can support annual increases in income, and limiting the volatility in the investment value. A significant fall in investment values may have serious consequences for the level of future income that can be sustained. If you are considering an investment in an ILLA, you should involve a registered financial advisor that specialises in investments.

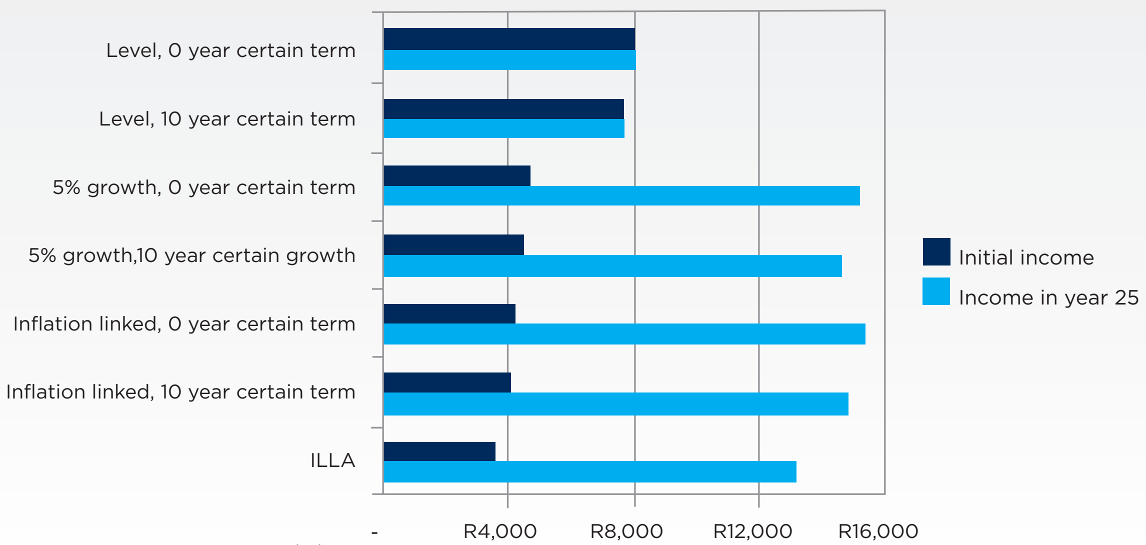
Any investment funds remaining at death will be paid to the annuitant's estate or beneficiaries.

Combined Life Annuity

A **combined life annuity** consists of a guaranteed (could be inflation-linked) life annuity and an ILLA. The guaranteed life annuity should be used to provide enough income to cover essential expenses, with the ILLA supplementing this with a more flexible income stream. When the market is low or unstable, the income drawn from the ILLA should be reduced to protect the capital and future income.

Comparing the different options

The following table compares the monthly income of different annuity options in years 1 and 25 for a 60-year-old male with a R1 million purchase amount (a with-profit annuity excluded). The ILLA income is based on the guidelines above (i.e. 4,4% initial income) and is assumed to increase with inflation annually. Inflation is assumed to be 5,5% per year.



Source: Sanlam Life (rates as at 05/11/2012)

The value of advice

The decisions to be taken at retirement are complex. There are many retirement income options available and the most appropriate income strategy for you may involve a combination of them. It is possible to convert an ILLA to a guaranteed life annuity, but a guaranteed life annuity cannot be changed. It is therefore critical that you think carefully about your options. It is recommended that you consult with an experienced registered financial advisor to ensure that you make the decisions that are most appropriate to your specific financial situation.

The funds saved for retirement remain the most important contributor to your financial security post-retirement. Consider delaying your retirement or taking a part-time job if you are still healthy enough to work and do not have sufficient funds available. If you are still some years away from retirement, an advisor can determine whether you are on track to a secure retirement. If not, save as much as you can afford.

V2435 - 4/2013