



## Employee benefits in the news

### **Initial cost is misleading**

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Retirement fund trustees and advisers have become accustomed to choosing retirement with-profit annuities (WPAs) based on the initial cost. However, considering initial pricing alone could be extremely misleading.

“Aggressive pricing upfront could have a profoundly negative impact on future returns,” says Johann Swanepoel, senior manager: annuities at Momentum Employee Benefits.

WPAs are similar to guaranteed products and frequently offer a range of post-retirement interest rates (PRI), which determines the level of participation in the fund bonuses declared. The increase received by the annuitant is roughly the bonus rate declared less the PRI.

According to a study conducted by the Actuarial Society a few years ago, prices quoted for a guaranteed annuity with the same terms and conditions will be directly comparable between various life offices. However, it found the prices quoted for WPAs, even for the same level of PRI and other benefits are not directly comparable.

Despite this, says Swanepoel the evidence suggests that trustees and advisers are still drawn in by lower initial pricing. “Trustees must realise that what you put into a WPA determines what you get out, so cheaper is not better in this case,” he says. “Trustees need considerably more information than just price and bonus history when deciding which WPA to include in their investment strategies. Issues such as bonus policy, asset allocation, investment strategy, mortality risk, cost of guarantees and capital charges all come into play,” he says.

To reiterate that cheaper is not better in the case of WPAs, the Association for Savings & Investment SA compared two identical WPA funds, except that the initial pension provided by the one was 10% higher than the other (the base pension). It proved that providing a higher initial pension comes at the expense of future bonuses. In the example, the base pension surpassed the pension from the cheaper WPA after about nine years.

“This is a powerful result as this compares identical WPAs,” says Swanepoel. “In practice there are a lot of other differences between providers that will add further to the arguments put forth.”

In a scenario of aggressive pricing, the Actuarial Society study found that trustees hoping to benefit from a low price will be disappointed to find that most of any mispricing by a life company will find its way back to the pensioners through a reduction in bonus rates and there will be a redistribution of wealth among the members of the WPA. That means those who live longer will bear the cost through lower accumulated increases in the future.