

## Employee benefits in the news

### Superior returns in with-profit annuities

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Retirement Fund Trustees are often faced with tough decisions when deciding on a retirement annuity, which will be in the best interest of their pensioners.

This is a result of many considerations such as price, annual and monthly administration fees, future expected returns, historic increases and track record as well as financial strength of the provider; to take into account before making the investment decision.

However, research by Metropolitan Employee Benefits (MetEB) has found that many decisions are frequently made based on price, according to Johann Swanepoel, head: annuities at MetEB.

He says this approach is feasible when it comes to guaranteed annuities like conventional annuities with fixed escalation as well as inflation-linked annuities.

“With these annuities the pensioner has certainty about the level of future increases either in nominal terms (conventional annuities) or in real terms (inflation-linked annuities).

“It is however worth noting that since the future increase are defined in nominal terms (for example 0 percent or 5 per cent per annum for conventional) or in real terms (CPI in the case of inflation-linked) there will be no difference in the future increases between different providers and the track record also becomes irrelevant as they will also be the same.

“However; when it comes to with-profit annuities (WPA), the situation is not cut and dry. What you put into a WPA determines what you get out, so cheaper is not better in this case,” says Swanepoel.

He explains that trustees need considerably more information than just price and bonus history when deciding to include WPA in their investment strategies. Issues such as a bonus policy, asset allocation, investment strategy, mortality risk, cost of guarantees and capital charges all come into play.

“MetEB has nonetheless found that there is a clear inconsistency with pricing WPA in South Africa – our research shows that the current mispricing of with-profit annuities upfront by certain providers is eroding the future bonus potential of the members in the long run.

“Our research shows that while our WPA can be more expensive based on the initial pension provided for a given lump sum investment, it is currently the cheapest in terms of annual charges in the industry.

“Our bonus history also outperforms all our competitors by a significant margin,” says Swanepoel.

He contends that many providers charge too little upfront for the product (the embedded options are not priced for correctly in the deterministic pricing basis), but this then leads to lower future increases. The balancing item in a WPA is always the future increases as the provider can reduce future increases to manage the liabilities relative to the available assets.

“We however have a higher equity allocation which should provide higher returns over the long term. We also manage the risk to the policyholder by having a six-year smoothing mechanism in place so that the bonus will fluctuate too much from one year to the next.