Maximising retirement income:

How to choose the right investment strategy

Your retirement plan should be tailored to your specific circumstances

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Planning for retirement is one of the most important financial endeavours of one's life. It is also a rather complicated one with a great deal of information to consider, options to weigh up and decisions to make. From the outset, it's crucial to recognise that there is no one-size-fits-all solution. You need to assess your situation carefully and understand the available options, so you can choose one that best fits your specific circumstances.

This article outlines the different annuities and hybrid combinations thereof, along with their implications for your money. An annuity can be understood as an investment vehicle from which you regularly withdraw or receive an income. First, it's important to understand the distinction between voluntary and compulsory annuities, and between non-guaranteed and guaranteed annuities.

Voluntary vs compulsory annuities

Voluntary and compulsory annuities are essentially differentiated by the origin of the funds you invest in them.

Voluntary money is that which is in the form of, among others, cash or unit trust, with few restrictions on liquidity or the asset classes in which it may be invested. Thus, no money already invested in a retirement structure, including the one-third cash portion you may withdraw upon retirement, may be considered voluntary money. However, voluntary investments can supplement your retirement income, of course.

Compulsory money is invested in a retirement structure, which carries clearly defined restrictions around liquidity, income and underlying investments. Upon retirement, if you convert two-thirds of your retirement benefit to an income-providing annuity, it becomes a compulsory investment.

Voluntary money can be used to purchase a life annuity, but not to invest in a living annuity, which must be funded by the compulsory portion of your retirement fund or retirement annuity.

Non-guaranteed annuity

In a non-guaranteed annuity (also known as a living annuity), the asset remains your property but there is no guarantee of capital or income. As it is investment-linked, the capital depends on investment growth and volatility. Income can be 2.5–17.5% (adjustable once a year) of the investment value, paid out annually, biannually, quarterly or monthly. In order to make your investment last, you'll likely start on a lower income than a life annuity.

The advantages of a living annuity include retaining ownership of your assets, which enables you to pass them on to a beneficiary of your choice upon your death; greater flexibility in terms of the underlying investment; and the fact that it can be converted to a guaranteed annuity at any time.

The primary risk is that you may outlive your capital, especially if you draw too much too quickly. Moreover, if the funds are mismanaged, your investment could lose value.

Guaranteed annuity

On the other hand, a guaranteed annuity (also known as a life annuity) pays a regular monthly income, which may or may not increase annually, for a set period or until you die. It's important to note that the capital is not yours, although a percentage of your monthly retirement income may be paid to your spouse upon your death. Once they pass away, however, the capital is forfeited.

You may start on a higher income than a living annuity, although this depends on your age when you take out the annuity – the older you are, the fewer years your capital amount will be divided into (based on the life expectancy as taken from the mortality tables of the Actuarial Society of South Africa). For this reason, it can make sense to take out a life annuity later, especially given that a living annuity can be converted a life annuity, but the reverse is prohibited.

The obvious advantage of this is the security of receiving a guaranteed income for the rest of your life. There is no chance you will outlive your capital.

On the other hand, being unable to amend your income is a disadvantage, as are the fact that capital falls away after death and a life annuity can't be transferred to a living annuity.

One further risk that isn't often discussed when considering a life annuity, is the risk of depending on one life insurance company to provide you with a life-long income. Just as when you invest all or a large portion of your money in one bank, or in one company's shares, with a life annuity you take that same risk – if the insurer defaults, you may run into trouble. Although something like this should hardly ever happen, it is a risk an investor should be aware of. Companies providing a guaranteed income should also have insurance against such circumstances, protecting the guarantees they offer their annuitants.

Combined or hybrid options

It's clear that living and life annuities have their respective pros and cons. The good news is you can strike a balance between the two.

The first option is to buy two separate annuities, with basic expenses covered by the life annuity, and others by the living annuity income.

The second and increasingly popular option is to buy a hybrid of the two. In this instance, you can partially create a life annuity within your living annuity, transferring additional money into the former as needed. Ideally, non-negotiable expenses are covered by the life annuity, with variable expenses coming out of the living annuity.

Combined or hybrid annuities make provision for the inherent truth that everyone's retirement situation is different. You need to consider your variables, such as adding a spouse as an additional life assured on your policy, taking a guarantee period, increasing your income or keeping it steady, and so forth.

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