ON THE SCALES 10 OF 2020

CHANGES TO LIVING ANNUITY DRAW DOWN RATES

On 23 April 2020, National Treasury released a media statement regarding amendments to the draw down rates for living annuities. In addition, a proposal was made regarding increasing the minimum value of a living annuity which may be taken as a cash lump sum from R50 000 to R125 000.

Following consultation with various industry stakeholders, National Treasury has released Government Notice No. 618 ("the Notice") to allow individuals invested in living annuities temporary relief on draw down percentages between the period 1 June and 30 September 2020. On the same day, Government Notice 169, which increases the minimum value of a living annuity which may be taken as a cash lump sum, was released.

The effective date of both Notices is 1 June 2020.

Summary

- Prior to 1 June 2020, individuals invested in living annuities were entitled to receive a minimum draw down of 2.5 per cent and a maximum of 17.5 per cent.
- As a result of the national lockdown imposed following the COVID-19 outbreak, living annuitants faced the risk of cash flow problems or significant losses as the value of assets in which they are invested decrease.
- National Treasury released a media statement regarding possible amendments of the prescribed draw down rates for a period of four months.
- On 1 June 2020, National Treasury released the Notice, effectively amending the minimum draw-down rate from 2.5 per cent to 0.5 per cent, with an increase to the maximum draw down rate from 17 per cent to 20 per cent.
- The Notice applies with effect from 1 June 2020 until 30 September 2020.
- The *de minimis* threshold has been increased to allow for living annuities below R125 000 to be taken in cash.

The existing draw down rates for living annuities

In terms of the definition of living annuity in the Income Tax Act, the Minister of Finance ("the Minister") has powers to issue a notice prescribing the minimum and maximum draw down rates that individuals are entitled to receive from a living annuity. In 2009, the Minister prescribed the minimum and maximum draw down rates as follows:

- Minimum draw down rate: 2.5 per cent
- Maximum draw down rate: 17.5 per cent

This means that living annuitants could select an income level between 2.5 per cent and 17.5 per cent.

By its nature, a living annuity is a special type of compulsory purchased annuity offered by insurers and retirement funds (in-fund living annuities) under which the income is not guaranteed but is dependent on the performance of the underlying investments. This means that living annuitants bear the investment and longevity risk in full. The income over the living annuitant's lifetime will ultimately depend on the lifespan, the draw down rate selected and the investment performance of the chosen investments.

The impact of Covid-19 on living annuities

The Covid-19 outbreak will have a significant and potentially lasting impact on the economy, as a result of which individuals will experience financial hardship. Similarly, annuitants will suffer significant losses as the value of assets in which their living annuities are invested decrease. In the media statement released on 23 April 2020, National Treasury acknowledged the following concerns with regard to the impact of the Covid-19 outbreak on living annuities:

- Living annuitants who are currently experiencing financial hardship are not allowed to increase their draw-down rates above 17.5 per cent, which may be extremely limiting.
- For living annuitants who elected draw down rates below 17.5 per cent, they have to wait until their next anniversary date before they can revise or increase their income level.
- Similarly, due to the market volatility caused by the Covid-19 outbreak, some living annuitants might want to draw income below 2.5 per cent before their next anniversary date. This will ensure that their investment values remain protected from the market volatility and their income sustains them for longer.

As a result, National Treasury announced that individuals who receive income from living annuities would temporarily be allowed to either increase their draw down rates (up to the maximum of 20 per cent) or decrease their minimum income level (down to a minimum of 0.5 per cent) before their next anniversary date. According to the media statement, this was done to assist individuals who either need cash flow immediately or who do not want to be forced to sell after the investments in which their living annuities are invested have underperformed.

The revised draw down rates

On 19 May 2020, National Treasury proposed to amend the existing draw down rates by expanding access to living annuities for a limited period of four months, between 1 June and 30 September 2020. The proposal made is as follows:

- Living annuitants would be allowed to temporarily either increase (up to a maximum of 20 per cent from 17.5 per cent) or to decrease (down to a minimum of 0.5 per cent from 2.5 per cent) the level of income they receive from their living annuities, instead of waiting for their next anniversary date.
- Living annuitants would be allowed to adjust their draw down rates anytime between 1 June 2020 and 30 September 2020.
- Any income level selected during the four months period will only be applicable for that period. With effect from 1 October 2020, the income level will automatically revert to the rates selected by living annuitants before the selection made during the four-month period.
- Individuals whose anniversary date falls within the four-month relief period may elect to amend their draw down rate either in accordance with the existing legislation (thereby making their election valid until their next anniversary date), or in accordance with the above-mentioned proposals, which only applies for a limited period of four months. This will result in their draw down rates automatically reverting to the draw down rates elected at their previous anniversary date after the four-month period.

Following extensive consultation with role players in the industry, the Minister issued Government Notice 618 to put into effect the proposals set out above. The Notice is applicable from 1 June 2020 until 30 September 2020.

Withdrawal of living annuities

The Minister has powers to determine when the remaining value of a living annuity can be taken as cash. The current prescribed threshold is R50 000. This means that living annuitants had a right to take their living annuity in cash, provided the remaining balance of such living annuity did not exceed R50 000.

The Minister has now released Government Notice 169, which increases the minimum threshold from R50 000 to R125 000. This means that individuals whose balance in the living annuity is below R125 000 can take their balance in their living annuity as cash. This Notice is effective 1 June 2020 and is intended to permanently change the minimum threshold.

Comment: The intervention by National Treasury is welcomed. Giving flexibility around draw down rates will assist annuitants to make a choice that is suitable to them during these four months. In addition, allowing living annuitants with values below R125 000 a right to take their investment as cash will also provide much needed relief to individuals experiencing financial challenges as a result of Covid-19.