PERSONAL FINANCE

Be wary of universal policies

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Universal life assurance products, which combine retirement savings with risk assurance, can be patently flawed, particularly when they are essentially risk products, Pension Funds Adjudicator Muvhango Lukhaimane says.

In a recent determination, Lukhai-mane strongly criticises retirement annuities (RAs) that pose as retirement savings products but are essentially risk assurance against death and disability (see "RA product 'was mainly a risk policy'", below).

Universal policies, which combine retirement savings or life assurance endowment (investment) policies with risk assurance, have been in the firing line for many years and are now seldom sold, according to Peter Dempsey, deputy chief executive of the Association for Savings & Investment SA (Asisa).

The main criticisms of universal products are:

* Your savings and assurance needs seldom correspond. Your risk life assurance needs change significantly over time. They are dictated by your circumstances, such as whether you are married and have children, and how much money you have saved. As you get older, you are likely to have fewer dependants and to have saved more money, and so you are likely to need less life cover.

Most universal products simply provide risk life assurance for a single amount, which sometimes increases with inflation, without taking into consideration your changing circumstances and financial needs.

* If you can no longer afford the premiums, you are likely to lose your risk cover. On the other hand, if your risk assurance is separate from your savings, you can stop paying towards your savings but maintain your risk life assurance premiums. This will ensure that your dependants will be provided for if you are no longer the breadwinner.

* If a life assurance company experiences a high number of claims for death and disability, it will increase its premiums. In universal products these increases may be camouflaged by reducing the proportion of your premium that goes towards the savings element, upsetting your long-term savings target.

* Universal policies have allowed life assurance companies to smack you even harder with confiscatory penalties if you can no longer afford the premiums. On the other hand, if you have stand-alone risk life assurance and you stop paying the premiums, the life company cannot confiscate any cash from you – your cover simply falls away.

Dempsey says that RAs that include life cover have not been withdrawn from the market, but it is now common practice to separate life cover and savings. As a result, some product providers no longer sell universal products, although they are still available for people who like the idea of being able to claim a tax deduction for the life policy premiums.

Dempsey explains that you can claim the risk life assurance premium against your taxable income up to the limit allowed for RAs – namely, 15 percent of your taxable income less your pensionable income. (Pensionable income is that from which contributions may be paid into an occupational retirement fund.)

However, Dempsey says that you need to take a number of factors into account when doing this. These include:

* **Tax.** If you die before the maturity date, the benefit (life cover plus the full value of the investment part of the contract) is subject to the Income Tax Act.

* **Distribution of benefits.** If you die before the maturity date, the benefit distribution will be subject to section 37C of the Pension Funds Act, which stipulates that benefits must first be paid to any dependants. The fund trustees have the final decision on who receives the benefit.

Dempsey says Asisa agrees with Lukhaimane that RAs were designed to help people save for retirement in a tax-efficient way.

"Therefore, loading an RA with a substantial amount of life cover, where the greater portion of the monthly contribution is paying for cover and not actually going towards retirement savings should be treated with caution," he says.

The Financial Services Board has told the life industry that RAs with 100-percent life cover "are not regarded as meeting the requirements and objectives of an RA and therefore should not be sold", Dempsey says.

RA product 'was mainly a life risk policy'

It is unacceptable that a universal retirement annuity (RA) paid out less than the death value at retirement, but nothing could be done to assist the fund member, Pension Funds Adjudicator Muvhango Lukhaimane has ruled.

Ms M had believed she was entitled to a guaranteed retirement benefit of R34 753, but she received only R2 167, after paying R30 a month for 23 years – a total of R8 280.

In 1988, Ms M signed up for the Meestertrust Annuiteitsfonds, a RA fund administered by Rentmeester, intending to remain a member until October 2011.

The product incorporated guaranteed life cover of R34 753 until October 2011, but not a guaranteed minimum pension payout of that amount, which is what Ms M understood it would provide.

Rentmeester and its RA fund were later taken over by Liberty Life.

Lukhaimane says that, in essence, the product that Ms M bought was predominantly a risk life assurance policy with a "residual" retirement fund value. This was apparent from Liberty's response to the complaint, in which it said that, as Ms M grew older, the premiums she was paying were no longer sufficient to meet the increased life premiums, and the retirement value was used to sustain the life policy.

Lukhaimane says she is satisfied that Ms M was paid in accordance with the rules of the fund and the policy's terms and conditions. However, she says "the product that was sold to the complainant was patently flawed in that it was a life policy disguised as an RA … it had to feed off the investment value of the RA to sustain itself. This was also noted by our independent actuary, who commented that 'the policy certainly looks odd', without disputing how the investment value was arrived at."

RA funds and their administrators have informed the adjudicator's office on numerous occasions that these old-style policies are no longer being issued, Lukhaimane says.

"The current complaint demonstrates that, for as long as these types of products remain in the market, members' retirement aspirations will continue to be undermined, while the industry's image remains tarnished, a situation that can be reversed if the participants in the latter are willing and place the needs of the members first," she says.