CHAPTER 4

RETIREMENT ANNUITIES, ANNUITIES AND SUPPLEMENTARY BENEFITS

Learning Outcomes

When you have completed this chapter you will be able to

- list the rules that a retirement annuity needs to abide by in order to be approved by the Commissioner for Inland Revenue;
- explain how to establish the maximum tax deduction allowed by an individual for contributions to a retirement annuity;
- discuss the differences between a voluntary and a compulsory purchase annuity;
- list and explain the different types of immediate annuities that are available;
- list and describe the supplementary benefits that can be linked to a life insurance policy;
- explain permanent health insurance;
- briefly describe hospital cash plans and major medical cover;
- list the limitations imposed by ASISA's Code of Practice on the Limitation of Disability Benefits.

4.1 INTRODUCTION TO RETIREMENT ANNUITIES

The Pension Funds Act and the Income Tax Act make provision for the recognition of a number of different types of funds. These are designed to give benefits on retirement, death or ill health to members of the fund and/or their dependants. Only two of these can, however, truly be called employee benefit funds.

The on-going relationship between an employer and an employee needed in a pension, or a provident fund, provides the opportunity for the employer to contribute towards the benefits of his employees. These are covered in more detail elsewhere.

There are, however, other types of retirement funds that can provide valuable benefits to members without needing a continuous employer presence. In fact, with a retirement annuity fund the employer cannot make a meaningful contribution on behalf of a member at all. The member is the only party to the scheme, and no employer / employee relationship exists.

The marketing of retirement annuity funds is, in fact, completely different from the way that pension or provident funds are marketed. In the marketing of what have generally come to be known as employee benefit funds, pension and provident funds, the presentation of the scheme is made to a group of people who will normally make the membership decisions on behalf of the members or prospective members.

Membership of a retirement annuity, on the other hand, is sold to individual persons. The marketing of retirement annuities is generally undertaken by individual life insurance intermediaries, such as the agents of an insurer or a broker. Members are, in fact, normally under the impression that they are purchasing an individual life policy.

While it is true that each member who elects to join a retirement annuity fund will be issued with a policy document, this document is, other than in the case of an ordinary life insurance policy, not proof of ownership but simply proof of membership.

Take very careful note of the fact that, while a retirement annuity purchased by an individual is in fact a person-to-person transaction much in the same way as with an ordinary life insurance policy, the member does not become the owner of a policy. He simply becomes an individual member of the retirement annuity fund set up and registered by the insurer.

4.2 RETIREMENT ANNUITY FUNDS

Retirement annuities were first introduced in this country in 1960. An amendment to the Income Tax Act allowed taxpayers the right to deduct, in the determination of taxable income, current contributions made to an approved retirement annuity fund up to a maximum of, then, R600 per annum.

The amount allowable was thereafter steadily increased every few years and currently, in the case of certain high-income earners, is virtually without ceiling, being 15% of taxable income from non-retirement funding sources.

The introduction of retirement annuity funds has had a far reaching effect. It enabled self-employed persons, such as professionals, the opportunity to take out individual pension plans and obtain tax relief on their contributions.

Before this, the advantage had been enjoyed only by employees who were members of group pension schemes. Note that the term retirement annuity is in a way misleading, as the annuitant does not have to actually retire before the annuity begins. As long as he is eligible to retire, and the annuity contract has been approved by the revenue authorities, he can start receiving a benefit.

Should the retirement annuity fund have been approved by the revenue authorities, then the member can claim tax relief, up to certain limits, on the contributions. Contributions paid by members are invested by the life office in its untaxed policyholder fund which is currently taxed at 0% in accordance with the Tax on Retirement Funds Act, 1996.

In accordance with the terms and conditions of the Second Schedule of the Income Tax Act, there is also a beneficial tax treatment of the eventual proceeds. The combination of these tax advantages makes this type of contract extremely tax efficient. And it is therefore a good investment, particularly for a tax payer who earns a substantial income.

Recent rulings made by the Pension Fund Adjudicator in favour of clients in respect of early cancellations, has led to an agreement between ASISA, and the National Treasury agreeing in principle on providing a minimum of 60% of the fund value at date of early cancellation.

4.2.1 DEFINITION AND RULES

A retirement annuity fund is defined in the Income Tax Act as

> *"any fund (other than a pension fund, provident fund or benefit fund) which is approved by the Commissioner and, is registered under the provisions of the Pension Funds Act".*

Approval should be applied for on an annual basis but, in practice, approval is automatic from year to year, unless there is an unapproved change. Any person, whether self-employed or not, and whether a member of any other fund, may become a member of a retirement annuity fund.

As is further set out in the definition of a retirement annuity fund the Commissioner may approve a fund subject to such limitations and conditions as he may determine. However, he must not approve a fund unless he is satisfied:

(a) that the fund is a permanent fund bona fide established for the sole purpose of providing life annuities for the members of the fund or annuities for the dependants or nominees of deceased members; and

(b) that the rules of the fund provide:

- *(i) for contributions by the members, including contributions made by way of transfer of members' interests in approved pension funds or other retirement annuity funds;*

- *(ii) that not more than one-third of the total value of any annuities to which any person becomes entitled, may be commuted for a single payment, except where two thirds of the total value does not exceed R50 000;*
  This means that if the fund value is less than R75 000 at retirement, the member can be paid the full amount as a lump sum, and does not have to invest two thirds of it in an annuity.

Clauses (iii) and (iv) were deleted.

(v) that no member shall become entitled to the payment of any annuity or lump sum benefit contemplated in paragraph 2(a) of the Second Schedule prior to reaching normal retirement age;

This clause used to limit retirement to between 55 and 70 other than in the event of disability but was changed in 2008 to allow for later retirement. The Act includes a definition of normal retirement age, with a minimum of 55 but the maximum only defined in terms of the person becoming incapable of continuing to work.

Clauses (vi), (vii), (viii) and (ix) were deleted.

(x) that a member who discontinues his contributions prematurely shall be entitled either to
- *(aa) an annuity or a lump sum benefit contemplated in paragraph 2(a) of the Second Schedule payable on that date;*
- *(bb) be reinstated as a full member under conditions prescribed in the rules of the fund;*
- *(cc) the payment of a lump sum benefit contemplated in paragraph 2(b)(ii) of the Second Schedule where that member's interest in the fund is less than an amount determined by the Minister by notice in the Gazette; or*
- *(dd) the payment of a lump sum benefit contemplated in paragraph 2(b)(ii) of the Second Schedule where that member emigrated from the Republic and that emigration is recognised by the South African Reserve Bank for purposes of exchange control;*

(xi) that upon the winding up of the fund a member's interest therein must either be used to purchase a policy of insurance which the Commissioner is satisfied provides benefits similar to those provided by such fund or be paid for the member's benefit into another approved retirement annuity fund;

(xii) that save
- *(aa) as is contemplated in sub-paragraph (ii);*
- *(bb) for the transfer of any member's total interest in any approved retirement annuity fund into another approved retirement annuity fund;*
- *(cc) for the benefit contemplated in paragraph (b)(x) (cc);*
- *(dd) as is contemplated in Part V of the Policyholder Protection Rules promulgated in terms of Section 62 of the Long Term Insurance Act, 1998 (Act no. 52 of 1998);*
- *(ee) for any deduction contemplated in paragraph 2(b)of the Second Schedule, no member's rights to benefits shall be capable of surrender, commutation or assignment or of being pledged as security for any loan;*

(xiii) that the Commissioner shall be notified of all amendments of the rules; and

(c) that the rules of the fund have been complied with.

4.2.2 DEDUCTION OF CONTRIBUTIONS

Current contributions by a member to any retirement annuity fund are deductible from his taxable income. The deduction is limited to the greatest of:

(A) 15% of an amount equal to the amount remaining of the taxpayer's income after excluding all income from retirement funding employment and deducting all deductions permitted, excluding the deductions for:

Sections	11(n)	(retirement annuities)
	17A	(farm land - soil erosion work)
	18	(medical & dental expenses)
	18A	(donations to universities)
	19(3)	(the dividend deduction)
and paragraph	12(1)(c) to (i) inclusive of the 1st Schedule	(certain farming expenses)

One must be cautious when including dividends in the determination of the amount of non-retirement funding income of the taxpayer. As Section 10(1)(k) now exempts from tax most dividends received by a person these dividends cannot be included in the income of the taxpayer and so must be ignored here.

OR

(B) the amount, if any, by which the amount of R3 500 exceeds the amount of any deduction to which the taxpayer is entitled under Section 11(k)(i) in respect of the current year of assessment; the amount permitted as a deduction for current contributions to a pension fund

OR

(C) the amount of R1 750.

The distinction between **retirement funding** and **non-retirement funding** income can best be explained if we use the example of a person who earns a salary and belongs to his firm's pension fund, but also has another source of private income, for example, rent on a block of flats that he owns.

Example

Let us assume that the taxpayer earns a salary of R60 000 per year, and also earns a rental income on the block of flats of R240 000 per year. If the expenses (for example, rates and the repainting of the exterior) come to R40 000, the taxpayer will have R200 000 of non-retirement funding income. The taxpayer will be allowed to base the 15% mention in (A) of the formula on the R200 000.

If we say that the taxpayer pays R1 000 to the pension fund per year then the amount that he can contribute to a retirement annuity fund will be the greater of:

(A) 15% of R200 000 = R30 000

OR

(B)	R3 500 - R1 000	=	R2 500
	OR		
(C)		=	R1 750

The tax payer will be able to contribute, and claim R30 000 as a deduction to membership of a retirement annuity fund.

The distinction between the landlord of a block of flats and a farmer could best be explained if we were to imagine that the R240 000 earned in our example above was earned by a farmer. Should the farmer now have spent R40 000 on fighting soil erosion he would be able to claim it as a tax deduction in terms of Section 17A.

For the purposes of determining (A) in the Section 11(n) deduction (retirement annuity contributions), the full amount of R240 000 could, however, still be used and therefore (A) for our farmer would be R36 000 and not the R30 000 allowed to our landlord of the block of flats.

4.3 ANNUITIES

One of the primary objectives of a retiree is the guaranteeing of a permanent and secure income for the retirement years.

There are a number of avenues that can be used to produce an income but none are more permanent, or secure, than an annuity purchased from an insurer. Those persons retiring from a pension fund will be required to accept an annuity, whether it be from the pension fund, or purchased from an insurer by the fund.

Note

The fund still retains the responsibility for the payment of the annuity, regardless of the source of the income to the pensioner.

Most people are on the lookout for an income plan which will provide them a systematic monthly income during their retirement days. Annuity Investments are considered ideal in this regard mainly due to the fact that along with providing periodic income payouts for a definite period or in some cases, lifetime of the person, such investments also offer a sort of insurance cover to the individual concerned. What makes it surprising is that many people are largely unaware of the benefits offered by Annuity Investments.

Annuity Investments are extremely beneficial to the investor for two main reasons. In the first place, these investments provide a definite and guaranteed monthly income. Secondly, it helps the investor in saving money over a long term. It can also be seen that Annuity Investments are used by investors for other secondary causes such as taking care of the costs involved in a dependant's education and with the rising costs of a good education, saving for educational expenses is critical.

Annuity Investments have some attractive features which make them stand apart from other types of investments. For example, these investments are not restricted by any contribution or income limits and the earnings through them are tax exempt. Another advantageous fact in relation to Annuity Investments is that if the investor outlives the period specified in the insurance contract, he is not liable for a premium.

If you are planning to invest in Annuities, it is really important that you understand more about this safe and stable type of investment. Basically, Annuity Investments are of three types - Fixed Annuity, Variable Annuity, and Indexed Annuity.

Fixed Annuities are those in which the interest rate accorded to the investor is on a fixed and guaranteed basis as per the initial contract. Even if the interest rate changes over time, it does so only as per the guidelines specified in the contract. These investments are extremely safe and low-risk and the investor can be assured of definite returns.

Variable Annuities on the other hand are based on the performance of mutual funds on which it is dependent upon and hence offers no guarantee as far as returns are concerned. The contributions of the investor are invested in specified mutual funds as per their choice, the returns of which are used to payout the investor periodically.

Indexed Annuities are the latest in such investments and are closely related to the financial index. Investors can select and closely monitor the functioning of the related financial index upon which their annuity is dependent. These type of investments come with a minimum annual interest so that even if the stocks crash, the investors are protected to a certain extent.

Annuity Investments are most certainly beneficial to the investor especially with regard to long term investments so that during their working years the money keeps growing in a totally tax free environment and after retirement, the investor can avail of the benefit of periodic and definite income which can sustain his lifestyle and various other financial requirements to a great extent.

4.3.1 THE DIFFERENCE BETWEEN A VOLUNTARY AND COMPULSORY PURCHASE ANNUITY

Any annuity arranged or paid by a pension fund is a compulsory annuity. Being a compulsory annuity has one very important implication for the annuitant as it must be for the rest of his life. There can be a guaranteed period linked to the annuity. This means that it will pay for a period of, for example 10 years, whether that annuitant survives the period or not. Should he survive beyond this period, the annuity will have to continue for as long as he lives.

The important implication that lies herein is the value of the annuity that can be obtained from the insurer. As the insurer knows that it is committed to the payment of an annuity for as long as the person lives, it stands to reason that:

- the younger the person is at inception;
- the healthier the person is at inception; and
- whether the person is male or female;

will have a marked impact on the annuity that the insurer will be prepared to guarantee.

Should the annuity, however, be a voluntary purchased annuity, it means that the person who is purchasing the annuity is under no obligation to do so. He has simply decided to do so for the permanent and secure income that can be derived therefrom.

There are some implications that differ with a voluntary purchase annuity:

- there is no need for the annuity to be permanent; and
- subject to certain conditions, the capital repayment portion of the annuity will be tax exempt.

4.3.2 ANNUITIES CERTAIN

The annuity certain is a voluntary annuity where the payment of purchase money provides an annuity for a specified period of years, irrespective of the duration of life. If the annuitant dies during the period, the annuity continues to the end of the period. The annuity also ceases at the end of the period, even though the annuitant may still be living.

Some offices make provision for education by use of this contract. A capital payment secures an annuity certain to pay school fees as they fall due. The settlor, who may be any person, normally pays the capital to trustees. They in turn, purchase the annuity and send the annuity payments to the school, through the parent. If the payment is deficient, the parent meets the deficit. Any excess is returned to the settlor, as is the unexpended purchase money if the child dies.

4.3.3 IMMEDIATE SINGLE LIFE ANNUITIES

Payment of purchase money secures periodical payments during the lifetime of an annuitant and, unless otherwise provided, no return of any part of the purchase money can be made in the event of the early death of the annuitant. Payment of the annuity usually starts one month after deposit of the purchase money, and is deemed to be an immediate (payment) annuity. Such annuities are used for pension provision. They are suitable as an income yielding investment, where the forfeiture of capital in the event of early death of the annuitant is of little consequence, in view of the absence of dependants.

4.3.4 GUARANTEED ANNUITIES

In many cases prospective purchasers of annuities hesitate to do so. This is because they realise that, in the event of their early death, the price paid will be forfeited, and only a small amount will have been received by way of periodical payments. Due allowance for this risk is made, in the calculation of the rates offered. This has resulted in a need for some provision that removes, or at least minimises, the risk. Insurers have amended the guaranteed annuity to overcome the objections put forward that capital will be lost to the annuitant's estate at death. The longer the guarantee period, the smaller the amount of the annuity for a given purchase price.

The following are **examples** of the contracts available:

(a) the annuity payments could be guaranteed for a fixed number of years and thereafter until death;

(b) the balance of the purchase money, over and above the amount already paid out by annuity instalments, could be refunded to the annuitant's estate at the time of his death;

(c) sufficient payments could be guaranteed to cover the return of the purchase money, and thereafter until death;

(d) provision could be made for the return of part of the purchase money, for example one half, if death occurred within a defined period, for example, five years from entry. Otherwise, instalments would continue throughout life.

Each of these methods is met in practice, although (b), (c) and (d) are seldom granted.

4.3.5 EXAMPLES OF PLANS INVOLVING ANNUITIES

Insured income system

A lump sum is invested to purchase two annuities. The first one is paid to the annuitant for his own use. The second one (a 10 year certain annuity) is paid into a 10 year pure endowment policy maturing (at, say, an assumed compound growth rate of 10% per year) for an amount equal to the original purchase price for the two annuities.

These plans were originally devised in an effort to overcome the restrictions imposed by the Sixth Schedule of the Income Tax Act. Initially the Sixth Schedule laid down that although the minimum endowment term permitted was ten years in any event, the premium paying term could be a minimum of five years.

The schedule was subsequently changed, as a result of which the minimum premium paying term was made ten years. With the abolition of the Sixth Schedule, the need for plans like this, have moved into the realm of specific application. You will therefore find that plans of this nature require an in depth knowledge of investment strategy - something not covered within the scope of this course.

Back to Back system

A person might purchase a life annuity and use part of the proceeds as premiums for a policy on his life for a sum insured equal to the purchase price of the annuity. When he dies, the annuity stops and his estate (or his beneficiary) is paid the sum insured.

4.4 INTRODUCTION TO SUPPLEMENTARY BENEFITS

Many policies include a selection of supplementary benefits in addition to the basic policy. It is usual for these benefits to run for the same duration as the basic policy if it is a short term endowment, although many supplementary benefits fall away at age 60 or 65 if the carrier policy is a whole life or long term endowment plan.

The most common supplementary benefit is probably term insurance in one form or another as this boosts the early life cover with only a limited increase in the premium required.

Supplementary benefits usually require extra caution in underwriting and are very often subject to extra premium loadings for specific occupations or hazardous pursuits. Alternatively they may be subject to a range of exclusions to avoid unduly excessive premiums.

In some cases, for example, capital disability and dread disease, the supplementary benefit accelerates the death benefit and the policy terminates in the event of a claim. In other cases the supplementary benefit is a true addition to the basic cover.

4.4.1 DISABILITY BENEFITS ATTACHED TO LIFE INSURANCE CONTRACTS

Life offices have improved the attraction of their policies by including benefits which come into operation upon the disablement of the insured, whose earning power, and capacity to pay premiums, would be affected by total and permanent disability. Disablement need not be the result of an accident, total and permanent incapacity through disease can also be covered.

The majority of contracts provide a benefit should the insured be unable to follow any gainful occupation through disability.

The general exclusions are:

- indulgence in alcohol or drugs;
- self-inflicted injury;
- criminal acts;
- war risk; and
- aviation other than as a fare-paying passenger on normal routes.

Permanent Health Insurance is sometimes sold as an additional benefit although it is more usually a free-standing policy.

4.4.2 WAIVER OF PREMIUMS

Under this option, in the event of the life insured becoming totally and permanently disabled, premium payments cease and the policy is maintained in force free of charge.

It is also possible to apply this benefit to policies under which premiums are paid by someone other than the life insured. In these cases the premium waiver benefit may cover the payer of the premiums, subject of course to satisfactory evidence of health. Where there is any doubt as to the permanency of the disability, the life office will require periodical evidence of continued disability.

Premium waiver on death

A version of the premium waiver often used where the premium payer is someone other than the principal life insured is premium waiver on death. Under this benefit the premiums due are in effect paid by the insurer should the payer die before the end of the policy term.

4.4.3 ACCIDENT BENEFITS

A fairly common benefit that can be attached to a life insurance policy is one providing for the payment of an additional amount, very often equal to the basic sum insured, in the event of death by accident. Many companies have extended this benefit to cover serious injury as the result of an accident. It is usual under the latter type to cover injuries only in so far as they involve the loss of, or loss of use of, legs, arms, eyes and sometimes fingers.

4.4.4 GUARANTEED INSURABILITY BENEFIT

Normally, a young person taking out life insurance will be restricted in the amount of cover that can be afforded. The intention is usually to supplement the cover in the future when his income will have increased.

There is, however, the possibility that when the policyowner is eventually able to increase the cover he will, due to a deterioration of his health, no longer be insurable. Another possibility is that, due to an accident or illness the life insured’s insurability may have become impaired. For a small extra premium, the Guaranteed Insurability Benefit may be incorporated with the original policy. This benefit provides the option to increase the cover at regular intervals without evidence of insurability, i.e. continued good health.

With the threat of AIDS being a very real factor in underwriting most companies do, however, require the successful completion of a negative HIV test. Should the HIV test return positive the current and all future options will usually be cancelled by the insurer and no further cover will be available to the policyholder.

The benefit would provide for additional policies to be issued to the insured on the “option dates”, the sum insured of each additional policy being equal to the sum insured of the original policy, subject to a stipulated maximum.

The first option date might be the third policy anniversary, with the proviso that if the third anniversary fell before the life insured had reached the age of 21, the first option date would be the policy anniversary following his 21st birthday. Subsequent option dates would be on every third policy anniversary, the final one falling before the attainment of age 45.

Accelerations of option dates such as at marriage or the birth of a child, or even the purchase of a home, are usually permitted. Most benefits also include some form of inflation escalation provision.

4.4.5 FUNERAL INSURANCE

Within the Long Term Insurance Act of 1998 funeral insurance is categorised as **Assistance Business**. An increasingly popular benefit, especially in lower income markets, is the funeral benefit.

The cover was limited to a maximum of R10 000 by legislation for many years but this limit was increased to **R18 000 in 2008**. Funeral cover is an additional death benefit which is paid out on receipt of the minimum details concerning the death, with very few, if any, exceptions. In some cases, other related non-cash benefits are payable, but legislation demands that the insured is given the option of full cash benefits.

Cover may be for the life insured only, or could be extended to the immediate family of the insured, including the spouse, children and parents of the main life insured. There is generally a reduced benefit for children and parents.

However, it should also be noted that some insurers sell funeral insurance packages under a **full life insurance license**, allowing sums assured of R20 000 to R50 000.

4.5 DISABILITY

Disability insurance cover protects your most valuable asset - the ability to earn over an extended period of time.

If this ability is curtailed, either through disability or through impairment, you may need to ensure that you have cover to meet your financial requirements. This does not only apply if you have dependents. It is as important if you have no dependents, as this enables you to remain financially independent of others, thereby maintaining your dignity.

It is necessary to distinguish between impairment and disability. Impairment implies a physical or functional disorder, but does not stop us earning an income. Your ability to earn may be impaired, but not completely stopped. Examples of impairment may be the loss of a limb or the loss of eyesight. Disability, on the other hand, implies an inability to earn an income.

The modern disability insurance cover often incorporates both disability and impairment cover. If you are impaired, you would receive a percentage of the insured amount. This information is included in the details of the policy, and outlines the percentage payable per impairment and usually increases with the severity of the impairment.

Drilling down further

There are three forms of disability insurance cover, namely Own Occupation Disability, Occupational Disability or Total Disability.

With Own Occupation Disability, you are covered if you are unable to perform your current nominated occupation.

If you have Occupational Disability, you would be covered if you were unable to perform your nominated occupation, or a similar occupation. To illustrate by means of example, if you were a heart surgeon, and you lost a hand, with Own Occupation Disability you would be fully covered and paid out, as you can no longer operate. Under Occupational Disability, you would not be paid out, because you could become a General Practitioner. Own Occupation Disability is therefore a better option, especially for professionals in a specialised field, but this does come at an additional cost.

With Total Disability, you would only be covered if you were unable to work at all.

Two Forms of Disability Insurance Benefit - Monthly (Income Protection) and Capital (lump Sum) Benefit

Income protection may compromise either a permanent or a temporary benefit.

With permanent income protection, benefit payments will usually continue from date of disability until age 60 to 70. The level of cover is usually limited to 75% of our latest taxable income. The 75% applies in aggregate, meaning multiple policies may not, in total, exceed 100% of our present income. With temporary income protection, benefit payments do not normally exceed two years. The level of cover may not exceed our latest taxable income. This too applies in aggregate. As this cover is so important, the government does allow the tax deduction on your contributions.

Income protection premiums vary greatly between products, both within a particular insurer and across different insurers. These products need to be tailored to our personal requirements.

Here are some key points that you should consider:

- What is the waiting period before a disability insurance benefit commences? You need to ensure you have sufficient funding of your own to cover this waiting period. As is to be expected, the longer the waiting period the lower the premium.

- When assessing the validity of a claim, will the assessment use your current occupation only or will it assess any occupation for which you are qualified? This may affect whether you get paid out for a claim or not, or whether you will be required to re-train for a similar occupation.

- Will the disability insurance benefit escalate annually? If it does not, inflation will impact negatively on our benefit payment over time.

- To what age will the benefit continue? Options may vary from age 55 to age 70.

With a capital or lump-sum benefit, an insurer will pay out a lump sum if you are deemed to be permanently disabled or permanently unable to earn an income. Capital disability cover should not be used to replace lost income. It should be used to settle debt and help with lifestyle adjustments that are required as a result of your disability. Examples would be to settle the bond or make modifications to your home or vehicle to assist your disability.

4.6 DREAD DISEASE BENEFITS

Dread Disease Cover pays out a cash lump sum in the event that the policyholder is diagnosed with critical illnesses. Also frequently referred to as trauma cover or critical illness insurance cover, it provides both the policyholder and their dependents with peace of mind.

No one likes to dwell on the devastating financial consequences of a critical illness. One could be in bed for months on end and unable to earn an income. Treatment costs could sky-rocket. In-home care service costs and associated lifestyle changes could wreak havoc with the family's budget. One may even need additional post-illness treatments or recovery therapies for which the costs could be astronomical.

The following are considered to be dread diseases, although some life offices have a more extended list and could therefore exceed this list:

- heart attack;
- stroke;
- certain types of cancers;
- coronary artery disease requiring surgery;
- renal failure;
- major organ transplants;
- coma;
- paraplegia;
- Alzheimer’s disease;
- major burns;
- blindness; and
- AIDS.

Where an insured life falls victim to one of these conditions, the sum insured, or that part to which the benefit applies, becomes payable.

Further Developments

It is perhaps interesting to note how the dread disease benefits available from many insurers have increased. In addition to the dread diseases already listed above, there is now also cover available from some insurers for conditions such as:

- aplastic anaemia;
- benign brain tumours;
- respiratory failure;
- Parkinson's disease;
- Down syndrome; and
- terminal illnesses (even including HIV/AIDS).

ASISA CRITICAL ILLNESS POLICY WORDING - STANDARDISED DISCLOSURE

In the interests of a better informed public and to assist consumers in the selection of critical illness, dread disease or trauma benefits, the member offices of ASISA have agreed to introduce a standardised form of disclosure. The disclosure grid will require insurers to indicate what percentage of the full insurance cover will be paid out for four different conditions. Heart attack, cancer, stroke and coronary artery by-pass graft, which are said to make up some 70 to 90% of all critical illness claims. The grid will reflect the percentage payment for each of the four conditions across four different levels of severity as indicated in the standardised definitions, which will be accompanied by a lay person's definition to assist in understanding the more comprehensive medical definition.

Companies that indicate a specified percentage benefit for any of these conditions will have to comply with ASISA's standard definitions at claim stage, irrespective of the definition of the condition in the policy wording.

The main outcome of this is to achieve more consistency in decisions taken by insurers on claims payments, by reducing the potential conflict between policy wordings and the various definitions of conditions that are use by the medical profession. It is also of great assistance to the intermediary in evaluating the different products and in ensuring that clients have a better understanding of the cover that they enjoy.

It should be noted that this does not mean that critical illness products do not differ from one insurer to the next, in that they still offer cover for different diseases, different percentages for the various conditions, the number of payouts that can be made for one client and the rates that apply, while one cannot ignore the claims payments history or experience of different insurers.

The use of the grid was introduced in all relevant marketing material and websites and in policy quotes and contracts (by 1 April 2010).

The application includes individual and group products offering critical illness cover, acceleration of life cover on diagnosis of a critical illness and premium waiver or mortgage protection on diagnosis of a critical illness should they contain any of the four critical diseases mentioned above. It does not apply to functional impairment, capital disability or limited cover products, such as one offering breast cancer only.

4.7 PERMANENT HEALTH INSURANCE

There are two serious disadvantages to the policyholder under any scheme of personal accident and sickness insurance by annual contract, in a short term insurance offering.

Firstly, the payment of a benefit is limited to a specified number of weeks, or restricted in some other manner.

Secondly, and far more important, if the insured becomes afflicted with some serious injury or illness, renewal may be refused, offered only at an increased premium or subject to some restriction in cover. This is usually at a time when full cover is most urgently needed.

This is inevitable in the case of an annually renewable policy, as such contracts are designed to provide maximum cover at minimum premiums. Consequently, impaired lives cannot be allowed to remain on risk.

This disadvantage can be overcome by effecting a permanent contract for which, as its name implies, renewal at the original terms is automatic unless there is a breach of the policy conditions. This type of insurance is known under various names, for example:

- permanent health;
- continuous disability;
- permanent sickness;
- income protection; or
- non-cancellable sickness.

Whatever the name, the contracts are similar. All such policies cover the risk of both accident and illness.

There is a threat to substantial life cover to protect a family, if total incapacity renders the breadwinner incapable of earning, and thereby incapable of paying the premiums to keep up those policies. Many families are financially worse off as a result of the incapacity of the breadwinner than they would be had he died.

To resolve this problem, permanent health policies are offered which provide cover if a person becomes totally incapacitated for a pre-selected deferred period. He may claim from the insurance company a monthly income benefit for as long as the incapacity lasts, or until death, recovery, or the expiry of the policy, whichever happens first.

This enables the policyowner to have a continuation of income, even though he may be totally unable to work. The policyowner will, thereby, be able to maintain, to some extent, his standard of living. The main objective of permanent health insurance is to eliminate the poverty so often associated with disability.

A number of different deferred periods are usually available. The deferred period specified commences on the first day after the date of disablement. During this time no benefit is payable, and the choice is usually made on the basis of expectations, as to how long the individual’s income would continue after disability. Many employers will continue paying a salary for up to 3 months.

The available deferred periods from most insurers are:

- 7 days
- 14 days
- 1 month
- 3 months
- 6 months
- 12 months
- 24 months.

Whether benefits are being paid or not, the policy will expire on the policy anniversary prior to age 55, 60 or 65 next birthday of the life insured. Selection of the required expiry age needs to be made at the inception of the policy.

Permanent health insurance policies are essential for those who are in:

- private practice;
- partnership;
- sole traders; or
- for any who do not have this protection provided by their employers.

There is tax relief on the premiums, in that the premiums are **deductible from income tax**. Subsequently, benefits are taxed. Where the benefits are provided by an employer, benefit payments are part of taxable income.

4.8 ADDRESSING THE LOW INCOME MARKET

As part of the Financial Sector Charter, providers undertook to introduce measures to accelerate the usage of financial service products amongst the lower income market. Living Standards Measures (LSM) 1-5, typically earning under R3 000 per month. These products are required to adhere to what is generally known as the CAT standards which are:

- fair Charges;
- easy Access; and
- decent Terms.

The first of these offerings was the range of Mzansi bank accounts, followed by the Mzansi short term insurance policies.

Key requirements for these products, as per the Financial Sector Charter access Committee, include:

- simple, easy to understand documentation;

- facilities to cater for irregular premiums;
- preset cover levels (i.e. no application of average);
- alternatives to the standard practice of requiring applications and changes to policies to be done in writing;
- alternative premium payment methods to cope with clients who do not have bank accounts;
- alternative distribution channels, not only brokers;
- household and contents cover, with disaster cover being the bare minimum;
- a compulsory excess to reduce the incidence of fraud; and
- theft cover as a percentage of the total cover.

The long term industry initiative, branded as Zimele which means to stand on your own two feet. These products, started with a no frills funeral policy, offering cover between R5 000 and R20 000. One unique feature is an extended non-forfeiture clause, as the policy period in force grows. In terms of this clause, policyholders may skip a number of monthly premiums equal to the period that the policy has been in force, without the policy being lapsed, up to a maximum of six months.

In line with the CAT requirements, policies must be available within 40km of home or work of all people, while claims payments must be able to be made within 80km of residence or place of employment and the product must be supported by a share-call line operating at least six days a week.

It is expected that the range of products under the Zimele banner will be expanded.

QUESTIONS ON CHAPTER 4

Mental revision questions

Work through these mental revision questions as a test of your understanding of this chapter. We suggest that you attempt these before tackling the written questions. Please note that suggested answers are not provided as the chapter's text contains the answers.

1. What are the limitations on the payment of benefits to a member from a retirement annuity fund?

2. What is the difference between a voluntary and a compulsory purchased annuity?

3. What is a joint and survivor annuity?

4. What are the minimum and maximum income levels set by RF 1/96 for a flexible annuity?

5. List the dread diseases that are commonly available from most insurers.

6. What is the limit applicable to funeral insurance, written under an assistance insurance licence?

Written questions

Attempt these questions after you have completed this chapter and its mental revision questions. Suggested answers to these questions are at the end of this book.

1. Describe how a retirement annuity policy works, making reference to the tax relief on contributions and the nature of the benefit payments.

2. Mr Smith earns a basic salary of R48 000 plus commission from his employer. He earned R120 000 in commission in the last financial year. (He had no expenses.) Mr Smith belongs to his firm's non-contributory pension fund. However, only his basic salary is considered as being retirement funding.

   Mrs Smith, who works as an estate agent, earned R100 000 in commission and incurred expenses of R20 000 in the same financial year.

   How much can Mr and Mrs Smith contribute to a retirement annuity fund and claim as a tax deduction?

3. Explain the reasons for the original development of equity linked annuities and the restrictions that have since been imposed on these annuities by the Receiver of Revenue.

4. Give a brief explanation of permanent health insurance.