WEALTH WATCH

STEPHEN CRANSTON: Unlike your selfies, these Selfies will look good in a decade or two

A new class of bonds is generating excitement at the level of returns it promises

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The word "selfie" was the Oxford English Dictionary's new word of the year in 2013, and other languages have adopted le selfie and der selfie.

Self-portraits have been around for several milliennia, and the first photographic self-portrait was taken in 1839 by Robert Cornelius. But now people do not even need to buy a camera, as it is embedded into their smartphones. Only actuaries could turn the concept of selfies into something a lot less fun. Selfies is the name of a new class of bonds. And only an actuary could learn to love its full name, which is "standard of living indexed, forward-starting, income only securities".

Colourfield Liability Solutions' co-founders Shaun Levitan and Costa Economou might look like characters from the Addams Family but they are also big promoters of the fun-free kind of Selfies, which have had a big push from their mentor Robert Merton, a Nobel laureate.

Levitan says that there has been a significant increase in the ability of members to engage with their retirement funds. Members can receive account balances in real time, they have access to investment choice and a choice of contribution rates, even a choice of the quantum of life cover.

Yet one thing no fund can offer is a clear indication of expected income in retirement. Levitan says that it is often forgotten that retirement funds exist to help individuals maintain their standard of living, and this should be done through a guaranteed real income from retirement for the rest of their lives.

But there is no simple trade between investing in assets such as equities and bonds and achieving a predictable cash flow. Bonds have a fixed coupon, paying, say, R6,250 a year on a R100,000 bond but most individual investors would prefer to see the capital distributed throughout the term as well, instead of receiving the full R100,000 back on the maturity date. Inflation-linked bonds might sound like a better solution conceptually, but buying an inflation-linked annuity with a typical defined contribution pot would not be nearly enough to allow members to maintain their pre-retirement standard of living.

The Treasury has shown interest in Selfies as they are a useful tool for funding large capital projects. They allow large cash flows upfront for infrastructure spending, then after a 10-year delay start paying out inflation-indexed revenues.

Usually no income is paid out until 10 years after the bond has been issued. They are aimed at investors turning 55 who are prepared to defer income for 10 years until retirement, so the 2029 Selfies would be the best-seller in 2019. But, as Levitan points out, unlike an insurance policy a Selfie will be tradeable on the bond market.

Selfies have a 20 year-term and during that time they distribute both their accrued income and capital. Selfies internationally are indexed to increases in the standards of living rather than inflation. In SA, with little growth in standard of living and relatively high inflation, the CPI is likely to be the more important metric.

Levitan says that there will be a simple calculation, you won't need an actuary or even a financial adviser to help you. Just keep accumulating Selfies to get a fully transparent income.

Selfies should not be confused with Target Date funds. The Target Date 2029 fund is also designed for investors planning to retire that year. But these are a retail version of Lifestage portfolios. They typically phase clients out of equities in the years leading to retirement. They aim to provide a smooth ride but they give no real help when it comes to certainty of income.

Levitan believes that once the market has matured people should buy enough Selfies to ensure the basic income they need for retirement but still look at alternatives such as living annuities for the balance, given that the risk of running out of money has been eliminated. The Treasury is particularly concerned that when funds start offering living annuities in-house the drawdown levels are strictly monitored. It is recommended that the drawdown is 5% of capital or less in the early years after retirement.

Selfies can be bequeathed to heirs, unlike life or inflation-linked annuities. In life annuities as the lower living standards measure (LSM) groups have a lower life expectancy they subsidise the richer, longer living people in the risk pool, but in Selfies all clients, or their heirs, enjoy the 20-year term.

Selfies are usually sovereign guaranteed with negligible risk of default, unlike an annuity bought from a life insurance company in which the corporate risk is embedded.

The Financial Sector Conduct Authority (FSCA) has introduced two key initiatives. In a draft guidance note on the communication of benefit projections to members it requires that the annual benefit statements of pension funds include a projection of expected retirement benefit, explained in a simple and clear manner. This should be far more than the accumulated fund value. It should include the expected income.

It also introduced default regulations to steer members towards appropriate investments. It is also encouraging them to preserve their funds on resignation as it can be parked in the original fund. Previously HR departments pushed people to take a cheque when they left, which made their life easier.

At last year's Actuarial Convention there was most excitement about the indexing feature of Selfies and also the deferred payment. Two-thirds of actuaries said they would be definitely interested in Selfies if the economics make sense.