

How Sustainable is your Retirement?

Many investors, who are now entering the retirement 'transition zone', must use their accumulated savings to fund retirement income, but sustained low interest rates, increasing longevity and the need for flexibility mean that many are now looking beyond conventional annuities. In this article we use a case study to understand the key trade-offs: income, bequest and sustainability.

We will consider James and Catherine's situation as they approach retirement. A married couple, both aged 65, with joint accumulated assets of £500,000, they could purchase a Lifetime Annuity, which would provide an annual income of around £31,000. However, they believe they could live comfortably on a slightly lower income level and are very keen to leave some form of Bequest to their children and grandchildren should they die. They are concerned about giving up the lion's share of their accumulated nest egg over the next few years.

In order to start to think about potential solutions to James and Catherine's retirement needs, we need to consider the important measures of success and risk that James and Catherine might use as a 'Dashboard' to assess any possible retirement plan:

Retirement Planning Dashboard	
Retirement Plan	Details of James & Catherine's retirement plan, including: initial fund amount, product choice, investment option
Retirement Income Amount	The specified annual income level: the higher the better, presumably!
Retirement Income Sustainability, RIS (%)	The chance of sustaining the specified income level for the rest of their lives. Clearly James and Catherine wish to get this number to be as close to 100% as possible and should certainly plan to get the RIS number above 80%.
Bequest Value, EBV (%)	The value of the bequest or legacy they can expect to leave to their dependents. This can be measured as a % of the initial retirement fund value.

James and Catherine met a financial advisor who suggested that an Income Drawdown plan might be suitable. Based on a risk profiling exercise, he suggested a typical 'Balanced' investment strategy: 60% Equities, 40% Bonds. They plan to draw an annual income of £28,000 – 90% of what they would have received by buying an annuity.

Case 1—Base Case

Retirement Planning Dashboard: James and Catherine	
Retirement Plan	<£500,000 Income Drawdown (Balanced – 60% Equity)
Retirement Income Amount	£28,000 pa (90% of annuity)
Retirement Income Sustainability, RIS (%)	53 %
Bequest Value, EBV (%)	68%

We can evaluate the Retirement Planning Dashboard for this chosen investment strategy:

The question is how can James and Catherine adjust their retirement plan to improve the outcome?

Action	Impact on Retirement Planning Dashboard
Reduce the annual income level (Retirement Income Amount)	Increase RIS Increase Bequest Value
Use part of their retirement nest egg to buy some type of Lifetime Annuity	Increase RIS Reduce Bequest Value
Change investment strategy (Equity allocation)	Impact on RIS and Bequest depends on income level

Clearly, the key trade off is between the level of income, the sustainability of this income, and the value of Bequest available to dependants.

The Retirement Planning Dashboard can be recalculated for a wide range of different planning options, to help James and Catherine decide which best suits their own preference. A few examples are given below.

Considering alternative retirement options

Case 2—Reduced Income

Retirement Planning Dashboard: James and Catherine

Retirement Plan	<£500,000 Income Drawdown (Balanced – 60% Equity)
Retirement Income Amount	£25,000 pa (80% of annuity)
Retirement Income Sustainability, RIS (%)	71%
Bequest Value, EBV (%)	75%

By reducing the initial income level (from 90% of the annuity income level to around 80%) the RIS(%) increases from 57% to 71%.

Case 3—Reduced Equity

Retirement Planning Dashboard: James and Catherine

Retirement Plan	£500,000 Income Drawdown (Cautious – 20% Equity)
Retirement Income Amount	£25,000 pa
Retirement Income Sustainability, RIS (%)	81%
Bequest Value, EBV (%)	68%

They can increase the income sustainability further by adjusting the asset allocation.

Retirement Planning Dashboard: James and Catherine

Retirement Plan	£400,000 Income Drawdown (Cautious – 20% Equity) £100,000 Fixed Lifetime Annuity
Retirement Income Amount	£25,000 pa
Retirement Income Sustainability, RIS (%)	90%
Bequest Value, EBV (%)	61%

However, to get the sustainability level up to 90%, they can annuitize £100,000 of their retirement fund.

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