HOW LONG WILL MY MONEY LAST? THE RISKS OF DRAWDOWN

Amongst the many considerations when reaching retirement, a key question if you hold a Defined Contribution or Personal Pension plan is "how long will my money last?"

This question is even more pertinent when considering a transfer out of a Defined Benefit scheme and the 'certainties' that this provides.

The question is often answered with the aid of charts and graphs that produce a time line based on several average assumptions and commonly show a future date when the pot will run dry.

The purpose of this document is to illustrate that straight-line investment returns do not reflect the reality of markets. Here we introduce the real-life factors that can affect your drawdown plan.

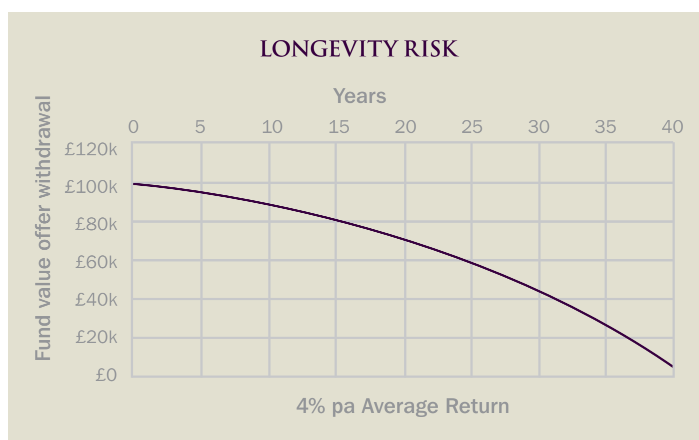
LONGEVITY - HOW LONG WILL MY MONEY LAST?

We can plot a simple chart for a person based on some basic assumptions at retirement.

Let's assume we have a person with:

- £100,000 pension fund
- Withdrawing £5,000 p.a. in arrears
- Achieves average 4% p.a. growth after charges

✓ **Pension fund will last 40+ years.**
✓ **A person can 'out live' their fund and run out of money.**
✓ **Defined timeline to build a strategy around.**
✓ **Beware! Investment markets do not move in straight lines.**



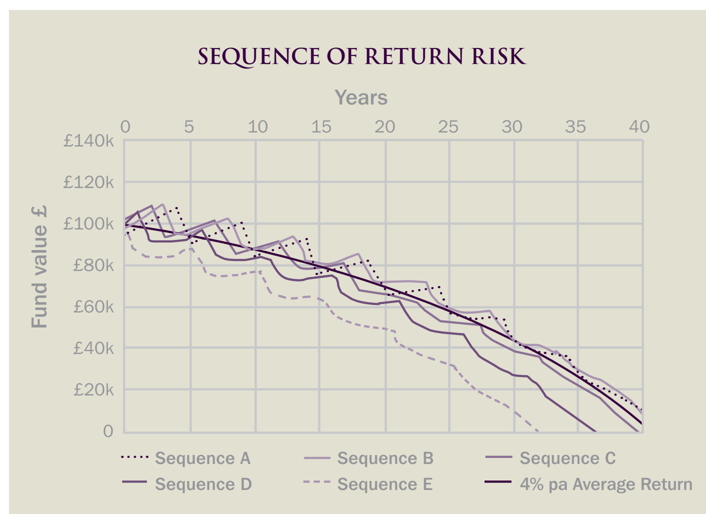
SEQUENCING – NOT ALL AVERAGES ARE CREATED EQUALLY

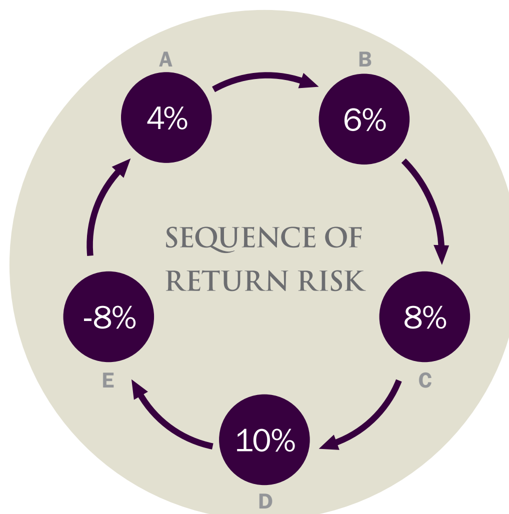
The sequence of investment returns can significantly impact the longevity of the pension fund. People with identical pension pots and the same withdrawal rate can have entirely different financial outcomes depending on the sequence of returns with the same long-term average.

Now let's assume we have 5 people all with:

- £100,000 pension fund
- Withdrawing £5,000 p.a. in arrears
- All achieve an average return of 4% p.a. after charges
- Sequence of the average is different for each
- Sequence of returns for person A is 4%, 6%, 8%, 10%, -8%.
- For person B is 6%, 8%, 10%, -8%, 4% and so on.

✓ **Same average. Different outcomes.**



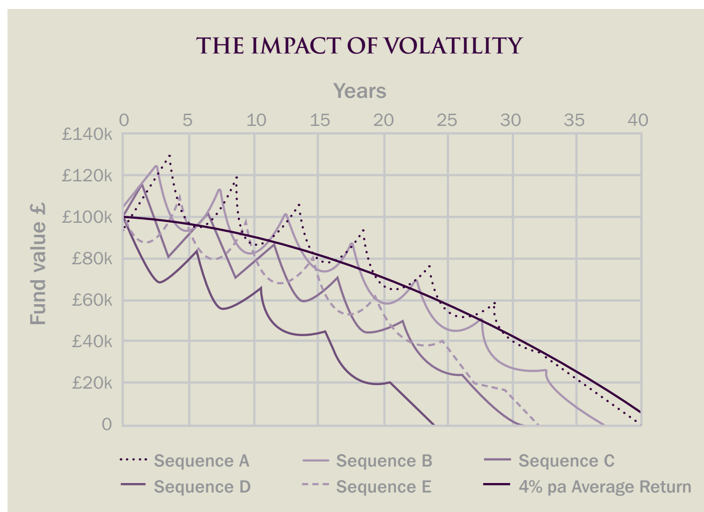


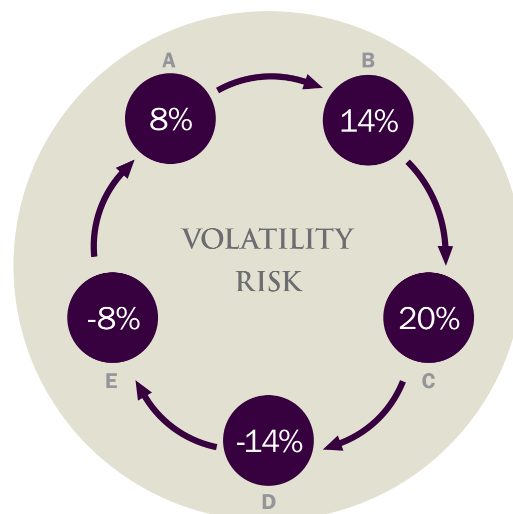
VOLATILITY – HIGHER HIGHS AND LOWER LOWS

The volatility of returns combined with the sequencing can have an even bigger impact on the longevity of the pension fund.

- £100,000 pension fund
- Withdrawing £5,000 p.a. in arrears
- All achieve an average return of 4% p.a. after charges
- Same SEQUENCE of returns as before
- Returns more volatile

✓ **Sequence D almost halves the lifetime of the pension fund from the original 40+ years.**



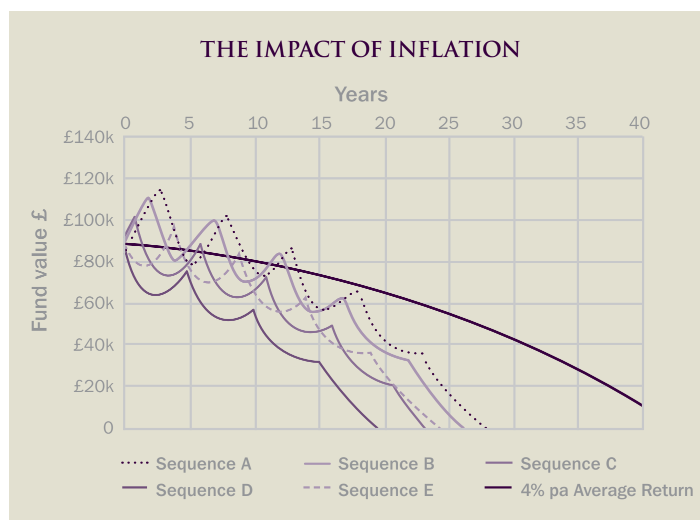


INFLATION – COST OF LIVING INCREASES

A person's starting point for the rate of withdrawal is unlikely to remain static. The price of goods and services increase with time and a person is likely to require more money each year to maintain their spending power.

- £100,000 pension fund
- Withdrawing £5,000 p.a. in arrears
- All achieve an average return of 4% p.a. after charges
- Withdrawal rate increases by 2% p.a.
- Year 1 £5,000, Year 2 £5,100 etc.
- SEQUENCE & VOLATILITY as above

✓ **Sequence D reduces the lifetime of the pension fund down to under half the time of where we started. Only 19 years.**



KEY POINTS

Drawdown can offer many benefits when accessing pension benefits:

- **Tax-free cash**
- **Flexibility of income**
- **Favourable inheritance rules**

However, these benefits also come with risks of running out of money through:

- **Mismanagement of withdrawals**
- **Unfavourable market returns**

All the more focus should be placed on these uncertainties when considering transferring out of the certainties of a Defined Benefit environment.

Ultimately the choices will be specific to the individual and a Financial Planner will be able to support the process to ensure you have the best possibility of making the money last.

The information and figures in this document are produced as a guide and do not constitute personal financial advice. Please consult your financial adviser before taking any action.