# Rethinking Retirement Income Options

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# DC savings pots – a changing environment

| Annual earnings | Weekly employee contribution | 40 years | 20 years (45-65) |
|---|---|---|---|
| £15,000 | £7.70 | £112,000 | £30,000 |
| £20,000 | £11.50 | £168,000 | £45,000 |
| £25,000 | £15.40 | £221,000 | £60,000 |
| £30,000 | £19.20 | £280,000 | £75,000 |

8% total contributions on income above £5,000 pa, of which 4% employee. Median returns of stochastic model; Portfolio of 70% Equities and 30% Bonds. Wage growth 2.06%, AMC 0.5%. All results in today's money

## Compulsion to annuitise was not the right approach

- As DC market matures, consumers will gradually look for greater flexibility and choice
- Increasingly heterogeneous sources of retirement income
- Risk / reward trade-off <u>always</u> present.  Key = appropriate level of risk for individual circumstances

# IMA research on drawdown

- Looks at range of different potential drawdown strategies
  - Percentage withdrawals, not fixed monetary amounts, to minimise risk of running out of money
  - Diversified asset allocation strategies
  - Rules-based approaches

- Possible to deliver higher median lifetime returns (up to 20% higher)
  - **Advantages** – higher potential returns, inflation hedge, gender neutrality, bequest potential
  - **Disadvantages** – uncertainty of future income, no mortality credits

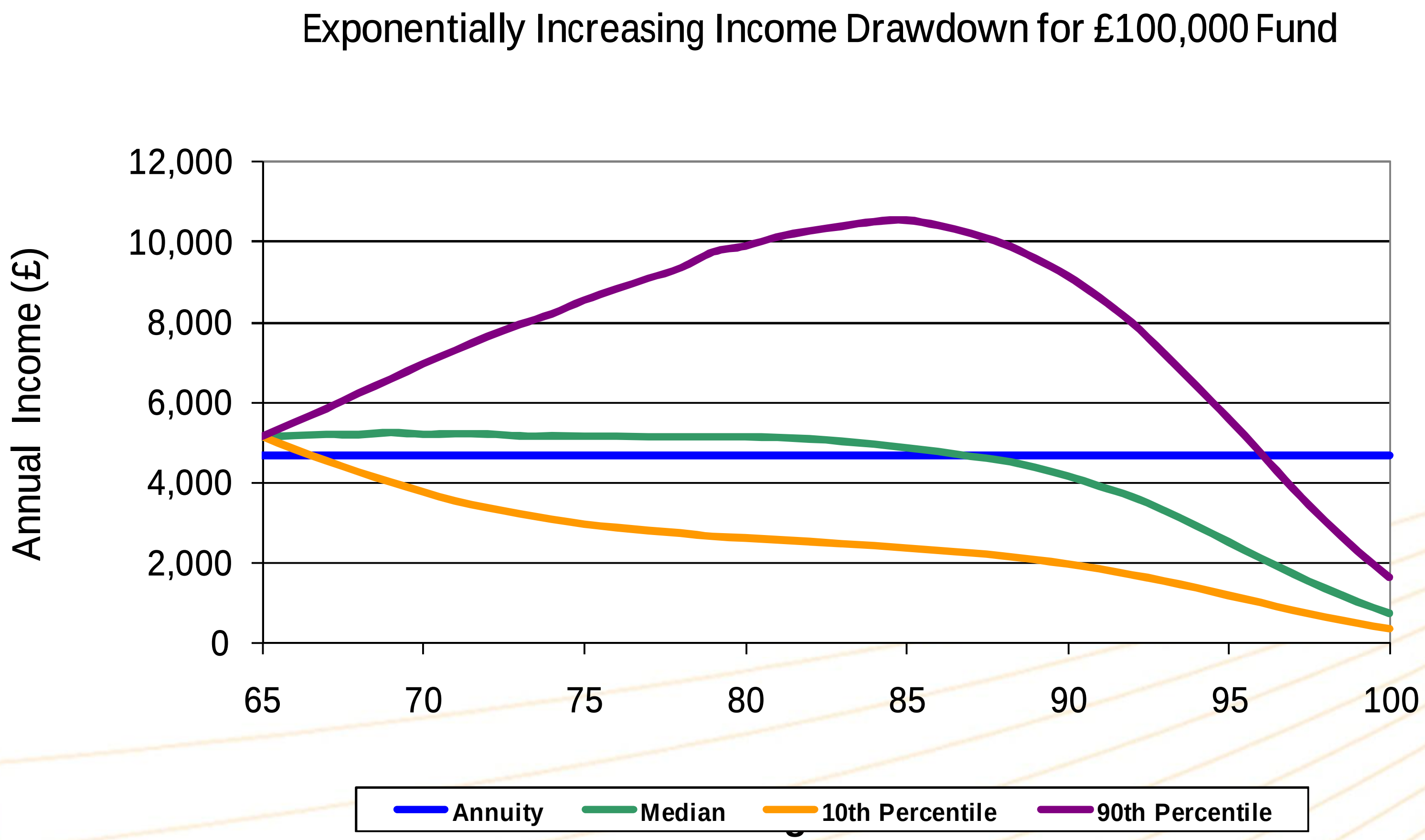
# An example
## (IMA 2008 research)

| | Age 65 | Age 70 | Age 75 | Age 80 | Age 85 | Bequest |
|---|---|---|---|---|---|---|
| **Index-linked annuity** | £4,660 | £4,660 | £4,660 | £4,660 | £4,660 | Nil |
| **Level annuity** | £7,210 | £6,163 | £5,066 | £4,164 | £3,422 | Nil |
| **Drawdown** | | | | | | |
| **Median** | £5,130 | £5,200 | £5,154 | £5,137 | £4,858 | £18,639 |
| $90^{th}$ percentile | £5,130 | £6,942 | £8,532 | £9,883 | £10,533 | £42,360 |
| $10^{th}$ percentile | £5,130 | £3,744 | £2,937 | £2,597 | £2,351 | £7,963 |

**Assumptions :**

Man aged 65 on retirement, 85 on death
"Exponentially increasing percentage" strategy
Investment strategy – 60% equities, 20% bonds, 20% cash
Tax of 55% applied to bequest
Inflation 4.0% a year

# For many people, drawdown may be too risky on its own....



# ...But broad spectrum of products possible

| Conventional Annuities | ‘Third Way’ Products | Income Drawdown |
|---|---|---|

**POOLED RISK** ⟷ **INDIVIDUAL RISK**

# Conclusions

- A maturing DC market, combined with accrued DB rights and diverse savings patterns, requires flexibility in decumulation phase
- Need to avoid polarisation between proponents and opponents of annuitisation
- Some form of longevity risk pooling will be necessary for many people at some stage of their retirement
- The right product should be bought for the right reasons, and not because it is mandatory