Rules of Thumb for drawdown: 2023 Update

Retirement Income Interest Group of the New Zealand Society of Actuaries (RIIG)

Financial Advice NZ, September 2023

This presentation covers:

1. Who we are
2. Drawdown: setting the scene
3. RIIG's Rules of Thumb Update 2023
4. Key takeaways

Ian Perera is Convenor of the Retirement Income Interest Group (RIIG) and a former President of the New Zealand Society of Actuaries. He has over thirty-five years' experience in financial services including being Chief Financial Officer and Chief Risk Officer of Sovereign (now AIA). He is currently applying his actuarial expertise in the banking industry.

Alison O'Connell was the founding Director of the Pensions Policy Institute in the UK before she came to New Zealand in 2006. She has continued her research in longevity and retirement policy and developed a governance career in insurance and investment sectors. She is currently a member of the Retirement Commissioner's Advisory Board, an independent director of Resolution Life New Zealand, and a Council Member of the New Zealand Society of Actuaries.

RIIG

- Retirement Income Interest Group of the NZ Society of Actuaries
- Current members: Ian Perera, Alison O'Connell, Christine Ormrod, Dinushi Jayasuriya, Fraser McKay, Kelvin Prisk, Simon Ferry
- Since 2015, papers on:
  - Retirement Income Policy, Longevity
  - Guidance for decumulation, Rules of Thumb
  - Distribution of KiwiSaver balances across the population

Latest RIIG reports on KiwiSaver drawdown

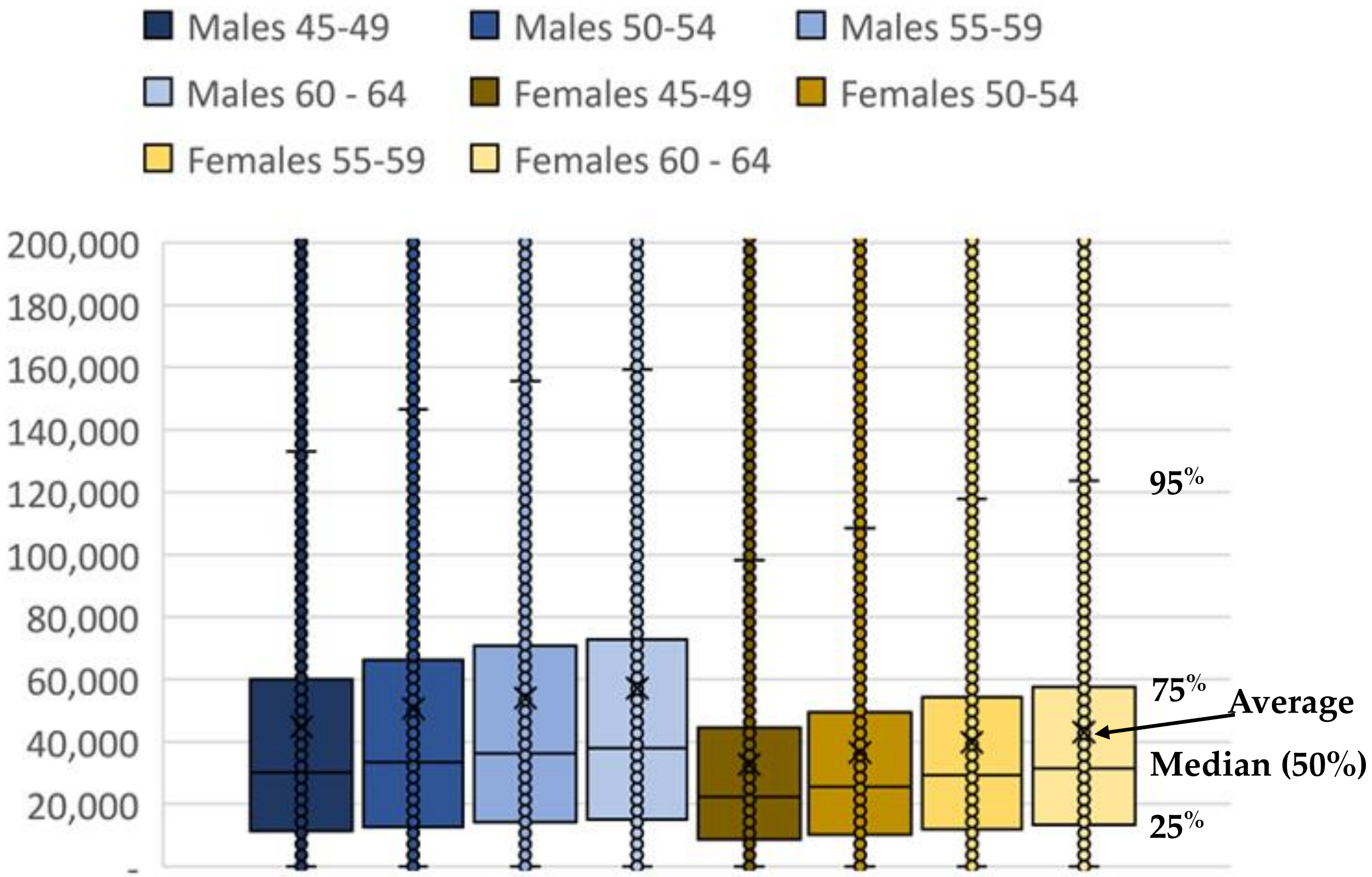
- ✓ November 2021: ***How to make drawdown a success***
  A framework for drawing down income from an invested fund (usually KiwiSaver)
- ✓ July 2022: ***Insights into pre-retirement KiwiSaver accounts***
  The size of KiwiSaver balances for members now aged 45-64

- ➢ November 2022: ***Future KiwiSaver balances and implications for retirement income policy***
  *A*ctuarial modelling to estimate KiwiSaver balances that could be available at age 65 for members currently aged 45-59
- ➢ August 2023: ***Drawdown Rules of Thumb: Update 2023***
  RIIG's four drawdown Rules of Thumb updated to reflect current investment and longevity prospects

How much do near-retirees have in KiwiSaver?

Distribution of account balances, in dollars, for KiwiSaver members aged 45-64 in 2021, by age group and gender, from RIIG's sample as at 31 March 2021

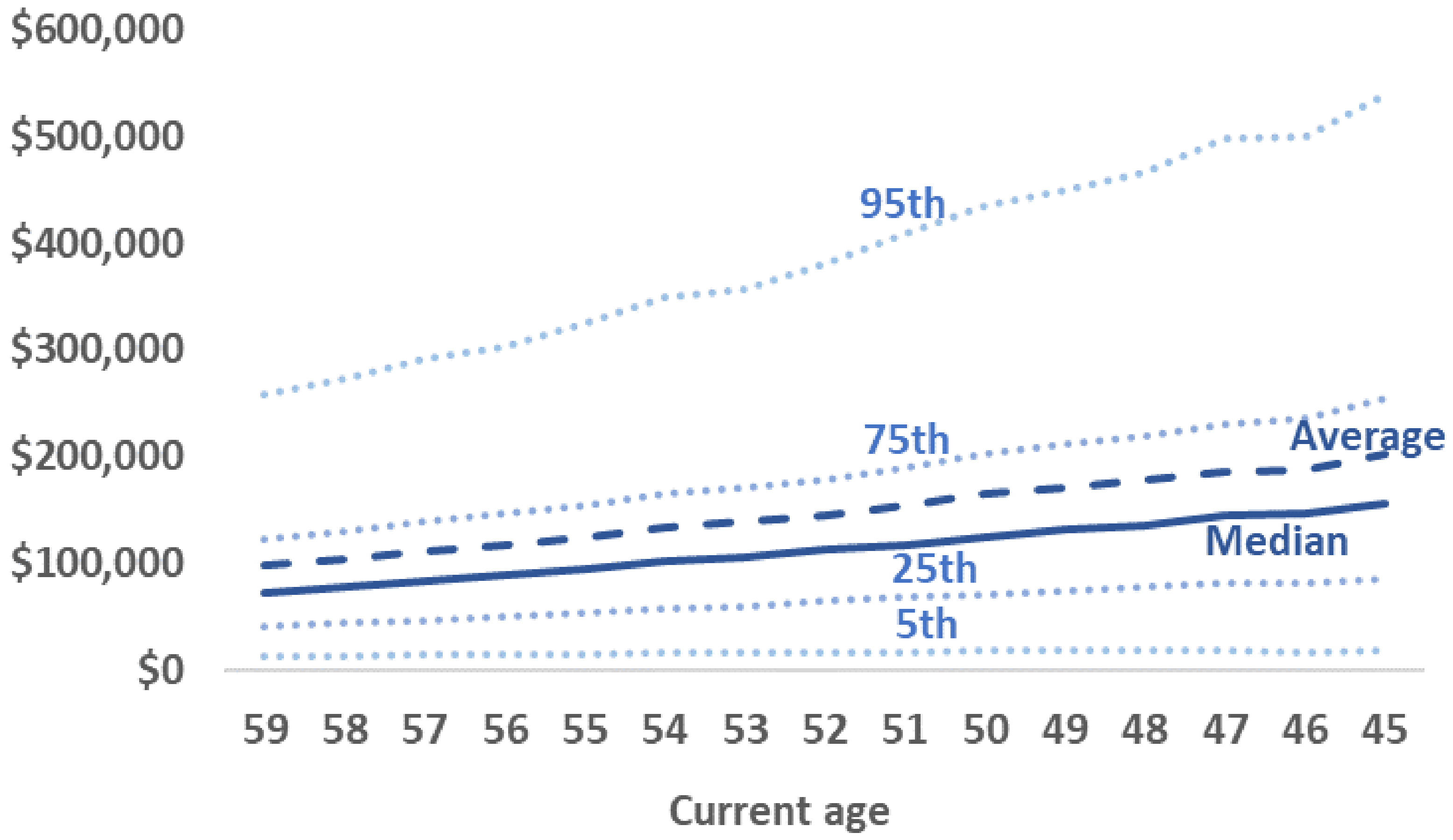
- Modest amounts for most – cluster and tail
- Older people have more than younger
- Generally, women have less than men



Source: RIIG (2022) *Insights into pre-retirement KiwiSaver accounts*

Skewed distribution extends to future balances

Indicators of distribution (median, percentiles and average) of estimated future account balances at age 65, in present day (2021) dollars, for ***contributing*** KiwiSaver members aged 45-59 in 2021



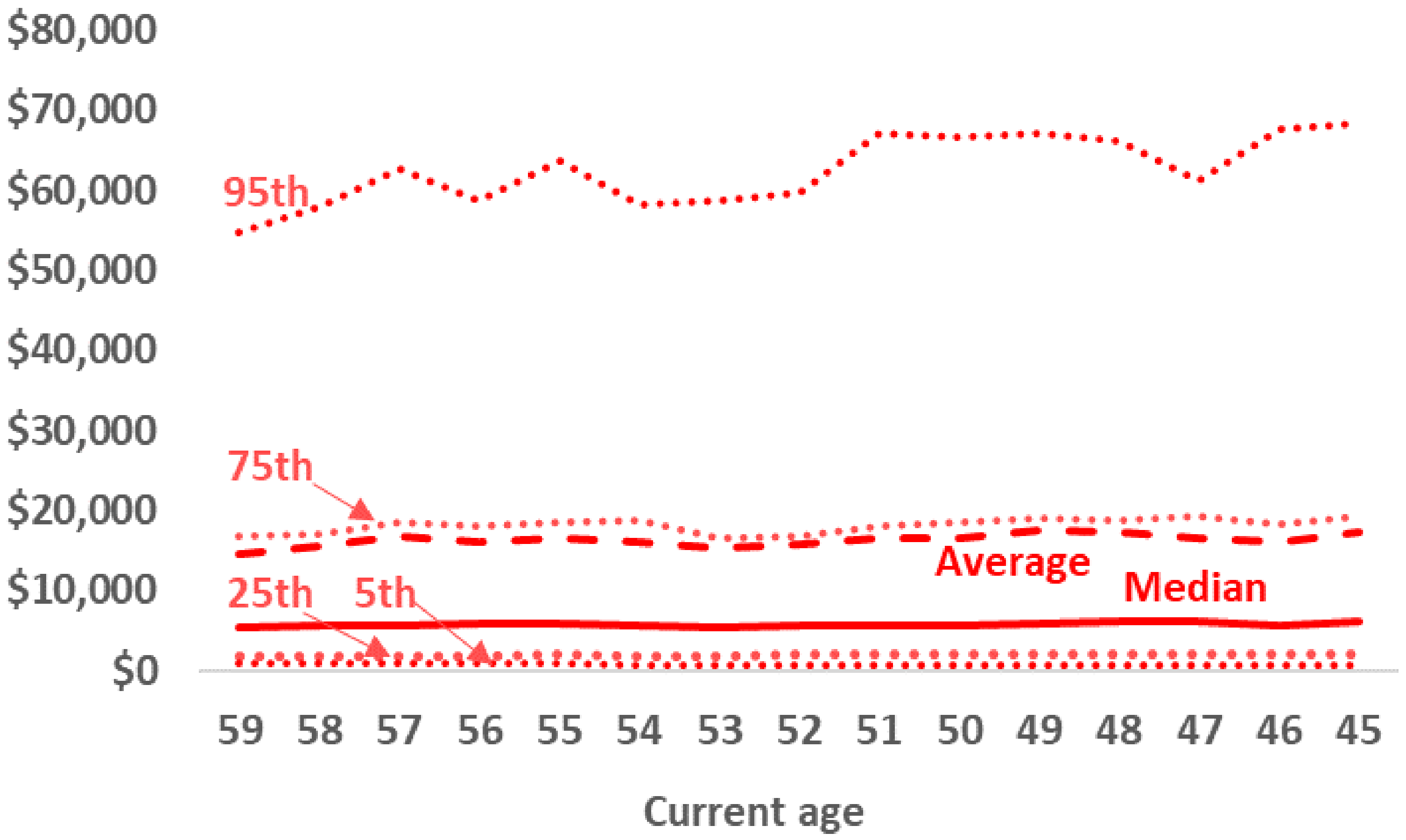
"Helpful, if modest" balances improving over time

- Members currently aged 54 expected to be the first to have a median balance at age 65 of $100,000
- Median for 45-year-olds estimated at $156,900 → $6,280 a year on the 4% Rule

Source: RIIG (2022) ***Future KiwiSaver balances and implications for retirement income policy***

Not contributing is usually disastrous

Indicators of distribution (median, percentiles and average) of estimated future account balances at age 65, in present day (2021) dollars, for ***non-contributing*** KiwiSaver members aged 45-59 in 2021



Median balance at age 65 for current non-contributors who stay non-contributing:

- $6,200 for 45-year-olds
- $5,400 for 59-year-olds

Source: RIIG (2022) ***Future KiwiSaver balances and implications for retirement income policy***

Financial Assets outside KiwiSaver are low

- Median Financial Assets:
  - 55–64 years $59k
  - 65-74 years $54k
- Mean Financial Assets
  - 55–64 years $408k
  - 65-74 years $338k

Source - Household net worth statistics: Year ended June 2021

RIIG's drawdown framework

1. What buckets?
2. What drawdown plan?
3. How long might I live?
4. Review regularly - not set and forget

Invested fund, likely KiwiSaver

A safe emergency fund
Bank accounts, term deposits
~ 1-2 years of costs

Lifetime income
NZ Super

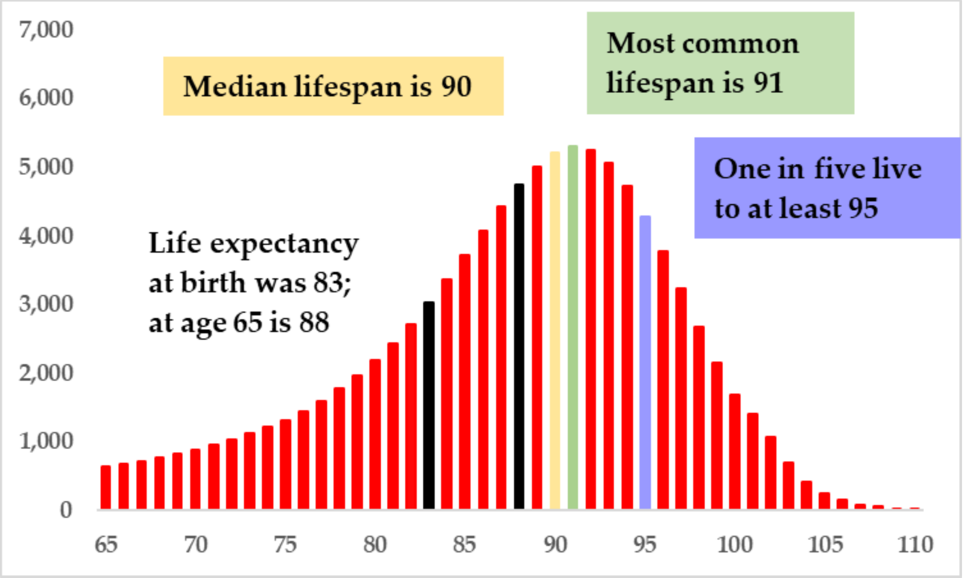
Rules of Thumb guide how to draw down from this bucket

What drawdown plan? RIIG's four Rules of Thumb

Rule of Thumb	How it works
6% Rule: Each year, take 6% of the starting value of your retirement savings.	You receive the same nominal amount each year but the length of time you receive it for varies.
Inflated 4% Rule: Take 4% of the starting value of your retirement savings, then increase that amount each year with inflation.	You receive the same real amount (i.e. inflation adjusted) each year but the length of time you receive it for varies.
Fixed Date Rule: Run your retirement savings down over the period to a set date – each year take out the current value of your retirement savings divided by the number of years left to that date.	The amount you receive each year varies but the length of time you receive it for is known.
Life Expectancy Rule: Each year take out the current value of your retirement savings divided by remaining life expectancy at that time.	You receive a payment each year until you die but the amount varies.

How long might I live?

- We suggest people currently aged 45 years or over should test their drawdown plan against the likelihood that they live until 90 to 95 years old.



Deaths by age per 100,000 female New Zealanders born in 1958 from age 65. Source: RIIG (2023)

Review: things change

- Expenditure Guidelines do not reflect diversity of individual situations – use personal calculators
- Definite planning for future 20-30 years not feasible
- Focus on short-term needs; then review and change drawdown if necessary every year or so

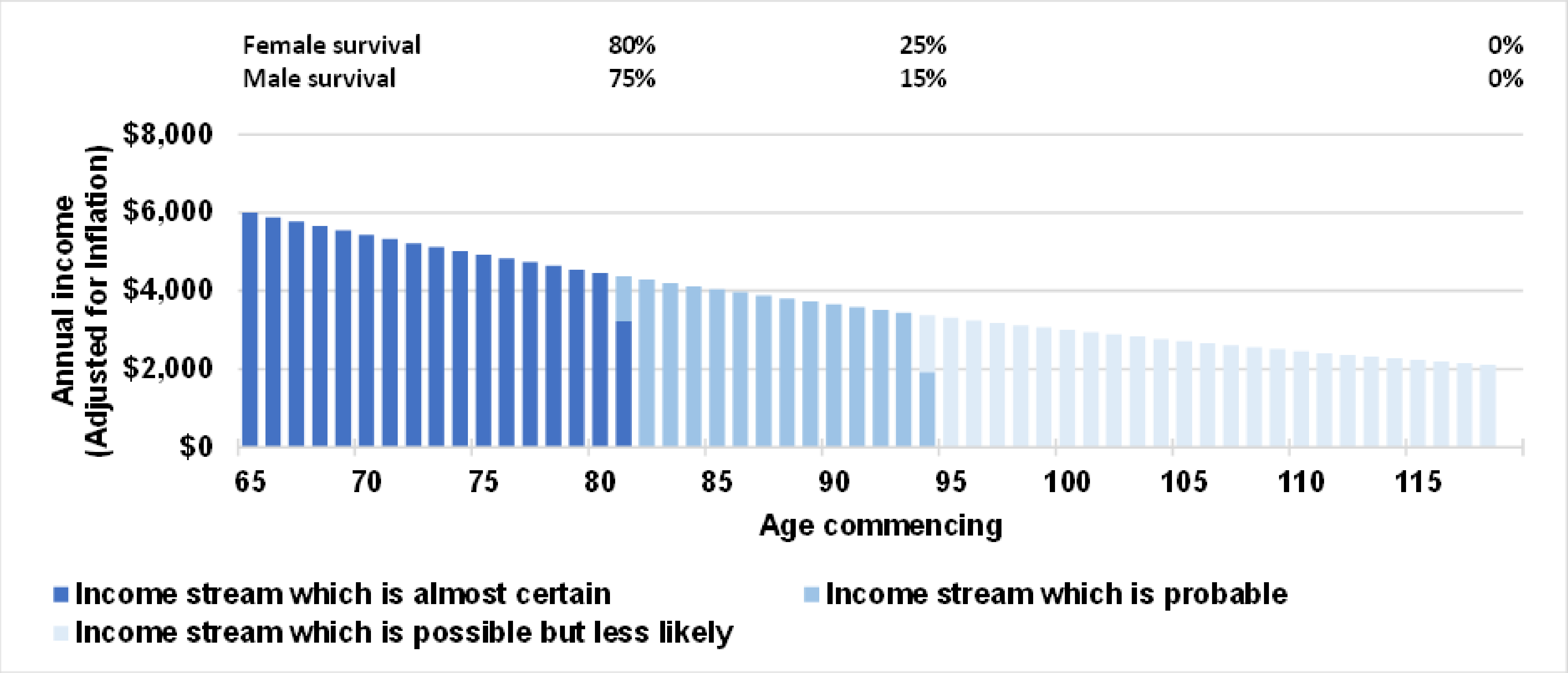
RIIG Rule of Thumb Update 2023

1. **Looked at $100,000 in Conservative, Balanced, Growth Funds**
2. **Investment assumptions: higher returns and volatilities than 2020. Differ from FMA: RIIG's are 1% pa higher and allow for variation.**

Fund type	Proportion of Growth assets/ Income assets	Expected return per annum, after tax and fees	Assumed annualised standard deviation	Risk indicator
Conservative	20% / 80%	3.5%	6.0%	4
Balanced	50% / 50%	4.5%	9.5%	4
Growth	80% / 20%	5.5%	14.0%	5

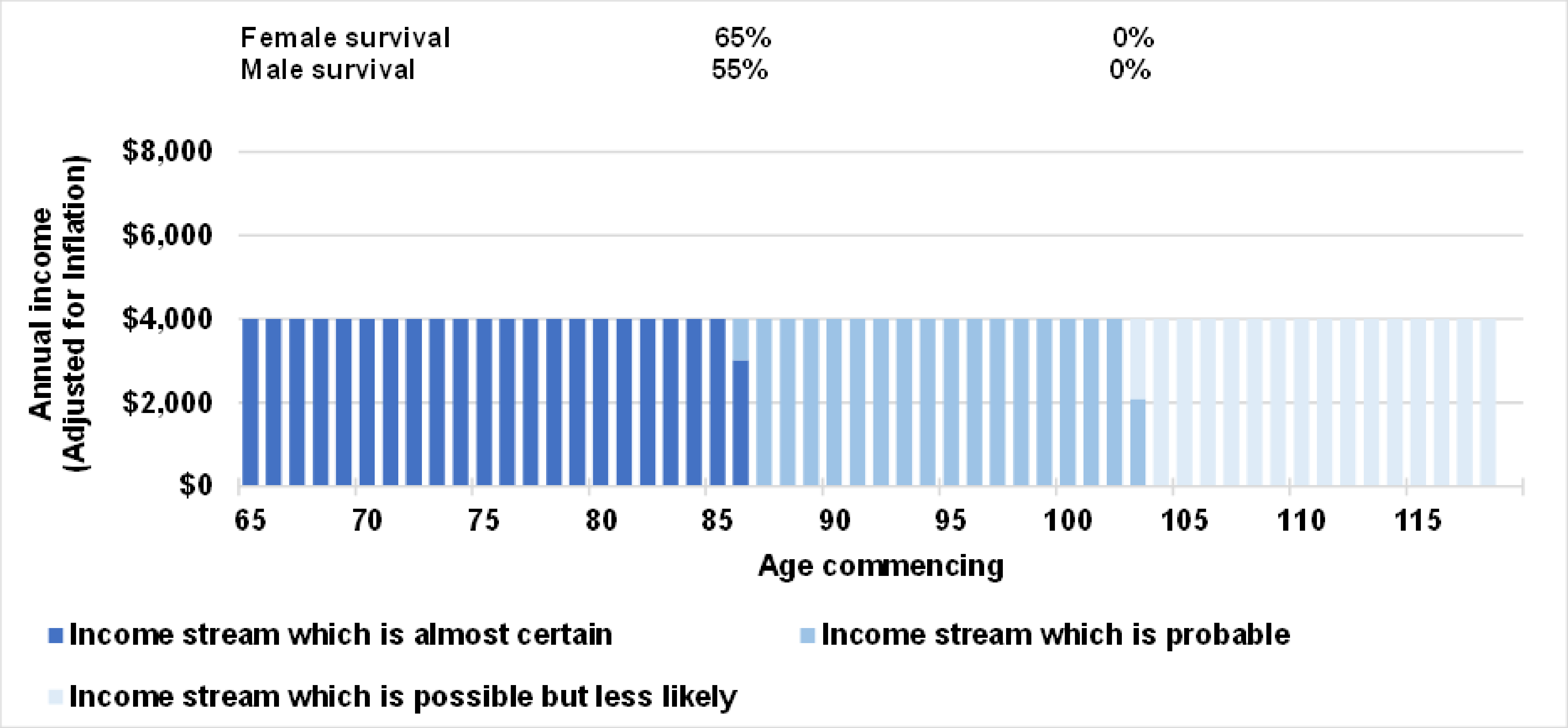
3. **Inflation 2% pa: higher than 2020**
4. **Mortality: latest StatsNZ projections. Slightly lower chance of reaching highest ages than previous assumptions, but lifespans still increasing**

6% Rule (2023) start age 65 with $100,000 in a Balanced Fund (50:50)



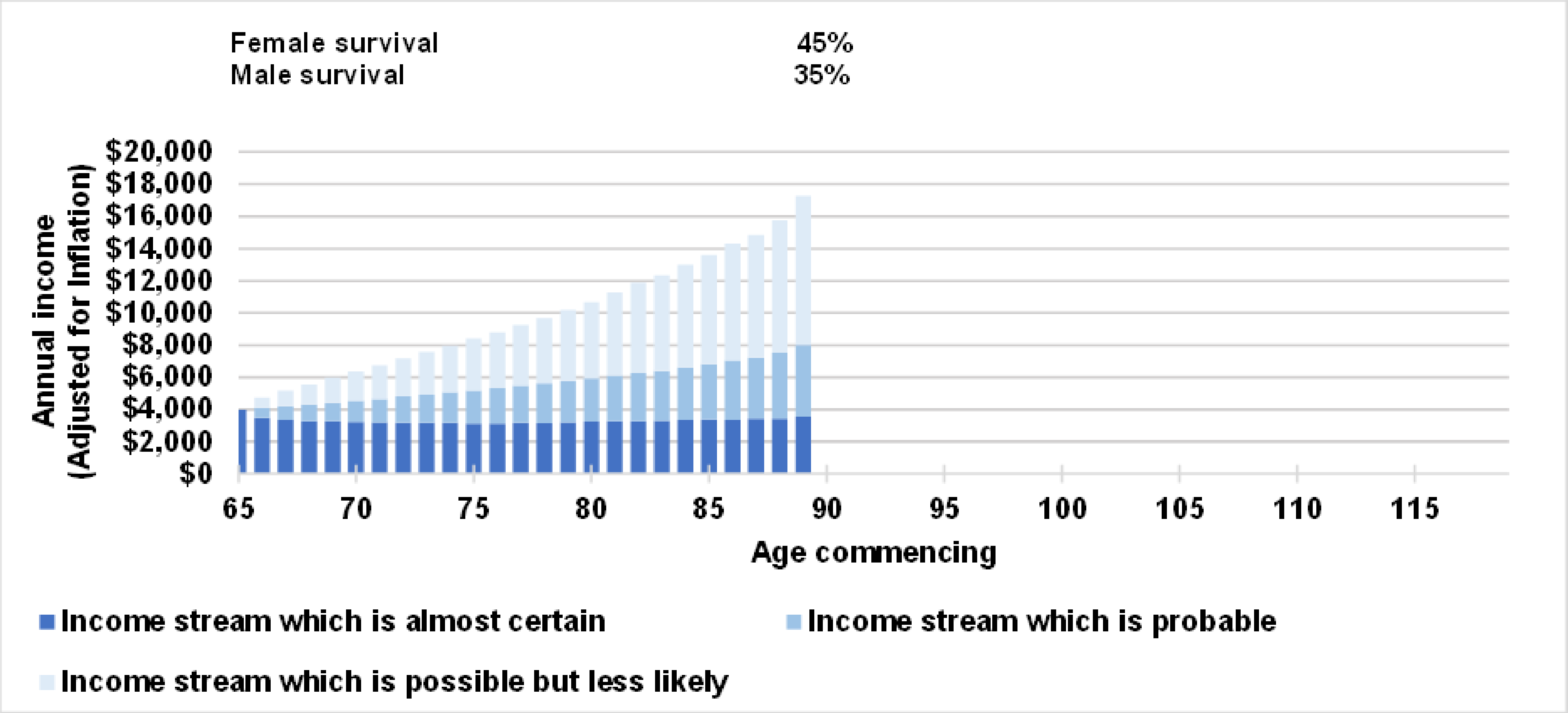
Source: RIIG (2023) *Decumulation Rules of Thumb: Update 2023*

Inflated 4% Rule (2023) start age 65 with $100,000 in a Balanced Fund



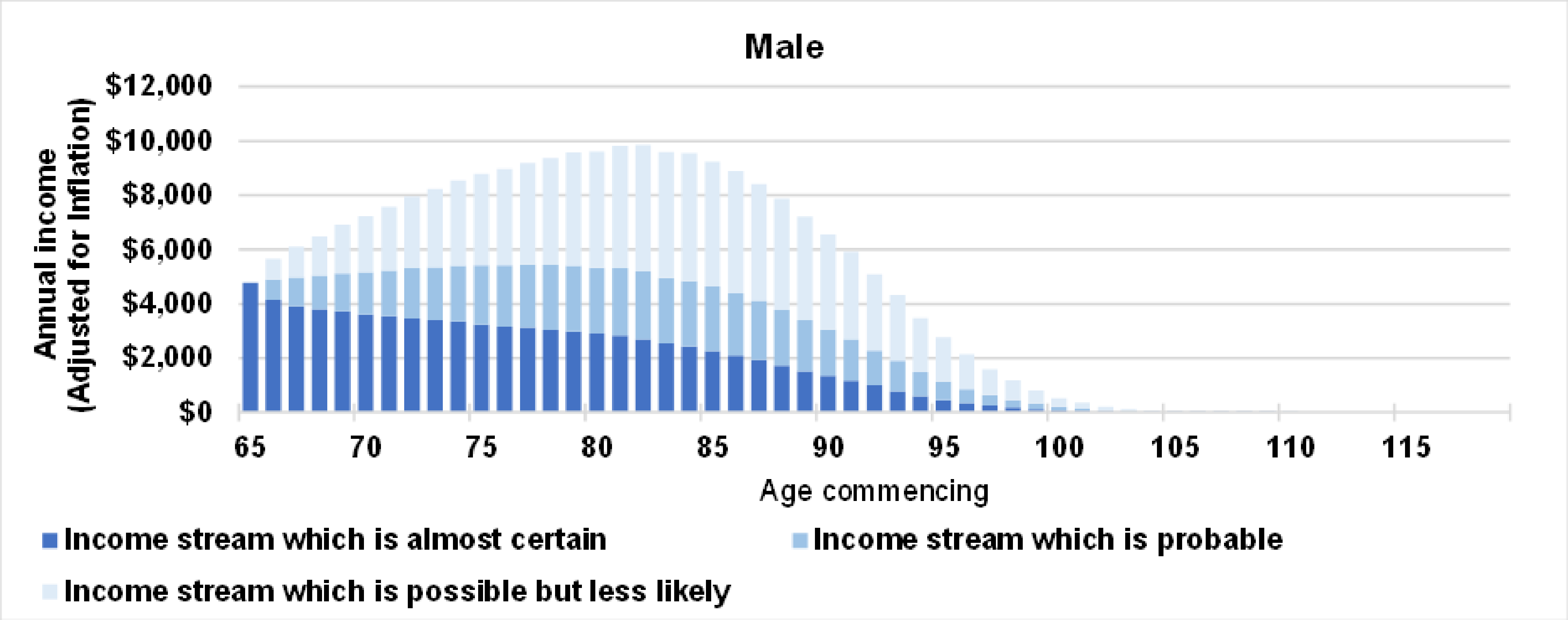
Source: RIIG (2023) *Decumulation Rules of Thumb: Update 2023*

Fixed Date Rule (2023) start age 65 with $100,000 in a Balanced Fund



Source: RIIG (2023) *Decumulation Rules of Thumb: Update 2023*

Life Expectancy Rule (2023) start age 65 with $100,000 in a Balanced Fund



Source: RIIG (2023) *Decumulation Rules of Thumb: Update 2023*

RIIG's four Rules of Thumb detailed descriptions - example

Rule of Thumb	Balanced Fund	Growth Fund	Conservative Fund
Inflated 4% Rule (start at age 65)	Income will probably last to age **103** and less than 2% of people are expected to live longer than this. It is very unlikely that income will run out before age **86** and 55% of males and 65% of females are expected to live longer than this.	Income will probably last to age **110** and less than 1% of people are expected to live longer than this. It is very unlikely that income will run out before age **84** and 60% of males and 75% of females are expected to live longer than this.	Income will probably last to age **96** and less than 10% of males and 20% females are expected to live longer than this. It is very unlikely that income will run out before age **87** and 50% of males and 60% of females are expected to live longer than this.
Inflated 4% Rule (start at age 70)	Income will probably last to age **108** … It is very unlikely that income will run out before age **91**…		

Source: RIIG (2023) ***Decumulation Rules of Thumb: Update 2023***

RIIG's four Rules of Thumb suitability checklist (1/2)

Rule of Thumb	Most suitable for	Pros	Cons
6% Rule	People who want more income at the start of their retirement, to "front-load" their spending, and are not concerned with inheritance.	Very simple. Known, regular income.	Income will not rise with inflation. Risk of retirement fund running out within lifetime.
Inflated 4% Rule	People worried about running out of money in retirement or who want to leave some inheritance.	Fund likely to last near to a full lifetime. Income will rise with inflation.	Lower income initially than other options.

RIIG's four Rules of Thumb suitability checklist (2/2)

Rule of Thumb	Most suitable for	Pros	Cons
Fixed Date Rule	People comfortable with living on other income (for example New Zealand Superannuation) after the set date. Those wanting to maximise income for most of their life and not concerned with inheritance.	Income for a known selected period.	Amount of income varies from year to year. Annual calculation necessary.
Life Expectancy Rule	Those wanting to maximise income throughout life and not too concerned with inheritance.	Efficient use of fund to provide income for whole of life.	Amount of income varies from year to year, low in later years. Annual calculation necessary; relatively complicated.

Illustrative first year incomes at age 65 for actual median KiwiSaver balances today plus ongoing contributions

	Age at birthday in 2021			
	Age 59	Age 55	Age 50	Age 45
Median balance at age 65 in present-day (2021) dollars	72,400	95,200	124,400	156,900
6% Rule income each year	4,344	5,712	7,464	9,414
Inflated 4% Rule income in first year, increases with inflation	2,896	3,808	4,976	6,276
Fixed Date Rule income in first year	2,896	3,808	4,976	6,276
Life Expectancy Rule (Female) income in first year	3,055	3,967	5,098	6,327
Life Expectancy Rule (Male) income in first year	3,415	4,407	5,629	6,973

Source: RIIG (2023) *Decumulation Rules of Thumb: Update 2023*

Key takeaways

1. **Rules of Thumb give a useful steer, suitable for a range of personal drawdown priorities.**
2. **Taken together, the income profiles from the four Rules are a way to engage retirees in thinking about the implications of drawdown decisions, especially investment and longevity risks**
3. **The most certain way to be able to draw down more income than the baseline illustration is to start drawdown at a later age.**
4. **More growth assets should lead to higher returns which allows more income - but it also increases uncertainty and the potential for less income to be available.**
5. **Don't 'set and forget' a drawdown plan - review regularly**
6. **KiwiSaver is increasingly important for New Zealanders, but regardless of drawdown approach, for most, New Zealand Superannuation will be the most significant part of retirement income.**

More at: https://actuaries.org.nz/resources-and-publications/reports/