

How much does a comfortable retirement cost?

Pension decumulation



Introduction



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As people begin to reflect on their life after work, they're often consumed by one question: How much do I need for a comfortable retirement? This isn't about the level of income they need, though that's an important part, but how much should they have saved to provide that income?

On the face of it, there's a straightforward answer to this question. The data suggests that for UK retirees a withdrawal rate of 3-4% will provide a high degree of certainty that income will last a lifetime¹. So once we know how much income is needed then, after deducting the State Pension and any defined benefit pension, we can calculate the size of the retirement pot required.

There's just one issue with this approach. The size of the pot needed may be much higher than the pot of money saved. Anyone in this position could simply rein in their expenditure to make ends meet, but is there an alternative?

They could take more than 3-4% from their retirement savings, but this increases the risk. The conundrum facing retirees is that 3-4% is the largely risk free rate to ensure funds last for a lifetime, but there's a reasonable likelihood that, in many cases, there could still be significant funds left on death. Analysis has shown that over the last 140 years, US retirees withdrawing at the rate of 4%, would have only a 10% likelihood of ending up with less than their initial capital after 30 years and a 10% chance they would have 6 times their original capital².

This report pre-dates the FCA thematic review of retirement income advice, but it echoes many of the themes in the review. For example, the need to match withdrawal rates to the client's specific circumstances, rather than adopt a blanket approach³.

In this report we look at the impact of different risk factors and how retirees could manage these to make the most of their retirement savings.

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1. The State of Retirement Income: Safe Withdrawal Rates, Morningstar, 2022.
 2. The Extraordinary Upside Potential Of Sequence Of Return Risk In Retirement, Michael Kitces, February 2019.
 3. Retirement income advice thematic review, FCA, March 2024.

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How much does a comfortable retirement cost?

One of the stellar achievements of the last century was the improvement in longevity. It's difficult to grasp that life expectancy was just 45 years at the start of the 20th century for men and 49 for women. By the end of the century, it had risen to 75 for men and 80 for women⁴. Today, it stands at 79 and 83 respectively⁵.

If we look at the life expectancy for 65-year olds the figures are even more startling. The prospect of a 20,30 or even 40 year retirement isn't out of the question. Welcome though this is, it poses one of the greatest challenges we face this century. How do we fund a comfortable retirement that could last as long as our working life?

To address this question, we need to:

- Understand how much income is necessary at outset for a comfortable retirement
- Track how income is likely to change over the course of retirement
- Calculate the present value of the income required

This will identify how much is needed to sustain an average retirement. We can then model variations to the base case to determine where the sensitivities lie. In other words, which factors have the greatest impact on the outcome?



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4. Century of change: Trends in UK statistics since 1900, Research paper 99/111 House of Commons, 1999.

5. National life tables – life expectancy in the UK: 2018 to 2020, ONS, September 2021.

Our start point is to understand what constitutes a 'comfortable retirement'? This in itself is a matter of conjecture. What defines 'comfortable' for one person may be quite different for someone else. Nevertheless, there are a number of inputs we can consider:

- Final salary pensions have long been the 'gold standard' in pension planning. These schemes usually pay a maximum of two thirds (66%) of final salary. With the State Pension, this could provide from 75-100% of pre-retirement salary.
- DWP research suggested there should be a range for the replacement rate from 50% to 80% of pre-retirement earnings depending on income⁶. For high earners, fixed expenses are a smaller percentage of their earnings. That means they have more wriggle room to cut back, so a replacement rate of 50% could be enough. In contrast, people on low incomes may need a much higher proportion of their pre-retirement earnings to maintain a reasonable standard of living.
- The Pensions and Lifetime Savings Association developed the Retirement Living Standards. The Retirement Living Standards study calculates how much is needed at retirement⁷. The study estimates the annual income required at different levels of comfort for a single person and a couple. They define three categories of expenditure 'modest', 'moderate' and 'comfortable'.

The figures for a comfortable retirement are as follows:

	Net (£)	Gross (£)
Single	37,300	43,482
Couple	54,500	61,840

Source: Retirement Living Standards, Pensions and Lifetime Savings Association, 2021

In terms of defining 'comfortable', it's worth noting that this isn't living extravagantly. The Retirement Living Standards study assumes the weekly shop is at Sainsbury's, holidaying is in Europe for three weeks each year and motorists will drive a five year old mid-range SUV, like a Nissan Qashqai plus an older, smaller run around⁸.

The Retirement Living Standards figures are a helpful starting point, but we need to calculate how much someone should have saved to provide for a comfortable income throughout their retirement.



Our start point is to understand what constitutes a 'comfortable retirement'? This in itself is a matter of conjecture. What defines 'comfortable' for one person may be quite different for someone else.

6. Automatic Enrolment Review 2017, Department of Work and Pensions, December 2017 chart 4.15, page 93.

7. Retirement Living Standards, Pensions and Lifetime Savings Association, 2022.

8. Retirement Living Standards, Pensions and Lifetime Savings Association, 2022

We could simply assume a reasonable withdrawal rate and work from that. In its 2021 study⁹, Morningstar modelled safe withdrawal rates based on future assessments of returns based on current market conditions. The Morningstar analysis suggests that a safe withdrawal rate for UK retirees, based on a 90% probability of success, is 3.3% over a 30 year period assuming a 50/50 equity/bond asset allocation.

In its 2022 study, Morningstar revised its estimate of a safe withdrawal rate to 3.8%. This takes into account increasing bond yields and lower equity valuations. Morningstar anticipates higher equity returns over the next 30 years and higher bond yields. The current inflation rate is expected to be relatively short term and over a 30 year horizon they expect inflation to average 2.8%. In this report we will assume 3.8% is a safe withdrawal rate.

If a gross income of £43,482 is needed for a comfortable retirement, and the maximum State Pension of £10,600 is included, this leaves a balance of £32,882. Ignoring other assets, and any defined benefit income, this would require a defined contribution fund of nearly £900,000. If the 25% tax free cash is used as part of the fund this would bring the number down, but it's still a substantial figure. People who can provide for a comfortable retirement, while withdrawing no more than 3.8% of their retirement savings, are in a privileged position.

A research study from Phoenix Insights revealed that over 12m people expect to receive the minimum level of income required to get by in retirement, but aren't on track to achieve it¹⁰. The Retirement Living Standards define a minimum standard of living as an annual income of £12,858. This means many people will fall short of the funds they need during retirement.

For many people, some degree of compromise will be necessary in their quest to fund a comfortable retirement. Probability of success defines the degree of risk, but it doesn't shed much light on the nature of the risks. For example, is inflation the nemesis of today's retirees or is longevity a greater concern? Can we quantify which risks pose the greatest danger and how they could be reduced or mitigated?

It's worth keeping in mind that William P Bengen, the architect of the original concept of the 4% rule, calculated that 4% is the correct level of withdrawal for US retirees over a 30 year period to avoid running out of money. However, Bengen's analysis showed that, while there is no money remaining in the worst case scenarios at the end of the 30 year term, in 96% of cases all of the original capital is left¹¹. There is the real possibility that people could deny themselves a comfortable retirement, and perhaps even experience hardship, by being too conservative. Of course, the alternative is that an unconstrained approach could mean retirees run out of money during their lifetime.



A research study from Phoenix Insights revealed that over 12m people expect to receive the minimum level of income required to get by in retirement, but aren't on track to achieve it.

9. The State of Retirement Income: Safe Withdrawal Rates, Morningstar, 2021 and 2022.

10. Great Expectations: Are people's retirement income expectations adequate and achievable?, Phoenix Insights, September 2022.

11. 20 Years of Safe Withdrawal Rate Research, Kitces Report, March 2012.

This is a difficult issue, but people who would like a comfortable retirement, but can't achieve this if they limit withdrawals to 3.8% of their retirement savings, have to confront this dilemma.

This report will identify some of the compromises people could make and the risks they can take to provide for a comfortable retirement. It will also explore how people can mitigate or underwrite the risks they face.

Key points

- The Retirement Living Standards study defines a 'comfortable' retirement as an annual income of £43,482 before tax for a single person (£61,840 for a couple).
- A study from Phoenix Insights revealed that over 12m people expect to receive the minimum level of income required in retirement, but aren't on track to achieve it.
- Morningstar analysis suggests a withdrawal rate of 3.8% has a 90% probability of success over a 30 year period, which equates to a fund of nearly £900,000 to provide for a comfortable retirement.
- Probabilities of success are indicative of the scale of the risks being taken, but say less about the nature of the risks and their relative influence on outcomes.
- Bengen's original analysis of the 4% rule concluded that, while money runs out at the end of 30 years in the worse cases, in 96% of scenarios the original capital is still intact.
- There is the real possibility that some people may be overly conservative and leave substantial funds on their death, while denying themselves a comfortable retirement.



Defining the base case

Our starting point is to define a base case we can work from then look at a series of variations.

Key assumptions

- **Retirement age.** Our base case assumes a retirement age of 65 for both sexes. There is no longer a fixed retirement age in the UK. Despite the absence of a mandatory retirement age, the average retirement age is still around 65 for both sexes¹².
- **Income.** Retirement Living Standards target for a comfortable retirement of £43,482 (gross) for a single person. The net figure is £37,300.
- **Longevity.** Average life expectancy for a 65 year old man and woman of 20 years and 22 years respectively¹³.
- **State Pension.** The maximum State Pension is included of £10,600. Not everyone will be entitled to the full amount. There will also be some people who are entitled to more than the maximum by virtue of their membership of the various additional schemes before the flat rate scheme came into effect in April 2016.
- **Investment returns.** Our core assumption of 5% pa compound investment return is in line with the intermediate rate prescribed by COBS 13¹⁴.
- **Charges and fees.** The assumption for the base case is that total charges are 1% of funds under management.
- **Pattern of expenditure.** There is a view that expenditure falls during retirement until long term care reverses this trend and expenditure rises. However, the issue is more complex than this. For the base case, we have assumed a level income in real terms.
- **Marital status.** The majority of 65 year olds (around 70%) are in a relationship¹⁵. However, this introduces the added complexity of different average life expectancies within a heterosexual relationship. As a result, we've constructed the base case around a single male and female.
- **Tax.** The income is taxable and payable from a defined contribution pension.
- **Legacy.** There is no specific requirement to leave a legacy in the base case.

For ease of reference, we'll call our 65 year old man Tim and our 65 year old woman Julie. Here's a summary of the base case assumptions.



Despite the absence of a mandatory retirement age, the average retirement age is still circa 65 for both sexes.

12. Unbiased, November 2022.

13. Life expectancy calculator, ONS, October 2022.

14. Preparing product information, Conduct of Business Sourcebook, FCA, November 2022.

15. Population estimates by marital status and living arrangements, England and Wales: 2002 to 2014, ONS, July 2015.

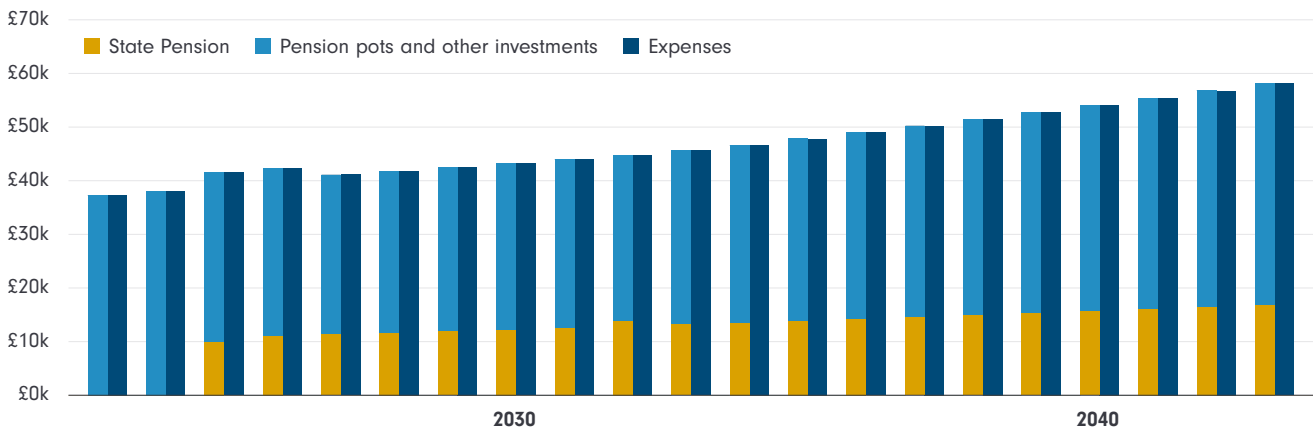


Chart 1: Summary of key assumptions

	Tim	Julie
Income required (gross)	£43,482	£43,482
Level, increasing or decreasing	Increasing by inflation	Increasing by inflation
Marital status	Single	Single
State Pension	£10,600	£10,600
Life expectancy at 65	20 years	22 years
Inflation	2% pa compound	2% pa compound
Investment return	5% pa compound	5% pa compound
Charges	1% pa compound	1% pa compound
Tax	All income taxable	All income taxable
Bequest or legacy	£0	£0

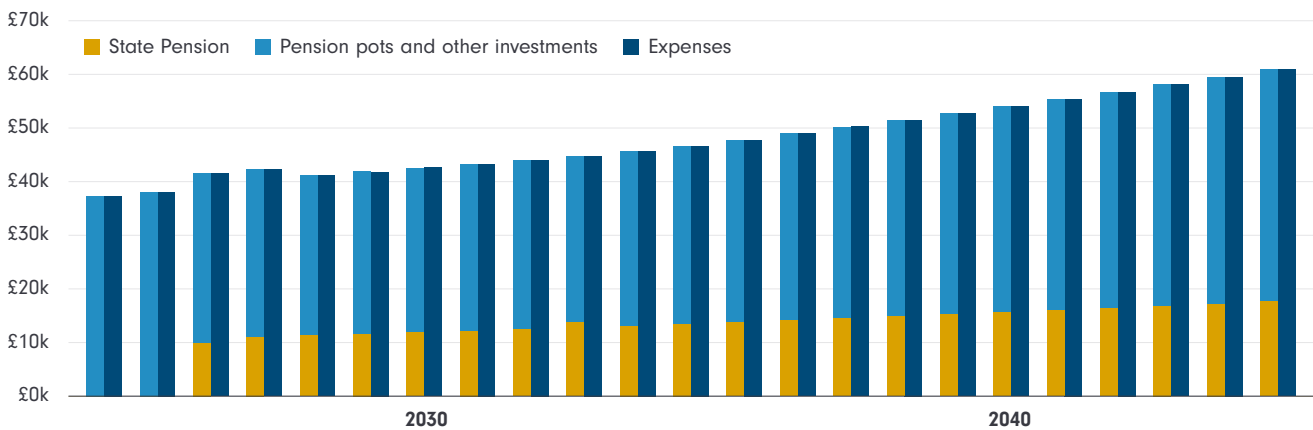
On the basis of our assumptions, the amount required to provide a comfortable retirement would be £600,000 for Tim and £640,000 for Julie (see charts 2 and 3). Bear in mind, the fund would be exhausted at the end of the period if the assumptions prove accurate. If the assumptions are not borne out the money could last longer or run out sooner.

Chart 2: The base case for male aged 65 requires £600,000 plus full State Pension



Source: Conquest Planning

Chart 3: The base case for a woman aged 65 requires £640,000 plus full State Pension



Source: Conquest Planning

Some people harbour thoughts of early retirement. Retiring early does impact the results for two reasons. Firstly, average life expectancy is longer. For example, at 60 Tim’s life expectancy is 24 years, while Julie’s life expectancy is 27 years. Secondly, there is a longer wait for the State Pension to take effect. If Tim and Julie retired at 60 the amount required to fund early retirement would be £750,000 and £820,000 respectively.

The retirement savings needed to fund a comfortable retirement at 65 is a factor of roughly 14 times the income level for Tim and 15 for Julie, compared with a factor of approximately 17 for Tim and 19 for Julie if they retire at 60.

Having established the base case, let’s take a closer look at some of the assumptions that lie behind the base case and how varying these assumptions can impact the amount required.

The flaw of averages

Average life expectancy is a useful way to track improvements across the population as a whole, but it's less effective in forecasting individual longevity. Probabilities are a better lens through which we can build a more helpful understanding of mortality:

- Tim has an average life expectancy at 65 of living to 85, but a 1 in 4 probability of living to 92 and a 1 in 10 probability of living to 96. The probability of becoming a centenarian is 2.9%¹⁶.
- Julie has an average life expectancy at 65 of living to 87, but a 1 in 4 probability of living to 94 and a 1 in 10 probability of living to 98. The probability of becoming a centenarian is 5.2%¹⁷.

It's not surprising that many financial advisers now plan for a 100-year life.

If we feed these extra years of life expectancy into our model, the amount required increases to £750,000 if Tim lives to 92 or £835,000 if he lives to 96. The equivalent figures for Julie are £790,000 and £870,000 respectively.



It's not surprising that many financial advisers now plan for a 100-year life.

Patterns of expenditure

The pattern of expenditure in retirement is often presented in the shape of a smile. In other words, income needs fall gradually throughout retirement, then rise when long-term care is required. While this is a legitimate pattern for some people, the assumption that long term care will be required towards the end of life isn't the case for most people:

- Only 1 in 4 men and 1 in 3 women over 65 will have 'substantial care needs during retirement'¹⁸.
- Other people will receive care in the home, but much home care is provided by family and friends. It has been estimated there are over 4m unpaid carers in the UK¹⁹. In contrast, it's estimated there are less than 1m paid carers providing care services²⁰.

Longevity professor, Robert N Butler, believes the need for long term care will recede further in the future as debilitating chronic conditions become treatable. Much like AIDs, a cocktail of drugs will keep illness at bay, which means more people will die after a short illness rather than experience a protracted period of time requiring expensive care²¹.



Only 1 in 4 men and 1 in 3 women over 65 will have 'substantial care needs during retirement'.

16. ONS, Life expectancy calculator, November 2022.

17. ONS, Life expectancy calculator, November 2022.

18. Pensions and the funding of long term care, Institute and Faculty of Actuaries, 2015.

19. House of Commons, Informal carers, June 2022.

20. Home care facts and stats: number of providers, service users and workforce, Homecare.co.uk, April 2021.

21. The Longevity Revolution, Robert N Butler, 2009.



There is another issue with the smile proposition. It assumes a gradual decline in expenditure over time. Data suggests around half of the average retirement for a 65 year old man or women will be spent in good health²². Therefore, income shouldn't decline much, if at all, during this period. The Family Expenditure Survey reveals that spending does decrease between the age groups 65-69 and those over 75. The total average reduction is a little over 25%²³. If we assume this occurs evenly over the period beyond healthy life expectancy that would equate to an annual reduction of about 2.50% for men and 2.75% for women.

However, the reality maybe more nuanced. Income does not universally fall over the course of retirement. Wealth appears to be a key factor insofar as it is often a proxy for a longer life. A healthier diet, higher levels of exercise and access to better healthcare means affluent retirees live longer and healthier lives on average:

- A 65 year old living in the poorest areas of England will spend, on average, around 6 years in good health, compared with over 12 years for a 65 year old living in the wealthiest areas of the country²⁴.
- A man aged 65 in Westminster and Chelsea can expect to live to 88 on average (90 for a 65 year old woman). This compares with a life expectancy of 80 for a 65 year old man in Glasgow (83 for a 65 year old woman)²⁵.

A 2022 study by the Institute for Fiscal Studies found that, on the face of it, average expenditure appears to decline with age, but if the data is analysed by five year birth cohorts the expenditure profile is flat or even slightly increasing. In other words, the decline in expenditure appears in part to result from different levels of spending between generations²⁶.



A 65 year old man living in the poorest areas of the UK will spend, on average, around 6 years in good health, compared with over 12 years for a 65 year old man living in the wealthiest areas of the UK.

22. Health State life expectancies UK: 2017 to 2019, ONS January 2021.

23. Household expenditure by age of household reference person: Table A9, ONS January 2019.

24. Centre for Ageing, Better Health: The State of Ageing 2022.

25. How long do you have left? Mirror Group September 2021.

26. How does spending change through retirement?, Institute for Fiscal Studies, May 2022.

So what conclusions can we draw from this? While income may decline over the course of retirement this is not a given. Nevertheless, in some instances income will decline so we've modelled the following scenario:

- In Tim's case, income is level after allowing for inflation, for the first 10 years, then reduces by 2.50% for the remaining 10 years.
- For Julie, income is level, again after allowing for inflation, for the first 13 years then reduces by 2.75% for the remaining 9 years.

Tim would require £530,000 on this basis, while Julie would need £565,000.

Investment performance

Our core assumption of 5% pa compound investment performance is in line with the intermediate rate prescribed by COBS 13²⁷. The rates for the lower rate and higher rate are 2% and 8% respectively. If we model these upper and lower rates against our base case, the size of the pension pot required increases/decreases as follows:

- For Tim, the lower rate of 2% pa compound return would mean the pension pot required would increase from our base case assumption of £600,000 to £810,000. In contrast, an 8% return would reduce the amount required from £600,000 to £460,000.
- For Julie, the lower rate of 2% pa compound would mean the amount required would increase from our base case assumption of £640,000 to £880,000, while an 8% return would reduce the amount required from £640,000 to £483,000.

Inflation

The base case assumption is in line with the Bank of England's long term target of 2%. There is a potential link between investment returns and inflation which suggests we shouldn't look at each in isolation, but the connection isn't straightforward. Over the long term real assets – equities, property and commodities – act as a hedge against inflation. However, in the short term, stock markets are much more volatile. There is often an inverse correlation. As inflation increases, equity prices will often fall and as inflation falls equity prices may rise.

If we assume, once stability is restored, the new normal for the long range inflation target increases from 2% to 4%, the size of Tim's pension pot would need to be £803,000. Julie's pot would need to increase to £890,000. It's also important to note that high inflation shortly after retirement can have a detrimental impact on safe withdrawal rates. This is because significant inflation rate increases in the early years of retirement are effectively 'baked in' to income withdrawals for the full term (assuming income is inflation linked)²⁸.



There is a potential link between investment returns and inflation which suggests we shouldn't look at each in isolation, but the connection isn't straightforward.

27. Preparing product information, Conduct of Business Sourcebook, FCA, November 2022.

28. Choosing the highest safe withdrawal rate, William P Bengen, October 2020.



Charges and fees

We know expenses play an important part in outcomes. The base case assumption is that charges and fees are 1%. Charges and fees might be as little as 0.50% for a DIY investor using a low cost platform, choosing indexed funds. In contrast, an advised client using actively managed investment funds might pay as much as 2% total charges or more. This is not to suggest one approach is better than the other. Drawdown is complex. Paying for advice can help people avoid costly mistakes and the best active fund managers can outperform index funds.

If we increase charges to 2%, the fund required would increase from £600,000 to £660,000 for Tim or increase from £640,000 to £715,000 for Julie. In contrast, a reduction in charges to 0.5% would reduce the amount to £570,000 for Tim or £605,000 for Julie.

Leaving a legacy

Many people will be interested in leaving a legacy from their pension fund. Often, there will be money left on death without any pre-planning. As previously noted, the original Bengen analysis revealed that, while there is no money remaining in the worst case scenarios at the end of the 30 year term, in 96% of cases all of the original capital is left²⁹. Nevertheless, if we model funding a £100,000 legacy against our base case, the amount required at outset would increase from £600,000 to £640,000 for Tim and from £640,000 to £679,000 for Julie.

29. 20 Years of Safe Withdrawal Rate Research, Kitces Report, March 2012.

Delaying State Pension

One way to reduce the size of the fund required to maintain a comfortable lifestyle in retirement is to work for longer. There are a number of potential benefits:

- More time to pay into a pension or other savings and investment products.
- Additional investment growth on funds already accrued.
- Deferring receipt of the State Pension will increase the amount eventually paid.
- Reduced life expectancy at older ages shortens the number of years to fund.

Our analysis makes no allowance for additional savings during the period of deferral or any additional growth during this time, but does account for reduced life expectancy and a higher State Pension. We considered two examples, deferring retirement firstly to age 67 and then deferring retirement to age 70. Life expectancy doesn't change at 67 for either Tim or Julie, it remains at 85 and 87 respectively. However, because retirement starts two years later, the period savings need to cover reduces from 20 to 18 years for Tim and from 22 to 20 years for Julie. Retiring at 70, does increase average life expectancy to 86 for Tim and 88 for Julie (though the number of years savings need to cover reduces to 16 years for Tim and 18 years for Julie). The State Pension increases by 1% for every nine weeks deferred. This works out at just under 5.8% each year.

The amount required to fund a comfortable retirement would be £520,000 at age 67 for Tim and £565,000 for Julie. At age 70, the amount would be £460,000 for Tim and £505,000 for Julie.

Key points

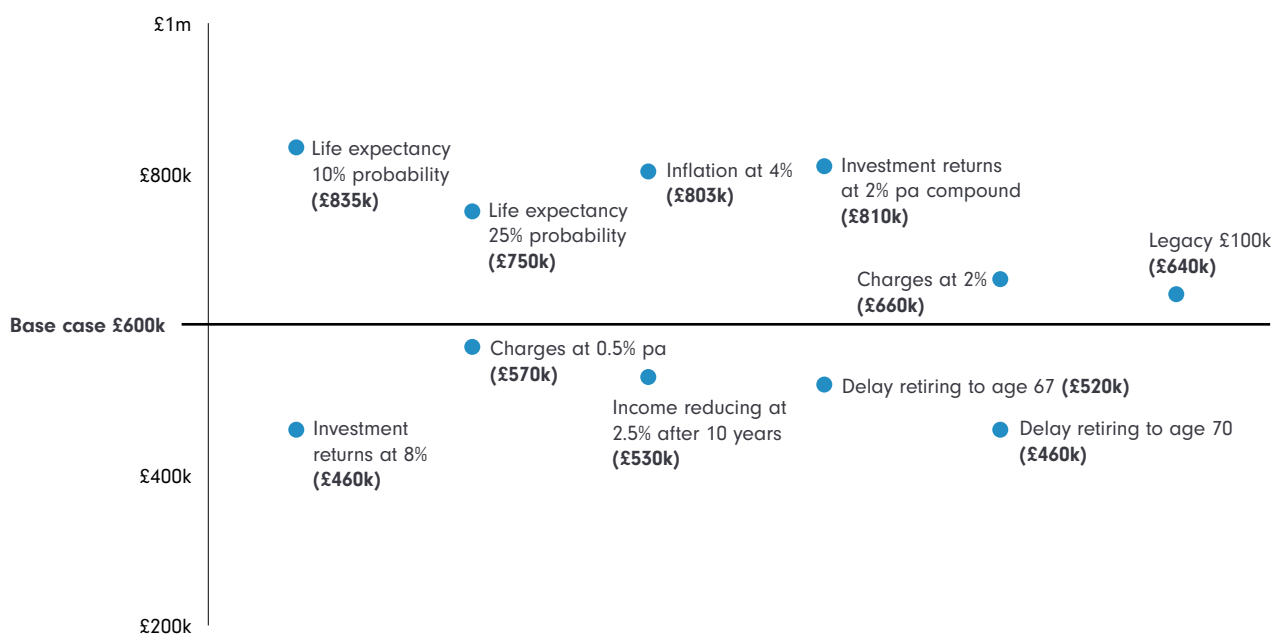
- The base case assumptions include average life expectancy, an income increasing by 2% inflation, a full State Pension, 5% investment returns and 1% charges.
- The amount required to fund retirement on this basis would be £600,000 for Tim and £640,000 for Julie.
- The variations focused on extended life expectancy, a declining income during retirement, higher or lower investment returns and charges, increased inflation, leaving a legacy and delaying retirement.
- The result ranged from a high of £835,000 and a low of £460,000 for Tim compared with a high of £890,000 and a low of £483,000 for Julie.

Interpreting the results

What do these results tell us? Let's look at Tim and Julie separately.

Tim

Chart 4: The impact of varying assumptions on cost of a comfortable retirement



Source: Data provided by Conquest Planning to provide an income of £38,860 for 65 year old male.

If we consider the factors that increase the base case costs, the probability of living to 96 has the greatest impact (£835,000), but only 1 in 10, 65 year old men will live this long. The prospect of living to 92 has less impact, but is still significant (£750,000), 3 out of 4, 65 year old men will die before 92. Inflation increasing to 4% is a significant risk factor (£803,000). Previous studies have shown that inflation has a significant impact in the early years, because high inflationary increases in income are effectively 'baked in' throughout life.

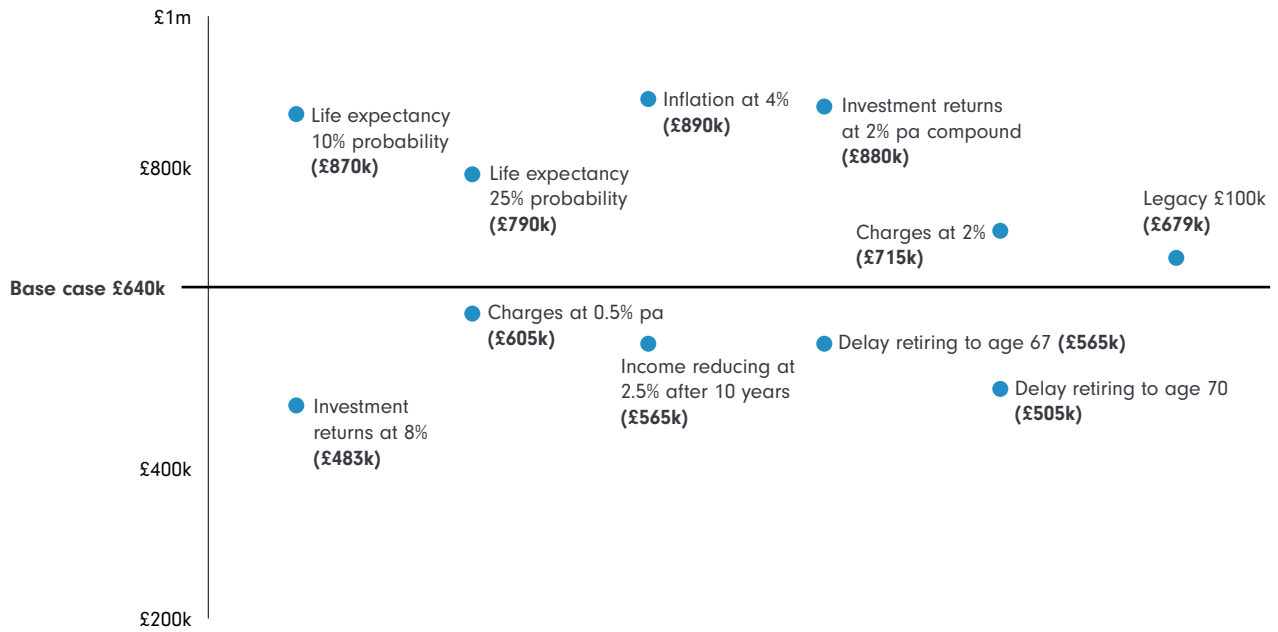
Low investment returns of 2% pa also have a major impact (£810,000), which reinforces the importance of investing in higher risk assets likely to outperform other asset classes over the longer term (while safeguarding against sequencing risk in the early years). Both 'charges at 2%' and 'leaving a legacy of £100,000' have a low impact, relatively speaking.

Turning to those variables that lower the base case costs, high investment returns of 8% have a significant impact in reducing costs. The base case costs reduce from £600,000 to £460,000. Similarly, deferring retirement to age 70, including delaying receipt of the State Pension, also reduces the cost to £460,000. Delaying retirement to 67 and reducing income after 10 years also have a substantial impact reducing the costs to £520,000 and £530,000 respectively.



Previous studies have shown that inflation has a particularly significant impact in the early years, because high inflationary increases in income are effectively 'baked in' throughout life.

Chart 5: The impact of varying assumptions on cost of a comfortable retirement



Source: Data provided by Conquest Planning to provide an income of £38,860 for 65 year old female.

Julie’s figures have a similar pattern to Tim’s, although 4% inflation (£890,000), slightly edges investment returns at 2% pa compound (£880,000) which was slightly ahead of living to 98 (£870,000) as the most significant contributor to cost.

In terms of reducing the costs, relative to our base case, 8% pa investment returns have the greatest impact bringing the costs down to £483,000, followed by delaying retirement to age 70 which reduces the pot size required to £505,000.

Best and worse case scenarios

For someone who hasn't amassed substantial retirement savings, this analysis suggests there are outcomes that could bring costs down significantly. However, this is not without taking on extra risk. Someone in this situation runs the risk that their money could run out during retirement. However, if people are conservative in the use of their retirement savings they could end up compromising on the quality of their retirement years, only to die with substantial surplus funds available.

It might be helpful to look at 'best case' and 'worse case' scenarios. In the best case, let's assume investment returns of 8% pa, charges at 0.5% pa and income reducing after 10 years by 2.50% each year for men and 2.75% for women. In all other respects, the base case assumptions are applied. In other words, full State Pension, average life expectancy and inflation at 2% pa. In this example, the cost to provide for a comfortable retirement would fall to £405,000 for Tim and £420,000 for Julie.

Alternatively, what happens if there's a perfect storm? Life expectancy extended to 98 for Julie and 96 for Tim, 4% inflation rate, low investment returns of 2% and charges at 2%. In this case, the cost of a comfortable retirement would soar to £3.1m for Julie and £2.8m for Tim.

While these combinations, both best and worse case, are unlikely to occur they can't be completely discounted. What's more, each individual parameter isn't an absolute limit. Inflation could be 6% in the worse case or investment returns 10% in the best case.



For someone who hasn't amassed retirement savings of nearly £1m, this analysis suggests there are outcomes that could bring costs down significantly. However, this is not without taking on extra risk.

Aspects to consider for couples

Generally, the same variations we've reviewed for Tim and Julie, apply to a couple, but there are particular nuances we should consider. We've identified two heterosexual couples. The first couple, Couple A, are both aged 65. In the second couple, Couple B, the female is three years younger than the male. The annual income required for a comfortable retirement for either couple is £61,840 gross (£54,500 net). In our base case, we've assumed that both parties work, have their own pension pot, and a full State Pension. We've also assumed that on the first death income needs reduce, but aren't half the income the couple received. This is because some costs are fixed. For example, TV licensing and subscription services like Netflix. Consequently, we've taken half the total income and multiplied this by 1.5 on the first death.

In other respects, the assumptions follow those used in the base case for Tim and Julie. A full set of assumptions is shown over the page.

Chart 6: Key assumptions

	Couple A	Couple B
Age	Male 65, female 65	Male 65, female 62
Initial income required(gross)	£61,840	£61,840
Initial income required (net)	£54,500	£54,500
Income reduction on first death	50% of total income x 1.5	50% of total income x 1.5
Life expectancy	Male 20, female 22	Male 20, female 25
State Pension (full amount £10,600)	Full amount for both	Full amount for both
Inflation	2% pa compound	2% pa compound
Investment return	5% pa compound	5% pa compound
Charges	1% pa compound	1% pa compound
Bequest or legacy	£0	£0
Tax	Both have equal pension pots	Both have equal pension pots

On this basis, Couple A, both aged 65, would need a combined pension pot of £740,000. In other words, on average, a pension pot of £370,000 for each person. Couple B would need a bigger pension pot of £810,000 or £405,00 per person (because of the age difference).

In some cases, one partner may not have any pension savings or a State Pension. In this case, the gross figure needed would be £71,400. This is because there's only one personal allowance and higher rate tax would be payable on income over £50,270. On this basis, the cost would be £1m for Couple A and £1.05m for Couple B. These are significant amounts but, where only one partner is working, this could be because they enjoy a very a well-paid career.

Key points

- The most important factors that increase the cost of a comfortable retirement above our base case are living longer than the average life expectancy, high inflation and poor investment returns.
- In contrast, delaying retirement to age 70 and high investment returns of 8% have the greatest impact on lowering the amount required for a comfortable retirement.
- Outcomes range from a high of £835,000 for Tim and £890,000 for Julie, down to lows of £460,000 for Tim and £483,000 for Julie.
- A 'best case' scenario combining all of the favourable outcomes could reduce the cost to £405,000 for Tim and £420,000 for Julie, while a 'worse case' scenario could see costs soar to £2.8m for Tim and £3.1m for Julie.
- The same themes apply for a couple, but there are some nuances like different ages within a couple, reducing income on first death and only one party with pension rights and a full State Pension.
- The base case for Couple A, both aged 65, requires a total pension pot of £740,000 compared with £810,000 for Couple B.
- If only one partner in a couple has pension rights and a State Pension, the costs rise to £1m for Couple A and £1.05m for Couple B.



Squaring the retirement circle

Our analysis suggests that people who can't stretch to a comfortable standard of living, if they limit their withdrawals to 3.8% of the retirement savings, could potentially fund a comfortable retirement with a smaller fund, if they take on extra risk. This may seem obvious, but it can pay off, particularly for someone in poor health and whose lifestyle suggests they may not exceed average life expectancy for their age.

However, it would be unwise for anyone to take a decision like this lightly. The consequences if it goes wrong could be disastrous. So what action can people take to mitigate or manage these risks?

Regular reviews

Regular reviews can help identify early whether it is safe to continue to withdraw at levels that carry a higher risk. This would allow people to take remedial action. This could include:

- Reducing income and reviewing expenditure.
- Returning to paid employment in some form.
- Accessing other assets (usually property equity).
- Annuitisation might be a solution in some cases.

Financial Advisers carry out periodic reviews during retirement to track progress against the strategy they've agreed with their client. This process should protect clients against any adverse changes or ominous signs. In respect of accessing other assets and annuitisation, these are considered in greater detail on the following pages.



Employ a backstop

It can make sense to consider taking higher withdrawals if there's a backstop that can be brought into play, if needed. Commonly, this will include:

- **Home equity.** Increasingly, people are using the equity in their property to fund their retirement. They may notionally earmark their home to be left to their children or grandchildren, but resort to using this if necessary for their retirement. A recent survey, 'Retirement Revisited', suggests nearly a third of people would downsize to use their property to fund their retirement, 16% would consider equity release and 8% would sell their home and rent³⁰.
- **Inheritance.** There may be the prospect of a legacy in the future from parents or relatives. The survey mentioned above, found that 11% of those surveyed said they intended to supplement any shortfalls in retirement income with inheritance money they might receive.
- **Children.** Children might be prepared to underwrite any financial shortfall or offer support if things go awry in some shape or form. Indeed, the 'Retirement Revisited' survey revealed that 4% of people planned to sell their home outright during their retirement and move in with their children.



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Delay retirement

Delaying retirement to age 70 has a significant impact. It reduces the cost of our base case from £600,000 to £460,000 for Tim and from £640,000 to £505,000 for Julie. What's more, this doesn't include the benefit of continuing to pay into a pension (or other savings and investment products) during the period of deferment. Nor does it take account of investment growth during this period.

30. Retirement Revisited, M&G Wealth, October 2022.

Full or partial annuitisation

There are a number of ways an annuity can help:

- **Outright annuitisation.** Current annuity rates for a 65 year old, including escalation at 3% pa, are £5,160 per £100,000 purchase price³¹. That means a single person with a pension pot of £637,248 could buy sufficient income to provide a comfortable retirement, guaranteed for life and increasing each year by 3% to offset inflation (including a full State Pension). This may not provide a complete hedge against inflation, but between 1989 and April 2022, the average annual rate of inflation was 2.5% (though it was much higher than this in the previous period 1950-88)³².
- **Partial annuitisation.** Many people may be reluctant to forego the flexibility of drawdown to annuitise their pension pot completely, but there is strong evidence that partial annuitisation can deliver better outcomes^{33,34}. Consider someone with a £600,000 fund. If they annuitised £300,000 of this using level annuity rates they could currently receive £7,132 per £100,000 purchase price³⁵. Their £300,000 would provide an income of £21,396, which means they would only need to withdraw £11,486 from their remaining £300,000 to provide the amount required for a comfortable retirement. In this example, we've used a level annuity. The remaining fund could be invested 100% in equities. The potentially high returns from investing 100% of the balance in equities could subsidise the annuity income to combat inflation. The State Pension benefits from the triple lock.
- **Annuitisation at older ages.** Someone who hasn't a large enough pension pot, could decide to annuitise if they find they're running out of money. Annuity rates increase significantly at older ages. At the time of this report, a 75 year old could receive an annuity rate of £9,251³⁶ each year per £100,000 purchase price on a single life, level basis and nearly £12,000 (£11,801)³⁷ for an 80 year old on the same basis.

It should be borne in mind that annuity rates are currently higher than they have been for some years and these rates are unlikely to continue if the government and the Bank of England's actions to bring inflation under control are successful.

There are no easy choices for people who aspire to a comfortable retirement, but haven't enough money to limit withdrawals to a safe withdrawal rate. There are ways they might make it work with a smaller pension pot, but they should carefully consider the risks they face.



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31. Sharing Pensions, June 2023, based on single life, 3% escalation, no guarantee.

32. Consumer price inflation, historical estimates and recent trends, UK: 1950 to 2022, ONS, May 2022.

33. Annuities reinvented: Are annuities the missing asset class for sustainable drawdown solutions?, Milliman, October 2018

34. Can we help consumers avoid running out of money in retirement?, Institute and Faculty of Actuaries, March 2018.

35. Sharing pensions, June 2023, based on single life, level income without guarantee.

36. Sharing Pensions, June 2023

37. Moneyhelper, June 2023.

Case study

Henry is 65 and about to retire. He is divorced and has a pension pot of £600,000. He plans to apply the tax free cash element of his fund towards providing his income so his £600,000 fund, together with his full State Pension should be broadly enough to sustain a comfortable retirement if the assumptions in our base case are borne out. Henry also has a home worth £500,000 with no mortgage.



The longevity assumption in our base case is average life expectancy, which would take Henry to age 85. As Henry nears his 85th birthday, he's still in good health and looks set to enjoy many more years of life. His adviser discusses this with Henry and they agree that, though Henry had planned to leave the proceeds from the sale of his home to his children, he should use the equity to fund the rest of his retirement. He's reluctant to sell his home, so they agree that Henry will use equity release. At age 85, Henry could release as much as 50% of the value of his home.

At 2% pa inflation, over the 20 year period since Henry retired, the amount of annual income Henry would need is now £64,846 (plus the State Pension). Assuming the value of Henry's property has also increased by 2% pa over this period, Henry's home would be worth £745,665. If Henry releases half of the equity in his home, this would give him a tax-free lump sum of £372,833.

If Henry applies this to provide a lifetime guaranteed income he could secure, on current annuity rates, an income of £62,472³⁸. This is broadly comparable with the income Henry needs and is payable for life³⁹. It should be noted that the annuity income is not inflation linked, so this will fall behind the amount required for a comfortable retirement over time.

38. The annuity rates shown are for a compulsory purchase annuity (pension annuity). A purchased life annuity would usually pay a smaller income, but the favourable tax treatment of this type of annuity will often more than offset any difference in net income.

39. Moneyhelper June 2023.

Key points

- There are ways people can still enjoy a comfortable retirement, even if they need to withdraw at levels in excess of 3%, but care is needed.
- Regular reviews can provide an early warning of impending issues, which may require retirees to take remedial action include reducing expenditure, returning to work or using other assets.
- Property equity is the most common source of additional income to fund a comfortable retirement and there is evidence that retirees are increasingly turning to the equity in their home.
- There are a number of studies that show that how partial annuitisation can deliver a better outcome for retirees and play a useful role in managing risk in retirement.
- Delaying retirement can have a significant impact on the amount required for a comfortable retirement and provides an opportunity to pay more into a pension.
- Our case study shows how a combination of regular reviews, using home equity and also annuitizing at a later age can mitigate some of the risks retirees may face.

Summary



As people look to their life beyond work, one question often dominates: How much do I need for a comfortable retirement? Analysis by the Pensions and Lifetime Savings Association, suggests that the annual income required for a single person is £43,482, before tax. The equivalent figure for a couple is £61,840. However, this only partly addresses the question. The critical figure isn't how much income is required, but what size pension pot is needed to provide that level of income?

A withdrawal rate of 3.8% has a probability of success of 90% over a 30 year period. Assuming a full State Pension, that means retirement savings of over £900,000 would be required. This is a sum that many people simply don't have. Higher withdrawal rates increase the risk that money could run out, but there could be enough to last a lifetime in many instances. The alternative is that people are overly conservative, only to leave substantial funds on their death, while denying themselves a comfortable retirement

The 'probability of success' is indicative of the scale of the risks being taken, but says less about the nature of the risks and their relative influence on outcomes. Based on average life expectancy for a 65 year old, we estimate that the amount needed to fund a comfortable retirement is £600,000 for men and £640,000 for women.

To understand which factors have the greatest influence on the outcome, we explored several variations: Extended life expectancy, declining income during retirement, higher/lower investment returns and charges, increased inflation, funding a legacy and delaying retirement.

The most important factors that increase the cost of a comfortable retirement are living significantly longer than average life expectancy, higher inflation at 4% and poor investment returns of 2%. In contrast, delaying retirement to age 70 and high investment returns of 8% have the greatest impact on lowering the amount required for a comfortable retirement. The results range from a high of £835,000 and a low of £460,000 for a 65 year old man compared with a high of £890,000 and a low of £483,000 for a 65 year old female.



The same themes apply for a couple, but there are nuances like different ages within the couple, reducing income needs on first death and only one partner in paid employment. Our base case reveals that for a couple, both aged 65, a total pension pot of £740,000 is required compared with £810,000 for a couple where the female is three years younger than the male. If only one partner has pension rights and a State Pension, the costs rise to £1m for the same age couple and £1.05m for the couple with different ages.

People who can't afford a comfortable retirement if they limit withdrawals to 3.8% of their retirement savings could withdraw more than this, but they should think carefully about how they manage and mitigate the risks they face.

Regular reviews can help. Issues can be identified early and remedial action taken. Some form of backstop, like property equity, can provide a degree of comfort and reassurance if things go awry. Full or partial annuitisation can solve the problem by providing the income required at less cost. Delaying retirement has a number of advantages including a higher State Pension, potentially more growth on existing savings and the opportunity to save more.

People can take heart from the knowledge that a comfortable retirement isn't beyond their reach but they must be aware of the risks they face and what they would do if corrective action is necessary. If this seems irresponsible, consider the alternative. The prospect that people forgo the enjoyment of a comfortable retirement, only to die with surplus funds. Neither situation is ideal. Ultimately, a deeper understanding of the issues and the risks should help advisers and their clients make more informed decisions in this difficult area.



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Important information

This document provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations. The value of benefits depends on individual circumstances. The minimum age clients can normally access their pension savings is currently 55, and is due to rise to 57 on 6 April 2028, unless they have a lower protected pension age. Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning.

The value of investments and the income from them, can go down as well as up, so clients may get back less than they invest.

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