This document is for investment professionals only and should not be relied upon by private investors.

Sustainable withdrawal rates for drawdown clients

Pension decumulation

Adviser Solutions

Introduction

Paul Squirrell
Head of Retirement
and Savings Development

The FCA in its 'Retirement income advice thematic review' expressed concerns around sustainable rates of withdrawal. Where firms use a withdrawal guide rate, the FCA wants to ensure this takes account of individual circumstances. The FCA cites the example of using the same rate for clients irrespective of age. Many firms will be using cash flow modelling, which will take account of individual circumstances. Nevertheless, we've produced this update to provide a quick guide to the variables that determine a sustainable withdrawal rate and how these could be applied in practice.

Methodology

There are numerous studies on this subject. For those who have an appetite to delve deeper, our report 'Help your clients survive retirement' reviews much of the research. For the purposes of this update, we've used one central source to avoid comparing studies using different assumptions. The source we've chosen is Morningstar's 'The state of Retirement Income: 2023'. Though based on US data, the results shouldn't differ markedly for the UK. The Morningstar analysis uses Monte Carlo simulations of 1,000 hypothetical outcomes based on future projected returns (see Appendix, Chart 1, for assumptions about future returns by asset class).

Sustainable withdrawal rates for drawdown clients

A brief background

When this research started in 2021 the highest starting safe withdrawal rate, based on an inflation linked income with a 90% probability of lasting for 30 years, was 3.3%. This increased to 3.8% in 2022. In the latest report, this has risen to 4%. The 4% figure aligns with the original analysis by William M Bengen, the so called father of the 4% rule. However, the Bengen analysis was based on historic data. In contrast, the Morningstar study is underpinned by its view of future returns.

Figure 1: Safe withdrawal rates based on term and equity weighting (90% probability of success)

Equity weighting	10 years	15 years	20 years	25 years	30 years	35 years	40 years
100%	8.3	5.8	4.6	3.8	3.3	3.1	2.9
90%	8.6	6.0	4.7	4.0	3.5	3.2	3.0
80%	8.9	6.2	4.8	4.1	3.4	3.3	3.2
70%	9.2	6.4	5.1	4.3	3.8	3.5	3.2
60%	9.4	6.5	5.2	4.4	3.9	3.5	3.3
50%	9.6	6.7	5.4	4.5	3.9	3.6	3.4
40%	9.8	6.8	5.4	4.5	4.0	3.6	3.4
30%	9.9	6.9	5.5	4.6	4.0	3.6	3.4
20%	10.0	6.9	5.5	4.5	4.0	3.6	3.3
10%	9.9	6.9	5.4	4.4	3.9	3.4	3.2
0%	9.7	6.7	4.2	4.3	3.6	3.2	2.9

Source: Morningstar. Data as of September 2023.

In determining the safe withdrawal rate, there are some general issues to consider and some personal circumstances, such as age, health and overall wealth.

General issues

- **Charges and fees.** The figures exclude the impact of adviser fees, platform charges or investment management costs. Morningstar suggests that 1% in charges and fees should lower the safe withdrawal rate by 0.4%[1]. This is broadly in line with other studies that propose a similar reduction[2].
- **Equity weighting.** The optimal asset allocation includes a 40% equity weighting. While projected returns from equities are higher than other asset classes, the safe withdrawal rate is lower, the higher the equity weighting. This is partly caused by the volatility of equities coupled with achieving a 90% probability of success. The higher the probability of success, the more this will favour bonds and cash.
- **Legacy.** The higher the equity proportion, notwithstanding the lower safe withdrawal rate, the greater the median amount left on death after 30 years. So if the intention is to leave as much as possible on death, a high equity content is more likely to achieve this (see Appendix, Chart 2).
- **Inflation.** In its 2022 report, Morningstar modelled partial inflation-linking by assuming income was inflation linked by 1% less than the actual rate of inflation. This increased the initial safe withdrawal rate by 0.5%. In 2023, Morningstar refined this by adjusting for spending patterns in the US, which fell by 19% from age 65 to 75, 34% from 65 to 85, and 52% from 65 to 95. This raised the starting safe withdrawal rate by 1%.

While projected returns from equities are higher than other asset classes, the safe withdrawal rate is lower, the higher the equity weighting

1. How Much Can I Take From My Retirement Savings? Allan Roth, AARP, January 2022.
2. Impact of Adviser Fees on Withdrawal Rates in Retirement Portfolios, Abraham Okusanya, February 2016.

Personal issues

- **Age.** Age is an important determinant of how much someone can take. If the objective is for money to last until 95 with a 90% probability of success, a 65 year old could take 4.0% and a 70 year old 4.5% (assuming a 40% equity weighting).
- **Longevity.** If, through lifestyle choices or health issues, someone's life expectancy is likely to be compromised, then a higher rate could be taken. For example, someone who chooses a 20 year term with a 90% probability of success could take 5.5% (assuming a 30% equity weighting). It should be borne in mind that the prognosis for many health conditions can vary widely, so there are risks with this approach.
- **Access to other assets.** A 90% probability of success over 30 years may be overly conservative. People who have access to other assets, like property equity, could assume a lower figure. Figure 2 shows that a 65 year old with a 70% equity weighting could take 5%, if they accept a 70% probability of success over 30 years.
- **Inherited wealth.** Someone who has a high degree of confidence that they will receive a significant inheritance in say 10-15 years, could decide to accept a lower probability of success or choose a term over which they are almost certain to receive their inheritance. For example, a 15 year term with a 90% equity weighting would produce a withdrawal rate of 6% with a 90% probability of success.

Figure 2: Withdrawal rates by probability of success and equity weighting

Equity weighting	50%	60%	70%	80%	90%	100%
100%	6.2	5.6	5.0	4.3	3.3	0.9
90%	6.0	5.5	5.0	4.4	3.5	1.1
80%	5.9	5.5	5.0	4.4	3.7	1.4
70%	5.8	5.4	5.0	4.5	3.8	1.6
60%	5.6	5.3	4.9	4.5	3.9	1.9
50%	5.5	5.2	4.9	4.5	3.9	2.2
40%	5.3	5.0	4.8	4.5	4.0	2.4
30%	5.1	4.9	4.7	4.4	4.0	2.6
20%	4.9	4.7	4.5	4.3	4.0	2.8
10%	4.6	4.5	4.3	4.2	3.9	2.8
0%	4.4	4.2	4.1	3.9	3.6	2.6

Source: Morningstar. Data as of September 2023.

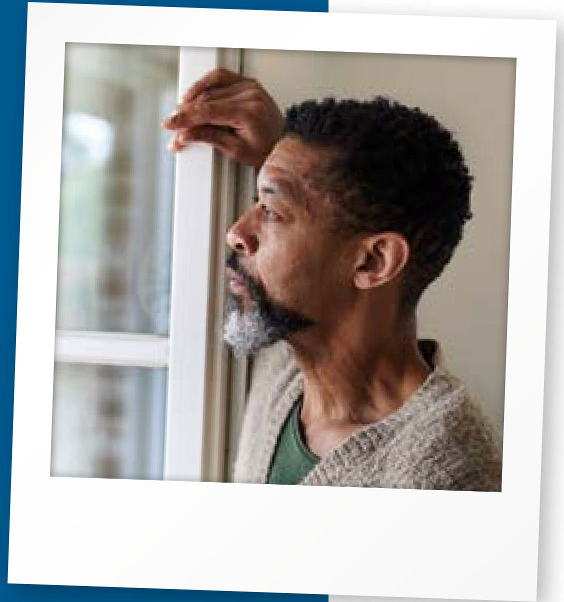
Interestingly, separate US analysis shows that over the last 140 years, US retirees withdrawing at the rate of 4%, would have only a 10% likelihood of ending up with less than their initial capital after 30 years and a 10% chance they would have 6 times their original capital[3].

A further point raised in the FCA thematic review was the due consideration of annuities as part of the development of retirement strategies. The case study on right highlights how including a degree of annuitisation within a drawdown strategy, while adopting a lower probability of success, can boost withdrawal rates further.

US analysis shows 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

3. The Extraordinary Upside Potential Of Sequence Of Return Risk In Retirement, Michael Kitces, February 2019.

Case study



Peter is 65, divorced, and has a pension pot of £500,000. He owns a property worth £400,000 with no mortgage. He's keen to take as much as he can from his pension pot and prepared to take a risk that the money could run out (given the equity in his property). However, to mitigate this risk, he'd also like some of his income guaranteed for life to cover essential expenses.

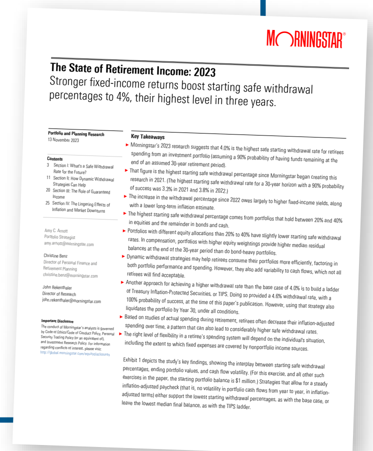
His adviser suggests buying a single life, level, annuity with half of his fund, generating an income of roughly £17,500[4]. With the remainder, he opts for a 70% probability of success over 30 years. Given over half of his income is guaranteed, Peter's adviser proposes equity content of 90 or 100%. This means he could withdraw 5%, which would equate to an overall withdrawal rate of 6% or £30,000 income (though the annuity income is not inflation linked).

Peter is concerned that any legacy might be impacted by buying an annuity. His adviser explains that he could include a guaranteed period in the short term. Longer term, given the equity weighting, the evidence suggests death benefits could be greater using an annuity and drawdown combination compared with a balanced portfolio (see Appendix, Chart 2).

4. Hargreaves Lansdown, April 2024 (65 year old, single life, level annuity).

Summary

Increasingly, cash flow models will support advisers' recommendations around withdrawals. Nevertheless, it is useful to understand the factors that underpin safe withdrawal rates. This update covers the main influences. To probe deeper into this subject there is much greater detail in the full Morningstar study. The study also reviews alternative strategies that can be deployed during retirement. It can be downloaded from the [Morningstar website](#).



MORNINGSTAR®

The State of Retirement Income: 2023

Stronger fixed-income returns boost starting safe withdrawal percentages to 4%, their highest level in three years.

Portfolio and Planning Research
13 November 2023

Contents

3 Section I: What's a Safe Withdrawal Rate for the Future?
11 Section II: How Dynamic Withdrawal Strategies Can Help
20 Section III: The Role of Guaranteed Income
25 Section IV: The Lingering Effects of Inflation and Market Downturns

Amy C. Arnott
Portfolio Strategist
amy.arnott@morningstar.com

Christine Benz
Director of Personal Finance and Retirement Planning
christine.benz@morningstar.com

John Rekenthaler
Director of Research
john.rekenthaler@morningstar.com

Important Disclosure
The conduct of Morningstar's analysts is governed by Code of Ethics/Code of Conduct Policy, Personal Security Trading Policy (or an equivalent of), and Investment Research Policy. For information regarding conflicts of interest, please visit: http://global.morningstar.com/equitydisclosures

Key Takeaways

- Morningstar's 2023 research suggests that 4.0% is the highest safe starting withdrawal rate for retirees spending from an investment portfolio (assuming a 90% probability of having funds remaining at the end of an assumed 30-year retirement period).
- That figure is the highest starting safe withdrawal percentage since Morningstar began creating this research in 2021. (The highest starting safe withdrawal rate for a 30-year horizon with a 90% probability of success was 3.3% in 2021 and 3.8% in 2022.)
- The increase in the withdrawal percentage since 2022 owes largely to higher fixed-income yields, along with a lower long-term inflation estimate.
- The highest starting safe withdrawal percentage comes from portfolios that hold between 20% and 40% in equities and the remainder in bonds and cash.
- Portfolios with different equity allocations than 20% to 40% have slightly lower starting safe withdrawal rates. In compensation, portfolios with higher equity weightings provide higher median residual balances at the end of the 30-year period than do bond-heavy portfolios.
- Dynamic withdrawal strategies may help retirees consume their portfolios more efficiently, factoring in both portfolio performance and spending. However, they also add variability to cash flows, which not all retirees will find acceptable.
- Another approach for achieving a higher withdrawal rate than the base case of 4.0% is to build a ladder of Treasury Inflation-Protected Securities, or TIPS. Doing so provided a 4.6% withdrawal rate, with a 100% probability of success, at the time of this paper's publication. However, using that strategy also liquidates the portfolio by Year 30, under all conditions.
- Based on studies of actual spending during retirement, retirees often decrease their inflation-adjusted spending over time, a pattern that can also lead to considerably higher safe withdrawal rates.
- The right level of flexibility in a retiree's spending system will depend on the individual's situation, including the extent to which fixed expenses are covered by nonportfolio income sources.

Exhibit 1 depicts the study's key findings, showing the interplay between starting safe withdrawal percentages, ending portfolio values, and cash flow volatility. (For this exercise, and all other such exercises in the paper, the starting portfolio balance is $1 million.) Strategies that allow for a steady inflation-adjusted paycheck (that is, no volatility in portfolio cash flows from year to year, in inflation-adjusted terms) either support the lowest starting withdrawal percentages, as with the base case, or leave the lowest median final balance, as with the TIPS ladder.

Appendix

Chart 1: Projected 30-year asset class return and inflation assumptions

Broad asset class	Asset class	2023
Equities	US Large growth	8.64
	US Large value	8.87
	US Small growth	10.30
	US Small value	12.87
	Foreign	9.57
Bonds	US investment-grade bond	4.93
	Foreign	5.15
Cash	US treasury bill	3.31
Inflation		2.42

Source: Morningstar. Data as of September 2023.

Chart 2: Starting safe withdrawal rate and median end balance at year 30

Equity weighting	Withdrawal %	Median balance at year 30
100%	3.3	$4.5 million
90%	3.5	$3.8 million
80%	3.7	$3.2 million
70%	3.8	$2.8 million
60%	3.9	$2.3 million
50%	3.9	$2.0 million
40%	4.0	$1.5 million
30%	4.0	$1.2 million
20%	4.0	$0.9 million
10%	3.9	$0.8 million
0%	3.6	$0.7 million

Source: Morningstar. Data as of September 2023.

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.

Past performance is not a guide to future returns. The value of the fund and the income from it can go down as well as up so you may get back less than you invested.

More insights on tax and pensions

We're committed to providing you with technical support to help you keep pace with the latest rules and legislation. Our range of practitioner material is designed to help you keep on top of all aspects of retirement planning. Themes covered include death benefits, pensions and divorce, the State Pension, pension withdrawals taxation and much more.

Visit the Technical matters hub on our website
fidelityadvisersolutions.co.uk/technicalmatters

Adviser Solutions

Issued by Financial Administration Services Limited, authorised and regulated by the Financial Conduct Authority. Fidelity, Fidelity International, the Fidelity International logo and F symbol are trademarks of FIL Limited.
UKM0724/388085/SSO/0725