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Briefing note

Answering the killer-question: How long does my drawdown fund need to last?

Choosing when to take benefits from your pension fund, and in what form(s), are among the most significant financial decisions most people will make. Each option (a cash sum, annuity or drawdown) has its own pros and cons; they can be used in stages, and they can be used in combination. It can get complicated!

Please note that this piece is for information purposes only and should not be construed as formal advice.

However, if you choose drawdown, a key concern for many people is making sure that they don't out-live their fund. Here, we will consider that issue but we can't do it without reference to the broader context of why drawdown was chosen in the first place.

Why drawdown?

Those reasons will vary according to the detail of each person's circumstances and are too many and varied to explore in detail here. However, reasons for choosing drawdown might include:

- providing or topping up an income for an interim period; for example, while waiting for a company pension to come into payment at a later age, or to fill in while waiting for state pension to begin;
- in-filling income, perhaps on an ad hoc basis; for example, for people in between work and retirement, perhaps engaged in part-time or occasional work;
- providing an income, whether regular or flexible, for life - as an alternative to annuity purchase; or
- a desire to pass on funds to surviving dependants or other beneficiaries on death.

In arriving at such a decision, you should consider your full financial circumstances – for example, your expenditure, other sources of saving and income and those of your partner – as well as your capacity and willingness to deal with the risks of drawdown. (For those with a love of reading, Somerset Maugham's 1935 short story "The Lotus Eater" still provides an excellent cautionary tale, albeit pre-dating the introduction of drawdown by 60 years.)

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How long?

If you need your drawdown fund to last 'as long as I live', you'll need to think about how long you might live, amongst other things. Since it is obviously unrealistic to expect to draw the final pound and final breath simultaneously, you need to 'allow a bit', which turns out to be complicated.

While most people underestimate their life expectancy quite markedly, it is probably not the hardest thing to work out as there are reams of statistics on longevity. Different stats show different things, so you need to look at the right ones. Your life expectancy now will be notably greater than it was at birth. This happens because, during the interim, some people born around the same time as you have already died. The life expectancy figures at birth made allowance for this. Since it has been established that you are one of the lucky ones, that falls out of the reckoning. It means that your life expectancy keeps rising as you live longer, albeit that the effect cannot go on forever.

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Life expectancy has risen significantly over a long period of time. If you are looking at the right stats, they will make allowance for ongoing improvements. It could add up to several extra years over the decades that some people will spend in drawdown. Further refinements to the picture can be made, such as looking at the "modal average" (that is, the most common outcome) instead of the mean, or adjusting for lifestyle and health factors.

If you have navigated that successfully, you should have a reasonably accurate figure. The trouble is, it is not as useful as you might think!

An average problem

One problem is that, although you may have calculated a reasonably accurate average for people like yourself, the actual outcome for any one individual in the group will vary either side of that average, in some cases, very significantly indeed. Your drawdown fund may need to cope with the upper end of the range of outcomes, not just the average life expectancy. Dealing with such a range of outcomes alone means that a strategy that involves spending the last pound on your last day is not a robust one.

Another problem is that how long you live is only one of the factors at play. How you invest your fund, how much you draw from it, and how much scope you have (both financially and psychologically) to adjust your plans in the face of changing circumstances are all vitally important, too.

All of which serves as a reminder that you need to look at the bigger picture and to keep plans under regular review. One of the attractions of drawdown is that it keeps your options open: you can still choose an annuity at a later date, should that become a more suitable option.

Advice

The government set up Pension Wise to offer free and impartial guidance to everyone over the age of 50. It is not a substitute for full, regulated advice but it is nonetheless a valuable service and a sensible place to start.

There are many benefits to using a regulated financial adviser. They are experienced in understanding people's circumstances, what they are aiming for and what risks they are willing and able to live with. Only an adviser can then give you a personal recommendation, which they can keep under review with you, adjusting over time as needs might dictate.

Please contact your your financial adviser or your usual Barnett Waddingham client manager if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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