

What's the UK's new safe income rate?

A presentation to the Institute and Faculty of Actuaries

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For business professionals only



Agenda

What does pension reform look like?

Whistle stop tour

Research background

Evolution of the 4% rule

The maths behind the research

What's the new sustainable income rate?

SIRi: Sustainable Income Rate Index

Questions

What does pension reform look like?

3

Recent changes to Defined Contribution pension pots

Death

- On death before age 75, any remaining pension funds can normally be passed on to beneficiaries tax free
- On death from age 75, any remaining pension funds paid to the beneficiaries will be taxed at the beneficiary's marginal rate of tax

Freedom

- Nobody has to buy an annuity any longer on retirement
- Freedom to cash in any amount from minimum age 55

Lump sum

- 25% of any lump taken is free of tax and the remainder subject to tax at marginal income tax rate in that year



Lifetime allowance

- Reduced to £1m from 6 April 2016

This information is based on our understanding of current, taxation law and HMRC practice, which may change.

Annual allowance

- The full annual allowance is now £40,000 which includes all personal, third-party and employer contributions. It's possible to carry forward any unused allowances from three previous tax years

Capped drawdown

- No new capped drawdown policies from 6 April 2015

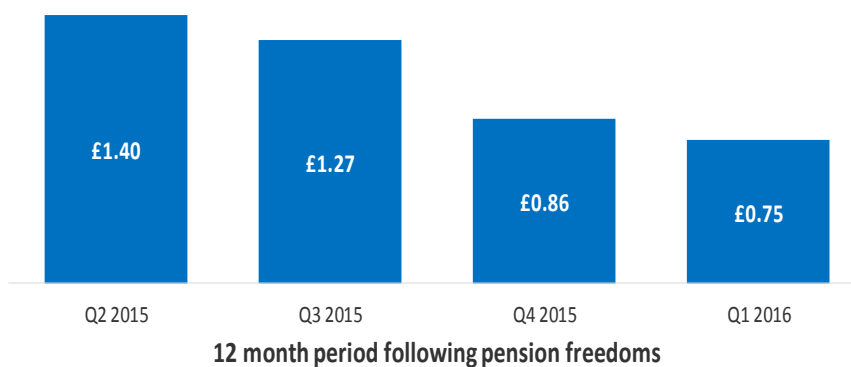
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Whistle stop tour

5

Customer behaviour since pension reform – cash withdrawals

Lump Sum withdrawals post pension freedoms (£bn)



£4.3bn
paid out

300,000
lump sum
payments

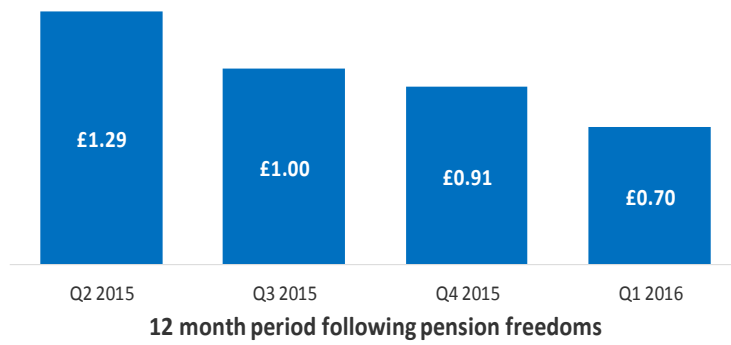
£14,500
average
payment

Source: ABI Pension freedom statistics – one year on factsheet, 15/08/2016

6

Drawdown withdrawals

Drawdown withdrawals post pension freedoms (£bn)



£3.9bn

paid out

1.03m

drawdown payments

£3,800

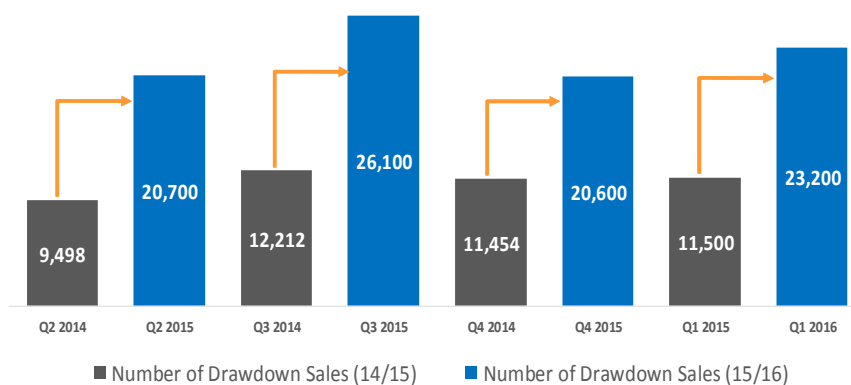
average payment

Source: ABI Pension freedom statistics – one year on factsheet, 15/08/2016

7

Drawdown sales

Number of drawdown sales pre/post pension freedoms



£6.1bn

invested

£67,500

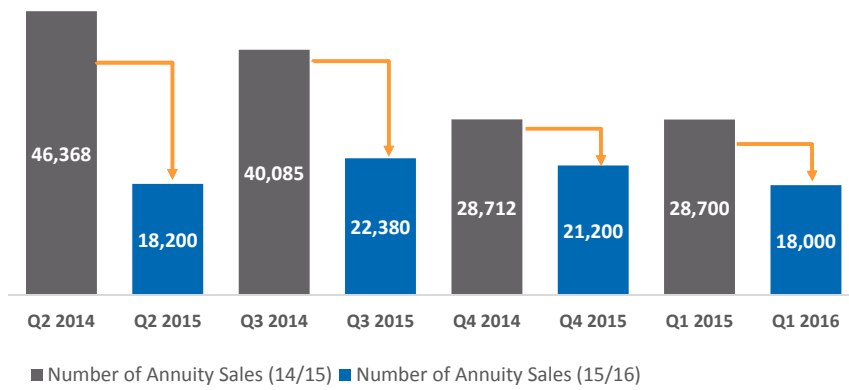
average fund

Source: ABI Pension freedom statistics – one year on factsheet, 15/08/2016

8

Annuity sales

Number of Annuity sales pre/post pension freedoms



£4.2bn
invested

£52,500
average fund

Source: ABI Pension freedom statistics – one year on factsheet, 15/08/2016

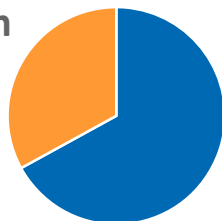
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Drawdown and annuity trends

Drawdown sales up **246%** (Q1 2014 to Q1 2016)

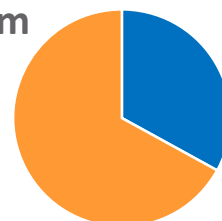
Annuity sales down **75%** (Q1 2014 to Q1 2016)

Pre reform



■ Annuity ■ Drawdown

Post reform



■ Annuity ■ Drawdown

2014/15 - Source: ABI Retirement Income statistics – Q2/Q3/Q4 2014 and Q1 2015
2015/16 - Source: ABI Pension freedom statistics – one year on factsheet, 15/08/2016

10

Research background

Since April 2015



Drawdown sales

+246%



Annuity sales

-75%



Financial Advice Market Review

Individuals in drawdown without advice



4% rule outdated

What's the new sustainable income rate?



£8.2bn

in cash & drawdown payments in 12 months since reform



Customers



Life expectancy increasing



Diminishing capacity



More personal responsibility



2,000,000

2 million Britons reaching retirement age from 2016 to 2020



Evolution of the 4% rule

The evolution of the 4% rule

Introduction

California based financial adviser, William **Bengen** introduces 4% rule



1994

- 4%, then adjusted for inflation
- US historical returns 1926 to 1976
- No investment fees
- % initial portfolio value

Confirmation

Trinity University Texas study confirms the 4% rule and Bengen's approach



1998

- Introduced *portfolio success* percentages
- 4%, on 50/50 asset split
- US historical returns
- No investment fees
- % initial portfolio value

Resilience

Michael Kitces – has the 4% rule endured 2000 tech bubble and 2008 crisis?



2012

- Warns of sequence of return risk
- Yr 2000 retirees “pushing the limits of the 4% rule” so annuitise the remaining pot

Expansion

Wade Pfau explores the 4% rule for the US and for 20 other developed nations



2015

- 4% rule has a 78% chance of success in the UK
- % of investment pot
- Inflation adjusted

New

Morningstar – over a 30 year timeframe the safe withdrawal rate is 3% (90%)



2016

- 60/40 portfolio, 3% is the sustainable rate
- % of investment pot
- Inflation adjusted

Sources: Bengen 1994, Cooley et al 1998, Kitces 2015, Pfau 2015, Morningstar 2016

15

The maths behind the research

EValue

EVALUE INSIGHT ASSET MODEL

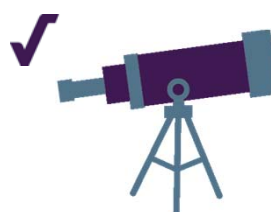
AN INDEPENDENT & EXPERIENCE PERSPECTIVE

EValue

We have been using an **Economic Scenario Generator (ESG)** since 1993 to help investors make asset allocation decisions.



We stick to a **medium/long term** perspective, not short term tactical decisions.



KEY REQUIREMENTS OF OUR ESG

EValue



Adapt to changing Economic conditions



Model inflation



Present a consistent global model



Model income and capital growth



Model exchange rates



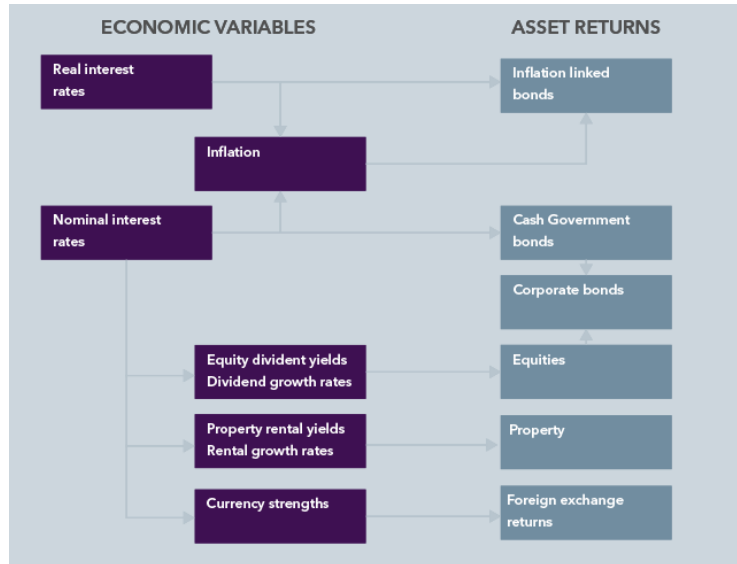
Reflect investment term



Ongoing investment and regular updates provide the most realistic model in changing economic conditions.

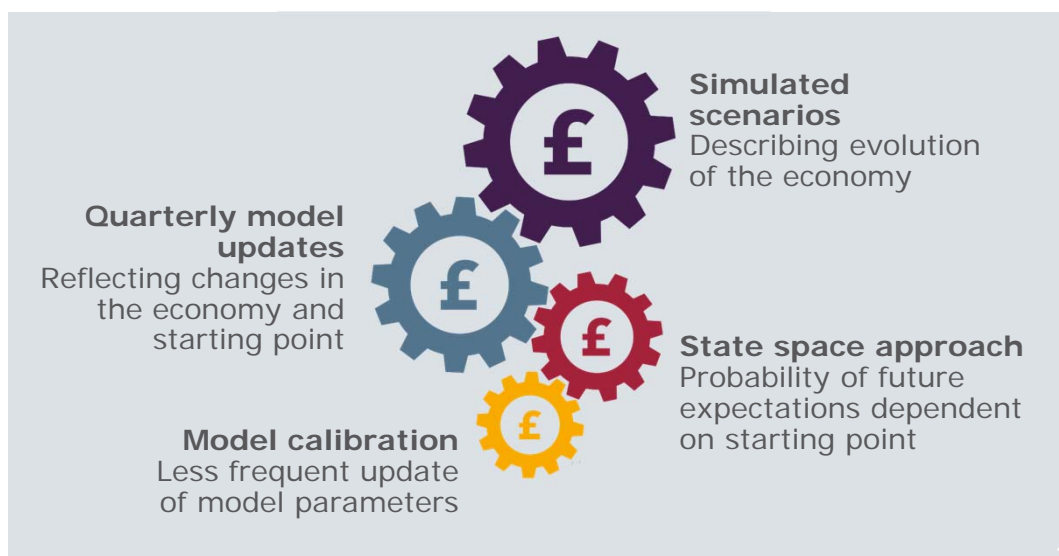
MODEL STRUCTURE

EValue



EVALUE ASSET MODEL CONCEPTS

EValue



EVALUE INVESTMENT RISK PROFILES



October 2016

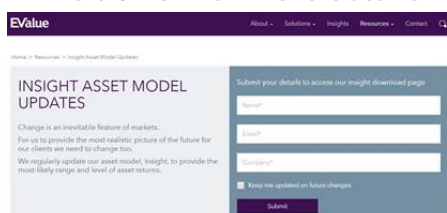


EVALUE ASSUMPTIONS - OCTOBER 2016



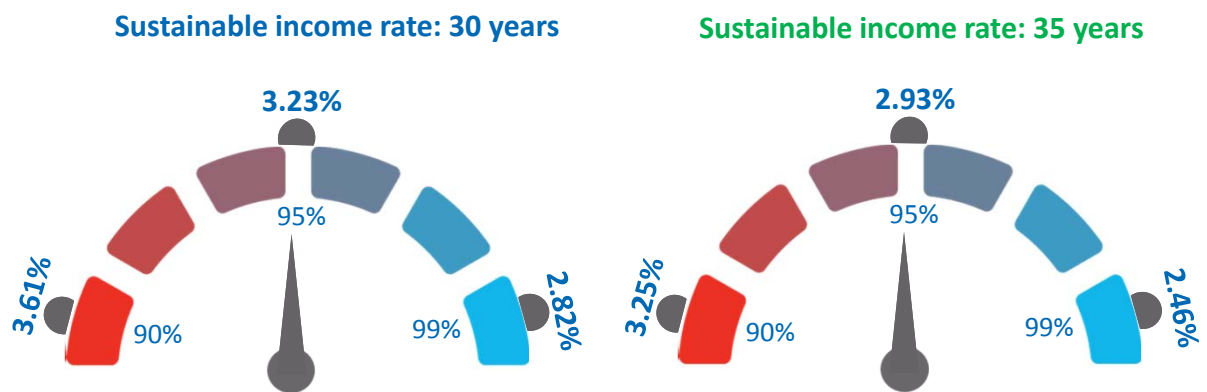
	MEDIAN RETURN	VOLATILITY
Government Bonds	1.2	9.7
Corporate Bonds	2.3	11.9
UK Equities	4.7	16.5
Overseas Developed Market Equities	4.6	19.7
Emerging Market Equities	3.4	27.8
Property	1.6	14.5

Visit ev.uk for more details



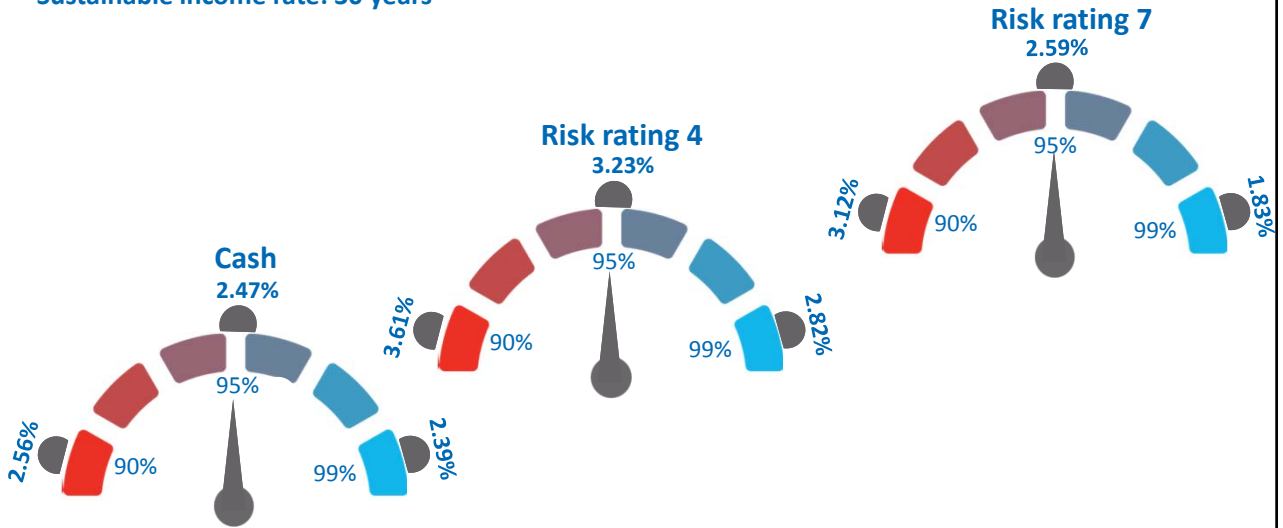
What's the new sustainable income rate?

Sustainable income rate and success probabilities: 30 years (and 35 years)



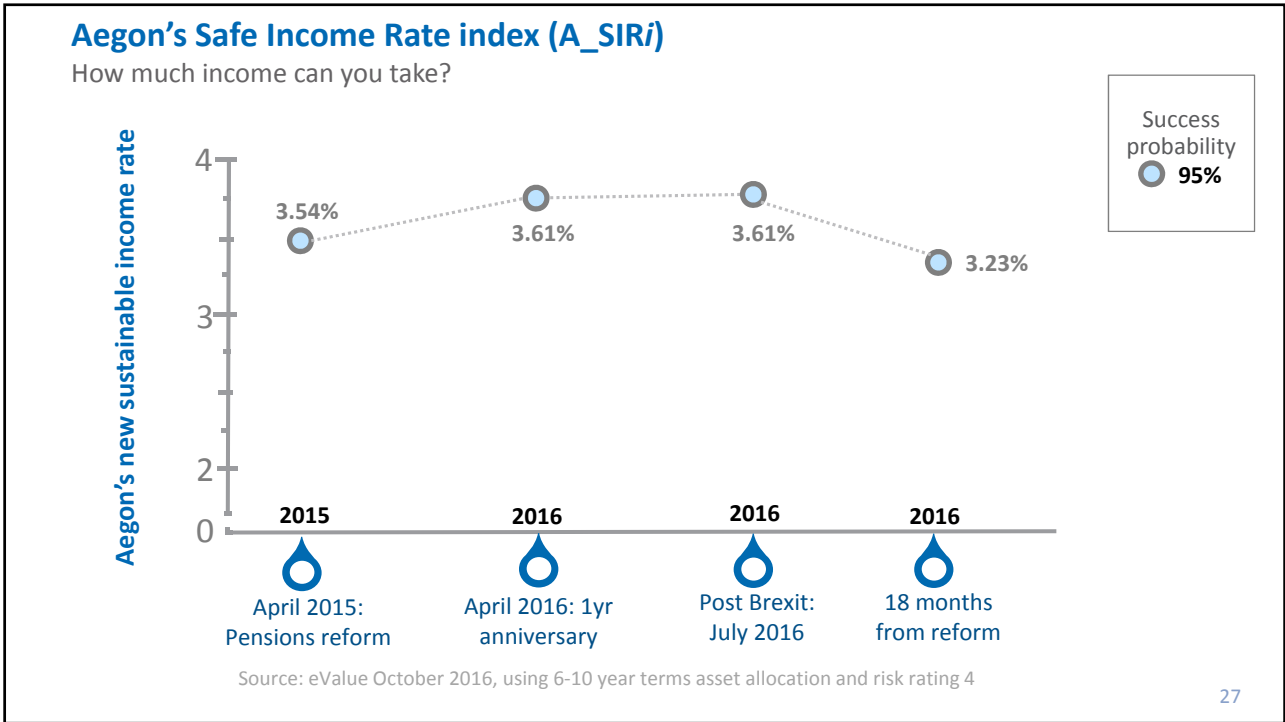
Source: eValue, October 2016, eValue's investment risk profile 4

How does my investment change things? Sustainable income rate: 30 years



Source: Aegon, October 2016

Aegon's sustainable income rate index (A_SIR_i)



Conclusions

18 months from pensions reform, drawdown remains favourite in terms of customer choice

Increased personal responsibility brings its own set of challenges

4% rule is outdated and was only ever Year 1 guidance for the US market

Aegon's research in conjunction with eValue:

Sustainable Income Rate for the UK is 3.23%

No one right answer

Questions?



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