Penguin Bitesize Guides to Better Money Management

Guide #7

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Retiring Soon? About to Retire? Just Retired? Then Learn all About Decumulation

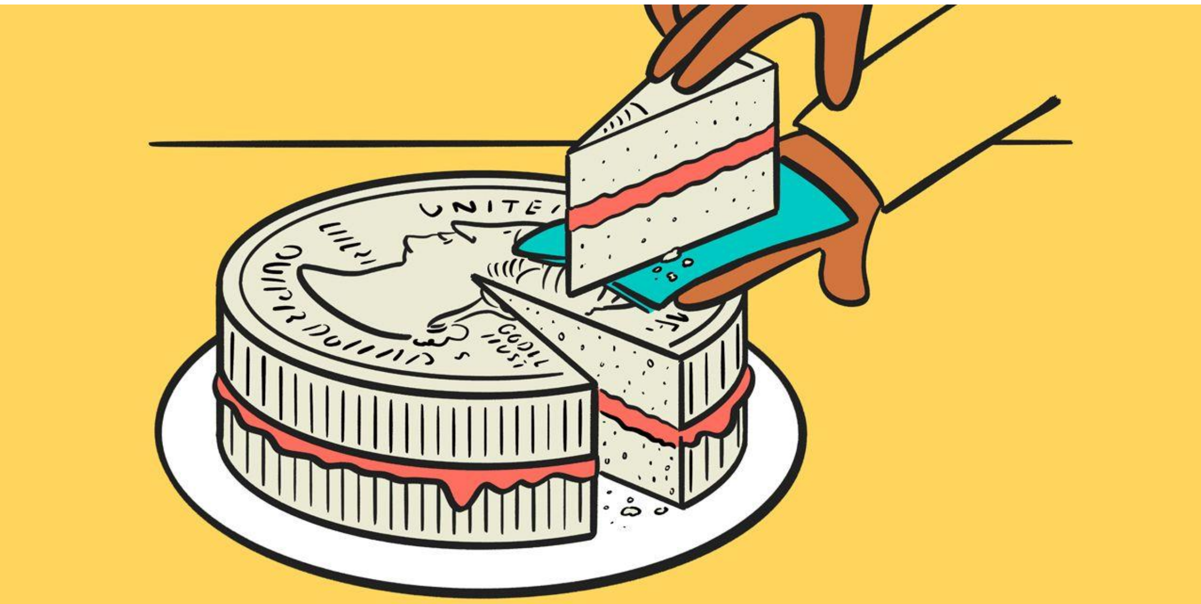
The convention suggests when you are somewhere around the point of retirement, you should think about and execute "planning your retirement income".

This is a great example where language and how something is described (in terms of words or a title) can be unhelpful.

Retirement Income Planning is a straightforward, uncomplicated exercise. However, that is not what most people in this position need.

They need to work out ***how to decumulate***, which is a completely different thing.

And decumulation is complex, <u>quite unlike anything you will have dealt with before.</u>



The significance of the decumulation challenge is summarised in quotes from two of the best financial minds anywhere on the planet, both Nobel Prize winning economists:

> *"Decumulation is a more difficult challenge than accumulation"*
>
> Richard Thaler

> *"Decumulation is the nastiest, hardest problem in finance."*
>
> Bill Sharpe

Both recognising that the mathematical calculations in seeking out an efficient decumulation strategy in any given situation are hideously difficult.

You're probably not too worried about the mathematical intricacies, but you will be concerned to make sure that you plan your finances through retirement to achieve one or more the following:

- ✓ You have the income level you ***want*** through all periods of your retirement – however long you live
- ✓ You can enjoy your life in retirement without worrying about money
- ✓ You can cover off all the financial risks that you may face
- ✓ You don't run out of money
- ✓ You can leave the legacy you want for your loved ones

That's a typical wish list and to achieve the goals expressed in that list, you need to work out *how to efficiently decumulate*.

If you fail to do so, then you will decumulate inefficiently, and the more inefficiently you do so, the more likely it is you will fail to meet one or more of those goals.

How decumulation planning is different to accumulation planning

Just about everybody prior to retirement organises their finances and their planning by accumulating.

This is by saving (e.g., putting money aside each month into ISAs, Pensions etc.) and investing, which is growing the savings by using shares, bonds, property etc. to generate a return which compounds the value of the saved money into ever higher amounts.

The accumulation "exercise" requires just a couple of factors to be weighed up to make good decisions about where to save/invest. These are to do with your time horizon and your tolerance to risk, from that your decisions can be made. It's comparatively simple.

When you shift to decumulating, because you need your saved money to help with providing for everything you require in your retirement, you also need to make decisions about:

- Where to 'house' your various assets (including which financial products to use)?
- Where to draw income from?
- How much income you should draw?
- When to take that income?

You can decide to keep investing the money and make regular withdrawals from these invested accounts or you can use non-investment financial products and organise to have a guaranteed lifetime income. Or you could do both, or you could simply have a cash/bank account and make withdrawals from that.

The products available to you and the detail of the choices are not especially important to the main point we are expressing within this short guide.

What is important is that you are now faced with a complex decision-making process.

Unknowable Factors

The 'correct' decisions will be different depending on how long you live.

You are facing new risks, the biggest of which is longevity risk, which means you may live for a very long time and must fund expenses for a much greater period than the average retiree.

You may also be facing the risk of having to pay for care or health expenses, at the very time of life when you only have income from your savings and/or pensions, as your earnings and earning potential have ceased.

When you accumulate you are effectively making investment decisions based on known factors, but when you decumulate you are having to work beyond investment decisions and with significant unknowns.

The problem is many people continue to plan/take decisions in retirement as if they were still accumulating, and don't look beyond the simple position of "I need £30,000 per year as my retirement income, where's the best place for me to take this from?"

This can lead to an over-simplified assessment and can, from there, lead to a massively inefficient decumulation position. In some cases, this proves troublesome, beyond simply wasting money.

Different questions need to be asked before decisions are taken

If you don't know how long you are going to live, then you really do have a challenge. **Why?** Because if you retire at age 63 and live to age 70, you will have a very different approach and decumulation strategy than if you retire at age 63 and live to age 97.

The question of how long you will live is unanswerable, and there is nothing you can do to get to an answer that helps.

"But what about my life expectancy?"

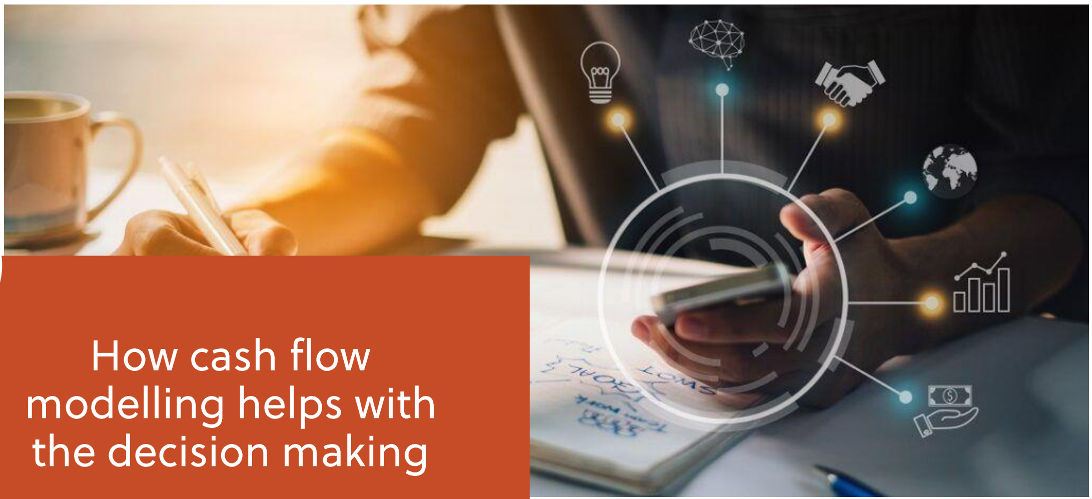
Your life expectancy is irrelevant – it tells you nothing of value in relation to decumulating. Your life expectancy is simply a figure which summarises how long a population of many people like you live on average. If you know that tens of thousands of people like you (e.g., female and age 63) live on average to age 86.6, how does this help you? It doesn't is the answer. Around that average will be a standard deviation and that will be wide and variable, so quite a few of those 63-year-olds won't get past age 65, and quite a few will live to beyond 100.

To work out how to manage your finances successfully, you must think and act differently.

To start with you need to question what happens if you do become one of the groups who live beyond 100? How would you organise your finances if that is your scenario?

You would then look at what happens if you are one of the groups that doesn't live very long. Make theoretical plans for both and see how they vary.

You can do this type of forward projection planning using cashflow financial planning software, we can help you with this.



How cash flow modelling helps with the decision making

Looking at what happens if you live to age 65 or over 100, comparing how this changes the picture is only one viewpoint. Your decision making must balance variables including:

- What happens if you need to cover care costs?
- What are your legacy wishes, how much of your wealth do you want to be available for your beneficiaries?
- If you keep investing beyond retirement, how much damage will be done if there are sharp falls in the invested assets you hold?
- What tax consequences do different income products have?
- How do you keep your income rising in line with inflation?
- How valuable in your case is a guaranteed income stream?

Decumulating is about trying to measure and balance many variables, way beyond a simple calculation on a paper. The number crunching is vast and requires software. Arguably, an accurate assessment cannot be done without a sophisticated model which draws out these variables.

That's what cash flow modelling software does for you, it allows you to input your finances into a programme and make assumptions about income and expenditure levels, investment returns, inflation and so on, and see how different outcomes occur as you vary these assumptions.

That way you get a glimpse into the future, especially in terms of spotting where the likely most efficient path is for you. This leads to much improved decision making about how to decumulate, in your unique case.

Penguin have cash flow modelling software to use to help you see how your retirement picture changes based on the variables.

Wherever you are on the retirement pathway today, this exercise can prove invaluable. Contact us now to discuss your decumulation requirements.

About Penguin Wealth

We are a Cardiff-based Financial Planning firm formed in 2010 by a group of Financial Planners who share the same vision and love for what we do. Our processes, support team and the accreditation we have achieved all reflect our principles and prove that we are best placed to help you live the life you deserve with peace of mind.

Our Mission Statement

Helping People Live their Best Lives, by Making Smarter Financial Decisions.

Core Values

- At Penguin we Commit to our Words, Actions and Results
- Clients' Needs 1st – Always
- Communication is key
- Have Penguin Positivity

Providing the highest standard of advice is at the heart of what we do, and we are always extremely excited to see what we can help you to achieve in the future!

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