Decumulation Options in the New Zealand Market: How Rules of Thumb can help – A summary
by the Retirement Income Interest Group of the New Zealand Society of Actuaries

How much income can I draw down from my retirement savings each year, given how long I want my retirement savings to last?

Many New Zealanders face the question of how to turn their savings into retirement income (“decumulate” their savings). The Retirement Income Interest Group of the New Zealand Society of Actuaries outlines how New Zealanders can draw down their savings, using one of four suggested Rules of Thumb, in a paper entitled Decumulation Options in the New Zealand Market: How Rules of Thumb can help. This document summarises that paper, which can be downloaded from the Society’s website.

Each retiree’s circumstances are different. One person may opt for one of the Rules, but someone else might find another of the Rules better suits his or her financial, family or health situation or income needs. For example, some people may not want to risk their savings running out, but others may be happy to spend down their savings by taking a higher income at the start of retirement. Some people want a quick and easy rule; others will be happy carrying out some calculations. These four Rules of Thumb cater for these variables.

We believe that Rules of Thumb will be most effective if there is a single set of Rules which can be confidently referenced widely and consistently.

Below, we explain the pros and cons of these Rules in general and have tried to suggest the type of person each Rule may suit best. Any retiree should consider his or her own personal situation and may also wish to speak to a financial adviser.

Overleaf, we set out how guidance to individual retirees may look.

The four Rules of Thumb are:

<table>
<thead>
<tr>
<th>Rule of Thumb</th>
<th>Most suitable for</th>
<th>How it works</th>
</tr>
</thead>
<tbody>
<tr>
<td>6% Rule:</td>
<td>People who want more income at the start of their retirement, to “front-load” their spending, and are not concerned with inheritance.</td>
<td>You receive the same nominal amount each year – but the length of time you receive it for varies.</td>
</tr>
<tr>
<td>Inflated 4% Rule:</td>
<td>People worried about running out of money in retirement or who want to leave an inheritance.</td>
<td>You receive the same real amount (ie inflation adjusted) each year but the length of time you receive it for varies.</td>
</tr>
<tr>
<td>Fixed Date Rule:</td>
<td>People comfortable living on other income (for example New Zealand Superannuation) after the set date. Those wanting to maximise income throughout life, not concerned with inheritance.</td>
<td>The amount you receive each year varies but the length of time you receive it for is known.</td>
</tr>
<tr>
<td>Life Expectancy Rule:</td>
<td>Those wanting to maximise income throughout life, not concerned with inheritance.</td>
<td>You receive a payment each year until you die but the amount varies.</td>
</tr>
</tbody>
</table>

New Zealand Society of Actuaries (Inc)
This is what the Rules could mean for you

The following charts show a likely income pattern if you follow each Rule, and they provide a guide to how long you might live so you can see the chances of running out of money before you die.

- The income shown is just the income from an initial fund of $100,000, not any other income you might have such as from New Zealand Superannuation. It is for a person who starts drawing down from the $100,000 fund at age 65. The figures are based on current investment conditions for a conservative investment profile.

- The income shown is adjusted for inflation. This is why the first Rule, which gives a flat income of $6,000 per annum, appears to fall over time – because the $6,000 per annum will buy less over time due to inflation – and why the second Rule, which gives an amount which increases with inflation each year, appears flat. If the income looks level from one year to the next that means it will be a higher number of dollars in future, but have the same spending power as today.

- As investment returns in the future are uncertain, the income you will receive is uncertain. The dark income is income which you will almost certainly receive (at least 95% probability of receiving), the medium colour is additional income you will probably receive (at least 50% probability of receiving) and the light colour is further income you might receive (less than 50% probability of receiving).

- The green pie-charts show the probability of surviving from age 65 to the age shown, allowing for typical New Zealand mortality experience.

These Rules are designed specifically for the New Zealand environment and tested for a general case of someone retired, receiving New Zealand Superannuation, with some savings to call on in an emergency as well as up to around $100,000 in a conservative or balanced investment fund. They have been tested for a retiree with drawdown starting at age 65, age 70 or age 75.

However, it’s important to consider your own personal situation. If your circumstances are more complicated than this, or you have a lot more invested (especially in more risky savings), or you are older or younger than this, then you may still be interested in using these Rules. Whatever your circumstances, you may wish to speak to a financial adviser.

Remember:

- You can take less in any year if you don’t need the money, but if you take more, then your savings are more likely to run out and you should recalculate.

- The graphs on the following pages estimated future income at a point in time (age 65). Your future income profile will vary, so you should review your choice every five years, and at any time if your circumstances change.
### Rule 1: 6% Rule

**Projected annual income and probability of survival**

6% Rule, conservative profile, starting age 65, starting fund $100,000

<table>
<thead>
<tr>
<th>Annual Income (Adjusted for inflation)</th>
<th>Probability of survival (male)</th>
<th>Probability of survival (female)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$12,000</td>
<td>64%</td>
<td>75%</td>
</tr>
<tr>
<td>$10,000</td>
<td>42%</td>
<td>56%</td>
</tr>
<tr>
<td>$8,000</td>
<td>11%</td>
<td>20%</td>
</tr>
</tbody>
</table>

#### Rule of Thumb

*6% Rule*: Each year, take 6% of the starting value of your retirement savings.

**Most suitable for**
People who want more income at the start of their retirement, to “front-load” their spending, and are not concerned with inheritance.

**Pros**
- Very simple.
- Known, regular income.

**Cons**
- Income will not rise with inflation.
- Risk of retirement savings running out within lifetime.

**Inheritance**
- Average inheritance low if drawdown commences at age 65; larger if it commences at a later age.
Rule 2: Inflated 4% Rule

Projected annual income and probability of survival
Inflated 4% Rule, conservative profile, starting age 65, starting fund $100,000

<table>
<thead>
<tr>
<th>Rule of Thumb</th>
<th>Most suitable for</th>
<th>Pros</th>
<th>Cons</th>
<th>Inheritance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflated 4% Rule: Take 4% of the starting value of your retirement savings, then increase that amount each year with inflation.</td>
<td>People worried about running out of money in retirement or who want to leave an inheritance.</td>
<td>Fund likely to last a lifetime. Income will rise with inflation.</td>
<td>Lower income than other options.</td>
<td>Inheritance payment likely and average inheritance amount large in relation to starting value.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Annual Income (Adjusted for inflation)</th>
<th>Probability of survival (male)</th>
<th>Probability of survival (female)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>1%</td>
<td>30%</td>
</tr>
<tr>
<td>$2,000</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>$4,000</td>
<td>19%</td>
<td></td>
</tr>
<tr>
<td>$6,000</td>
<td>1%</td>
<td></td>
</tr>
<tr>
<td>$8,000</td>
<td>30%</td>
<td></td>
</tr>
<tr>
<td>$10,000</td>
<td>2%</td>
<td></td>
</tr>
<tr>
<td>$12,000</td>
<td>30%</td>
<td></td>
</tr>
</tbody>
</table>
**Rule 3: Fixed Date Rule - 20 years**

Projected annual income and probability of survival

**Fixed Date Rule – 20 years, conservative profile, starting age 65, starting fund $100,000**

<table>
<thead>
<tr>
<th>Rule of Thumb</th>
<th>Most suitable for</th>
<th>Pros</th>
<th>Cons</th>
<th>Inheritance</th>
</tr>
</thead>
</table>
| **Fixed Date**
**Rule:** Run your retirement savings down over the period to a set date – each year take out the current value of your retirement savings divided by the number of years left to that date. | People comfortable with living on other income (for example New Zealand Superannuation) after the set date. Those wanting to maximise income throughout life, not concerned with inheritance. | Income for a known selected period. | Amount of income varies from year to year. Annual calculation necessary. | Lowest average inheritance amounts. High probability of no inheritance, especially if selected date is age 85 or earlier; average inheritance amounts greater when selected date is later. |
Rule 4: Life Expectancy Rule (male)

Projected annual income and probability of survival
Life Expectancy Rule, conservative profile, male, starting age 65, starting fund $100,000

### Rule of Thumb

**Life Expectancy Rule**: Each year take out the current value of your retirement savings divided by the average remaining life expectancy at that time.

### Most suitable for

Those wanting to maximise income throughout life, not concerned with inheritance.

### Pros

Efficient use of fund to provide income for whole of life.

### Cons

Amount of income varies from year to year; low in later years.

Annual calculation necessary and relatively more complicated.

### Inheritance

Some inheritance normally paid; average inheritance amount moderate.

The Rule will provide some income for the whole of your life. If you live longer than expected as at the start of your draw down, the Rule will adjust but the income in the latest years may be very low.
Rule 4: Life Expectancy Rule (female)

Projected annual income and probability of survival
Life Expectancy Rule, conservative profile, female, starting age 65, starting fund $100,000

<table>
<thead>
<tr>
<th>Rule of Thumb</th>
<th>Most suitable for</th>
<th>Pros</th>
<th>Cons</th>
<th>Inheritance</th>
</tr>
</thead>
</table>
| **Life Expectancy Rule**: Each year take out the current value of your retirement savings divided by the average remaining life expectancy at that time. | Those wanting to maximise income throughout life, not concerned with inheritance. | Efficient use of fund to provide income for whole of life. | Amount of income varies from year to year; low in later years.  
Annual calculation necessary and relatively more complicated. | Some inheritance normally paid; average inheritance amount moderate. |

The Rule will provide some income for the whole of your life. If you live longer than expected as at the start of your draw down, the Rule will adjust but the income in the latest years may be very low.
Background

In our 2015 paper *Income Streaming in Retirement: Options for New Zealand* we estimated there will be over 1 million New Zealanders reaching age 65 over the next 20 years. We estimated the median KiwiSaver balance of those aged 65 will reach $100,000 in inflation-adjusted terms in 25 years’ time.

Typically, New Zealanders approaching or in retirement have New Zealand Superannuation, some savings that could be used for emergencies and some retirement savings in KiwiSaver or another fund. Most KiwiSaver providers allow an income to be taken after age 65, but still the questions of *how much?* and *for how long?* can be difficult to answer. We believe these Rules of Thumb help to address these questions. By virtue of being simple, Rules of Thumb add to the range of tools available.

We believe that Rules of Thumb will be most effective if there is a single set of Rules that is referenced widely and consistently. This set of Rules would be available to providers, distributors, regulators, commentators and others who communicate with New Zealanders on decumulation matters. There would need to be confidence in this set of Rules and we envisage the FMA approving a set of Rules for this purpose.

Further information is contained in the full report *Decumulation Options in the New Zealand Market: How Rules of Thumb can help*.

---
