

RETIREMENT PLANNING - FIXED VS VARIABLE WITHDRAWALS

In the quest to help ensure individuals don't outlive their retirement assets, an ongoing debate within the advisory community persists on how best to manage withdrawals in an effort to support this ultimate challenge. At the forefront of the discussion has been at what withdrawal rate provides the best solution to balance out not outliving your money with not being so conservative in your spending that you cannot enjoy the golden years to their fullest. Fixed withdrawal amounts dominated past recommendations but new ideas utilizing variable withdrawals are leading current discussions as they address the concern head on with a qualified solution.

Fixed Withdrawals

A fixed lifetime withdrawal (with annual increases for inflation) provides a desirable income solution to most retirees because managing expenses during retirement are much easier when knowing exactly what income will be available. In addition, the fewer the changes one has to make and the maintenance of the status quo provides comfort for the retiree. Knowing they were able to live comfortably off the same amount of income last year helps ease their concerns about the coming year. There are enough other items to be worried about during retirement (such as health care, etc.) that being able to remove fluctuating income from the list is very desirable. The inherent problem and greatest risk with a fixed withdrawal amount is the possibility of outliving your money. This is because the calculation of the fixed amount is done at the outset of retirement (a 20-30 year retirement is not an unreasonable expectation today) and is done based upon a number of assumptions for variables that impact the withdrawal computation (annual return, rate of inflation, number of years money will be needed, etc). The number used for each variable is typically based upon either historical data and/or best guesses of the person doing the calculations. It's obvious the longer the time horizon of the withdrawals the higher the chance the assumptions used in the calculation will be wrong. As you would expect, this also increases the odds the amount calculated will be wrong thereby providing an undesirable outcome.

Fixed Amount Annual Retirement Asset Withdrawal Considerations

Pros	Cons
Simple and easy to administer	Potential of outliving retirement nest egg
Low cost of maintenance - no annual review necessary	Potential to under-spend and not live a comfortable retirement
Simplifies budgeting	Potential of undesirably large estate at death
Consistency - maintenance of the status quo	

Variable Withdrawals

An ideal solution to the fixed withdrawal conundrum is start out with the same fixed withdrawal amount (and utilize the same assumptions), but rerun the calculation and adjust the amount withdrawn regularly based upon changes seen in the actual vs. assumed numbers used for each variable. This is the theory behind variable withdrawal rates which are rapidly becoming the desired methods of handling retirement asset withdrawals. Because of its ability to greatly reduce or even eliminate the chance of running out of money, it is the method of choice for professionals in the industry. There are a number of variations on how best to monitor and adjust your withdrawal rate; each attempts to minimize the actual change made to the withdrawal amount to have the least impact on a retiree's lifestyle. Which of these methods to use, how to use it and when is a whole other discussion that will not be covered in this article. The bottom line is that all variable withdrawal methods propose reviewing the initial withdrawal amount established at the outset of retirement and making regular changes based upon actual, not assumed, values used in the withdrawal amount calculation.

Variable Amount Annual Retirement Asset Withdrawal Considerations

Pros	Cons
Reduces or eliminates the chance of running out of money during retirement	Increased costs - Regular review and possible adjustments to portfolio necessary
Potential for increased income available for expenditures or gifting	Potential for decreased income available for expenditures
	Unknown/Uncertainty of year to year withdrawal


Which is one is right for you

As with most everything in life, there is no one perfect solution for everybody. In addition, there is usually a trade off one must be willing to make depending upon which path is chosen. In the case of variable withdrawals, being able to remove the uncertainty and primary concern every retiree has of running out of money is highly desirable. However, doing so doesn't come without a price as it will require the retiree to be flexible in managing their expenses and diligent in living within their budgeted means. Additionally, it comes with a financial price because unless they are comfortable with ongoing analysis and adjusting that is required, they will have regular professional advisory expenses. On the other hand, a fixed withdrawal is beautifully simple and highly manageable. But, it has the potential of either making your heirs extremely happy or forcing you to find work at the most inopportune time. Neither of these may be possible or desirable.

In spite of the additional expenses and potential disruptions to one's lifestyle, being able to retire with the comfort of knowing you will be financially secure is well worth the inconveniences and expenses associated with the variable withdrawal method. It is for this reason we recommend every retiree look closely at variable withdrawal methods when tapping their nest eggs.

Financial Perspectives was founded in 2000 by Charles "Chuck" Gibson—a CERTIFIED FINANCIAL PLANNER™ certificant, Accredited Asset Management Specialist, and Chartered Retirement Plans Specialist—who has worked in the financial advisory industry since 1994. With more than \$50 million in assets currently under management*, Chuck and his staff have advised hundreds of individuals, businesses, and other organizations, helping them establish sound investment strategies by providing informed, objective financial planning and asset management advice.

*As of 04/16/2007. Dollar value of assets under management at any given time can and does fluctuate according to current market values, economic conditions, etc.

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