Briefly Noted

Five Strategies for Withdrawing From Retirement Savings

The 4% rule has long been the standard model for drawing down savings in retirement. It is not the only approach to retirement income, however. BlackRock recently listed five ways for making withdrawals. In doing so, the firm noted the ability to mix and match. A blended approach may help to match the withdrawal strategy with each income need.

These five retirement withdrawal strategies are:

Fixed-Dollar Withdrawals: A fixed-dollar amount is withdrawn for a period of time. This is the simplest and most easy-to-implement strategy. It does not adjust for inflation, which may lead to withdrawals not being large enough to fund future expenses. It can also erode a retiree's principal if the withdrawal amount is too large.

Fixed-Percentage Withdrawals: A fixed-percentage amount of retirement savings is withdrawn annually. While the percentage does not change, the actual dollar amount of the withdrawal will change depending on whether the portfolio has increased or decreased in size. Over time, this strategy has the potential to allow the portfolio to grow if the percentage amount withdrawn is lower than the rate of return. It may erode the portfolio, however, if the portfolio's rate of return is lower than the percentage withdrawal rate.

Inflation-Adjusted Withdrawals: A specified amount is withdrawn during the first year of retirement and is then increased during each subsequent year of retirement. This follows the same methodology as the 4% rule, but can be applied to higher or lower percentage withdrawal amounts. The upside is that retirement income will increase over time, but the strategy requires annual calculations. It can also erode principal and, if too high of a withdrawal rate is chosen, deplete the account.

Withdrawal of Investment Earnings: Commonly referred to as an approach that never touches principal; only the income provided by dividends, interest payments and fund distributions are withdrawn. This preserves the underlying value of the portfolio, but may not provide enough retirement income to keep up with inflation. It can also lead to variable amounts of retirement income.

Buckets: Assets are separated into three "buckets," one holding cash, the next holding bonds and the third holding stocks. Cash spent from the first bucket is replenished with earnings from the second and third buckets. It controls risk and gives the portfolio more time to grow.

Source: "5 Retirement Income Strategies," BlackRock.

Be Wary of Offers for High-Yield CDs

The Financial Industry Regulatory Authority (FINRA) issued a warning about advertisements promoting high-yielding certificates of deposit (CDs). While some of these promotions may be legitimate marketing efforts by banks and credit unions, many others are "bait-and-switch" ploys to sell a different, high-commission product. FINRA says it issued the alert in response to calls on its Securities Helpline for Seniors (1-844-574-3577).

These promotions typically require an individual to visit the company's office and speak with a salesperson. Once there, the product pitched will often be a high-cost annuity. Unlike the CDs commonly offered by banks, these annuities are not FDIC-insured and are not risk-free.

Always read the fine print and ask questions, because the structure of these promotions is intended to benefit the firm offering the promotion and not you. FINRA says that the advertised yields for high-yield CDs generally include a bonus. The bonus is an excess amount paid by the salesperson to the customer in addition to the CD's actual average percentage yield (APY). It is an incentive by the company or the salesperson to get potential customers in the door to listen to a pitch for a different product.

The pitched product—often an annuity—will often be sold with some type of incentive pricing. This discount may be close to the interest and bonus paid on the advertised CD. Even with the discount, the commission on the non-CD product is still likely to be high.

FINRA says those who turn down the additional products can still generally purchase the CD. The salesperson will likely direct those only interested in the CD to another bank. The advertising firm will still honor the quoted yield by paying the difference between the CD's actual yield and the promotional rate to the customer.

The big key to remember is that the promise of higher yields comes with higher risks. The high-yield CDs being pitched are often just marketing ploys. The annuities being pitched in place of the CDs may not only be costly, but also unsuitable and not easy to get out of. Though annuities can have a useful role in a portfolio, they can also be misrepresented and misunderstood. Most importantly, realize that you can always say "no" and walk out the door.

"High-Yield CD Offers Can Be Bait for High-Commission Investments," FINRA Investor Alerts, February 9, 2016.

Online Retirement Calculators Called 'Misleading' by Researchers

Researchers used harsh words to summarize their analysis of online retirement planning tools. They bluntly concluded, "The advice provided from a majority of these tools is extremely misleading to households." Out of the 36 tools tested, just 11 succeeded in giving the correct analysis. Even then, a questions were raised about at least one of the successful 11 tools.

The retirement planning tools tested were designed to tell individuals whether or not they (and their spouse) can meet their retirement goals. These tools are either free or cost just a modest amount. They can also be used without the assistance of a financial planner. Included in the study were tools from AARP, Bankrate.com, Chase, Fidelity, Voya, MarketWatch, Prudential, Schwab, TD Ameritrade, USAA, Vanguard and Yahoo Finance, among several others. The study did not state which tools passed or failed.

Among the faults found with these tools was the lack of options for drawing down retirement savings, such as annuitizing 401(k) assets. Most tools do not account for gradual retirement where one or both members of a household choose to continue to working on a part-time or consultancy basis. Additionally, the results given by the tools were "highly variable and confusing." The latter critique is troubling because of the lack of consistency among the tools, but also because many individuals are unaware that the answers differ depending on which tool is used.

The variables considered by each tool were a particular point of contention. Key variables important to determining retirement success include current age and life expectancy, current income, bequest amounts, expected returns, Social Security income and retirement living expenses. The average tool lacked most variables suggested by accepted financial theory and recommended by a survey of financial professionals. In other words, most tools do not consider all of the major variables that will influence an individual's chance of a financially successful retirement.

To test the tools, the researchers used a hypothetical couple in their late 50s with a targeted retirement age of 65 for the older spouse and the two-year-younger spouse retiring at the same time. Using an accepted professional financial planning software program as a benchmark, this couple only had a 53% chance of not running out of money in retirement. Yet most of the tested tools said the couple could retire successfully.

Source: "The Efficacy of Publically-Available Retirement Planning Tools;" Taft Dorman, Barry Mulholland, Qianwen Bi and Harold Evensky; SSRN, January 20, 2016.

The Financial Literacy Quiz That Many Retirees Flunked

In a survey of retirees, most flunked a quiz on retirement income. Nearly one of out of every four respondents gave the wrong answer on at least 70% of all questions. Even those who passed the quiz incorrectly answered a large number of questions—just 6% of all respondents received a grade of "C" or better. Not a single person who took the quiz answered enough questions correctly to earn an "A."

What's surprising is that those surveyed were both affluent and financially literate. Respondents were between ages 60 and 75 with at least $100,000 in investable assets beyond their house. The majority worked with a financial adviser. They also understood that mutual funds offer more diversification than stocks (84%) and that inflation erodes purchasing power (90%).

Yet, the list of topics respondents misunderstood or could not correctly answer questions about was long. For example:

- Only three in 10 understood that is better to work longer or defer claiming Social Security benefits for two years than it is save 3% more during the five years leading up to retirement.
- Three-quarters of respondents didn't understand the relationship between bond yields and risk (higher yields mean more risk).
- A similar number didn't understand that annuity contracts are more expensive when payments start at younger ages.
- Two-thirds didn't know to take advantage of being in a reduced tax rate when deciding the best time to roll over traditional IRA assets to a Roth IRA. (It's best to do a rollover during a year when one is in lower marginal tax bracket.)
- Most did not realize that small-cap stocks have historically realized the highest returns.
- Less than 20% knew that Medicaid pays for the majority of long-term care expenses. Most thought that individuals did.

The study was conducted by the American College of Financial Services. Those interested in testing their knowledge can take the quiz at www.theamericancollege.edu/ricp-retirement-income-survey. The correct answers and the rationale as to why they are correct are shown after the completion of the test.

Source: "RICP Retirement Income Literacy Survey," David Little, Matt Greenwald and Jamie Jopkins, The American College.