

# The Withdrawal Policy Statement

by Jonathan Guyton, CFP®



Jonathan Guyton, CFP®, is principal of Cornerstone Wealth Advisors Inc., a holistic financial planning and wealth management firm in Edina, Minnesota. He is a researcher, mentor, author, and frequent national speaker on retirement

planning and asset distribution strategies, and a former winner of the Journal of Financial Planning's Call for Papers competition.

Recently, I was in a conversation with a consumer financial journalist who I respect both for his thoughtfulness and willingness to learn from the sources he seeks out. The topic? The so-called “distribution phase” of financial planning that millions of retiring baby boomers are entering each year. “The most important thing I’ve learned about distribution planning,” he told me, almost speaking to himself, “is that it’s more complicated than I ever imagined.”

No wonder! For starters, not one financial planning issue of the accumulation phase—save possibly education planning—is removed from the table. Many of these issues, including construction of the income “paychecks” to fund lifestyle goals, tax efficiency on both a short- and long-term basis, and assembling integrated healthcare planning solutions to name just three, become more complex. In addition and for the first time, decisions must be made at least annually (and sometimes on

the spot in client meetings) about the sources of the investment portfolio income on which the client will rely, when (and when not) to alter intended withdrawal amounts in light of the economic conditions that may be at hand, the magnitude of the change when such a decision has been made, and how to handle those “one-time” needs for extra money that seem to come up time and time again. And all this in an environment that frequently contains the unsettling mix of turbulent economic times and latent, unresolved aspects of the client’s relationship with money.

Clearly, my journalist friend has it spot on!

Anyone who is somewhat familiar with my writings over the years or who has managed to stay awake through one of my talks knows of my belief that we, as a profession, are so much better equipped than we were even a decade ago to navigate the varying depths of the retirement waters in which our clients may find themselves. Simply put, our knowledge, insight, skills, and wisdom have grown significantly. However, so much more is asked of us in the frequency and complexity of the never-ending demands inherent in these matters.

I have found that the articulation of the policies and practices that will govern such decisions into a written withdrawal policy statement is a powerful way to both enlist client support and manage their expecta-

tions in a proactive manner—before the first inevitable economic and emotional storm breaks upon their retirement. A withdrawal policy statement specifies the goals, policies, and parameters that the client and adviser agree to adopt to guide future decision-making regarding the use of the client’s financial capital to help fund their lifestyle during their retirement years.

The establishment of a withdrawal policy statement begins with a conversation to re-focus your client’s values, goals, fears, and expectations about his or her upcoming

“Policies are not goals, nor are they optional guidelines; in fact, policies are informed by a client’s goals. Neither are policies the same as strategies or action items; these flow from policies.”

retirement. While this has no doubt occurred early and often in the client relationship to this point, retirement is a significant and complex life transition filled with emotional, psychological, and spiritual—as well as financial—aspects. It’s not merely about having enough money. Bogeymen come out of closets when an imminent retirement becomes the present. A few, simple, open-ended questions are

often all it takes to bring such matters into the open:

- How are you feeling about being retired?
- What was your parents' retirement like?

“Benefits abound from the use of planning policies: they lay out a framework for evaluating trade-offs, proactively establish expectations, create a touchstone of stability for clients when emotions and markets are roiled, and guide planners in decision-making during the most turbulent of times.”

- What do you want your retirement to be like?
- What do you envision yourself doing in retirement?
- Where do you want to be and who do you want to be there with you?
- What concerns or fears do you have about being retired?
- What really matters?

Be aware that while it's healthy for clients to verbalize such personal matters, it may also be difficult. Let them know this is okay. Remind them that it's natural for these concerns to be present in a big life transition. Remember that they have never done this before (and neither have you!), although you probably have observed many retirement transitions up close and personal. Let them know they are not the first to experience concerns or fears about retirement, by relating experiences or sto-

ries from other clients. Share life lessons you have gleaned from watching other clients. Keep your eyes open for these going forward.

Answers to these questions help you and your clients fine-tune their income needs and, just as important, provide insight on potential stumbling blocks. In addition, the questions will help you frame a conversation about the kinds of choices and trade-offs clients may have to consider regarding withdrawal amounts, the chance of outliving their assets, portfolio volatility, and purchasing power maintenance. As this conversation unfolds, you will gain insight into the various planning policies and strategies it would be most prudent for you and your client to adopt in a withdrawal policy statement.

### The Role of Planning Policies

According to Buie and Yeske, “Well-crafted financial planning policies can serve both planners and their clients by acting as a powerful touchstone in the midst of a rapidly changing world.”

They go on to say:

Among the necessary characteristics of an effective planning policy, two stand out. First, the policy should be broad enough to encompass new or unexpected events as they arise. Second, it should be specific enough so that we are rarely in doubt as to what action to take in response to changing events. In satisfying these dual criteria, the policy acts as a bridge between a client's core values and aspirations and the specific, concrete steps that should be taken at any given time to sustain progress toward achieving those aspirations.

The notion of policies and their role in the financial planning process is not new, although until recently, it has been less than explicit. Planning policies were implicitly described by Hallman and Rosenbloom in their classic personal financial planning texts. A policy-based approach is essentially required to satisfy the fiduciary standards of the Uniform Prudent Investor Act, a version of which has been adopted by 45 states and the District of Columbia. And investment policy statements are now widely accepted as best practice.

That said, it can be easy to confuse goals with policies and policies with strategies. Policies are not goals, nor are they optional guidelines; in fact, policies are informed by a client's goals. Neither are policies the same as strategies or action items; these flow from policies.

Consider a common, non-financial goal: to be physically fit. One might execute varying strategies toward its implementation at different points in her life. However, having set such a goal, she could adopt this policy statement: “I will create and maintain a personal fitness plan that I can realistically implement within my current lifestyle.” Note that such policy statements veer more toward the descriptive than the specific. The author of the above statement will judge how well she is honoring it as much by feel as by fact.

This policy could then lead to a wide variety of strategic and tactical actions—scheduling regular workouts, adopting (or eliminating) certain eating habits, hiring a personal trainer, joining a club or organization, asking a friend to join her for both accountability and company—but only to the extent that they can be realistically implemented. Certain strategies may be appropriate at some points in her life but not others. While such strategies would need to be modified periodically in response to health and lifestyle changes or shifts in the meaning of “physically fit,” this policy is both sufficiently broad and specific to meet the two-part criteria suggested by Buie and Yeske.

## Withdrawal Policies

As planners, we frequently leap from the discovery and clarification of client values and goals (for example, “maintain our current lifestyle while leading a fulfilling, meaningful life”) to implementation steps that use the various strategic and tactical arrows we have in our well-stocked financial planning quiver. But in so doing, we miss the policy step and the opportunity to establish the key parameters that can guide us toward appropriate decision-making in the face of new or unexpected events.

Thus, a couple’s policy around retirement income generation might sound like this: “We will live our retirement both now and in the future by appropriately and realistically balancing our present lifestyle financial wishes with our future lifetime financial security.” We can easily imagine an adviser facilitating conversation about what being in or out of balance might feel like and examples of the trade-offs that appropriately and realistically might entail. Such conversation builds the bridge between the values-based aspirations and the concrete action steps that will be needed to achieve them.

## The Withdrawal Policy Statement

We are now ready to create the withdrawal policy statement (WPS) to articulate the goals and policies as well as the strategies and tactics that the client and adviser agree to adopt to guide future decision-making around portfolio withdrawals. Based on this agreement, the client could give the adviser discretion over any or all of the provisions within the WPS.

Beginning with the client goal and policy declarations as described above, a WPS would go on to specify: (1) the client income goals to be met via withdrawals, (2) the client assets to which the WPS applies, (3) the initial withdrawal rate, (4) the method for determining the source of each year’s withdrawal income from the portfolio, and (5) the method for determining the withdrawal amount in subsequent years, including both

the trigger points for adjustments other than an inflation-based increase and the magnitude of the adjustment itself.

For example, a WPS could contain the following parameters regarding the income goal:

- Receive ongoing monthly after-tax withdrawals of \$3,000 throughout our lifetime
- Maintain our purchasing power through systematic increases that offset future rises in our cost of living
- Minimize the long-term income taxation of our withdrawal income
- Minimize the chance that we could outlive our assets
- Minimize undesired changes to our regular monthly income

A WPS could also specify the portfolio management approach (based on Guyton and Klinger, 2006) to identify the source of the ongoing withdrawals:

- Interest and dividend distributions

are held in cash and not reinvested in shares

- Capital gains distributions are reinvested in IRA accounts and held in cash in after-tax accounts
- Following years with a positive return where an equity asset class exceeds its target allocation, the excess allocation is sold and the proceeds invested in cash to meet future withdrawal needs
- Portfolio withdrawals are funded in the following order: (1) cash, (2) withdrawals from remaining fixed income assets, (3) withdrawals from remaining equity assets in descending order (best first) of the prior year’s performance
- No withdrawals are taken from any equity asset following a year in which it had a negative return if cash or fixed income assets are sufficient to fund the intended withdrawal

Finally, a WPS could include the following strategies to determine the ongoing



**FPA.**  
FINANCIAL PLANNING ASSOCIATION  
*The Heart of Financial Planning™*

FPA would like to recognize its  
**2010 NATIONAL SPONSORS:**

**ID AMERITRADE**  
Institutional Member FINRA/SIPC

**Thornburg** Investments®

withdrawal amount:

- Each year, the monthly withdrawal will increase by the prior year's inflation rate, as measured by the Consumer Price Index, unless:
  - A) The prior year's return was negative and the new year's withdrawal rate would be above the initial withdrawal rate. In this situation, there is no increase in the monthly withdrawal amount.
  - B) The new year's withdrawal rate would be more than 20 percent above the initial withdrawal rate. In this situation, the new year's monthly income is reduced by 10 percent from what it would have been with the inflation adjustment. This supersedes "A" above, should they occur simultaneously.
  - C) The new year's withdrawal rate would be more than 20 percent below the initial withdrawal rate. In this situation, the new year's monthly income is increased by 10 percent from what it would have been with the inflation adjustment. This supersedes "A" above, should they occur simultaneously.

### Those Extra Wants and Needs for Money

As all experienced planners know, clients frequently want or need additional income beyond the intended regular monthly amount from their core portfolio. Sometimes this is for once-in-a-lifetime opportunities; other times, it is to meet personal emergencies or to assist family members. It really doesn't matter. The result can be a significant increase in that year's withdrawal rate. If continued regularly, this could quickly create an unsustainable pattern. Anticipating such a situation and initiating a conversation about its likelihood and impact is both prudent and wise. Couples may find themselves on the teeter-totter of their withdrawal policy's balancing act. Long-held money fears may surface, and a zero-sum game could ensue. The planner could even be

drawn into what feels like a good-cop/bad-cop role even when it appears that both spouses are right! In short, we need to change the conversation.

In such a situation, creating what our clients often call their "discretionary fund" can work wonders. (One couple called it the best advice we've ever given them.) This is distinct from a traditional cash reserve or emergency fund. The discretionary fund is literally a separate investment account that is established with assets from within the client's total portfolio. Using after-tax assets is preferable, though IRA assets can work as well. While the appropriate amount for each client will vary, our clients typically allot 5–10 percent of their investment assets.

The discretionary fund is not covered by the withdrawal policy statement. In fact, clients can do anything they wish with it. This can be immensely freeing to the adviser, who no longer needs to consider what will happen if these extra withdrawals keep occurring. More importantly, it almost always focuses clients' intentions, prompting them to imagine possibilities and to ask themselves some very revealing questions: What extra expenditures matter enough to put these funds toward? Do we really need this? How long do we want to be able to afford such extras? Before long, they begin creating their own policies for this discretionary fund!

Depending on how quickly clients see themselves using their discretionary fund, its asset allocation may be more conservative than their core portfolio, to which the more disciplined policies of the WPS apply. Additionally, when these discretionary funds are depleted, the fund is gone—unless it has been replenished by diverting some of the income distributed under the WPS.

### A Brief Word About Investment Policy Statements

A withdrawal policy statement can stand side-by-side with a traditional investment policy statement. The latter would include the typical goals and policies pertaining to

the portfolio's purpose, return expectations, risk and volatility tolerance, asset allocation, asset classes to be utilized, manager selection criteria, and performance measurement standards. It is easy to imagine these being combined into a single document. What matters, however, is that their goals and policies be integrated and realistic. For example, as Guyton and Klinger showed in 2006, a client whose income needs required a 5.0 percent initial withdrawal rate at the 99 percent confidence standard could not meet their goal to "maintain our purchasing power" with an investment policy that included only a 50 percent allocation to equities.

### Conclusion

Benefits abound from the use of planning policies: they lay out a framework for evaluating trade-offs, proactively establish expectations, create a touchstone of stability for clients when emotions and markets are roiled, and guide planners in decision-making during the most turbulent times. Collaborating and communicating with clients through conversation is key to realizing these benefits. The adoption of withdrawal policies and use of a withdrawal policy statement within a trusted advisory relationship can help form the bridge between these conversations and the tactics that will be needed to navigate retirement. In so doing, planners can use this policy-based framework to make a significant contribution to helping clients experience retirements that are both rewarding and fulfilling.



### References

- Guyton, Jonathan T., and William Klinger. 2006. "Decision Rules and Maximum Initial Withdrawal Rates." *Journal of Financial Planning* (March).
- Yeske, David B., and Elissa Buie. 2006. "Policy-Based Financial Planning Provides Touchstone in a Turbulent World." *Journal of Financial Planning* (July).