Most of us are very aware of the constant drumbeat from financial advisors who are telling us to save now for retirement. There are all kinds of different plans from standard IRAs to Roth IRAs to pension and SEP plans. And if you are like most people, then your focus has always been how you put the money away and how you invest it to develop the largest nest egg that you can. But there is another side to retirement planning that gets less attention. This is the issue of how much you can withdraw from your nest egg each year after you retire. And it turns out that one of the more powerful tools for handling this problem requires action from you years before your retire.

I’ve heard it described this way before: that you don’t want to run out of gravy before you run out of biscuit and vice versa. The concept is simple, the solution very complicated. What is the right amount of money to withdraw from your retirement savings each year so that you don’t run out of money before you die and also so that you don’t have most of it left behind after you die? Experts have worked on this problem for many years and the the answer itself is an elusive moving target.

While there is some disagreement on the percentage of withdrawal that you make each year from your retirement accounts, most experts will put the range at somewhere between 2% and 4%. So, let’s crunch those numbers just a bit to give you an idea of what that looks like. Let’s say you have accumulated $1 million in your retirement account. A 4% withdrawal each year would be $40,000 per year. Assuming your retirement funds are not Roth IRA funds, then it is likely that you will have to pay income taxes on that money. Suddenly, that $1 million doesn’t seem like so much money. And to make matters worse, there is the timing issue to consider. If you began your 4% withdrawals on January 1, 2000 with your retirement account invested in 55% stocks and 45% bonds, then today you would only have a 29% chance of making it through 3 decades without running out of money.

To further complicate this decision, consider that you just can’t choose a withdrawal number and stick with it with no future adjustments. Prior to the 2008 market meltdown advisors were telling people that a 7% per year withdrawal was safe. That is because they were relying on past history of stock market returns to make their calculations. But this process is like driving a car by only looking in the rear view mirror. So you will need to constantly adjust your expectations and if you get it wrong early in your retirement, then you will have almost no way of making up the losses.

Earlier I mentioned that there are ways to create income streams that you cannot outlive.

Annuities can do this very well. The problem is that some are expensive and may not generate the monthly income that you need from your nest egg. However, there is another solution. One life insurance company is now offering a cash value life insurance policy that can generate guaranteed lifetime withdrawal rates of 7% or more as long as you live. And if you die early, unlike with straight annuities, the life insurance and cash value amounts return to your estate so that your investment is not lost. Of course these policies are not for everyone, you have to be healthy enough to qualify for the life insurance policy in the first place and you need to put this tool in place a few years before you retire. But once you have created this bucket, you can dump more money into it later on from other retirement accounts and have all of that money going to work providing you a larger income stream throughout your retirement years.

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