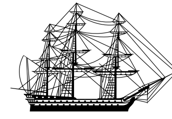

Withdrawals from financial accounts in retirement

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- One-quarter of wealthier household retirement income comes from financial account withdrawals. The role of these withdrawals is expected to grow as financial accounts make up an increasing share of retiree wealth in the future.

- In our sample of wealthier households, the median withdrawal rate from financial accounts is modest at 3%. The median spending rate—focusing only on the portion of a withdrawal actually used for consumption—is even lower. This indicates that, on average, the rates of withdrawal and spending from financial accounts are sustainable at the current pace. However, about one-quarter of households have spending rates of 5% or more and may be at risk of exhausting financial assets.

- Tax policy regarding required minimum distributions (RMDs) from tax-advantaged accounts prompts withdrawals from these accounts. RMDs increase the proportion of households withdrawing, although withdrawal rates remain modest. More importantly, some or all of RMDs are not spent but reinvested in other financial accounts.

- Withdrawal strategy varies by the type of financial account. Systematic withdrawal programs are more common from annuities with a balance and what we refer to as "cornerstone" accounts—mutual fund and brokerage accounts, employer-sponsored defined contribution accounts, or IRAs. However, liquid accounts and cash-value life insurance tend to be tapped more on an ad hoc basis.

- The composition of retiree spending does not vary even if composition of income does. The proportion spent on various types of expenses is similar whether the retiree household's wealth holdings are dominated by guaranteed income sources or financial account wealth.

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Introduction

As defined contribution (DC) plans become more prevalent in the U.S. retirement system, income from financial accounts will increasingly be relied upon as an important resource for retirement funding. And yet, at least today, most research has documented little evidence of widespread drawdown from financial assets.[1] Instead, retirement wealth appears to be constant or rising throughout retirement, particularly among married households. Indeed, there is evidence that many retirees continue to save into retirement. Among the reasons offered for such precautionary saving in retirement are extended longevity, unexpected health care costs, low asset returns, and bequest motives.

In this paper, we describe the nature of financial account withdrawals as observed in a survey of affluent retiree households. Retirement income decision-making is typically conducted at the household level and includes all resources available to the household. Using a proprietary survey of retired households, we study financial account withdrawal behavior in the context of other income sources. We impose a minimum financial asset threshold of $100,000 among our survey sample, in order for the households to have a meaningful amount in financial accounts to draw from in retirement.[2] This results in a group with higher income and wealth characteristics, requiring caution when projecting results to the broader retiree population.

We specifically aim to answer the following questions:

- What is the withdrawal rate from financial accounts? Does the rate vary by the type of financial account?
- What is the effect of tax policy, specifically RMD rules, on tax-deferred retirement accounts?
- How are withdrawals taken from financial accounts? Are they systematic, ad hoc, or in some other form?
- On what expenses are financial account withdrawals spent? Does the pattern of spending vary on whether wealth holdings are dominated by guaranteed income sources or financial assets?

In an earlier paper, we segmented households based on total nonhousing wealth and then further classified them into two general groups.[3] The Traditional Retirement group is made up of households whose wealth holdings consist largely of guaranteed income sources like Social Security and pension income. The second group, which we call the New Retirement group, has predominant wealth holdings from financial accounts, including tax-deferred retirement accounts, a variety of taxable investment and insurance accounts, as well as bank checking and savings, money market, and similar accounts.

1 See, for example: Poterba, Venti, and Wise, 2011; Love, Palumbo, and Smith, 2008; Hurd and Rohwedder, 2015.

2 Additional survey sample criteria include: the householder is between the ages of 60 and 79 and at least one person in the household is retired. The survey was administered in March and April 2012. The final sample consists of 2,658 households.

3 There is a third group, the Specialty Retirement group, which makes up 5% of the households. Their wealth is predominantly in either real estate or business income. Because of their small size, we do not focus on them much in this paper, other than being included in calculations involving all groups.

Components of retirement income

Retiree household income can come from guaranteed income sources like Social Security and pensions, wages, a mix of other income sources, as well as from financial account withdrawals. Withdrawals from financial accounts contributed, on average, about one-quarter of a retiree household's annual income (Figure 1).[4] As DC plans continue to expand as a source of retirement income, financial account withdrawals are expected to play a larger role in the future.

In our entire respondent population, the median total household income was about $69,500. The two groups of retirees, Traditional and New Retirement, showed very similar median incomes. However, the role of financial account withdrawals varied between the two groups. These withdrawals composed, on average, 39% of retirement income for the New Retirement group, more than two times the level for the Traditional Retirement group.

Financial accounts: Ownership versus withdrawals

We focus on ten types of financial accounts in this study: individual retirement accounts (IRAs), employer-sponsored DC accounts, annuities with a balance, cash-value life insurance, mutual fund accounts, brokerage accounts, money market accounts, certificates of deposit (CDs), and bank savings and checking accounts.[5] Median household wealth in all financial accounts is $419,000. For purposes of this study, we are interested in understanding the ownership of the different accounts and from which accounts assets are being withdrawn.

On average, the total number of accounts held by retiree households is seven; the corresponding number of financial account types held is four. So for example, a household could have a combination of two IRAs, two money market accounts, two CDs, and one brokerage account.

Figure 1. Household-level components of income

Mean proportion of total income from source

Mean proportion of total income from source	Total	Traditional retirement	New retirement
Guaranteed income	53%	69%	39%
Wages	11	8	13
Other income*	10	7	9
Withdrawals from financial acconts	26	17	39
Median income	**$69,469**	**$68,202**	**$68,876**

* Other income may include business or real estate income, inheritance, trust income, financial support from family and friends, and others.

Source: Vanguard, 2015.

4 Similar to the other financial account information, we measure withdrawals taken in 2011, the latest "full year" before the time the survey was taken. So the withdrawal data in this study represents a one-year snapshot of household financial account withdrawal behavior.

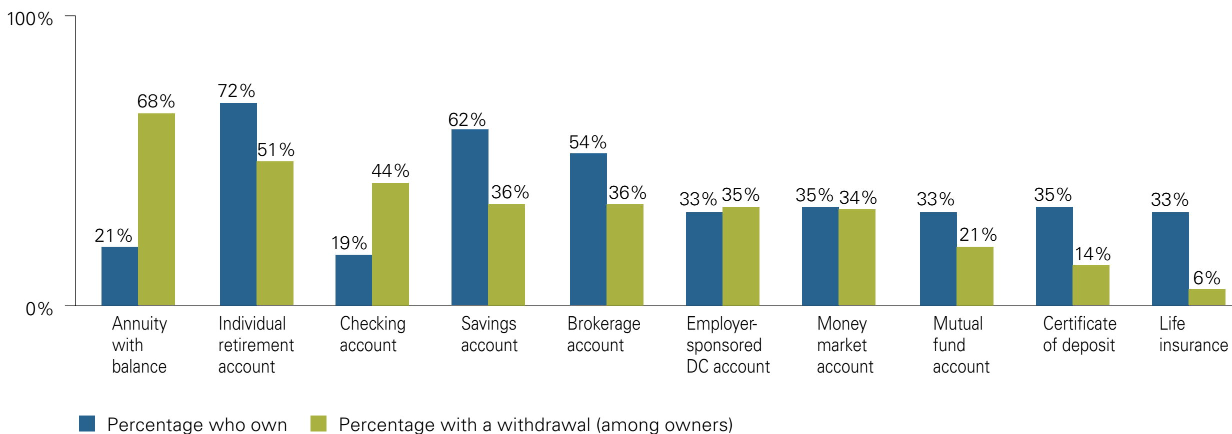
5 Annuities with a balance include accounts like cash-balance accounts and variable annuities. For money market accounts and bank savings and checking accounts, our focus is on nontransactional accounts, meaning those not used directly for paying routine expenses.

IRAs, savings accounts, and brokerage accounts have the highest account ownership rates, with each category being held by more than half of wealthier retiree households (Figure 2). On the other hand, a minority of households hold checking accounts and annuities with a balance.

In terms of withdrawals, annuities with a balance have the highest withdrawal incidence. So while only 21% of households own annuities with a balance, about two-thirds of these owners made a withdrawal from these accounts. This may be because these accounts are sold as income-producing vehicles for retirees. IRAs also have a high incidence of withdrawals, but this is primarily due to the RMD rules requiring withdrawals for retirees who reached age 70½. (This topic is further discussed later.) For most other types of accounts, less than one-half of owners took withdrawals.

Certain types of financial accounts seem to be tapped less often for withdrawals. These include mutual funds, CDs, and life insurance. About one-third of households own these types of accounts. But among those owners, one-fifth or less took actual withdrawals. This behavior was brought to light during qualitative research interviews, where retirees indicated that there were certain accounts which they identified as being “off limits” and reserved for the future. There may be some type of mental accounting at work, where retirees tend to associate certain types of accounts or a certain account within a particular category as reserved for future use.

Figure 2. Incidence of withdrawals from financial accounts



Source: Vanguard, 2016.

Withdrawal and spending rates

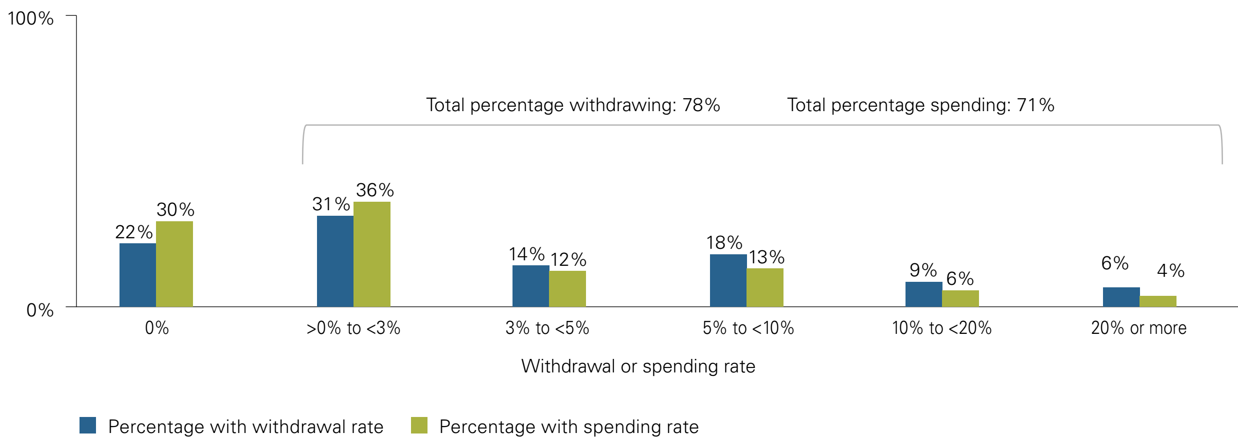
A common way to measure the sustainability of income from financial accounts is to calculate a withdrawal rate—the amount of income as a proportion of the total balance in all financial accounts over a given period, such as a year. For example, if a retiree withdraws $4,000 from a financial account portfolio worth $100,000 in a year, their withdrawal rate is 4%. A leading topic of discussion in the retirement services industry is identifying an optimal drawdown rate from accounts to ensure that assets will last throughout a retiree's life.[6]

In our survey, however, we were able to take this analysis a step further, by tracing each withdrawal from a financial account and determining whether it was actually spent or saved in another account. In our prior paper, we found that in the aggregate, 31% of financial account withdrawals are actually saved and reinvested in another financial account.[7] To net-out these savings effects, we also calculate a spending rate from financial accounts—the amount of income withdrawn and spent on consumption, again calculated as a percentage of the total financial account wealth. For example, if a retiree withdraws $4,000 from a financial account portfolio worth $100,000, spends $3,000 and reinvests the $1,000 elsewhere, their withdrawal rate is 4% but their spending rate is 3%. We believe that spending rates, not withdrawal rates, are the more relevant statistic when considering the depletion of account wealth over time.[8]

In our sample, about three-quarters of our wealthier retiree households made a withdrawal from their financial accounts, yet only 7 in 10 households used withdrawals for spending (**Figure 3**). And we observe great heterogeneity in spending rates. A full 66% of households had spending rates of less than 3% (including not spending at all), while 23% of households were spending 5% or more. This means that close to one-quarter of households are at risk of rapidly depleting their financial assets if the observed one-year spending rate is sustained. Withdrawal rates show similar heterogeneity.[9]

Figure 3. Distribution of household withdrawal and spending rates

Among account owners



Source: Vanguard, 2016.

6 The "4% rule" is what has stuck as a basic rule of thumb—retirees could withdraw 4% of their initial retirement account balance, with periodic adjustments of the dollar amount for actual inflation, to ensure a low probability of outliving their assets (Bengen, 1994). This rule has been subject to criticisms and modifications and other dynamic drawdown strategies have also been suggested. See Pfau, 2015, and Jaconetti et al., 2016, for examples.

7 See Madamba and Utkus, 2019.

8 Our study only observed one-year spending rates, and so only if this is observed on a repeated basis is it an indication of asset depletion.

9 See Appendix for the distribution of withdrawal and spending rates by account type.

Consistent with academic research on this topic, median withdrawal and spending rates were quite low and follow a model of growing wealth in retirement (Figure 4). Among those owning financial accounts, the median withdrawal rate was 3%, the median spending rate was 1%. Conditional on having a withdrawal, the withdrawal and spending rates are higher—respectively 4% and 2% at the median—but still remain low. Withdrawal and spending rates did not vary by type of investor group (Traditional versus New Retirement), but tended to decrease with total wealth. For example, the median withdrawal rate of those in the lowest third of nonhousing wealth was two times the rate of those at the top third of wealth (4% versus 2%).

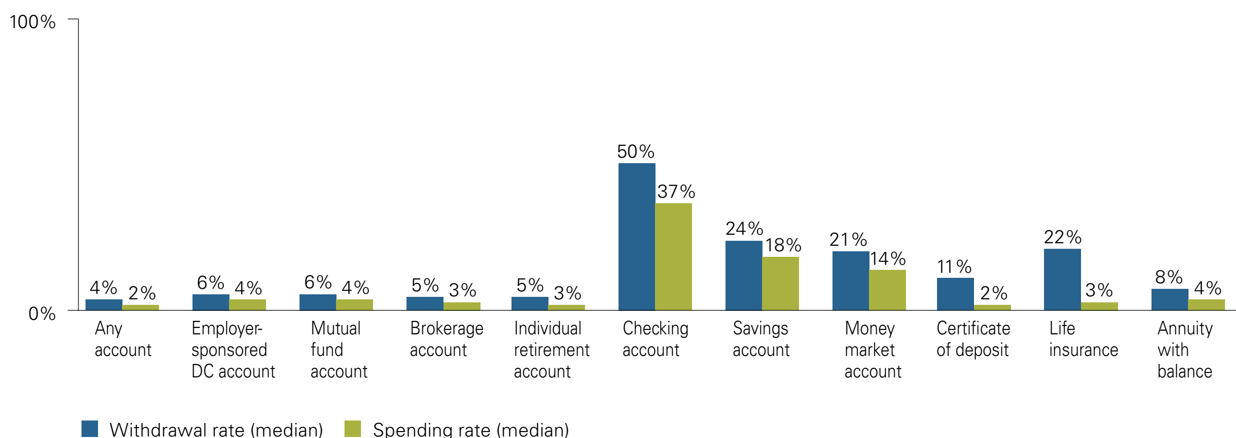
Shifting from the overall spending rates above, we look at spending by account type given that a withdrawal was made from the account(s). Most liquid accounts—bank checking and savings accounts as well as money market accounts—have higher spending rates compared with the other types of financial accounts (Figure 5). In general, this is explained by the lower balances and short-term nature of these savings or investment vehicles. Other accounts designed for income (like IRAs, employer-sponsored DC accounts, mutual funds, brokerage accounts, and annuities with a balance) and those seemingly reserved for future use (CDs and cash-value life insurance) tend to have relatively modest spending rates.

Figure 4. Median withdrawal and spending rates

	Withdrawal rates (median)	Spending rates (median)
Among account owners	3%	1%
Among account owners with withdrawals	4	2
Among account owners		
Traditional retirement investors	3%	1%
New retirement investors	3	1
Nonhousing wealth—Bottom tercile	4	2
Nonhousing wealth—Middle tercile	3	1
Nonhousing wealth—Top tercile	2	1

Source: Vanguard, 2016.

Figure 5. Withdrawal and spending rates, by account type
Among account owners with withdrawals



Source: Vanguard, 2016.

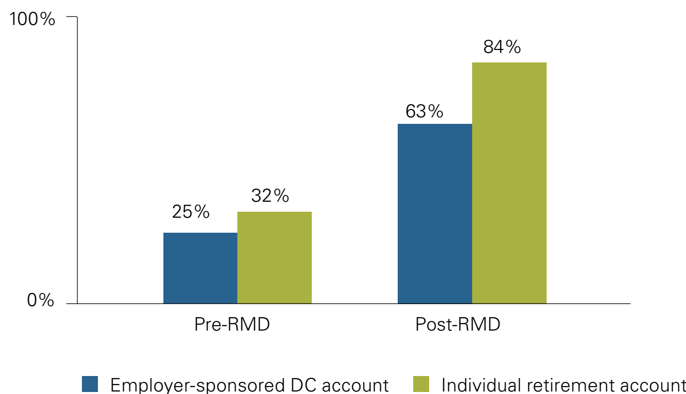
The impact of RMDs

Under RMD tax rules, investors in tax-advantaged retirement accounts must withdraw a certain portion of their retirement account balance starting in the year following the calendar year when the account owner turns age 70½. We analyzed the withdrawal and spending rates from IRAs and employer-sponsored DC accounts according to whether a household is subject to RMDs or not.

Eligibility for coverage under the RMD rules triggers a sharp (and expected) increase in the number of households making withdrawals from retirement accounts (Figure 6). The incidence of withdrawals increased more than two times once RMD rules are applied. As is common in other research on RMD behavior, however, the incidence of RMD withdrawals among older households is not 100%. One possible reason is that employer-sponsored plan owners are exempt from those RMDs while still working. Another is the prevalence of Roth IRAs, which are not subject to RMD withdrawals.

Even among households over age 70½, much of the withdrawal behavior from retirement accounts is tax-related, not driven by the need for spending. For IRAs subject to RMDs, the median withdrawal rate was 4% versus a median spending rate of 1%. For employer plans, the equivalent figures were 4% and 0%. This suggests that some households would not have made the withdrawals if they were not required, consistent with previous research on this topic. For example, when the government suspends the minimum distribution requirement—like it did in 2009 during the financial crisis—about one-third of retirees suspended their RMDs.[10]

Figure 6. Incidence of withdrawals from tax-advantaged accounts, by RMD*-status
Among account owners



	Pre-RMD		Post-RMD	
	Employer-sponsored DC account	Individual retirement account	Employer-sponsored DC account	Individual retirement account
Median withdrawal rate	0%	0%	4%	4%
Median spending rate	0%	0%	0%	1%

* RMD: required minimum distribution, a tax policy requiring a minimum level of withdrawal from tax-advantaged accounts in the calendar year following the year the account owner hits age 70 1/2. Pre-RMD households do not have any member subject to the RMD rule; post-RMD households have at least one member who is subject to the rule.

Source: Vanguard, 2016.

10 Brown, Poterba, and Richardson, 2014.

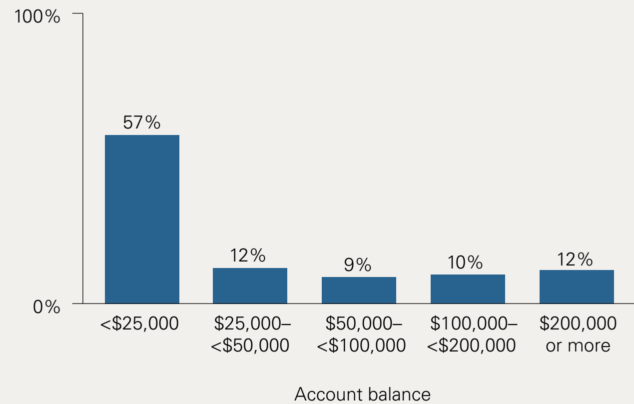
Cashing out small accounts

One characteristic of the data on withdrawals from financial accounts is that, in some instances, households may cash out a given account entirely, or withdraw a substantial proportion such as half or more. We hypothesize that households are more willing to liquidate accounts when they have smaller balances—while preserving larger accounts as a source of more regular income in retirement.

We find some limited evidence of such a liquidation-of-small-account hypothesis (**Figure 7**). Accounts with balances of less than $25,000 are almost five times more likely to have withdrawal rates of 50% or more compared with accounts with larger balances. While owners of these small accounts tend to make these lumpy withdrawals (that is, they do not set up income streams), they do not disproportionately cash out. In other words, spending and saving behavior from these small accounts are similar to financial accounts in general—roughly three-quarters is spent and one-quarter saved.

Figure 7. Cashing out small cornerstone accounts*

Accounts with a withdrawal rate of 50% or more



* Cornerstone accounts refer to any of the following accounts: individual retirement accounts, employer-sponsored retirement plans, mutual funds, and brokerage accounts.

Source: Vanguard, 2016.

Ad hoc versus systematic withdrawals

Retirees have several choices when generating income from financial accounts. They can make withdrawals as needed (ad hoc), set up a systematic or periodic withdrawal plan to provide for a regular income stream, or some mix of the two.

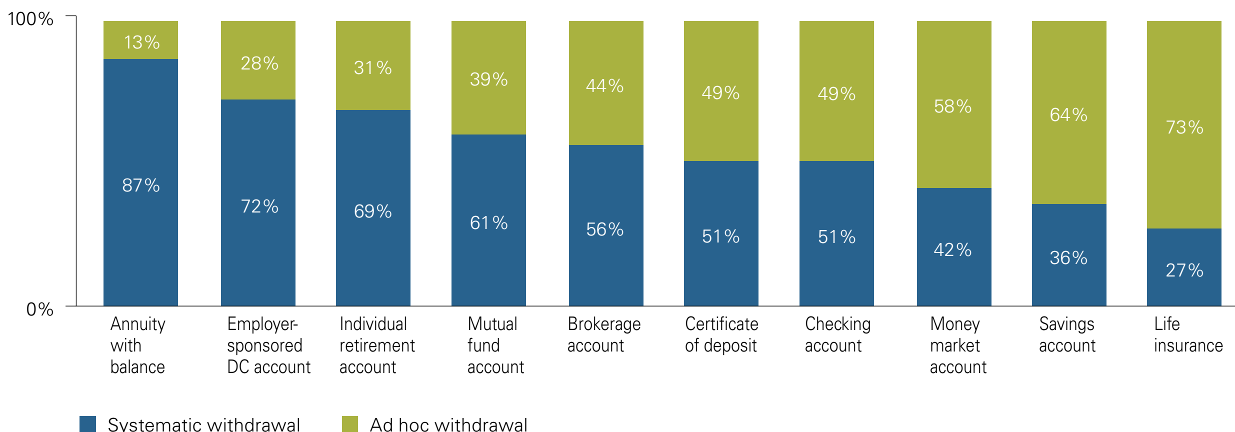
We find that the type of withdrawal varies substantially by type of account (**Figure 8**). In cornerstone accounts—brokerage and mutual fund accounts, employer-sponsored DC accounts, and IRAs—and annuities with a balance, more than 50% of withdrawals are systematic (as high as 87% for the latter). More liquid accounts like money market and savings accounts are likely to be tapped at an ad hoc or as needed basis.

Spending withdrawals and other income in retirement

The final step in retirement income planning is actual spending—how the money is actually used. We traced the allocation of income from "regular" sources (Social

Figure 8. Withdrawal type

Among account owners with withdrawals



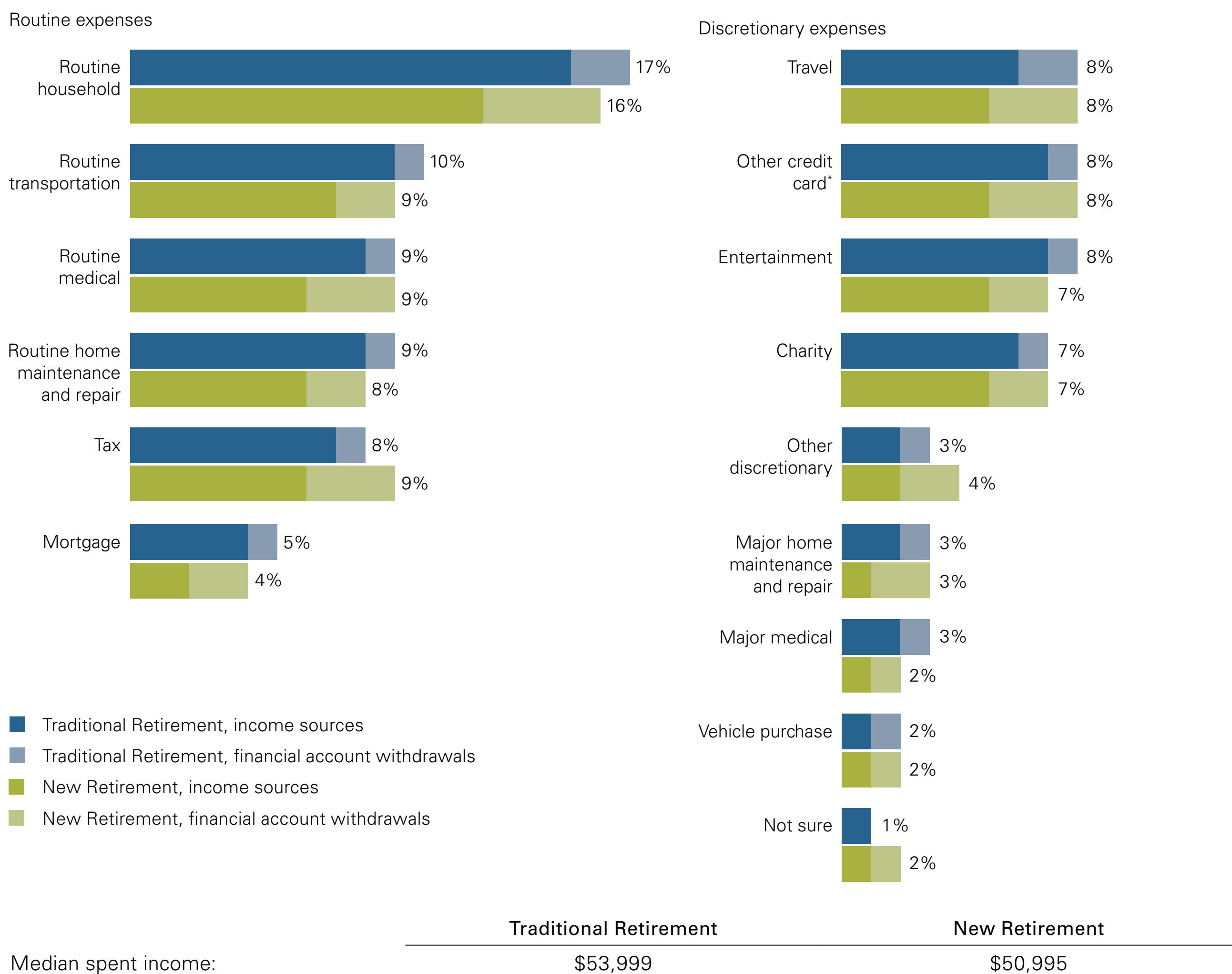
Source: Vanguard, 2016.

Security, pensions, wages) and from financial account withdrawals and linked it to specific expense categories. These categories included routine expenses like mortgages, routine household expenses, or taxes. It also included a group of discretionary expenses like major home maintenance and repair, travel, entertainment, and others. We looked at spending separately for the Traditional Retirement and New Retirement groups.

What is immediately apparent is the similarity of the two groups and their spending (**Figure 9**). Median spending was similar—$53,999 for Traditional Retirement and $50,995 for New Retirement—a difference of about 6%. Not surprisingly, financial account withdrawals played a larger role in spending among the New Retirement group. Finally, the distribution of spending within expense categories was very comparable. In other words, while the composition of income is different between the two groups, the composition of spending is very similar.

Figure 9. Allocation of spent income to expense categories

Mean percentage of income spent on expense category



* Other credit card expenses (not otherwise covered in other expense categories).

Source: Vanguard, 2016.

Summary and implications

Withdrawals from financial accounts are a growing source of income for retirees, particularly among New Retirement households where these accounts represent a major portion of retirement wealth. Withdrawal rates from financial accounts are modest.

Within both the workplace and retail retirement system, the focus of attention has been on the question of sustainable withdrawal rates from financial accounts. This assumes that financial account withdrawals are used for consumption. Our research has shown that not all withdrawals are spent, suggesting that the discussion needs to shift to spending rather than withdrawal rates from financial accounts, in order to effectively measure the sustainability of savings in retirement.

For our affluent retiree sample, current spending rates are modest and appear reasonable for the vast majority of retiree households. But in our one-year look at behavior, about one-quarter of households had spending rates of 5% or more, and may be at risk of exhausting financial assets were this withdrawal rate to continue over time. This group, as well as any retiree reliant on financial accounts for income, could benefit from advice on how to set up a sustainable stream of regular income.

Using financial accounts in retirement also seems to be characterized by certain unique behavioral characteristics. Certain types of accounts are more likely to have withdrawals. Systematic withdrawals are more common from certain accounts than others. Meanwhile, retirees seemed to treat small balance accounts differently and are more likely to make large withdrawals from those accounts. Learning more about this mental-accounting-like behavior surrounding financial accounts is an important agenda for future research.

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Appendix. Distribution of withdrawal and spending rates by account type

Percentage with withdrawal or spending rate, among account owners

	Withdrawal or spending rate					
	0%	>0% to <3%	3% to <5%	5% to <10%	10% to <20%	20%+
Individual retirement accounts						
Withdrawal rates	49%	12%	17%	13%	5%	5%
Spending rates	60%	15%	10%	9%	3%	3%
Employer-sponsored DC account						
Withdrawal rates	65%	5%	10%	8%	3%	9%
Spending rates	72%	7%	7%	6%	3%	5%
Mutual fund account						
Withdrawal rates	79%	5%	4%	4%	2%	5%
Spending rates	83%	6%	3%	4%	2%	3%
Brokerage accounts						
Withdrawal rates	64%	12%	7%	7%	4%	5%
Spending rates	69%	12%	6%	6%	4%	3%
Certificate of deposit						
Withdrawal rates	86%	4%	2%	1%	2%	5%
Spending rates	89%	4%	2%	1%	1%	3%
Savings account						
Withdrawal rates	64%	3%	2%	4%	7%	21%
Spending rates	67%	3%	2%	4%	7%	17%
Checking account						
Withdrawal rates	56%	2%	1%	0%	4%	37%
Spending rates	60%	2%	1%	1%	6%	30%
Money market account						
Withdrawal rates	66%	3%	2%	4%	6%	18%
Spending rates	70%	5%	2%	4%	5%	14%
Annuity with a balance						
Withdrawal rates	32%	10%	14%	19%	10%	15%
Spending rates	44%	16%	9%	13%	8%	9%
Life insurance						
Withdrawal rates	94%	1%	0%	1%	1%	3%
Spending rates	96%	1%	1%	1%	0%	1%

Source: Vanguard, 2016.

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