

# **Four Percent for Withdrawals? So What's the Rule for Savings?**

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## **Abstract**

The four percent rule is a rule of thumb used by retirees to determine the amount of funds to withdraw from a retirement account each year to provide a stream of funds to the retiree while keeping an account balance that allows fund withdrawals throughout retirement. The four percent rate is considered safe since withdrawals would consist primarily of interest and dividends. The withdraw rate is kept constant, though it can be increased to keep pace with inflation. Life expectancy plays an important role in determining if this rate is going to be sustainable, as retirees who live longer will need their portfolios to last a longer period of time and medical costs and other expenses can increase as the retiree ages. While this rule has been questioned recently due to lower returns on equities and bonds, it is still used, although the recommended percentage is sometimes lower than four percent.

Although the four percent rule is widely known and applied for retirement distributions, no such rule exists for contributions. A percentage rule is needed because current methods typically suggest investing a level annuity amount over a working lifetime to accumulate retirement assets, and the amount is often large relative to beginning salaries. The large amount discourages starting contributions early. A more encouraging approach to accumulating retirement assets might be similar to the four percent rule, but applied to contributions. For example, if the four percent rule were used to make contributions, it might be a percentage of salary that should be contributed over some period, say 30 or 40 years. Someone with an entry-level salary might be more inclined to start making contributions using a percentage of salary rule rather than a fixed annuity amount, because the percentage would require smaller contributions during the early part of the accumulation phase when salaries are lower. In the later part of the accumulation phase, the percentage would require larger contributions, when salaries are higher.

This study explores the concept of a percentage rule for the accumulation phase of retirement assets. Median salary at entry-level, mid-career, and end-of-career data will be used as sources of retirement contributions. Current rates of return will be used to estimate accumulations that will be able to replace 80 percent of median salary in retirement, assuming the only other source of retirement income is Social Security. A sensitivity analysis will be performed on the accumulation percentage using different rates of return to arrive at the best possible estimate for a percentage of salary to invest during the accumulation phase of retirement assets. The potential benefit of the results of this study could motivate more people to start investing earlier and have more funds available in retirement.