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Chess and retirement decumulation

The end game requires a dynamic strategy

Did you catch *The Queen's Gambit* on Netflix recently? It's a fictional account of a 1960s prodigy who disrupts the world of chess. Apart from drawing millions of viewers, it's led to a bonanza in chessboard sales.

There are some interesting parallels between chess and our income choices in retirement. As in chess, a lot of moving parts affect retirement, some we can control and some we must contend with. Both domains require strategy, forethought and flexibility.

Decumulation with tax in mind

Some retirement decisions are one-time, like starting Old Age Security and Canada Pension Plan. Others may be infrequent, like winding-up a business, downsizing a home, whether to engage assisted living support or when to consider a move into long-term care.

In terms of private savings, a critical juncture is when to switch modes from building retirement savings to drawing from them. This is the move from accumulation to decumulation, with three common savings sources to draw from: an RRSP/RRIF (including locked-in versions), a TFSA and non-registered investments. Respectively, the draw from each of these sources is taxable, non-taxable and partially taxable.

Usually, the desire is to maintain a certain lifestyle while minimizing income tax. That's not as simple a task as it may seem, given our progressive income tax system that charges higher tax rates on higher income levels. Paying tax may not be pleasant, but too much focus on reducing a current year's tax bill could lead to a disproporationately heftier tax bill in future years, especially if brought into income at death. It depends on personal values how much of tax planning is about the here, the here together (as a couple), and the hereafter.

The key is to determine how best to draw on these savings sources to achieve the desired result.

Planning through the permutations

Effective decumulation is often framed as a search for the optimal order for depleting each savings source before moving on to the next. That's the way financial planning software algorithms may solve for targets such as maximizing net wealth at life expectancy. In this case, the software might provide a rank order of the six possible permutations among the three savings sources.

But we shouldn't expect the output to be a set-it-and-forget-it prescription. That would require knowing not only our present circumstances and intentions, but also all future developments.

Consider again the game of chess. The board is an 8 by 8 grid, with each of the two players having 16 playing pieces. So, before the game starts, half of the 64 squares are occupied. White chooses among 20 opening moves, as does Black to follow, leading to 400 possible board layouts when White considers move number two. By round three, there are 197,281 layout possibilities, and over 119 million two moves later.

Amazing as that is as an example of exponential expansion, it pales in comparison to our years in retirement. Life has far more variables, and more actions that may be taken with each. These include the option to draw from multiple sources from time to time to tactically exploit tax opportunities, rather than fully liquidating each source in succession.

Vision, revision and annual reviews

Chess and financial planning share the need to anticipate, act, observe and adapt. That's what chess masters do, always looking a few moves ahead and then continually adapting as each turn comes around.

Similarly, as life unfolds in retirement, we are not necessarily bound to continue on a path that was suitable when set some years ago, but that may no longer fit current needs. Changes happen to us, and to the world around us:

- Personal circumstances
- Available wealth, in each savings source and as a whole
- The world we live in, with particular attention on any new or modified tax rules

Often, things are fairly fixed over the short term, but become more flexible looking further out in time. With some foresight and forethought, adjustments can be made according to changing conditions – both as required and as desired – in the way we spend our time and how we spend our money.

The important point to emphasize here is that the process is dynamic, ideally anchored by annual reviews with a capable financial advisor. At each turn, advisor and client can plot the best course using the information presently at hand, with full understanding and intention that the plan will revisited as each year unfolds, and revised as necessary according to developments.

For more information, please consult your financial advisor and tax professional.