EXPERT SERIES: LONGEVITY

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ARE YOU AT RISK OF OUTLIVING YOUR MONEY?

Nearly 10,000 Americans turn 65 each day, eligible to retire and start what should be a new, exciting phase in life. Yet their retirement may be more precarious than ever.

A recent survey by the Alliance for Lifetime Income found that 80% of Americans say they fear running out of money in retirement.

Some of that anxiety is triggered by not knowing how much money you'll actually need in retirement. This is based on uncertainty about living expenses such as rising health care costs and inflation. But it's related to how much longer we are living: Live long enough, and you risk outliving your savings. It's what economists term longevity risk.

There's good reason for this anxiety. A 2019 World Economic Forum report indicates a high likelihood that 65-year-old Americans today could outlive their retirement savings within a mere nine years.

Colin Devine, principal at C. Devine & Associates and an Education Fellow with the Alliance for Lifetime Income, agrees. "Based on the retirement savings numbers we're seeing today, it's almost a near certainty that people are going to run out of money in retirement," Devine says.

"While it's wonderful to live longer than the average lifespan, it's also financially demanding," adds Ken Mungan, chairman at Milliman, a global consulting firm and leader in actuarial products and services.

"The challenge that people have is they don't know how long that period of time is going to be," Mungan says. "If it's significantly longer than average, that's wonderful, but it also presents a scenario where at best you're unable to live the life you want in retirement, and worst you run out of money."

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With research showing that only a quarter of baby boomers have saved $200,000 or more for retirement, there's a high likelihood that they will have to significantly reduce their lifestyle expectations to fit a reduced budget, or risk running out of money.

Most Americans will still receive monthly Social Security payments in retirement, but those typically only cover 40% of your pre-retirement income.

A GENERATION WITHOUT PENSION INCOME

Previous generations of retirees generally had guaranteed retiremetn income from Social Security and a company pension, plus personal savings – the "three-legged stool" – to support them when they stopped working. But pensions have largely disappeared – only 17% of today's workers have access to one – replaced by 401(k)s and other defined contribution plans.

At the same time, the average life expectancy in the United States has significantly increased. For example, a typical retiree in 1980 could expect to live to age 71. Today, the average life span is close to 85 years, and a 65-year-old woman has a 31% chance of living to age 90.

When you consider that the typical retiree spends $46,000 per year, those additional years can be a substantial burden.

Add to that the aging of baby boomers– the largest demographic group to ever reach retirement – and you can see why some predict a looming retirement income crisis.

CREATING A FINANCIAL PLAN THAT ADDRESSES LONGEVITY

The solution, of course, is to create a retirement financial plan that helps address this issue. "And that means one that finds a way to reduce longevity risk," says Devine.

Along with whatever retirement investments they've accumulated, people also need to include a source of income that's protected and guaranteed for as long as they live.

"If consumers and financial professionals don't find some way to address longevity risk in their retirement plan, it's not a truly comprehensive plan," Devine says.

One way of addressing the risk is by adding an annuity to your retirement plan. At its most basic, an annuity is a contract with an insurance company where you invest money upfront and then receive guaranteed monthly income payments over a period of time.

"Certainly annuities specifically address longevity risk because they provide an income benefit until death, or, in some cases they are passed along to a family member. Annuities are extremely versatile and customizable investments and come in many different shapes, sizes and flavors, depending on what is suitable for a particular person," Devine says.

FROM SAVING TO SPENDING – A NEW CHALLENGE IN RETIREMENT

The other challenge facing retirees is switching their thinking from accumulating assets – saving the money they'll need – to using those assets to generate the income they'll need to live the rest of their lives.

"When you're in your 30s and 40s, you need the advice and services of financial professionals to establish savings and investment behavior," Mungan adds. "Once you get within range of retirement, it becomes a risk management problem. And it's not like the problem changes incrementally; it changes completely from one problem to a different problem."

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For that reason, it requires more of a change in mindset and specialized approach geared to your retirement goals and needs, Devine says. "I'm not going to say saving for retirement is easy, but to some extent, there are fairly tried-and-true ways to do it. But planning for income is more of a customized person-by-person assessment. It's dynamic. You can't just set this and forget it."

And while it might seem you can wait to see how much you'll need or use in retirement, Mungan points out that the longer you wait to make decisions, the fewer options you have. For example, if you're worried about running out of money at age 65, you can continue to work; at age 85, that's likely not an option.

Thankfully, there are financial "building blocks" you can use to successfully shift your portfolio from accumulating savings to also focusing on generating income.

Annuities are certainly a key part since they generate protected lifetime income that can help reduce or eliminate longevity risk.

"If you have an annuity, the insurance company has addressed the longevity risk for you and now you can live confidently," Mungan says. "You can live life to the fullest and have confidence addressing the various possibilities that present themselves month after month. Do you want to help your grandchildren with their college education? Do you want to fund a trip to bring your family closer together? You can do those things with confidence because you have the annuity. You're not going to outlive your money."