The Longevity Opportunity

By Editor Test *Mon, Jun 15, 2009*

Is calling longevity a "risk" the best way to connect with our clients and prospects on this critical and often sensitive issue?, asks the chief operating officer of the Retirement Income Industry Association.

How long do you expect to live? More importantly, how long would you *like* to live?

As the baby boomers (now as old as age 63 or as young as 44) approach retirement, we hear more and more about unprecedented gains in longevity. IRS tables[1] show that a 65 year old today can expect, on average, to live to age 86. Many will live much longer than that, as Thomas Perls, MD, MPH, and Margery Hutter Silver, EdD, so deftly illustrate in *Living to 100: Lessons in Living to Your Maximum Potential at Any Age.*

Perls and Silver also underscore the idea that there are steps we all can take to increase our odds of having a long, healthy life: Not smoking, exercising regularly, even simple steps like flossing your teeth, can add years to your life. Of course there are also factors that we can’t control. Women tend to live longer than men. And having good genes helps. People who have a history of longevity in their families tend to live longer than those who don’t.[2]

And what about the possibility of medical breakthroughs that could help us live healthier, more productive senior years by finding cures for diseases such as cancer, diabetes, heart disease, or Alzheimer’s? In their new book, *Fantastic Voyage: Live Long Enough to Live Forever*, Ray Kurzweil and Terry Grossman, M.D., suggest that, as more radical life-extending and life-enhancing technologies become available over the next two decades, “Immortality is within our grasp.”

An opportunity to connect

Clearly, a longer lifespan is considered a good thing, something we can all aspire to – as long as we remain active, healthy, and solvent. At the same time, no one wants to outlive their health or their money. This latter concern is something that we in the financial services industry are accustomed to calling “longevity risk.”

Indeed, longevity risk-the risk of outliving one’s money-has become a catch-all for a number of related, but separate, risks which can include: loss of principal, inadequate returns, inflation risk, and the risk of unexpected expenses for health problems or long-term care. Separately, any one of these can result in too quickly consuming one’s assets. In combination, these risks can be devastating.

But is calling longevity a “risk” the best way to connect with our clients and prospects on this critical and often sensitive issue? The *American Heritage Dictionary* defines risk as “The possibility of suffering harm or loss, danger.” Becoming physically or mentally disabled is a risk. Needing long-term care is a risk. Certainly, running out of money or not being able to maintain your desired lifestyle are risks. But, would we connect better with our clients on an emotional level if we instead found a way to embrace the longevity "opportunity" and to tailor our dialogue and solutions accordingly?

Address the individual, not the average

Of course life expectancy tables are based on averages, and there are many people who live much longer than the average. Conversely, this also means that some other people will have significantly *shorter* life spans. Many of our clients may have family histories, current health problems, or detrimental behaviors that suggest that they will not have to worry about longevity risk.

While these individuals may still be faced with many of the same risks as those who can reasonably expect to live longer than average, some of the solutions for them may be less appropriate than those for the longer lived. Certainly, a conversation focused on longevity risk for those who are more worried about immediate health issues and dying prematurely is not the best way to connect. Some basic discovery of each individual's situation and attitudes is clearly essential in determining the best approach.

Legacy objectives also play an important role in determining the potential solutions that best fit each client. Does he or she want to have a more conservative lifestyle in retirement to provide more to beneficiaries or is the objective to spend their last dollar on the day they die?

Returns *do* matter

And let's not lose focus on returns: Over long periods of time, they *do* matter a great deal. If the key challenge is how to help people with twenty or twenty-five year life expectancies ensure that their money lasts, returns are absolutely critical. According to Gerry Murtagh, manager of Ernst & Young's Insurance and Actuarial Services' *Retirement Income Knowledge Bank (RIKB)*, "A 1.25% greater compound annual return (whether through better investment management or lower expenses) could potentially extend a 20-year payout by 4 years or a 25-year payout by 7 years.[3] A 1.9% greater return could add 6 ¾ years or 14 years respectively."[4]

Murtaugh's figures are based on the 251 variable annuities they track (all VA's in the RIKB offer some type of living benefit), where the average mortality and expense (M&E) charge is 1.25%. This M&E charge varies from 0% (on a product that has a $20 monthly fee) to 1.90%. Of course this charge is for the guarantees provided and is in addition to the investment management fees for the underlying investments.

While these examples offer a simple illustration of the importance of average returns, we also know that the *sequence* of returns has a profound impact on asset longevity. That's why variable annuities that offer guaranteed minimum withdrawal, income and/or annuity value benefits (living benefits), in addition to longevity protection, have such great appeal. For many clients, the living benefits that protect against *market* risk are even more valuable than the pure protection from longevity risk. At the same time, how do we evaluate the combination of benefits provided by a variable annuity for a client with shorter than average life expectancy? Should the industry provide rated premiums for annuities the way it does for life insurance?

In their book, *Lifetime Financial Advice: Human Capital, Asset Allocation, and Insurance*, Roger G. Ibbotson, Moshe A. Milevsky, Peng Chen, and Kevin X. Zhu provide a useful model for determining the point where it makes economic sense to purchase an income annuity designed to protect against longevity risk. For them, it's the point at which the benefit of the transfer of mortality risk exceeds the increase in fees, all other things being equal. Examples they include show that, at younger ages, what you give up in return may not be offset by the benefits of this risk pooling. At older ages, with shorter average life expectancies, the risk pooling may be much more advantageous.[5]

Clearly these are complex trade offs. And they underscore the need for a comprehensive and personalized solutions for each client rather that a one-size-fits-all approach. Clients need sound advice from a knowledgeable advisor who can match appropriate solutions to a client's needs.

So, how do we explain and simplify these complex solutions and trade offs for our clients?

No longer a predictable path

First and foremost, let's change the way we begin the discussion with our clients and eliminate the awkward industry label of "longevity risk". Instead let's talk about longevity as an *opportunity*. While there may be many challenges in creating a retirement income stream, longevity presents a great opportunity for future generations of retirees to redefine retirement for the better.

In reviewing the results of *The Merrill Lynch New Retirement Survey: A Perspective From The Baby Boomer Generation*, Ken Dychtwald, Ph.D., President and CEO of Age Wave, found what he called "a birth of a whole different vision" of retirement. "It's all very exciting," he observes, "but when society no longer lays out a predictable path for retirement, individuals will have to be creative in planning what retirement means to them and deciding how to get there." The Merrill Lynch study also suggests that a significant number of baby boomers will make their money last in retirement by continuing to work, either part time or by cycling in and out of the work force: 78% of the baby boomers surveyed envisioned an "ideal plan" for retirement as including work in some capacity.[6]

Other studies confirm this trend. In *Rethinking Retirement*, a 2008 study from Age Wave (sponsored by Charles Schwab), survey respondents were almost twice as likely to say that retirement is a time for a new, exciting chapter in life as they were to say it is a time for rest and relaxation. And 60% said they would like to get involved in a new line of work.[7]

Working in some capacity in retirement will undoubtedly be one of the key ways future generations will turn the so-called longevity *risk* into the longevity *opportunity*. If Stump, the 10-year-old Sussex spaniel (that's 70 in dog years) can come out of retirement without any training to take the best of show in the Westminster Kennel Club's 2009 competition, we baby boomers can be productive a bit longer too!

Let's turn our focus to first helping our clients find ways to maximize their longevity opportunity and then to providing solutions to the many *real* risks that can "cause harm or loss." Lifetime income annuities, variable annuities with living benefits, and structured products, as well as new products in development or those not even conceived as yet, may all be part of the solution.

I believe the key is to package these solutions with the positive message that longevity is potentially a great bonus, not a risk!

[1] IRS Publication 590, *Individual Retirement Arrangements*
[2] www.livingto100.com
[3] Based on a 4.25% vs. a 3% real annual effective return and payments at the beginning of each month
[4] Based on a 4.9% vs. a 3% real annual effective return and payments at the beginning of each month
[5] *Lifetime Financial Advice: Human Capital, Asset Allocation and Insurance*, © 2007, The Research Foundation of the CFA Institute
[6] Merrill Lynch *Advisor™*, 2005
[7] http://agewave.com/research/landmark_rethinkingRetirement.php

A recognized expert in retirement income planning, Stephen Mitchell has spent more than 30 years in the retirement and financial services industry as a marketing executive at Fidelity Investments and at Merrill Lynch, where he lead the development of *The Merrill Lynch New Retirement Studies – A Perspective From The Baby Boomer Generation* (in 2005) and *A Perspective from Individuals and Employers* (in 2006). Today, Mitchell is chief operating officer for the Retirement Income Industry Association and a consultant to the retirement industry. Additional resources: www.riia-usa.com; www.stephenwmitchell.com. He can be reached at steve@stephenwmitchell.com.

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