Uncertainty at Both Ends of Retirement

By Kerry Pechter *Fri, Oct 18, 2019*

'Ignoring retirement age uncertainty can potentially have a significant (negative) impact on potential retirement outcomes,' writes David Blanchett of Morningstar in an award-winning research paper.

Uncertain lifespans are a well-known confounder of the best-laid personal retirement plans, for advisers and clients. Uncertainty about the retirement start date makes the planning process doubly hard.

Welcome to a newly identified of longevity risk: the front-loaded kind. The problem might seem too obvious to attract academic attention, but David Blanchett of Morningstar just won the Montgomery-Warshauer Award from the Financial Planning Association for his paper on it.

Blanchett, the head of retirement research at Morningstar, presented the 2018 paper to several hundred financial planners at the 2019 FPA annual conference in Minneapolis yesterday. The gist of his paper is a heuristic that he chooses to call “the Rule of 61.”

David Blanchett

“Individuals targeting a retirement before age 61 tend to retire *later* than expected,” Blanchett writes in the paper. “Individuals targeting a retirement age of 61 retire *when* expected; and those targeting a retirement age after 61 generally retire approximately a half-year *early* for each additional year of work planned past age 61.”

Along with all the other retirement risks that advisers need to anticipate for clients as they approach—sequence risk, market risk, inflation risk, health risk, and longevity risk, to name only a few—advisers should also factor in the likelihood that a client might retire two years earlier or later than they told you they would.

For a client who retires a few years earlier that expected—and who stops working earlier—the implications on his or her retirement savings target can be significant. Once you factor in a shorter saving period, a longer retirement, and a smaller Social Security benefit, an early retiree might need to save 25% more than expected to enjoy the same level of retirement security.

"If the "average investor" is assumed to be seeking a 4% initial withdrawal rate (i.e., a moderate success target) and wants to retire at age 65," Blanchett wrote, "the impact of retirement age uncertainty would require approximately 25% more savings than suggested by traditional models (28.29% to be exact)."

Blanchett based his findings largely on the Health and Retirement Study, a long-term population study by the Rand Corporation, the Social Security Administration, and the Centers for Retirement Research. Participants in the study have been interviewed every two years since 1992.

His projections varied from person to person, he found, depending on several variables, including, health, gender, education, marital status, housing wealth, savings, occupation, income, and remaining years to retirement.

"Half of your clients will retire earlier than expected," Blanchett told the planners. About 24% of those who retire early do so because they can afford to. About 10% retire to pursue other activities. The remaining 66% retire because of ill health, layoffs or the need to care for an ailing spouse, he said.

Ironically, those who can afford to retire early, such as highly educated professionals, tend to work longer and retire later, Blanchett pointed out. Those who need to work longer, who have earned and saved less prior to retirement, are often the ones who are forced to retire early because of poor health or job loss.

Advisers need to recognize that their clients don't necessarily have control over their retirement date, and to plan accordingly. "Ignoring retirement age uncertainty can potentially have a significant (negative) impact on potential retirement outcomes," Blanchett wrote. "Therefore, financial planners should consider showing clients the implications of an early retirement to potentially get them to save more than they would using a more traditional approach where retirement age is treated as certain."