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summaries

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Longevity Risk: Reshaping Perspectives

We are still in the early stages of the retirement of the Post-World War II baby boom population. Those between the ages of 50 and 68 are considered to be a part of this cohort. Obviously, baby boomers have played a major role in our history and will continue to shape our future. The opportunities and challenges they will present for all generations, producers, consumers, and policymakers will be unlike any other we have faced for some time. As the projected life expectancy has continued to rise, the importance in understanding and planning for the continuous formation of a new longevity economy over the next twenty to thirty years becomes even greater. Longevity creates significant financial risks which will impact us in some way. It is important to have the appropriate long-term perspective while planning for our particular future.

Longevity is having a long existence. The goal of most businesses and individuals is to live a long, healthy, and meaningful life. At the biological roots, survival and longevity is evident by those able to adapt and evolve. John Davis, co-author of Generation to Generation: Life Cycles of the Family Business, said three factors lie behind longevity: "By the end of every generation, family firms need to have built a reservoir of trust, pride, and money so that the next generation has enough of them to maintain the momentum of the business and the spirit of the family."

Today, more people are surviving to older ages than ever before. In 1940, prior to the baby boom, a much smaller percentage of the population survived from age 21 to age 65. For those that did, the remaining period life expectancy was 12.7 for males and 14.7 for females bringing their ages to 77.7 and 79.7 respectively. Recently, the Society of Actuaries updated the average period life expectancy for those attaining age 65 to 21.6 for males and 23.8 for females bringing their ages to 86.6 and 88.8 years respectively. According to the U.S. Census Bureau, by 2030 more than 20% of U.S. residents are projected to be aged 65 and over compared with 14% today. This is a major shift in our demography and these statistics are further guidance into the aging world in which we live.

The aging population appears evident. Various behavioral and medical advancements have contributed to this progression. Developed countries face a period in their economic life cycle in which the financial resources needed to care for an aging population becomes capital intensive as the ratio of young, productive citizens to the older, less productive citizens decreases. In turn, we continue seeing less and less large private pension funds and more proposals for public pension reform in an effort to increase funding for the long-term sustainability of these funds. For individuals, Social Security continues to be a popular topic of discussion as many retirees depend on their benefit to live. The financial implications of longevity risk will continue to create debate, gridlock and unrest across the globe.

Social Security was established in 1935. Following the Great Depression, Franklin D. Roosevelt established the Social Security program to provide retirement benefits as well as aid to the impoverished at a time when the poverty rates among senior citizens exceeded 50%. Today, the Social Security Administration's Program Operating Manual System has more than 2,700 rules. It has adapted as adjustments have been made for benefits, funding, and more.

These changes are not without extensive political debate and a very long timetable before any implementation takes hold. One of the greatest misperceptions is that Social Security will not be around in the future. From an individual financial planning perspective it is always a great strategy to be conservative in your income estimates. However, it is more likely that the retirement age will increase or strategies to collect more tax revenue will be implemented in order to maintain solvency. Either way, benefits will not disappear. Some argue increasing the age in which one can receive benefits is an injustice to those whom need the benefits the most. From the consistent miscalculations of life expectancy over the past century to the differential mortality rate among social class, it is not believed to be such a simple fix on a large scale.

Every individual situation is different and it is very important to understand the implications some of these factors may play in one's financial life. Knowing one's family history of longevity and health as well as a realistic view on one's own lifestyle is very important when planning for longevity risk.

For eligible baby boomers, Social Security will continue to provide an income stream upon eligible benefit age. If one continues working or has the financial resources to delay benefits until age 70, to get the highest benefit, then this strategy makes the most sense when hedging against longevity risk. Typically the break-even age is roughly 82 or 83 years old. If one dies before this age, they may not have gotten as much out of the Social Security system, but they did not run out of money while living. And, if one lives beyond this age they will receive more money over their lifetime from the Social Security system with the higher benefit. This is painting one's Social Security decisions with a broad brush and we would recommend contacting a financial professional for a more detailed evaluation of your financial situation prior to any Social Security decision being made.

Pension funds will continue attempts to limit longevity risk. One major strategy in which baby boomers should be aware of is private pension buy outs. It is important to have a good understanding of the finances of the pension fund of your current or former employer to make an informed decision when an offer is presented. We recommend contacting a financial professional to evaluate the various factors involved in determining whether a pension buy out is the best option. Calculations and assumptions will provide the framework while factors such as control and investment risk tolerances will guide the decision.

Thinking about longevity provides great perspective on the evolution of life. When we are young, most fear death. As we get older, most fear outliving our resources. From the forecasts discussed in this piece to forecasts made to capital markets, mathematical models impose a structure on data. Structure is very important in one's financial well-being. We also recognize there is much more to it than just the numbers. The same way biology and demography can be a volatile elixir, investments and emotions are oftentimes similar.

At Sigma, we take great pride in our ability to understand people in the implementation of the art and the science of wealth management. Together, we work closely to build a reservoir of trust and pride for our client's and their families.

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