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Longevity Is the Biggest Threat to Successful Retirement

Wealthier people are most likely to outlive mortality averages; advisors have a special obligation to focus on longevity risk with their clients.

Mark Miller | Feb 09, 2023

If you ask clients to name the most important risk in planning for their retirement, what would they pick? Stock market risk? Inflation? The cost of health care?

The correct answer is “none of the above.” Research tells us that the biggest risk to a retirement plan is longevity: the danger of exhausting resources before the end of life. And it is the least understood by people planning for retirement. Longevity risk is rising, along with lifespans, and the income products available to hedge the risk are inadequate. Fewer retirees have the guaranteed lifetime income protection of a defined benefit pension, and mapping out safe withdrawal rates from portfolios presents thorny problems.

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Social Security provides some measure of protection, but it replaces a smaller percentage of preretirement income for wealthier households. And those replacement rates are falling under the reforms to the program legislated in 1983. Meanwhile, 1 out of 3 men and half of women who are in their mid-50s now will live to age 90 or beyond, according to the Society of Actuaries . And wealthier, better-educated people are most likely to outlive the mortality averages.

That means advisors have a special obligation to focus on longevity risk with their clients.

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The Longevity Conversation

Many advisors don't explore longevity with clients in any depth, says Surya Kolluri, head of the TIAA Institute. "Since it's a very uncomfortable topic, many just plug in an actuarial assumption without having a more nuanced conversation about probabilities — and that could be opening the door to a conversation about this, and using a better number in a plan."

New findings in the 2022 TIAA Institute-GFLEC Personal Finance Index survey show that just 37% of adults have a strong understanding of longevity, although the figure was somewhat higher among boomers (44%) and the silent generation (45%). Women also demonstrated higher rates of strong longevity literacy (43%) than did men (32%).

"Women are more likely to be making health care decisions than men are in families, and very often they are taking responsibility for caregiving for parents," says Kolluri. "So, that's a bridge to a closer connection with the topic of how long people are living." And, he thinks, this presents an opportunity for advisors to communicate more broadly with couples about longevity, especially in cases where the primary client relationship is with the male spouse. "It allows the advisor to say, "Hey, I need to speak to both spouses about this topic, to have this richer, broader conversation."

The TIAA-GFLEC study also found a strong link between overall financial literacy and retirement readiness, and a specific link with longevity literacy. Retirees with poor knowledge about life expectancy were less likely to prepare for retirement while they were still working. They were also less knowledgeable about ways to draw income from savings during retirement.

TIAA's longevity findings are in line with earlier research about perceptions of longevity. The Center for Retirement Research at Boston College published a study in 2020 that compared measurable and perceived retirement risk. The risks considered included those posed by longevity, rising health care costs, the stock market, inflation, the need to provide caregiving to a family member and changes in public policy (such as a government failure to fully fund Social Security or Medicare).

Most people believed the stock market posed the highest degree of risk, rather than longevity.

Social Security Claiming

The longevity literacy research points to an opportunity to rethink the conversation with clients about the timing of Social Security claims.

Many advisors approach this critical client conversation with a break-even analysis, calculating the point when total lifetime benefits would be equal or better by delaying a claim with the amounts generated by claiming earlier.

One problem with break-even analysis is that no one knows for certain how long they will live. And break-even analysis is a return-oriented analysis of Social Security that obscures its value as longevity insurance. Even relatively affluent retirees can exhaust their savings when they live to advanced ages—especially women, who tend to outlive men. For a widow in her 90s who has exhausted her savings, a maximized Social Security benefit with inflation protection is highly valuable.

Delayed claiming is the right move for most households, and the trends have been moving in the right direction over the past decade but only modestly. Fewer retirees claim at the earliest age (62), but most have filed by their full retirement age (FRA), typically 66 and a few months. That strikes me as retirement planning malpractice: Claiming at FRA is worth 33% more in monthly income than a claim at 62, and a claim at age 70 is worth 76% more.

Delayed claiming will become even more important in the years ahead, because Social Security is on track to replace less preretirement income for today's younger workers than it will for boomers and Gen-Xers. That is due, mainly, to the Social Security reforms enacted in 1983, which gradually increased the FRA from 65 to 67. For everyone born in 1960 and later, the FRA is 67. And every year increase in the FRA equates roughly to a 6.5% cut in benefits.

Withdrawal Rates and Longevity

The question of longevity is baked into any client discussion about safe withdrawal rates, since the goal is to stretch portfolio life throughout retirement. But complexity swirls around the topic, with endless debates among retirement researchers about the rules of thumb on drawdown rates.

Sustainable drawdown rates can be tough to understand from a client standpoint. Consider Morningstar's latest research on safe drawdown rates, which pinpoints 3.8% as a safe starting rate for retirees seeking a fixed real withdrawal over a 30-year time horizon. (This figure assumes a 90% likelihood of not running out of funds, and a balanced portfolio allocation.) The figure is considerably higher than the 3.3% safe drawdown rate Morningstar recommended in 2021, which might seem counterintuitive for many clients.

"The key reasons are that stock valuations were lower last year and that bond yields rose," explains Christine Benz, director of personal finance at Morningstar and a co-author of the report.

"Lower stock prices means that we can be a little bit more sanguine about their long-term return potential; when stocks were on a tear from 2019 through 2021, our return expectations for them were falling. And the higher bond yields set up bond investors with a better returning portfolio than would have been the case when yields were so low in 2021."

Another Morningstar finding that clients might view as counterintuitive: A more aggressive equity allocation does not meaningfully improve safe starting withdrawal rates. Why?

“Certainly, stocks tend to have higher long-term returns than safer investment types — but the key issue here is their greater variability of returns,” Benz says. “We believe stocks will have a higher long-term return potential, but they also could be worse, especially in specific periods of a retiree’s drawdown period.”

That perspective drives Morningstar’s perspective that balanced portfolios drive the best withdrawal rate outcomes.

But, along with that 3.8% rule of thumb, Benz recommends that advisors emphasize spending flexibility as a source of financial power. “In reality, most retirees are willing to adjust spending up or down over their time horizons, and they were probably making such adjustments during their working years, too,” she says. Being flexible rather than rigid about in-retirement spending helps ensure that a retiree's assets will last, and the opportunity for upward adjustments gives them a chance to enjoy their assets in a way that would be difficult with an inflexible spending system.”

A Good Longevity Estimator

You can find plenty of longevity projection calculators online, but most are questionable because they use dubious health factors to project lifespans. One that I do like was created by the American Academy of Actuaries, which relies only on inputs proved to be accurate predictors, and it’s simple to use. The calculator considers your age, gender, whether you smoke and your own assessment of your general health. The resulting numbers show a range of possibilities.

Mark Miller is a journalist and author who is a nationally recognized expert on retirement and aging. His latest book is Retirement Reboot: Commonsense Financial Strategies for Getting Back on Track. *Mark also writes for* The New York Times*, Reuters and Morningstar. He publishes a weekly newsletter on news and trends in the field at https://retirementrevised.com/enewsletter/ .*