THE LONGEVITY PROBLEM
HELP YOUR PARTICIPANTS MANAGE
ONE OF THEIR GREATEST RISKS
BY TREVOR OLIVER
he increase in the average life span ranks among the greatest success stories of the last hundred years. After reductions in infant mortality, improvements in late-life health have made some of the biggest contributions to longer lives. In the United States, life expectancy at age 65 jumped about 50% between 1913 and 2013, while other developed countries enjoyed similar—and in some cases greater—gains. In the last half-century, many developing nations have followed suit.

It’s been said that every silver lining has a gray cloud, and that adage applies here. Despite our increased life expectancy, the typical retirement age has increased only slightly. Thus, savings in retirement now must stretch over a greater number of years. In fact, longevity may be the greatest risk to retired participants’ ability to produce sustained lifetime income. The good news is that insurance-based tools provide extremely efficient ways to address participants’ longevity. Insurance excels at protecting against low-likelihood but high-consequence situations, such as crashing a car, losing a roof to a tornado or living past age 100. Providing participants with income protection insurance in the event of a long life can help them plan for comfortable spending without fear of running out of savings in retirement.

**PLANNING FOR AN UNCERTAIN HORIZON**

At retirement, participants’ most pressing financial risk is no longer a bear market; it’s the possibility they’ll outlive their savings. Absent insurance, participants’ best strategy to deal with the uncertainty of their life span is to take conservative withdrawals. Such conservatism comes at a cost. Hedging against potential longevity may require reducing annual withdrawals by tens of thousands of dollars—and that reduction has just as meaningful an impact on the participant’s quality of life as a large investment loss.

Insurance offers a more efficient way to account for potential longevity than highly conservative withdrawal rates. To see why, consider that longevity is the product of two components:

- **Systemic longevity** refers to the degree of a person’s life span that is related to average life expectancy in the general population. Gains in a society’s life expectancy incrementally increase the expected life span of each individual in the society.
- **Idiosyncratic longevity** refers to the degree of longevity attributable not to society but to a specific individual, which may be influenced by lifestyle, family history, luck and other factors.

Idiosyncratic factors have a far greater impact than systemic factors on any one person’s longevity risk. Society-wide changes may extend an individual’s life by a year or two, but factors specific to the individual, such as health problems or good fortune, could subtract or add decades.

The chart below illustrates the impact of systemic versus idiosyncratic factors. Average life expectancies for 65-year-olds have increased gradually over the past 50 years. Yet large percentages of the population can expect to live considerably shorter or longer lives than the average. The discrepancy between the impact of systemic and idiosyncratic factors makes longevity an ideal fit for an insurance-based solution. From the insurer’s perspective, pooling many individuals into large groups that mirror the broad population effectively diversifies away exposure to idiosyncratic risk. From the participants’ perspective, insurance pools their high idiosyncratic risk and instead exposes them to the low, population-wide risk. This exchange reduces risk to individuals and lowers the cost of retirement. In practical terms, income insurance can help participants live lifestyles they are comfortable with in retirement without worrying that they’ll outlive their savings.

Timing is essential when considering insurance solutions. Participants should have protection when they really need it, and shouldn’t have to pay for it when they don’t. We believe the optimal time to provide insurance protection

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**Retirees are living longer…**

**AVERAGE AGE 65-YEAR-OLDS WERE EXPECTED TO REACH**

<table>
<thead>
<tr>
<th></th>
<th>MEN</th>
<th>WOMEN</th>
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<tbody>
<tr>
<td>1960</td>
<td>77.9</td>
<td>80.9</td>
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<tr>
<td>1970</td>
<td>78.1</td>
<td>82.1</td>
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<tr>
<td>1980</td>
<td>79.0</td>
<td>83.3</td>
</tr>
<tr>
<td>1990</td>
<td>80.1</td>
<td>84.1</td>
</tr>
<tr>
<td>2000</td>
<td>80.9</td>
<td>84.0</td>
</tr>
<tr>
<td>2010</td>
<td>81.5</td>
<td>84.2</td>
</tr>
</tbody>
</table>

**…but life spans vary dramatically**

**PERCENTAGE OF 65-YEAR-OLDS LIVING TO…**

<table>
<thead>
<tr>
<th>AGE</th>
<th>MEN</th>
<th>WOMEN</th>
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<tbody>
<tr>
<td>75</td>
<td>77%</td>
<td>84%</td>
</tr>
<tr>
<td>85</td>
<td>42%</td>
<td>34%</td>
</tr>
<tr>
<td>95</td>
<td>7%</td>
<td>14%</td>
</tr>
</tbody>
</table>

begins in participants’ early 80s, when idiosyncratic risk jumps (see the chart below).

The likelihood of mortality in any given year prior to roughly age 82 is relatively low, meaning participants who have reached their 60s are likely to live at least into their early 80s. At that point, participants start facing much greater uncertainty: They are less and less likely to need income, yet they have to guard against the possibility that they will beat the odds. Insurance thrives at managing exactly this kind of uncertainty.

**SOLUTIONS**

Plan sponsors have a few insurance options to help participants protect against the income implications of a long life span:

- **Lifetime annuities** guarantee income throughout retirement. Participants haven’t embraced them, however, in part due to concerns about cost and complexity.

- **Guaranteed minimum withdrawal benefits (GMWBs)** are insurance wrappers on income products. They offer both liquidity and security, but they can be costly and, in practice, their liquidity may become prohibitively expensive over time.

- **Longevity insurance** offers the most efficient way to manage longevity risk. It enables plan sponsors and participants to address the core problem without sacrificing a great deal of liquidity.

Longevity ranks among participants’ greatest retirement-planning risks. Moreover, the threat of outliving their income is one of participants’ greatest sources of retirement-related anxiety. Plan sponsors have an opportunity to use insurance solutions to help participants prepare more effectively for retirement income and feel more secure about their future.

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