

Retirement Income, Part 6

By Gary Case

This week I'll begin a discussion of the key risks to lifetime income planning. Financial security in retirement depends on understanding a series of risks that can erode even significant life savings—unless people understand these risks and plan to manage them. Managing these risks are the biggest challenge to creating a secure lifetime income. The first risk I'll discuss is longevity risk.

One of the most astounding success stories of the 20th century was arguably the sheer extension of human life spans. Advances in science and medical research have driven this success by increasing the likelihood that more infants will survive to adulthood and the probability that 65-year-olds will have a greater chance of living into their 80s and even 90s.

But when it comes to retirement income planning, life expectancy figures can be seriously misleading. Many people born at any given time will outlive their own life expectancies. This means that most people ought to think hard about “longevity risk”—the real possibility of living 20, 30 or even 40 years past retirement age. Without planning, a longer than expected life could easily lead to a person, or couple, outliving their savings.

Though it really boils down to a simple sentence, **“You will need to plan for the possibility that you will live longer than you think,”** longevity risk is probably the least understood variable in lifetime income planning. Very few people have any clear sense of the distinctions between the life expectancy of their own age group and the probability that they will live many years beyond their life expectancy once they reach age 65. Fewer still realize that if they are in good health, even people who have reached 80 or 85 still have quite high probabilities of living 10 or 15 years more.

As a result, most people underestimate the length of time they need to plan for living in retirement. As the graphs show, an American man who has reached age 65 in good health has a 50% chance of living twenty years to age 85, and one chance in four of living to age 92. For a 62-year-old woman, the odds rise to a 50% chance of making age 88 and one chance in four of living to age 94. One member of a 65-year-old couple has a 50% chance of living to age 92—with a one in four chance of living to age 97!

As medical research and technology continue to push that lifespan envelope, more and more healthy individuals entering retirement will need to plan on 30-40 years of post retirement income need! More on risks threatening your retirement income next week

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