Living “Room”?

The problem with living too long

PEOPLE are living longer. In most ways, that is a good thing, but it creates problems for workers who need life-long retirement income. One problem is that workers don’t know how long they will live in retirement and, thus, how much savings is needed to fund their retirement income.

Shlomo Benartzi, a UCLA professor, explained the problem in a paper published by Allianz:

“To illustrate the unique financial complexities facing retirees, consider 10 high school friends who decide to retire at age 65. Now, guess when the first of those 10 friends will die. As it turns out, the first death is likely to occur only four years into retirement, at age 69. Next, try guessing when the last person will die. The answer is 34 years into retirement, at age 99!”

The first retiree to die probably had accumulated enough savings to last for his “retirement lifetime”—four years—but the last to die probably had not; after all, it is difficult in a 40- or 45-year working career to accumulate the money needed for a 34-year, pre-paid retirement. It is impossible for a person to tell whether he will be first or last—or somewhere in between.

Dr. Benartzi’s example is a dramatic illustration of the need for a single person to plan for the possibility of a long retirement. The probabilities for the joint lives of a 65-year-old couple are even more stunning. At the 50th percentile, at least one of the spouses will live to age 91, 26 years after retirement. There is a 25% probability that one of the spouses will be alive at 95 and a 10% probability at 99.

If you want to plan on the 25% probability, a 65-year-old couple should save enough to fund a 30-year retirement, but it is difficult to accumulate enough money to accomplish that goal, and it is just as difficult to invest and withdraw the money during retirement so that the accumulated sums are not prematurely exhausted.

While these problems can be “solved”—at least partially—by more saving and better investing, they also can be managed by a lower standard of living, part-time work in retirement, or a delayed retirement.

Let’s examine the impact of the last alternative: delayed retirement. For example, for a married couple, the statistics are:

Joint Probabilities

RETIREMENT AGE	50TH PERCENTILE	75TH PERCENTILE	90TH PERCENTILE
65-year-old joint life expectancy	91.07	95.07	99.80
67-year-old joint life expectancy	91.14	95.11	98.83
70-year-old joint life expectancy	91.25	95.20	98.89

Accepting the 25% probability that one of the spouses will live beyond the stated age, the 65-year-old couple will need to fund a 30-year retirement, the 67-year-old couple a 28-year retirement, and the 70-year-old couple a 25-year retirement. It seems much more likely that saving over 45 years (that is, 25 to 70) for a 25-year retirement will be achieved than saving over 40 years (i.e., 25 to 65) for a 30-year retirement. In fact, the latter seems very difficult.

Since our society now seems to be firmly committed to a defined contribution, deferral-based retirement system, participants must face the realities of life expectancies, standards of living in retirement, and deferred retirements. Plan sponsors can help in that process by providing retirement education and lifetime distribution products, and by supporting delayed retirements.

Fred Reish is Chair, Financial Services ERISA Practice, at the law firm of Drinker, Biddle & Reath. A nationally recognized expert in employee benefits law, he has written four books and many articles on ERISA, IRS and DoL audits, and pension plan disputes. Fred has been awarded the *Institutional Investor* Lifetime Achievement Award and the *PLANSPONSOR* Lifetime Achievement Award. He is one of the 15 individuals named by *PLANSPONSOR* magazine as “Legends of the Retirement Industry,” and also one of five individuals acknowledged as Retirement Plan Adviser Legends by *PLANADVISER* magazine.