VIRTUS INVESTMENT PARTNERS

# Addressing Longevity Risk

**As the average life expectancy rises, the opportunities for financial advisors to help clients navigate financial challenges will be remarkable.**

**In brief:**

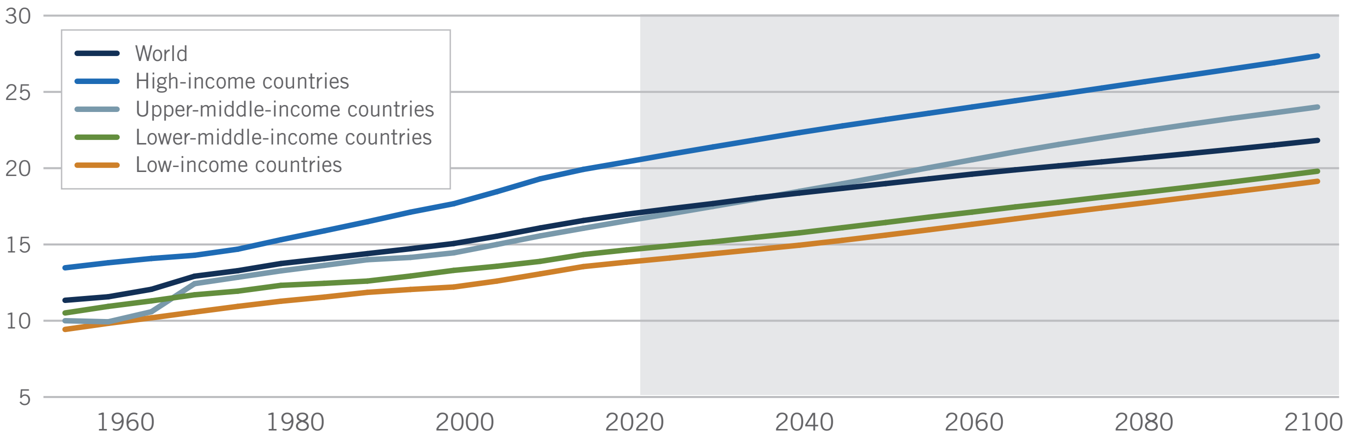
- Between the decline of defined benefit plans and a shortfall in retirement savings, individuals are directly exposed to more actuarial risk than before.
- With more people living longer than ever, the challenge will be to not run out of money, as the need for monthly income grows.
- Rising health care expenditures add another dimension to longevity risk.

Ask a financial advisor what issue may transform the financial services industry in the decades to come, and the answer may surprise you. The overarching concern, according to several surveys in recent years is longevity risk—clients outliving their money thanks to medical advances, greater access to health care, and a decline in smoking. At the same time, pension and health care plans and insurers are dealing with the risk that actual survival rates and life expectancy will exceed expectations or pricing assumptions, resulting in greater-than-anticipated retirement cash flow needs.[1]

According to the United Nations, one in six people in the world will be over the age of 65 by 2050, up from one in 11 in 2019, and the number of people aged 80 or over will triple in the next 30 years. In many regions, the population aged 65 will double by 2050, while global life expectancy beyond 65 will increase by 19 years.[2] According to the National Association of Insurance Commissioners, those reaching retirement age will more than double from 2010 to 2050, rising from an estimated 40.2 million to 88 million people. Baby Boomers (born between 1946 and 1964) who live to age 65 could live another 20-30 years, putting additional pressure on Social Security, Medicare, Medicaid, long-term care insurers, and of course, whatever remains of their nest eggs. (See Exhibit 1.)[3]

[1] National Association of Insurance Commissioners, The Center for Insurance Policy and Risk, "Longevity Risk," January 16, 2020
[2] United Nations, "Our world is growing older: UN DESA releases new report on ageing," October 10, 2019
[3] "Retirement Security: Most Households Approaching Retirement Have Low Savings," U.S. General Accountability Office, May 2015

**EXHIBIT 1: YEARS LEFT TO LIVE AT AGE 65**




Projections made for five year periods. Source: United Nations Population Division.

Whether the current retirement system can support succeeding generations (Generation X, born 1965-80; Millennials, born 1981-96, and Generation Z, born 1997 and later) will be debated fiercely in the years to come. (See Exhibit 2.)

Call it "The Great Risk Transfer," as The Institute and Faculty of Actuaries (IFOA) refers to such intergenerational challenges. "Where institutions such as employers, insurers, and the state once offered guarantees that protected individuals from longevity and investment risk, these appetites have reduced," said IFOA President John Taylor. "As a result, individuals are directly exposed to more actuarial risk than before."[4]

## Going the Distance

According to the U.S. General Accountability Office (GAO), "rising life expectancy after age 65 may exacerbate the challenge of achieving economic security throughout retirement, requiring that individuals engage in more planning and saving to support longer retirements."[5]

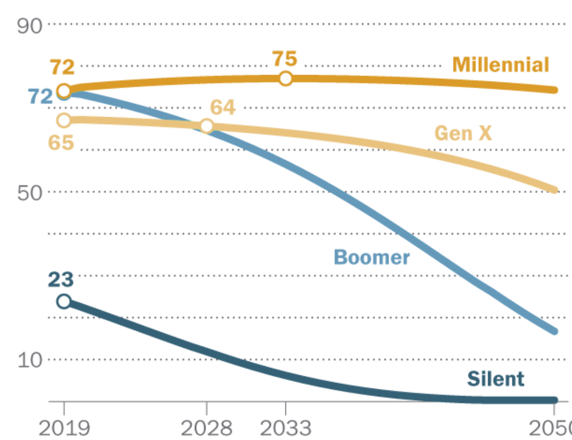
## Meeting Retirement Goals

For all the challenges created by the COVID-19 pandemic, Americans overwhelmingly continued saving for retirement in 2020 through defined contribution (DC) plans such as 401(k)s, but IRAs remain the largest source of retirement assets, according to the ICI.[6]

"Despite the many challenges over the past year, the data indicate retirement savers generally were committed to preserving their nest eggs," said Sarah Holden, ICI senior director of retirement and investor research. "These data suggest that DC plan savers view their 401(k) as a special pot of money earmarked for retirement, which they try to avoid tapping into, even in tough economic times."

**EXHIBIT 2: PROJECTED U.S. POPULATION BY GENERATION**

In Millions




Note: Millennials refer to the population ages 23 to 38 as of 2019. Source: Pew Research Center tabulations of U.S. Census Bureau population estimates released April 2020 and population projections released December 2017.

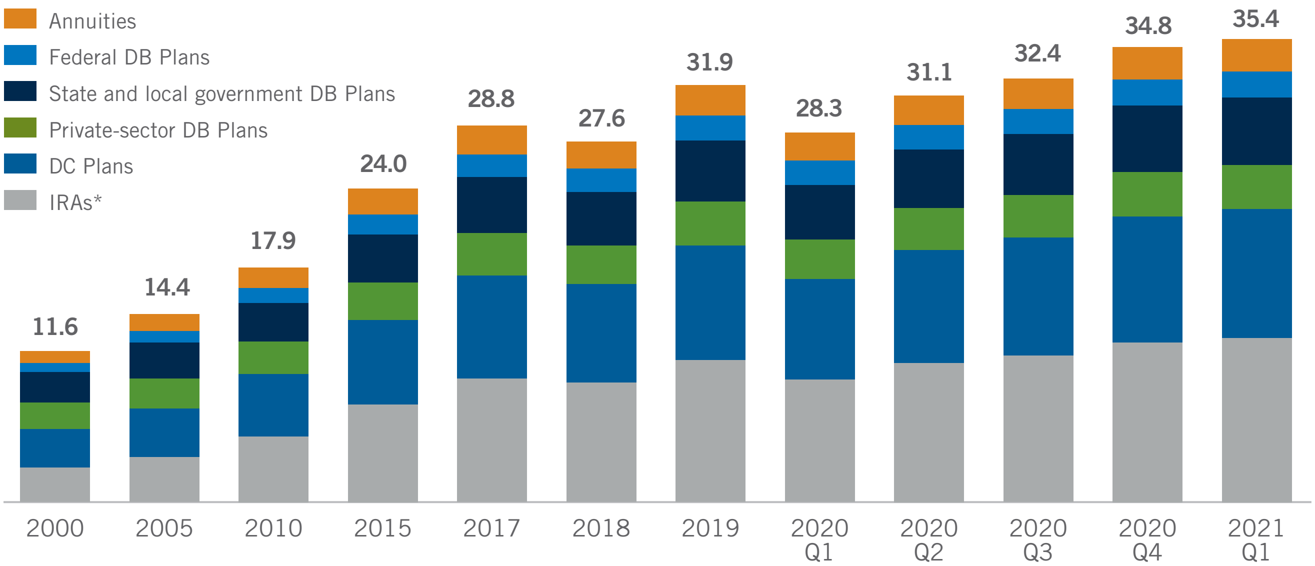
[4] John Taylor, "The Great Risk Transfer," The Actuary, February 5, 2020

[5] GAO, Retirement Security: Most Households Approaching Retirement Have Low Savings, GAO-15-419 (Washington, D.C.: May 12, 2015)—subsequently updated in 2017 and 2019

[6] Source: ici.org/research/retirement

Most DC plan participants stayed the course with their asset allocations despite high stock market volatility in the first quarter of 2020, and withdrawals for the full year remained low, the ICI found. In 2020, 10.6 percent of DC plan participants changed the asset allocation of their account balances, lower than 11.8 percent in 2009 as the stock market started to recover from the global financial crisis. In 2020, 6.3 percent changed the asset allocation of their contributions, lower than 10.5 percent in 2009.

**EXHIBIT 3: U.S. TOTAL RETIREMENT MARKET ASSETS**
Trillions of dollars, end of period, selected periods




*Data are estimated. Note: Components may not add to the total because of rounding. For definitions of categories, see Table 1 "The U.S. Retirement Market, First Quarter 2021".
Sources: Investment Company Institute, Federal Reserve Board, Department of Labor, National Association of Government Defined Contribution Administrators, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division.

## What About Rising Health Care Costs?

Rising health care expenditures add another dimension to longevity risk. According to the Centers for Medicare and Medicaid Services, the lion's share of such health care spending is on the 65 and older population. U.S. health care spending grew 4.6 percent in 2019, reaching $3.8 trillion or $11,582 per person. As a share of the nation's Gross Domestic Product, health spending accounted for 17.7 percent.

But that doesn't even begin to account for the rapidly increasing incidence (and costs) of Alzheimer's disease. The Alzheimer's Association estimates that Alzheimer's and other dementias cost the nation $305 billion. (A separate study found that in the last five years of life, the costs of a person with dementia, on average, total more than $287,000 (in 2010 dollars).

This is compared with $175,000 for a person with heart disease, and $173,000 for someone with cancer, the association added. For the general patient population that has health insurance, their out-of-pocket costs are rising to sometimes unaffordable levels. Between 2009 and 2019, average annual worker premium contributions jumped 71.1%, while average annual employer premium contributions increased 47.7%, according to the Kaiser Family Foundation (KFF). In 2020, annual premiums for employer-sponsored family health coverage reached $21,342, up 4% from 2019, with workers on average paying $5,588 toward the cost of their coverage, KFF added. Then there's the exorbitant cost of senior care (e.g., assisted living or nursing homes), which has given rise to multigenerational housing (modifying an existing home to suit multiple generations) to facilitate "aging in place."

Yield-starved retirees and near-retirees will no doubt have to factor anticipated health expenses into their income strategies and risk tolerances.

## The Bottom Line

The United States, the world's largest retirement market, already has $35.4 trillion in assets held in retirement-related accounts, and this asset pool will not diminish as baby boomers complete their retirement journey, says an August 2019 report by McKinsey & Co., which expects retiring and elderly individuals to contribute more to consumption growth through 2030.[7]

The Employee Benefit Research Institute's 2021 Retirement Confidence Survey provides further perspective:

- Over seven in 10 are at least somewhat confident, including three in 10 who are very confident.
- Eight in 10 were confident they will have enough money to live comfortably throughout retirement, including one in three who are very confident.
- While the past year has taken a toll, half of workers and seven in 10 retirees surveyed say the pandemic has not changed their confidence in achieving a secure retirement. Still, a third of workers and a quarter of retirees say it's made them somewhat or significantly less confident they will have enough to live comfortably throughout retirement.
- About one in 10 workers and one in 20 retirees feel significantly less confident—three in 10 workers say the pandemic has negatively impacted their ability to save for retirement, due to reduced hours, income, or job changes.

Whatever their allocation strategies, advisors may want to ask clients about their family health histories to get a better sense of longevity, since some clients may be underestimating the possibility of longer lifespans and playing it too safe—at the risk of arriving at retirement with resources inadequate to meet their needs.

The reality is that most retirees today, between low interest rates and longevity risk, need a bigger allocation to the long-term growth potential of equities and alternative investments than traditional guidance has offered.

Joseph Coughlin, founder and director of the Massachusetts Institute of Technology AgeLab, once suggested that advisors reinvent themselves as longevity planners or navigators.

Look to Virtus's multi-manager, multi-strategy approach for help serving aging and retired clients. Our goal is to offer clients high-quality investment strategies that have generated compelling performance and meet multiple financial needs.

[7] "Long Term Value Creation in Retirement," McKinsey & Co., August 2019

To learn more about strategies that may help address longevity risk, please contact us at 800-243-4361 or visit virtus.com.

**IMPORTANT RISK CONSIDERATIONS**

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