Discussion 2

Chapter 3, pages 36 to 38 of *The New Wealth Management* discusses how a client's mortality figures into the IPS assumptions. For your initial post, write a 2- to 3-paragraph (minimum) summary of mortality information found in the text and discuss how this issue is handled by advisers.

Explain your own approach as well as what you have come to find in your research about other methods. Find two sources to support your opinions and make sure you cite your sources! Do not just make statements as if they are general knowledge–back up any statements with research. If your source is online, make sure to provide a link in order for your colleagues to have easy access. One of the sources must have been written within the last twelve months.

My initial post:

Thoughts About Mortality Assumptions in Financial Planning

-William H. Keffer, CFP®

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Preface: These are some notes I took while doing an assignment for a course I am taking through the College for Financial Planning. The course is "Portfolio Management for Financial Planners."

A financial planner's assumption about client mortality has a more significant impact on the results, and thus on the planner's recommendations, than is often understood. On the one hand, it would be dangerously aggressive to assume that a client will live to their average life expectancy, setting them up for a 50% probability of failure (Evensky, 2011, page 37). On the other hand, some planners may use ages well past any reasonable probability of the client's surviving, such as age 100. This perhaps unrealistically conservative approach may impose an impossible and unnecessary burden on the clients in terms of their spending goals.

Evensky argues for the use of an age to which the client(s) have at least a 70% probability of survival. And for those in excellent health with a history of family longevity, the planning ages to which they have an 80%-90% probability of surviving may be a better choice. Another important consideration is the fact that couples collectively have a longer time horizon than either of them individually. The Evensky text offers the example of a couple for whom there is a 30% probability of living beyond 88 for the husband and 92 for the wife. However, even though they individually have just a 30% chance of surviving beyond these ages, there is a 51% probability that one of them will live past those ages.

A third major take-away is the importance of customizing these assumptions for each client or client couple. A simple set of questions regarding smoking habits, current health, and family longevity can be used in conjunction with some financial planning software to set planning ages for clients tied to mortality tables at a greater level of specificity. I use this feature in *Money Guide Pro.*

In a 2011 presentation to "NAPFA University," a training program for planners, Cheryl Krueger, CFP, FSA, and a team of her colleagues from the Society of Actuaries and NAPFA struck many of the same themes as the Evensky text, identifying these key points for planners to bear in mind about longevity:

- People routinely underestimate their longevity

- Longevity is highly variable
- Couples’ collective longevity is greater than their individual longevities
- Longevity is positively correlated with education and income
- Longevity is increasing, it is expensive, and it is insurable

In further support of the need for a more nuanced approach to choosing a planning horizon, Wade Pfau points out in a 2016 article in the *Journal of Financial Planning* (pages 40-41), that planners and clients may get longevity assumptions wrong for three reasons:

1. Measuring life expectancy from the wrong age: Life expectancy at birth is lower than the life expectancy of someone who has actually attained a higher age, such as 65.
2. Use of current rather than future mortality rates: Mortality has and will continue to improve in the future. Planners should use cohort mortality tables that take this into account.
3. Clients of financial planners tend to be longer-lived than the general public: This speaks to the correlation between income and education and longer lives.

I use the longevity planning tool in *Money Guide Pro* financial planning software which allows for the entry of tobacco, family longevity and state of current health to arrive at live expectancies and the associated probabilities. This allows for a higher level of personalization and takes into account the ages to which the clients have already survived.

Evensky, H., Horan, S.M., & Robinson, T.r. (2011). *The New Wealth Management, The Financial Advisor's Guide to Managing Clent Assets.* Hoboken, NJ: John Wiley & Sons.

Krueger, Cheryl, et al (2011), "Understanding Longevity: What to Tell Your Clients"; Presentation to National Association of Personal Financial Planners in collaboration with Society of Actuaries.

Pfau, W. (2016). "Helping Clients Understand Their Longevity Risk". *Journal of Financial Planning* (pages 40-41). November, 2016 issue.