

Using Expectancy Scenarios in Financial Planning

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– Elaine Floyd, CFP®

Scenario planning shouldn't stop at retirement. It's unpleasant, but necessary to imagine what your situation might look like after the death or incapacitation of a partner. An early dose of reality can help you build a financial foundation.

Two weeks ago, my neighbor died unexpectedly at the age of 76. Three weeks after beginning to feel sick, he was dead of lymphoma. Judging by his widow's reaction, I am pretty sure they never contemplated this scenario. I am not close enough to my neighbor to pry into her financial affairs, but I am guessing that she will have to carry on with one less Social Security check and a small investment portfolio that she may or may not know how to manage.

I don't know if he had life insurance. If he did, she should be able to maintain her current lifestyle, which includes living in a nice house, playing golf several times a week, and traveling to see their kids several times a year. If he didn't, she may end up having to sell the house, curtail some of her activities, and pinch pennies to pay the bills.

Further musings about my neighbor's situation cause me to wonder how the rest of her life will play out. How much longer will she live? Will she remain in good health, or will she acquire some debilitating chronic condition? At what point will she become one of the frail elderly—generally healthy but too weak to take care of herself? And how will she afford the care she needs as she moves through the natural phases of aging?

Why it's necessary to imagine possible scenarios

Scenario planning is fun when you're planning vacations, but not so enjoyable when it involves contemplating life's worst events. Attempting to imagine the death of a long-term partner and then organizing the financial (and emotional) resources to carry on for up to 25 more years seems like too brutal an exercise to put yourself through. But if thinking about it for a minute would help you prepare for such an eventuality, the pain of imagining worst-case scenarios can be replaced by relief that the necessary insurance policies and investment plans are in place to preserve your financial security, should that scenario play out.

To keep scenario planning realistic, and practically, rather than emotionally oriented as you lay the groundwork, make sure to keep projections within the context of your overall life plan. What do you see for yourself in the years ahead? How do you want your life to play out? What do you want to accomplish? How do you want to live? Then... what if something goes wrong? Can you imagine yourself getting old? Can you imagine yourself acquiring a debilitating disease? Can you imagine yourself becoming widowed? Can you imagine yourself dying?

The current trend in retirement planning is to focus on the positive. It's exciting to dream of all the trips and leisure activities that await in retirement while putting an investment portfolio in place to fund that eagerly anticipated lifestyle. Naturally, nobody wants to think about how those dreams might be shattered by illness or an untimely death.

But this type of worst case scenario planning is exactly where advisors can help the most. By helping guide your mind to those darker places, a well-informed, trusted advisor can make it easier to contemplate scenarios you may never consider on your own. Then, working together, you can develop solutions that recast those scenarios in a less terrible light. My widowed neighbor never would have wanted to contemplate her husband's death at age 76. But if she had, and if she knew that she would be OK financially, at least she would be less fearful about the future.

The phases of aging

Following are the phases that naturally tend to play out after age 65. Not everyone will go through each phase. But, in each case, scenario planning can help mitigate the possible damage. Notice that health expectancy is at least as important as life expectancy.

- **Healthy and active.** Individuals in this phase are able to do pretty much anything they want, save mountain climbing or hard physical labor. Everyone would like to stay in this phase as long as possible, whether it's to work a little longer to fund a more comfortable retirement, or to start crossing items off their bucket list after they retire. Anyone who wants to prolong this phase should be exercising, eating right, not smoking, and getting regular screenings, as failure to engage in these proven health-preserving activities might throw them into the next phase. Scenario planning for a long healthy and active phase involves making sure you have adequate income to allow you to do all the things you want to do.
- **Limitation of activity caused by a chronic condition.** Common diseases that some people live with for varying lengths of time include heart disease, cancer, diabetes, arthritis, osteoporosis, hypertension, and more. Not everyone will enter

this phase, but good scenario planning should provide for every possibility. If you are working full-time, you may have to stop, or at least cut back, which could cause an unexpected drop in income. If you are a frequent traveler, or accustomed to plenty of leisure activity, being forced to curtail those parts of your life may actually save you money on that end; only to pay it out to doctors and hospitals at the other end in the form of deductibles and co-payments. Scenario planning for this phase involves making sure you have sufficient health insurance and have set aside adequate funds for out-of-pocket medical costs.

- **Limitation of activity caused by aging and general frailty.** My neighbor died before entering this phase, but his widow may not. If she's like many older women, she will remain relatively healthy for many more years but face natural muscle loss or cognitive declines as she ages. The curse of a long life is the gradual erosion of capabilities, from opening jars to simply getting around the house. Everyone knows someone in this phase, so it's not such a stretch to imagine it for ourselves. Scenario planning involves the consideration of some form of assisted living, along with long-term care insurance or a plan for self-funding the associated expenses.
- **Death.** This is the end of the line, and it could come at any time. Some people, like my neighbor, may enter this phase unexpectedly early. Others will live well past the average life expectancy.

Average Life Expectancy in Years

Current age	Men	Women
50	29.67	33.23
55	25.50	28.81
60	21.58	24.56
65	17.89	20.45
70	14.39	16.54
75	11.14	12.92
80	8.28	9.68
85	5.89	6.95
90	4.05	4.78
95	2.81	3.31
100	2.12	2.42

Source: Social Security Actuarial Life Table

Scenario planning involves looking at death in two ways: (1) the effect on survivors if it occurs early, and (2) the financial resources necessary to fund an extraordinarily long life if it comes late, also called longevity planning.

For couples, the most devastating is when the husband dies early and the wife lives on with limited resources. This can be mitigated by life insurance on him and long-term care insurance for her, along with guaranteed lifetime income from Social Security and annuities.

For those who have a choice, the high earner should delay Social Security benefits until age 70 in order to maximize the survivor's income. Annuitization of some assets can supplement Social Security.

What are the odds?

Everyone is an individual, of course, and the rate of slowing at the end of life is highly variable, but statistics can help determine the odds. Life expectancies continue to rise. In 1900, life expectancy at age 65 was 12 years; by 2017, life expectancy for this age group had increased to 18 years. Keep in mind that when you are looking at average life expectancies, half of all people will die sooner, and half will live longer. Scenario planning should incorporate both possibilities.

Prevalence of Chronic Conditions

(Number of persons with limitation of activity caused by selected chronic health conditions per 1,000 population)

Chronic Health Condition	Age 65-74	Age 75-84	Age 85 and older
Senility or dementia	9	30	77
Lung	33	49	42
Diabetes	39	46	45
Vision	18	36	88
Hearing	10	24	78
Heart or other circulatory	93	145	211
Arthritis or other musculoskeletal	120	172	272

Source: National Health Interview Survey (NHIS), Centers for Disease Control and Prevention

Chronic conditions and general frailty

The frequency of debilitating chronic conditions rises with age. Among non-institutionalized people, 25% of those age 65-74, 42% of those over 75, and 60% of those over 85 report being limited in their activities by some kind of chronic condition. Arthritis and other musculoskeletal conditions were the most frequently mentioned chronic conditions, followed by heart and circulatory conditions.

The perception of aging in this country has turned positive, thanks in part to television ads showing happy, dancing couples with silver hair and nary a line on their faces. It's safe to assume that we all want to live a long and healthy life. But beginning to imagine less-ideal scenarios is an imperative first step to putting the necessary arrangements in place. Once that has been accomplished, you can turn your attention in a more positive direction.

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