The Importance of Managing Life-Stage Risks for an Aging Population

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When financial advice professionals talk about "risk," they are usually referring to the risks associated with a portfolio of investments. Advisers typically view the preservation of wealth through successful portfolio risk management as their number one job, and in most cases, their compensation is tied directly to the performance of client investments.

Historically, this almost exclusive focus on portfolio risk made sense. For most of the 20th century, the typical client did not work, let alone live, much past the age of 65. Healthcare costs, including long-term care costs, were much lower and generally not a major financial risk. Shorter lifespans meant that advisers didn't need to worry too much about clients outliving their money. "Retirement planning" was mostly about making sure the client's investment portfolio was in good order. If an adviser was able to successfully manage investment risks, there was a high probability that the client was going to be OK financially.

Demography Is Destiny

Today, that is no longer the case. Longer lifespans have dramatically changed the nature and severity of the financial risks faced by most clients, especially older adults. Life expectancy was 58 years for a man born in 1930 and about 61 for a woman. Today, a typical 60-year-old man can expect to live another 23 years; a woman, 25 more years.[1]

As a result of longer lifespans, investment portfolio volatility is only one class of risk confronting older adults—and arguably not even the most consequential. Health- and longevity-related risks now constitute a major threat to the financial security of adults over the age of 50. These risks increase with age and can ruin any savings, investment, or financial plan, no matter how well portfolio risks are measured, aligned, or managed.

The risks associated with a particular period in one's life, defined mostly by age, I refer to as life-stage financial risks. Life-stage risks are linked to the financial opportunities, threats, and constraints associated with a particular stage of life. Life-stage risks are especially acute for adults over the age of 50.

Life-stage risk is not the same as longevity risk. Longevity risk has a generally accepted meaning, denoting the possibility that survival rates exceed expectations. The term is used most frequently in the context of the cash-flow needs of insurance firms or pension funds.

When longevity risk is applied to individuals, it refers to the chance that a person will outlive their savings. But "running out of money" is an outcome measure that explains "what" happened, not "how" or "why." Longevity risk is best viewed as the aggregation of (often multiple) life-stage risks, like high healthcare or long-term care costs, or cognitive decline.

Moreover, running out of money is not the only financial risk confronting older adults. High-net-worth individuals' objectives for wealth transfer are at risk, while less-well-off individuals risk total bankruptcy.[2]

A partial list of life-stage risks that threaten the financial security of older adults includes:

- **Healthcare costs.** Approximately 80 percent of people over 55 in the U.S. suffer from one or more chronic illnesses like diabetes, cancer, or high blood pressure.[3] Per capita spending on healthcare in the U.S. has increased roughly six-fold in inflation-adjusted terms since 1970.[4] It is not uncommon for drug treatments alone to cost over $25,000.[5] Sixty percent of cancer patients spend more than $5,000 out of pocket to treat a single cancer, with 20 percent spending more than $20,000. This does not include travel expenses, lost wages, or in-home care expenses.[6]
- **Long-term care costs.** Most adults will need at least three years of long-term care.[7] Many people want to die at home, but most of them will require 24/7 care late in life, at an average cost of about $25 per hour, or $18,000 per month. Assisted living facilities in most metropolitan areas cost $50,000 a year or more, while a nursing home bed can easily cost over $120,000 annually.[8]
- **Cognitive decline.** *The Wall Street Journal* recently published an article declaring cognitive decline "baby boomers' biggest financial risk."[9] An estimated 10 percent of adults over 65 have Alzheimer's.[10] Another 3 percent suffer from related illnesses, like vascular or frontotemporal dementia. In addition, 15–20 percent of adults over 65 suffer from mild cognitive impairment.[11] This implies that more than 25 percent of a typical wealth management firm's clients are at risk of poor financial decision-making or exploitation.
- **Illness or death of income earner.** While most people are living longer, some get very sick while they are earning a substantial salary. The average age of a first heart attack is 65 years for men;[12] the median age of a diagnosis of breast cancer in women is 63;[13] and early onset dementia can occur while a person is in their 50s.[14]
- **Caregiving responsibilities.** Many adults provide caregiving assistance to parents or spouses, and taking care of a relative can be very expensive. Almost 90 percent of caregivers act as financial coordinators (e.g., help with paying bills, managing investments), while nearly 70 percent provide direct financial support.[15]
- L**ack of transparency in financial organization.** Too often when someone dies, family members don't know how to access the deceased's financial account information, hard assets (e.g., collections, stock certificates), or other personal property. Poorly organized finances often force family members to spend considerable time and energy cleaning up the mess. This can result not only in financial losses, but also high professional service fees and family discord.
- **Financial exploitation.** Estimates of the costs of financial exploitation range from $3.7 billion to over $35 billion per year.[16] Older adults appear to be especially vulnerable, with roughly 37 percent of seniors having experienced financial abuse in any five-year period.[17]
- **Gaps or errors in estate plans.** Only about

one-third of adults in the U.S. have a will,[18] and only about half have appointed a legal power of attorney.[19] The absence of wills, trusts, powers of attorney, and other legal documents threatens financial security and jeopardizes successful intergenerational wealth transfers.

- **Behavioral health.** Traits like impulsivity, loneliness, gullibility, and overconfidence are not often associated with dementia, but their prevalence often increases with age, and their effects on financial decision-making can be devastating.[20]
- **Medication errors and side effects.** The average older adult in the U.S. takes four or more prescription drugs each day, and 39 percent take five or more.[21] Taking multiple medications simultaneously can lead to potentially dangerous drug interactions and creates exposure to many different side effects, including those affecting judgement and decision-making.
- **Driving accidents.** For older adults, car accidents are much more costly, both physically and financially. Adults aged 65–69 are almost twice as likely to die if they are involved in a car accident than drivers or passengers in their 40s. Adults over 80 are about five times more likely to die.[22]

Balancing Life-Stage and Portfolio Risks

Given their prevalence and potential severity, financial advisers should be spending as much time and effort managing the life-stage risks of their age 50-plus clients as they are managing their investment portfolio risks, if not more. Here are five reasons why:

1. **Life-stage risks have more far-reaching financial consequences.** Portfolio risks affect wealth and the income derived from wealth, e.g., interest and dividends. Life-stage risks affect those areas and other aspects of a person's finances. In fact, it is hard to think of a personal finance category—wealth, income from wealth, income from other sources like salaries, spending—that is not exposed to adult life-stage risks.
2. **Most adults are (much) more concerned about life-stage risks than portfolio risks.** Virtually every survey has shown that investors are more worried about life-stage risks than portfolio risks.[23] A typical client cares more about the price of long-term care than the price of Bitcoin, more about their life-work balance than their portfolio balance, and more about what a parent or spouse with dementia might do than what the Fed might do.
3. **Portfolio risks are more easily managed by technology.** For most of the 20th century, advisers could not rely on powerful computers, sophisticated trading algorithms, or the internet to help manage investments. Now they can. Moreover, new investment products, especially index funds and ETFs, make it easy for advisers to construct highly personalized and risk-adjusted portfolios. The introduction of new technologies and products is only going to continue, making portfolio management even easier (and cheaper). Life-stage risks, on the other hand, are by nature highly personal and complex, requiring more human involvement and limiting the applicability of (current) technology.
4. **Lengthier time horizons enabled by longer lifespans help reduce portfolio risk.** Since people are living longer, they can more easily afford a large, temporary decline in the value of their investments because they have more time to wait out a recovery. They also have more years to benefit from interest rate compounding. A $10,000 investment earning 5 percent

annually is worth $26,533 after 20 years—but $70,400 after 40 years.

5. **Life-stage risks have greater emotional impacts.** For many clients, a major personal or family health issue will have a greater impact on emotions, and possibly finances or financial decision-making, than a decline in share prices. Moreover, while emotional responses to market fluctuations come and go, concerns about health tend to increase over time.

If you are a financial adviser, it's time to start paying as much attention to life-stage risks as you do to investment portfolio risks. It may be hard at first, but your clients will appreciate it. A lot. ■

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