FINANCIAL PLANNING

LONGEVITY

Independent Financial Advisers - Financial Life Planners

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Introduction

How long you are going to live is the most important element in determining how much money you are going to need in your retirement.

Put simply, and as an example, if you retire at 65 and live to 70 you will need a lot less money than if you live to 90.

Surprisingly - many people fail to understand longevity factors. Consequently their financial planning decisions can become misplaced. Worse, bad decisions are taken.

This subject, arguably, is the most crucial financial conundrum facing millions of people in the UK today. It has profound implications both at an economic level and at an individual level.

Nothing could be more worrying for people than not having enough money to live comfortably in retirement; reversed, what could be better than having a wonderfully enjoyable retirement, free of financial constraints?

This is the single biggest challenge for people of all ages today, how to go about planning for retirement and how to manage finances up to and then through retirement.

If longevity is not properly understood, then there is every chance this could go wrong.

Our guide is designed to help you understand the position, to explain clearly the reason why life expectancy numbers are a poor benchmark (and why those numbers are, in fact, unreliable) and what you can do to plan for your retirement.

Let us start by considering the one aspect of long term financial planning that seems to be most misunderstand – life expectancy.

LONGEVITY
THE LENGTH OR DURATION OF LIFE...

The Common Misunderstanding of Life Expectancy

Life expectancy is the average number of years that any group of individuals has left to live. The key word here is average.

Life expectancy numbers are calculated around thousands of individuals and the range of ages they will all live, divided by that number of individuals. This is a constantly shifting figure to take into account the most current numbers available. These numbers having been improving year on year for some time.

To highlight and illustrate why relying on life expectancy might be a problem imagine two groups of three people as simplified examples.

Group one:

- Person one lives to 84
- Person two lives to 85
- Person three lives to 86

Group two:

- Person one lives to 64
- Person two lives to 85
- Person three lives to 106

In both groups the average age of death is 85 but clearly the distribution is very different.

This relates to the 'real world' because around the average there is a wide distribution and, as an example, some people will live to 106 and some to 64; the problem in financial planning terms is that you don't know, in advance, who will fall into which band.

In any event the average is not the most likely date of death.

Even so-called "informed" politicians make the error of misunderstanding the importance of life expectancy. A previous Pension Minister actively campaigned for every individual to be provided with a life expectancy age when they came to retire. A position which would have had potentially disastrous consequences, as it could have seriously misled those individuals. Fortunately this proposal has not been adopted.

This emphasises a crucial factor. Your life expectancy does NOT translate to the most likely age you will die.

This is because of what is known as a skew distribution in ages of death. Basically the distribution of ages of death is uneven and this affects the life expectancy, what most people think of as the average.

Using Office of National Statistics (ONS) Life Tables, we know the numbers of women expected to die at each age, out of 100,000 born, assuming mortality rates stay the same as 2010-2012. The expectation is 83, median 86, the most likely value (mode) is 90. So the most likely age of death is seven years more than the life expectancy.

For little baby boys the mode is 86, again seven years more than the mean of 79. And even the median is 3 years more than the mean.

The average creates the life expectancy number. This means that life expectancy is of limited use on its own when we come to retirement planning, because you have to assume you could easily be an outlier. An outlier being one of the group who lives far longer than the average.

If you don't plan to be an outlier then you run a very big risk of running out of money in retirement – if you turn out to be an outlier!

Understanding that life expectancy is only an average and is not even the most likely age of death is a very important step in retirement planning.

What are the Recent Life Expectancy Statistics in the UK Looking Like?

We have aimed to explain in our opening section, above, the main aspect of life expectancy numbers and the flaw this produces if you were to rely on this.

This does not mean that your life expectancy is totally irrelevant or of no value at all; on the contrary there are important aspects to be taken from the basic statistics. It is worth examining the numbers, allowing for the interpretation problem previously explained.

Here are some examples of recent official statistics that may be of interest:

- A new-born baby boy could expect to live 78.9 years and a new-born baby girl 82.7 years if mortality rates remain the same as they were in the United Kingdom (UK) in 2011-2013 throughout their lives.
- Life expectancy at birth has increased by 6.3 hours per day since 1980-1982 for males, and by 4.6 hours per day for females in the UK.
- The most common age at death was 86 for men and 89 for women in 2011-2013.
- In 2011-2013 a man in the UK aged 65 had an average further 18.3 years of life remaining and a woman 20.8 years.

Source: Office for National Statistics; *National Life Tables, 2011-2013*

How do men and women's life expectancies vary?

- The gap between life expectancy at birth between boys and girls in the UK has narrowed from six years in 1980-1982 to under four years in 2010-2012.
- Life expectancy at birth has increased by two and a half years per decade since 1980-1982 in the UK for males, and by two years per decade for females.
- Life expectancy at age 65 in the UK increased by 40% to 18.2 years for men and for women by 23% to 20.7 years in the 30 years between 1980-1982 and 2010-2012.
- In 2010-2012 a man in the UK aged 85 had an average further 5.8 years of life remaining and a woman 6.8 years.

Source: Office for National Statistics 21st March 2014

Based on figures from 2011, a 70 year old woman has just about a 10% chance of living to 100, that means 1 in 10 women from age 70 will still be alive 30 years later. For men it 6%, or roughly 1 in 16.

For a child born in 2011 this rises to nearly 1 in 3 women who will still be alive at 100 and just over 1 in 4 men.

By 2066 it is predicted over half a million people in the UK will be alive over the age of 100.

So people are living longer and the 'improvement' is more pronounced for men than women.

Statistics show that there are also significant regional variations and also people with greater wealth live longer than those with less wealth.

STATISTICS PREDICT:

BY 2066... OVER 500,000 PEOPLE

The Implications of this Changing Picture of Retirement

The relativity of retirement

It is commonly understood that on average people are living longer and this trend seems to be continuing. This means that retirement for most people will span many years and possibly several decades. The complications around this increased longevity are considerable.

Firstly think of the "relativity of retirement" and how this has changed. Thirty years ago an individual retiring at 65 had an average life expectancy of roughly six years less than today. Those extra six years may look innocuous but in proportionate terms that changes the savings years/retirement year's ratio quite significantly. Someone who works for 45 years (age 20-65) now has to fund for 19 years not 13 on average. This means that the savings ratio is 19/45 not 13/45.

Again, as earlier, this represents an average. Many people who live to 100 may effectively have a ratio of 35/45. Unless people work to much older ages and retire later, there is a lot more that needs to be done in the savings years.

It is also probable that future economic conditions could be very different and, potentially, problematic for retirees. In many ways the period since the retirement years started to stretch out have been golden ones for retirees.

Very low inflation, multi-decade property price increases and up until a few years ago, widespread generous final salary schemes, have potentially masked the big structural changes in retirement. Possibly even kidded the next generations of retirees into thinking that somehow everything 'will be alright on the night'.

Who pays?

Let us consider some other factors: how often do you hear people say "50 is the new 40" or similar such sentiments! How different will it be for retirees in the future when they have a large population of other retirees to 'compete' against? How different will the financial picture be when the demographic time bomb stops ticking and explodes? When the tipping point is reached where the younger generation can no longer pay the taxes necessary to protect the older population? Arguably on this last point, this may already have occurred……the parlous state of government finances and the inability of government to properly contain annual deficits suggests this could be in play today.

It is difficult to conclude anything other than tomorrow's retired population need to start thinking about paying their own way in retirement; it is simply inconceivable that government will be able to prop them up, that they will be funded by company schemes (bar some exceptional cases) or that the 'property is my pension' scenario will work.

IN THE UK WILL [LIVE TO BE] 100

A healthy or unhealthy retirement?

Following on from this, those same statistical sources quoted above, also evidence that healthy retirement years are increasing, but slightly slower than overall life expectancy. In other words, the extra years are quite likely to be spent in good health. This suggests that lifestyle expenditure (holidays, travel etc.) will remain viable for longer and many people show strong preferences to maintain lifestyle choices for as long as possible.

Ill health can mean expenditure needs reduce (except where care is required) – but the statistical evidence suggests that years in ill health are increasing more slowly. But this can be seen as a "heads they win, tails you lose" benefit – because of the threat of health costs if you are not healthy.

Who Cares?

As with most big subjects there is a likely to be an 'elephant in the room' and in this regard care costs are that elephant. Most people will not need to pay care fees, but a growing number do and this number is not insignificant, meaning that although care is on average not likely to be required, it is going to be in enough cases for it to be a real threat to anyone thinking (and planning) ahead.

This is a thorny, complex, subject because of dramatic changes to social care budgets, NHS strains and the proposed cap on paying for care fees coming into place in a few years.

This guide is not one to cover this off in detail except to say that where care is required it can be very expensive and can have a devastating impact on an individual's or family's finances.

The £72,000 cap proposed to be introduced in a few years is also widely misunderstood and there are copious aspects to this which suggests the threat to individuals will not be reduced as much as many think.

Having to deal with care costs is still a real factor that just about everyone needs to prepare for, wherever feasible, even though it may not occur.

Lifestyle in today's retirement

The great news is that retirement now represents a real horizon which can involve the best years of one's life. Active years, with multiple opportunities to explore new places, hobbies, adventures and interests.

The growth in every age group above 65 does however suggest that supply and demand will impose greater costs in enjoying these advantages, another factor suggesting that expenditure in retirement will remain high for the majority of people.

The state of the company pension schemes

Possibly the biggest generational shift from the late 1900s into the early 2000s is the rapid disappearance of final salary pension schemes, those wonderful schemes which for millions of people have offered a secure, growing and generous income in retirement. The public sector remains the mainstay in offering such schemes.

Looking at the wider picture makes for an interesting analysis; the number of people in a work-related pension has actually risen in recent times. This is because of the introduction of Workplace Pensions. However the level of savings into schemes has reduced fairly consistently for some time.

The picture therefore can be confusing; as the numbers who have a pension are only one factor, it is the rate of contribution which is the other important one.

Old style final salary schemes, those gilt edged, generous, truly beneficial schemes are now becoming extinct in the private sector, being replaced by Personal-style Workplace Pensions, which whilst take up is good, have a fraction of the value. People are saving quite widely but simply nowhere near enough.

For more details visit:
http://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/pensionssavingsandinvestments/bulletins/occupationalpensionschemessurvey/2015-09-24

"My property is my pension"

There may well be people who will be able to use their property to support their retirement needs; but this is both risky and likely to change. People often forget that property transactions represent a 'nil sum game', in the sense that there is a buyer and a seller. So if property prices rise then someone if gaining and someone is losing. It is a delusion to think that property price rises are universally a good thing.

The idea of a prolonged, severe depression in property prices seems extremely unlikely given today's interest rate levels (base rate is 0.5% at the time of writing). But hold on – didn't a base rate of 0.5% seem like a fantasy proposition 10 years ago?

In other words there can be no assumption that a universal policy of downsizing, releasing money from property, will work as some form of retirement backstop. It would not take too much of a downturn, for a few years, in property prices for this to become a disaster for many, many people who have put their eggs largely in the property basket.

These various aspects of retirement are intended to highlight the changing nature of what these years entail and the complexities in planning towards them. It is not sufficient to look at today's retirees and their financial positions and conclude things will remain consistent. Tomorrow's retirees simply have to take a different financial planning view and plot their way forward in a unique way, which involves a series of carefully positioned steps.

The Financial Planning Steps

To recap we are facing a rapidly changing retirement picture both at a collective and an individual level. Life expectancy figures do not help us understand the extent of the money that may be needed in retirement; indeed life expectancy figures quoted in articles or by 'experts' are often misleading in their own right, simply because they misrepresent the most likely age of death.

Beyond this we have to plan to be an outlier, one of the lucky few who live well beyond the most likely date of death.

We also need to be wary of care fees and the impact of needing to pay for expensive care in retirement.

Therefore we have to make plans for a very long retirement and take some crucial steps to protect ourselves as best we can.

How do we do this?

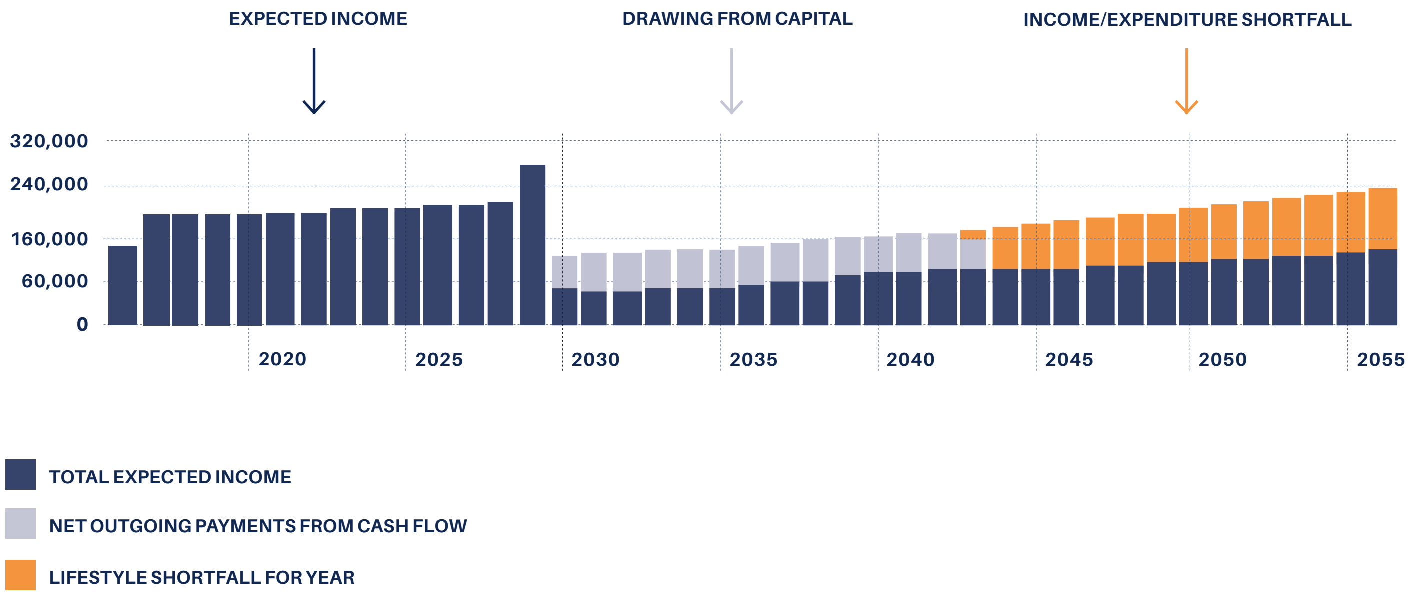
1. Treat this subject ("retirement planning") as a high priority. Wherever you are today on the 'pathway' please take immediate steps to review your retirement plan. Is there anything more important for you to do in the next few months?

2. As part of this review process aim to get some form of assessment of your lifetime income and expenditure requirement. There are several ways of doing this, the most popular of which is to get some form of personal financial cash flow forecast. This will provide you with a long term projection of what you are heading towards and, importantly, where the shortfalls might be and what you need to do today, as well as at future stages.

3. It is likely for most people that the key to meeting future needs will be determined by aggressive savings. Assessing current budgets and reorganising finances today to increase the savings amount could represent the difference between a comfortable retirement and the opposite. All the evidence shows that collectively UK savers are not saving enough. In many cases this may be down to affordability, but in others, this may be down to a misunderstanding of the amounts needed (and could be influenced by misconceptions about life expectancy).

4. An often hidden action point is the ability of individual's to get more from their pots, whether these are savings pots, pension pots or investment pots. It is astonishing how many people have a pension, for example, take a 45 year old who has £40,000 in a pension plan, who have no idea of the returns they are getting. Or they do know the returns but have no idea if these can be improved or if they are 'good' or 'bad' returns. They leave their £40,000 to do as they will. This is a mistake – it is absolutely essential to maximise returns and to avoid, wherever possible, leaving money in dud funds. Strive to squeeze the maximum out of every pot you have.

EXAMPLE: Income Assessment & Financial Forecast



PENSION POTS

A 45 year old who has £40,000 in a pension pot which grows at 3.5% per year will have £79,600 in the pot when they get to age 65.

A 45 year old who has £40,000 in a pension pot which grows at 7.0% per year will have £154,800 in the pot when they get to age 65.

That's £75,000 MORE!

No-one can guarantee better returns, but you can aim for them by getting the best investment help and advice, making sure you do everything you can to actively pursue the best return from the level of risk you can afford to take.

5. Consider family finances; it is always worth looking at, if appropriate, the interaction between parents and their children's finances to see how these may be interlocked to provide help, this is especially the case given the new pension freedom rules. The timing of gifts or inheritances, of using valuable inter-generation planning techniques can make huge differences to long term outcomes. This could be extended to looking at the use of trusts to protect bloodline interests and stopping family wealth being lost in a divorce or bankruptcy. Isolating the view to one generation can mask many opportunities.
6. Use expert help. This is a sophisticated position, where making a few short term changes can make a very long term difference (either positive or negative), using a qualified expert, especially one with modern software programmes to support the exercise, can reap huge rewards. It is not an area that especially lends itself to DIY solutions, to get right on top of this take time to get the best help you possibly can.

ISOLATING THE VIEW TO ONE GENERATION CAN MASK MANY OPPORTUNITIES

Conclusion

Longevity is now a reality for the majority of people. For all this is a wonderful thing, it does represent a series of challenges in terms of financial planning. The most important message we have aimed to emphasise in this guide is that you will, in all likelihood, need to plan to be an outlier, someone who lives even longer than the life expectancy figure so often portrayed as the benchmark.

This requires a major shift in thinking and will – in the vast majority of cases – require a large increase in the amounts saved during the 'savings years'; the fact there is no evidence that this is happening in a meaningful way at a collective level is a worry and there needs to be more done to correct this. However – at an individual level you can do something about your position. It is in anyone's hands to take control over their own destiny and to tackle and meet these challenges on their own behalf.

History, structure, and expertise

Interface Financial Planning started providing independent financial advice in 1992. From the beginning it had the aim of providing professional advice and quality service to people with modest income and wealth.

Its key value was putting people before profit, and contribution before reward. This mission statement has been our torch to light the path ahead and has been the reason that we have endured for over 24 years.

Alan has lead the company with his personal values of: Integrity, Compassion, Respect, & Loyalty, and he is proud that over the years he has worked with clients who share similar values. Like him they want to help others and make the world a little better.

Client care and service is important and he is proud that his first two clients from January 1990 remain his clients today.

We believe that every client should have access to highly qualified advice and expertise.

Technology is used to the full to maximise efficiency and engage expertise from throughout the UK. The business has been paperless for 10 years and for over 5 years has been ‘cloud’ based. This structure reduces costs and allows support staff to operate anywhere - from Colchester to Honiton to Leicester and elsewhere.

Clients are encouraged to access their online account where they can exchange messages and documents securely. They can view their investments and reports, and they have immediate access to their paper file. Clients love the transparency and openness of being able to view and print paperwork going back for years and many clients use it as a source of reference.

ALAN MORAN
Owner, Director
Interface Financial Planning

Alan Moran is one of the most highly qualified advisers in the UK. He became a Certified Financial Planner in 1995 and he was one of the first Chartered Financial Planners in 2005.

He is a Chartered FCSI, a holder of the IMC certificate and member of CFA UK. His expertise has been called upon by The CII, The IFP, The Kinder Institute, and others, where he has trained and examined other financial advisers.

Alan Moran B.Sc. M.Soc.Sc. Cert.Ed. FPFS FSWW IMC CFP^CM RLP®
Chartered Financial Planner - CERTIFIED FINANCIAL PLANNER^CM professional – Chartered FCSI
Registered Life Planner® - Affiliate of STEP
Certified to ISO 22222 by Standards International
Independent Financial Adviser
A member of The Ethical Investment Association and The Sustainable Investment and Finance Association UKSIF

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The information contained in this guide is based on legislation as of the date of preparation and this may be subject to change.

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CONTACT US

Alan Moran
0121 554 4444

enquiries@interface-ifa.co.uk

To book an appointment, schedule a call by telephone/Skype or arrange an online meeting, visit:
www.interfacefinancialplanning.co.uk