# AUTOMATING RETIREMENT PLANNING AND DECUMULATION TO ADDRESS RISING HEALTHCARE (AND OTHER) EXPENSES

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**WHITEPAPER**

# Section I: Introduction

*For the millions of Americans preparing for and entering retirement each year, addressing healthcare expenses is among their top priorities. As awareness has grown around the importance of building healthcare into retirement plans – and that these costs will rise faster than inflation – clients are looking to advisors to ensure this fundamental need is met.*

## Key Highlights

- Decumulation presents a significant and time-consuming challenge for financial professionals.
- HealthView's *Health Planner Plus* application automates this process and ensures portfolios remain in line to fund future healthcare expenses during both the accumulation and decumulation phases of retirement.
- Advisors are alerted whether clients are on track during the accumulation phase, and for those who are underfunded, investment options to offset this gap are included.
- Automation of the decumulation process ensures that client needs are met, time is saved, and regulatory requirements are followed.

Market performance, annual withdrawals, changes to expected lifetime healthcare costs based on health condition(s), inflation, and regulatory changes will all impact the ability of portfolios to address projected future expenses. For most advisors, determining the status of a portfolio's funding against these costs, planning withdrawals for key expenses, and changing the asset allocation of portfolios is a time-consuming manual process. The automation of these functions is key to meeting clients' decumulation needs.

Drawing on our industry-leading retirement healthcare cost planning and asset management expertise, we have developed *Health Planner Plus* a software application designed to help financial professionals meet the specific challenge of addressing future healthcare expenses.

By leveraging our benchmark healthcare cost data, this new application automates the process of ensuring that portfolios remain on track to fund projected health expenses, that cash is available to meet costs each year, and that personalized portfolio allocations are rebalanced consistent with client goals during both the accumulation and decumulation phases of retirement.

In this paper, we detail how this process addresses the unique challenge of matching retirement cash flows against the retirement healthcare decumulation curve – the steep, compounding incline of in-retirement health expense inflation, which typically averages around 6% per year. This document will also illustrate how the tools can be used to benchmark portfolio management for healthcare using existing portfolios and portfolio management systems.

Although designed with healthcare in mind, the process outlined in this paper can be applied to a range of goal-based financial planning applications.

# Section II: Healthcare Costs and the Retirement Healthcare Decumulation Curve

Healthcare will be a significant expense for American retirees. Since health condition(s), gender, retirement location, market performance, and changes to healthcare legislation are all variables that can impact health costs, projections of lifetime and future annual expenses must rely on the best available data and be run for individual clients on at least an annual basis.

HealthView Services applies proprietary algorithms to 530 million actual healthcare claims, government and actuarial data to provide healthcare cost projections for clients. This data underscores that – driven by rising Medicare expenses, age rating of supplemental insurance, and increased use of services as clients age – healthcare costs will continue to increase faster than the rate of the consumer price index (CPI). As a result, these expenses will account for a far greater portion of retirement budgets at the end of retirement than at the beginning: For an average 65-year-old couple, healthcare costs will require 45% of Social Security benefits; but by the time they are 85, it will be more than 88%. For advisors and their clients, portfolio cash flows required to address these expenses need to track the *retirement healthcare decumulation curve*.

## Putting this into practice:

For a healthy 55-year-old couple retiring at age 65 and living to average projected longevity, national average total lifetime costs for unfunded medical insurance premiums and out-of-pocket expenses will be approximately $712,000 (in future dollars).

In the first year of retirement, combined annual healthcare costs (the income the clients will need to withdraw from their portfolio) are projected be just under $14,700. As the chart below shows, in the final year the portfolio will need to cover nearly $54,500 at age 87, the husband's life expectancy. Note that these costs do not include potential long-term care needs.

Figure A highlights the projected distribution of these expenses over time versus a simple linear increase based on a fixed 3% inflation rate based on expenses at age 65. As the chart shows, for each year in retirement retirees will need to fund higher amounts for healthcare.

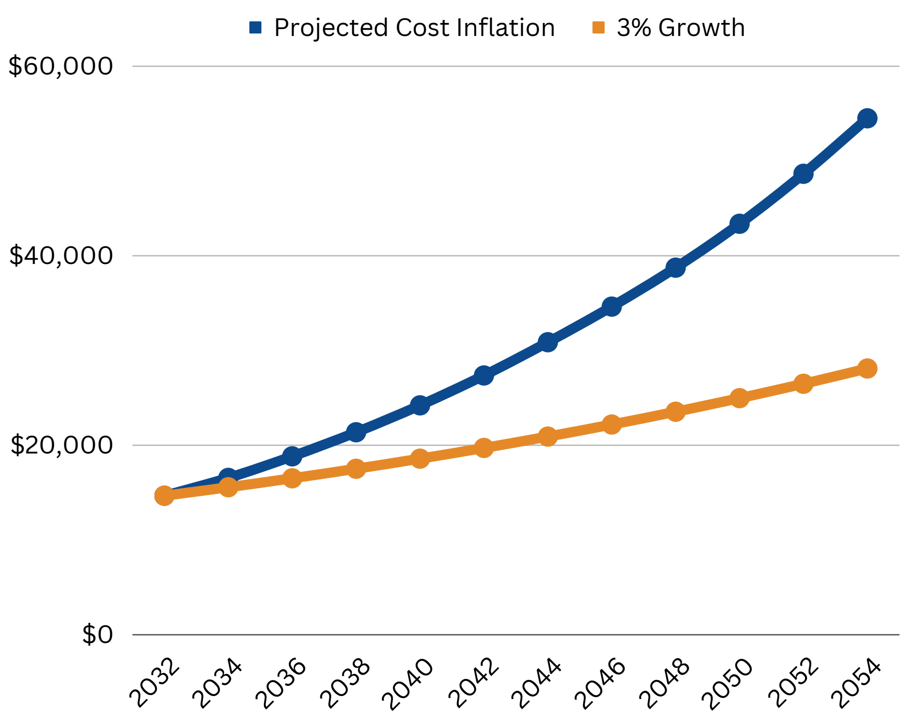


**FIGURE A:** Retirement Healthcare Decumulation Expenses – Projected vs. Linear Inflation (Healthy 55-Year-Old Couple from age 65 to 87)

# Section III: An Approach for Accumulation and Decumulation

In the run up to retirement, advisors' primary objective is to ensure that clients will have the financial resources to meet their general and healthcare-specific needs in retirement. Projecting future healthcare costs and regular reviews to determine where a client stands against their accumulation goals are key to driving investments and savings. Experience shows that when clients are provided with specific data about future healthcare costs, they take action – increasing investments or savings to ensure this need is met.

In retirement, advisors and clients shift their focus to generating the income needed to match individually projected healthcare expenses. The automation of the decumulation process (arguably the most complex part of retirement planning) offers a path to address client needs, consistent with regulatory requirements, while reducing the workload on time-pressed advisors.

With an average longevity horizon at retirement of 20-plus years, automation also provides an opportunity for portfolio returns and principal withdrawals to be managed around a healthcare-specific decumulation glidepath to provide an optimal balance between risk, return, and income goals through life expectancy.  Since actuarial expectations provide a framework for planning, advisors need to discuss a range of longevity scenarios with clients using reliable data for a range of scenarios.

*Health Planner Plus* leverages HealthView Services' actuarially-backed healthcare cost projection data to track progress against accumulation and decumulation goals and uses a glidepath-driven approach to portfolio rebalancing. Our approach provides the flexibility to choose a zero balance in the healthcare portfolio at projected actuarial longevity or to plan for the potential that the client may live far longer. The automation built into the tools highlights the funding status of a portfolio to meet healthcare expenses based on a range of end-of-life expectations.

The completion of a simple questionnaire provides the basis for determining expected costs and average actuarial longevity based on the client's health condition(s). It produces an individualized healthcare expense decumulation curve to use as a basis for planning and highlights the savings required at retirement based on portfolio performance assumptions and the risk profile of each client to meet future needs. The system updates health cost projections each year. Clients are informed of their portfolio's funding status, and whether they are above target, on target, or have fallen behind, which may require additional savings to fund future medical expenses.

*Health Planner Plus* can be used to automatically generate the data required for firms to benchmark the management of existing portfolios. Integrated into third-party systems or the portfolios we have developed specifically for healthcare, the system will rebalance allocations based on client risk tolerance and expected longevity as cash is withdrawn. The tools optimize the balance between clients' cash needs, portfolio returns, and risk through retirement. With the automation of the decumulation process, additional advisor time is freed up to focus on the clients' overall portfolio, choices around Social Security claiming, investment product selection, and legacy planning.

# *Health Planner Plus* Process & Features

*With a few simple steps, financial institutions utilizing the Health Planner Plus system can provide advisors with a personalized, automated administrator system to help clients address in-retirement healthcare expenses. The system alerts advisors when changes may need to be made to a client's investment strategy.*

## Phase 1 — The Healthcare Plan

- System projects actuarial longevity and future healthcare costs based on personalized, actuarially-calculated data.
- System calculates the necessary investment based on projected costs and asset allocation.
  - Advisor can modify this approach by adding emergency cash for possible unforeseen expenses.

## Phase 2 — The Accumulation Period

- System accepts changes which may occur that will affect projections: market performance, personal health, relocation to new state, revised health cost data.
- System adjusts actuarial projections and portfolio performance annually to verify that savings will ultimately meet client objectives.
- System notifies advisor when changes cause client to be underfunded, on track, or overfunded.
  - If underfunded, investment required to fill gap is included.

## Phase 3 — The Decumulation Period

- System ensures that cash is immediately (and continuously) available to fund projected costs.
- System transitions to retirement with an updated asset allocation that will glide to a 100% cash portfolio during the last year of life (firm's asset management system may also be used.)
- System adjusts actuarial projections and portfolio performance annually to verify that savings will ultimately meet client objectives.
- System remains responsive to regulatory "best interest" requirements.

# Case Study

*The following case study illustrates how the healthcare portfolio automation process would work for a specific hypothetical client. In this example, the advisor is using Health Planner Plus within their own asset management system. Since data is based on individual circumstances, numbers may vary significantly for each client.*

Marie is a 56-year-old unmarried woman who lives and plans to retire in New Mexico at age 66. She has been diagnosed with average-managed high cholesterol but has no other underlying chronic conditions and is not a tobacco user. Marie provides her advisor with this information, which he uses to project her retirement medical expenses and life expectancy.

She then fills out the advisor's risk-tolerance questionnaire which will help determine her portfolio's asset allocation. The results show that Marie is not necessarily "risk averse," but she is willing to forgo some growth to reduce volatility. Based on the analysis, Marie is placed in a Growth and Income allocation pre-retirement with 60% in equity, 38% in bonds, and 2% in cash. Marie and her advisor agree that the portfolio should be set up with a $10,000 cash cushion at retirement to give her peace of mind in case a health-related event requires access to additional funds.

Each year, the system informs Marie's advisor whether she is underfunded, on track, or overfunded to meet her projected future in-retirement health expenses. If she's underfunded, it will also indicate the additional investment required to offset that gap. Her portfolio may fall off track due to a number of factors, including market performance, changes to her health, new healthcare legislation, or changes to future plans like retirement age and state of residence.

When she enters retirement, the portfolio automation will allocate a portion of the investment to cash to match her projected annual healthcare expenses. Following an automated decumulation glidepath, a gradual process of adopting more conservative asset allocations will be implemented as she ages.

Marie's retirement healthcare premiums and out-of-pocket costs* are projected to be $257,751 plus the $10,000 cushion which can be covered with a one-time investment today of $93,794. The advisor can adjust Marie's asset allocation based on her risk tolerance and time horizon at any time.

The table on the following page illustrates the portfolio status and anticipated health expenses at key points.

**Includes Medicare Part D, supplemental insurance, dental insurance premiums, and out-of-pocket spending on hospitalization, doctor visits, tests, prescription drugs, hearing services, hearing aids, vision and dental. Medicare Part A premiums are assumed to be no-cost in retirement. Medicare Part B premiums are not included, as these costs are typically funded by Social Security benefit withholdings.*

**FIGURE B:** Marie's Asset Allocation (Funding All Retirement Health Expenses)

| | Year (Age) | Portfolio Balance | Retirement Healthcare Cost | Asset Allocation (Equity/Fixed/Cash) |
|---|---|---|---|---|
| **Current Year** | 2023 (56) | $93,794 | N/A (Pre-Retirement) | Growth & Income (60% / 38% / 2%) |
| **Year Before Retirement** | 2032 (65) | $160,221 | N/A (Pre-Retirement) | Growth & Income (60% / 38% / 2%) |
| **5 Years Retired** | 2038 (71) | $174,292 | $10,196 | Income & Growth (40% / 58% / 2%) |
| **10 Years Retired** | 2043 (76) | $151,879 | $13,831 | Income (20% / 78% / 2%) |
| **15 Years Retired** | 2048 (81) | $97,146 | $18,303 | Income (20% / 78% / 2%) |
| **Life Expectancy** | 2051 (84) | $42,682 | $21,572 | 100% Cash |

The system automatically adjusts the portfolio annually and allocates the necessary cash to cover healthcare costs for that particular year.

This illustration is based on Marie's current health status. Should she develop an additional chronic health condition, such as type 2 diabetes prior to retirement, her life expectancy and annual retirement healthcare cost projections will change. Despite increased out-of-pocket spending each year, the condition would lead to a lower longevity projection (from 84 to 80), and thus fewer years of healthcare costs to fund. In this scenario, Marie's portfolio would be overfunded by just over $45,000 at her retirement age of 66. She could choose to keep the excess investment in this account or transfer to another account managed by her advisor.

# SECTION IV: A Flexible Approach to Managing Retirement Portfolios to Address Healthcare (or Other) Expenses

Using healthcare cost data to manage portfolios that generate income to match rising expenses can help address a key client concern through retirement. We have long argued for the importance of allocating a portion of retirement savings specifically for future healthcare needs for a number of reasons. These include the practical recognition that healthcare will be such a significant component of future retirement budgets, and that the safest way to ensure these costs will be covered is to put sufficient funds aside for this specific purpose. Healthcare is not an optional expense – using CPI or the 4% rule and expecting healthcare costs will not put pressure on other parts of a client's budget is not realistic.

Further, the ability to set savings goals for clients pre-retirement to address healthcare is a proven motivator of contributions to savings plans and investments. Providing clients a clear sense of whether they are on track to address future needs in retirement on an ongoing basis provides peace of mind that this critical need will be met.

Since healthcare costs will increase over time, clients using an asset allocation glidepath have the opportunity to optimize portfolio risk/returns given the potential 20-plus-year retirement time horizon. Additionally, when it comes to healthcare, there is also the opportunity to take advantage of the triple-tax benefit of health savings account (HSA) contributions and investing that can be used in retirement to address healthcare needs.

Having touched on how our software can be used to manage or benchmark portfolios, we detail below how the methodology can be applied to achieve client goals that reflect the different ways advisors manage client assets.

## Automated Accumulation & Decumulation Through Healthcare-Focused Portfolios

Financial professionals (who, on average, have over 100 clients) can save significant time and more efficiently manage their practice through the automated process outlined in this paper. During the accumulation period, advisors are updated on a periodic basis on how their clients' portfolios are performing relative to their retirement goals. The system provides alerts on whether a client is behind, on track, or even overfunded. Throughout decumulation, asset allocation integrity is maintained, and the system makes the changes necessary to ensure that each client has the cash in their account to pay for annual healthcare expenses. This is managed consistent with regulatory "best interest" requirements to provide peace of mind for firms and advisors.

The key to achieving client goals is to leverage healthcare cost projection data to build savings pre-retirement, to ensure that withdrawals can be made during decumulation to meet annual expenses. Automated communication during both stages ensures that changes to a client's personal situation, investment performance, or healthcare legislation that may impact expenses are incorporated into the planning and decumulation process. Whether through existing advisor-managed portfolios or with healthcare-focused portfolios from HealthView Services, the automation of this approach improves the speed and efficiency of advisor services, and helps clients take healthcare off the table as a retirement concern.

## Addressing Healthcare Needs with Existing Client Portfolios

Health Planner Plus data can be used by advisors to help clients manage existing portfolios to ensure they are fully-funded to address future costs, and to guide withdrawals or allocations during the decumulation process. This can be done in multiple ways. Based on the income projected from an overall retirement portfolio, the software can be used to determine the portion of income required to address projected healthcare expenses. By working with a client to calculate future costs through retirement, advisors can determine the impact of healthcare on retirement budgets and whether or not current savings will be sufficient to address future needs. By running this data annually, any changes to the client's situation that will impact future costs can be addressed during pre-retirement with additional savings or in-retirement by reviewing portfolios and goals. The data we provide can also be used to benchmark asset allocation, withdrawals and re-balancing for a portion of an overall portfolio to ensure needs are met.

# Conclusion

Automating the process to generate retirement income to address specific financial needs provides a path for advisors to better serve the millions of boomers retiring each year as well as future generations. With regulators laser-focused on the industry meeting clients' retirement goals, this approach is not only consistent with best interest requirements but also reduces advisors' operational risk.

Because the system notifies the advisor whether clients are on track to meet their healthcare cost funding goals, the advisor can then set up a meeting to address any shortfalls and ensure that portfolios are well-positioned to cover future health expenses.

Automating annual accumulation projections and decumulation management is of critical importance for clients, because it provides the best way to reliably ensure that funds will be available to match clients' *healthcare decumulation curve*, providing a powerful way to drive savings pre-retirement and portfolio funding conversations through retirement.

This is also significant for advisors, who may be managing hundreds of portfolios for clients. Automation provides a more efficient path to managing individual portfolios to address healthcare needs at scale for this specific client priority, as well as for other goal-specific applications.

## About HealthView Services

HealthView Services (HVS), founded by a team of financial professionals, healthcare industry executives, and physicians, is the nation's leading provider of healthcare cost projection software. Its portfolio of retirement healthcare planning applications – which create comprehensive and reliable cost projections for around 40 million users annually – is utilized by advisors, financial institutions, employees and consumers.

Drawing on actuarial and government data, as well as 530 million medical claims, HVS applications rely on a patented data process that utilizes simple user inputs (age, gender, health conditions, income, and state) to create personalized estimates of retirement healthcare costs. The data also incorporates inflation projections for each component of retirement healthcare: Medicare premiums, supplemental insurance, and out-of-pocket spending.

With more than a decade of use across the financial services industry, these solutions have proven to be a powerful driver of savings and retirement planning. HVS has numerous software applications which include healthcare cost projections, long-term care costs, Medicare premiums and surcharges, Social Security optimization, and more.

The firm's asset management arm offers and manages targeted portfolio strategies that migrate clients from accumulation to the distribution phase of retirement planning. The decumulation strategies calculate cash flows needed to match rising healthcare and long-term care expenses.

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