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Longevity Puzzle: A Medical Diagnosis Complicates Retirement Planning

Many People Worry About Running Out of Money. There's Another Risk for Those Who Could Die Early

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Peter Nelson, a 61-year-old widower, was recently diagnosed with a serious medical condition.

Investors often worry about outliving their money. Many won't get the chance.

Even as life expectancy rises, the threat of passing away prematurely persists. More than 632,000 U.S. residents 60 to 74 years old will die in 2014, representing nearly a quarter of all deaths, the U.S. Census Bureau projects.

That means many people may make more financial sacrifices than they need to.

How long you will live is the most important but unpredictable variable in your financial plan. Trying to make sure retirement is both solvent and satisfying means taking the whims of fate into account.

Consider the dilemma facing Peter Nelson, a 61-year-old software engineer who lives in Chelmsford, Mass. He recently learned that he suffers from a form of blood cancer that can put patients at heightened risk of clots or stroke. Some patients that age die 10 to 20 years after getting a diagnosis, experts say.

After getting the news, Mr. Nelson says, his thoughts soon turned to making his remaining time fulfilling. He may hire people to help with household chores so he can devote time to painting, a favorite hobby. An avid traveler, he says he wants to hike in Patagonia, tour India and attend the Venice Biennale.

His guiding principle: "If there's something I want to do, do it sooner."

At the same time, people with Mr. Nelson's disease—known as polycythemia vera—often lead active lives for years. Proper treatment can reduce the risk of clots or stroke, often without debilitating side effects, experts say. Many patients survive for decades.

"For most patients, they can continue doing everything they're doing," says Jerry Spivak, a professor of medicine and oncology at Johns Hopkins University who isn't involved in Mr. Nelson's treatment.

Mr. Nelson worries about spending his savings on activities he loves now, then not having enough left to cover his needs if he is fortunate enough to live to a ripe old age. The average life expectancy of a man his age is 84, according to a Social Security Administration calculator.

"I just don't know whether I should plan everything around the expectation of a shorter lifespan," he says.

Mr. Nelson is confronting the unknown now. Other investors in or near retirement face a similar risk, even if they don't realize it.

Managing that risk, experts say, can mean setting priorities and staying flexible about factors you can control, such as how much you spend, how much you draw each year from retirement accounts and when you start taking Social Security benefits.

"The more flexible you are, the more aggressive you can be early on," says William Bernstein, co-principal of Efficient Frontier Advisors in Eastford, Conn.

Here's how to deal with an uncertain future.

'Not That Different'

It is rare for people to know how long they will live with any precision. It is also unusual for people to have so much money that they are unlikely to run out no matter how long they live.

Most everyone else lives with the mystery. Mr. Nelson's situation "is really not that different from anyone else" who could be felled by illness or accident at any point, but who wants to enjoy a full life in the meantime, says Dan Goldie, a financial adviser based in Palo Alto, Calif.

Mr. Goldie has worked with clients with terminal illnesses that shortened their lives. He co-wrote a book, "The Investment Answer," with a friend and client, Gordon Murray, after Mr. Murray was diagnosed with brain cancer. He died in 2011.

When he meets with clients, Mr. Goldie says he asks about their health as well as their finances, because of the potential impact on their financial plans.

Investors wrestling with the uncertainty can weigh two possible bad outcomes—on the one hand, regretting that you decided not to do something important to you because of concern about the cost; on the other hand, lowering your standard of living dramatically if your savings run low.

If the second option seems particularly troubling, think about ways to hedge that risk. For example, consider postponing taking Social Security benefits until age 70—when you could qualify for the maximum payment based on your salary history—which can boost your monthly check considerably.

The trade-off for someone who could be at higher risk of dying prematurely is that the move could increase the chance of getting less out of the Social Security system than you put in—a scenario that troubles some recipients.

But the maneuver also could provide “a safety net,” Mr. Goldie says, allowing you to spend more in the near future while preserving a certain standard of living in the long run.

The difference could be substantial. A single 61-year-old man eligible to collect $1,500 a month starting at age 62 could instead collect $2,640 by waiting until age 70, without adjusting for inflation, says William Reichenstein, a finance professor at Baylor University and a principal at Retiree Income, an advisory firm based in Overland Park, Kan.

Buying Protection

Other maneuvers also could be effective.

For example, investors who think they may want a steady flow of cash down the road, beyond Social Security benefits, can set aside a chunk of money now and invest it in a low-risk manner, says Allan Roth, a financial adviser at Wealth Logic in Colorado Springs, Colo.

Such an investor could take a certain amount—say, $100,000—and divide it into two pots, he says. The first pot would be used to guard against loss of principal for a set period, not adjusted for inflation. For example, an investor could take a little less than $72,000 and use it to purchase a 10-year certificate of deposit that would be worth $100,000 in a decade, based on a current high yield, Mr. Roth says. Deposits are protected by the government within certain limits at federally insured institutions.

The second pot, roughly $28,000, would go into a low-cost stock-market index fund. Even if stocks are basically flat over the following decade, the investor would get back about the same amount.

At that point, Mr. Roth says, the investor could see whether circumstances had changed—whether, for example, his or her health or finances were better or worse than expected—and decide then whether to purchase an immediate annuity, which provides a steady payout.

Currently, a 70-year-old man could buy an immediate annuity for $128,000 that would pay out more than $800 a month for life, according to ImmediateAnnuities.com, an online brokerage.

Careful investing can also help protect the ability to maintain a set level of spending. “I would want to make sure that my investment portfolio is extremely diversified” in the face of a dilemma like Mr. Nelson’s, Mr. Goldie says. “I wouldn’t be speculating on individual securities.”

Such an investor, he adds, should be “a little bit more conservative than your average 61-year-old”—with, for example, a smaller portion of the portfolio devoted to stocks and a larger portion to bonds.

Investors also should think about how they could cut their expenses down the road—and how they would feel if they had to do that.

One way to test that is to draw up a budget that calls for cutting your current spending in half, Mr. Bernstein says. If that seems too harsh, try a budget of 75% of your current spending, which might be more palatable.

A Full Life

"Financial planning isn't just about finances. It's about feelings and emotions," Mr. Nelson says.

In 2007, Mr. Nelson's wife, Esther, was diagnosed with another form of cancer and given a year to 18 months to live, he says. She survived for 4½ years.

The couple continued to travel, kayaking in Alaska and hiking in Yosemite National Park while Esther was still strong enough. She kept working, eager to finish a long-term project that meant a lot to her professionally.

"She led a full life in her remaining years," he says.

Yet financial concerns shaped those years, Mr. Nelson says. He was laid off in 2009, and remained out of work until shortly before Esther died in 2012.

"I tried to persuade her to spend more and do a lot more," but she worried about depleting their savings, he says.

Mr. Nelson was left with their combined assets, which he says are in the low seven figures. The couple had no children, and their house is paid for. "I was always assuming I was going to live into my 90s," he says. He felt confident about retirement.

His health issues threw his plans into question. Mr. Nelson initially pondered whether he should leave his job at a small local firm that makes laser projectors. He also began to consider moving to a single-story house closer to Boston, given that he could be incapacitated by a stroke or other ailment.

He also wondered if he could ramp up his spending without risking eventual destitution.

Mr. Nelson says he buys a new car about every 10 years. His current expenses are less than his income, and increasing his outlays by 50% would still leave them below $100,000 a year.

"I'm not the kind of person who goes out and buys a Lamborghini," he says.

But he would like to travel more frequently in light of his disease, and to contemplate purchases such as new camera gear to pursue another hobby, wildlife photography.

If Mr. Nelson has money left over when he dies, he plans to give some to relatives and to the hospital where Esther was treated. But, he says, "I wouldn't mind getting close to zero."

Still, he is troubled by the possibility of doing just that, then being fortunate enough to live far longer.

A Compromise Approach

Mr. Nelson got the first hint that he might have the disease at a doctor's appointment in August. He met an old friend, Scott Hankin, for lunch, and they discussed his options.

“He said, ‘If I’m only going to live for five years, let’s use the 401(k) and live on a cruise ship,’” Mr. Hankin says.

As Mr. Nelson learned more about the disease, he concluded that five years was probably unnecessarily grim. One member of a support group he has joined has been living with it for 24 years. That drove home the risk of living too large. “It was almost disappointing to me,” he says—though he adds that cruise ships aren’t his style, anyway.

Mr. Nelson discussed the situation with his employers and asked if they could accommodate his desire to travel more. “I don’t want to leave them in the lurch,” he says.

Matt Zmijewski, the firm’s chief operating officer, says, “It would be difficult to replace him.”

Mr. Nelson now expects to work at least through 2015, which will postpone the date at which he needs to start tapping his savings. He also plans to put off taking Social Security until 70. His investment portfolio is already fairly low-risk, he says.

As for living it up a bit, Mr. Nelson is considering what he dubs “a compromise”: Setting aside a chunk of money, perhaps two to three hundred thousand dollars, to fund extra travel and other activities over the next five years or so.

At that point, Mr. Nelson expects to pause to evaluate his finances and his health.

Mr. Hankin says watching his friend work through the issues has encouraged him to reflect on his own life.

“I don’t know when I’m going to die either. I may die before him,” Mr. Hankin says. “Let’s face it: It’s a crapshoot.”