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This Week's Top Articles

We'll live longer, but what will it be like?

David Williams

In a recent article (Cuffelinks, 21 February 2014) I showed that longevity has continued to increase steadily since the 1800's after being relatively stable for at least 2000 years. These increases accompanied the onset of the industrial age and the growth of science. New discoveries, inventions and social strategies have combined to increase the lifespan of a baby from 35 to 82 in just over 200 years.

One school of thought believes that increasing community longevity is the result of a ratchet effect – the more we learn (and contribute to increasing longevity), the more we retain the wisdom of our older population which in turn helps to further increase longevity. Increasing longevity then plays a part in further longevity increases. Definitely one for the philosophers.

How long and how well?

Until about age 50, people typically take little interest in their own lifespan other than to insure against its untimely end. Between ages 20 and 50 life expectancy only increases by about one year.

However, people over 50 are increasingly aware they might live well into their 90's. There is a growing realisation that how they manage their remaining years will strongly influence just how long and how well they might live.

Longitudinal studies (studies of the same people over an extended period) are revealing how the lifespan of older people is panning out. The following table shows how – on average – things are shaping up at age 65 and beyond.

Stages in Longevity

Men & Women

Age Now	Disability Free Years	Years with Some Disability	Dependent Years*	Totals	Average Age at Death
65	8 10	7 7	4 6	19 23	84 88
75	4 5	5 4	3 5	12 14	87 89
85	1 1	2 2	3 4	6 7	91 92

*Dependent years are defined as those with severe or profound core activity limitations. Core activities comprise self-care, mobility and communication.

Source: AIHW

These numbers, from the Australian Institute of Health and Welfare, are useful for people looking to make informed decisions about managing their futures. While accepting the limitations of applying this general data to an individual, there are some important planning opportunities. For example:

- At the age of 65, for both men and women, over half their remaining years are lived with some disability and ultimately dependency.
- For most people still alive at 85, around half their remaining lives are will be spent with severe core activity limitations.
- There is a survival bonus: the longer you live, the longer you are likely to live and the additional years are likely to be with less disability. Looking after ourselves physically and mentally could pay off now as well as later.
- Expected dependent years decline with increasing age (it's clearer in the numbers above at the next decimal point). This is contrary to most people's expectations.
- The gender differences are striking. Currently, women live longer but seem to be in worse shape than men over time. Could this be rectified at the personal level?

In interpreting this research and applying it to our own lives, we should note:

- These findings show how things are now. However, knowing this information, enables us to take action to influence our own outcomes.
- As we age, we become more different from each other, not more alike. We can address what is important to us individually, not just follow 'trends'.

In 20 years from now, this table could (and probably will) look a lot different. Just how different will depend on what we do in the meantime.

Longevity awareness should improve decision-making

Personal longevity awareness can lead to better decisions. What is 'longevity awareness'? At the personal level, I use the definition 'seeing the future and planning for it'. Can we really plan for our longevity?

Ten years ago our thinking was still dominated by the tolling bell of the Life Tables, the deeply ingrained notion of retirement and the fear of disappearing into a grey and formless future after age 65. These limitations have been largely washed away by waves of reliable information about the potential richness of later life. But how many people realise this?

Greater longevity awareness can impact on personal and community decisions. We should be making better decisions affecting our health, employment, housing and social support as we age, along with many other strategies.

Perhaps we should be working longer, believing that there will be enough quality time left at age 70 or more to achieve our 'retirement goals' with time to spare.

We can develop a plan for tackling the spectre of dependency by addressing now the factors which lead to it – such as frailty and poor balance, muscle loss and declining cognitive awareness. Understanding more about our possible timeframe at least gives us the choice of whether we will take action or not.

Longevity awareness is becoming at least as important as financial literacy in helping people achieve and maintain the greatest possible independence. Greater longevity awareness, both in number and quality of years, will improve our personal decisions, our community decisions and our lives.

David Williams began longevity research in 1986 and was a Director with RetireInvest and CEO of Bridges. He chaired the Standards Australia Committee on Personal Financial Planning. David founded My Longevity Pty Limited in 2008.

Longevity perceptions and post-retirement products

Melinda Howes

How long do you think you're going to live?

Humans have been on earth for around 100,000 years and of all the humans who have ever lived to age 65, half are alive today. Average global life expectancy has doubled in the past 100 years, and Australia is one of the longest living nations. Right now, your life expectancy is increasing by six hours for every day you live.

Official statistics underestimate longevity

Most of us think we'll live as long as our grandparents or parents did which is a major perception problem. We don't realise how long we're going to live. In 2010 I co-authored a white paper for the Actuaries Institute called Australia's Longevity Tsunami. The paper explored longevity and some reasons why we consistently underestimate how long we're going to live. This excerpt describes the reality:

"The latest ABS data reports the life expectancy at birth for a male as 79 and a female as 84. These figures are reported in the media and most Australian retirees base their views on how long they will live on this information.

*The more realistic predicted scenario is much more dramatic. After allowing for mortality improvements on a cohort basis ... it's estimated that **retirees** aged 65 now (i.e. in 2010) will live until 86 for men and 89 for women ...*

By 2050 the average life expectancy for people aged 65 is projected to have improved to 92 for men and 93 for women. And this is an average. Many will live longer than this."

So rather than living 14 years in retirement from age 65, males who have reached 65 are expected to live another 21 years – 50% longer. Similarly, women will be living 26% longer than expected. What does this mean for our retirement planning?

I think these figures could turn out to be conservative considering that we have consistently underestimated the speed of mortality improvements over the past 50 years. My personal prediction is that if the current rate of medical advancements continues then if you are currently 65 and healthy, there's a 50% chance you will live until 100. If you are in your 20's now, you could live well beyond 110.

It's not just the general public that have failed to recognise these trends. It's also those of us working in the superannuation industry. Are fund executives, product developers, fund trustees and risk managers really thinking enough about the implications of increasing longevity? If we believe a significant proportion of today's retirees will live until 100, we know they won't have enough super to last that long. How can we help them to manage the two biggest risks they will face in retirement - investment risk and longevity risk?

Poor acceptance of post-retirement products

Over the past two decades a series of post-retirement products have been launched which attempt to address these risks, but hardly any retirees have bought them. Why is this? There are many reasons, including:

- The products (such as lifetime and deferred annuities) are complex and it can be difficult for customers to understand them. We have not yet found a way to simply present the value proposition of these products to a customer.
- Interest rates have been low for a long time so it would mean customers are locking in a low rate of return for life and their returns look poor.
- We struggle to find natural assets to 'back' these products. An ideal hedge would be a long term indexed bond. The lack of suitable assets to match these liabilities increases the risk and therefore the cost.
- Fees appear high because they include insurance premiums for the significant protection provided against both market downside and outliving the money. If a customer doesn't recognise how long they are going to live, this protection seems expensive.
- Protection is expensive because the risks are so high. The market downside protection is the most expensive. Longevity protection becomes even more expensive when actuaries are not sure how fast longevity is improving. Longevity risk also exacerbates the investment risk as the longer a retiree lives, the higher the chance they will experience a market reversal.
- Retirees want flexibility and do not like the concept of putting their retirement savings into a product which they cannot surrender and access the capital. It also works against their desire to leave a legacy to their family when they die.
- Taxation legislation is out-dated and penalises deferred annuities compared with other retirement products. Other legislation (SIS, Centrelink) creates a number of other barriers.

Shifting perceptions

Perhaps we all have to shift our perceptions to be able to solve these problems. Product manufacturers need to design products which are easy to use, able to be understood by customers and present a clear value proposition. Trustees and fund executives need to recognise the importance of offering retiree members protection against the high risks they will face. Individual Australians need to recognise that we are going to live for a very long time, and look at ways to protect ourselves against running out of money. And last but certainly not least, governments, regulators and policymakers need to prioritise the removal of legislative roadblocks to allow innovative products to be developed.

Melinda Howes is an actuary. She is Director of Product Strategy and Services at AMP, and is also a non-executive director.

Lessons for all directors from Senator Sinodinos's grilling

Graham Hand

It is the dream of many executives at the end of their corporate careers to pick up a neat portfolio of non-executive directorships. Who wouldn't want to be on the board of the Commonwealth Bank (annual director's remuneration about $320,000, Chairman's remuneration $856,000) or BHP (directors earn about $300,000, Chairman about $1.2 million)? These ASX20 companies all have lawyers and experts who specialise in compliance, hundreds of staff compiling reports and following regulations, and there is negligible personal liability. It is prestigious and interesting work, and can last a decade or more if done well.

The other end of the scale, however, is a different ball game. Join the board of a small private company, which might have a handful of staff and a couple of senior executives, and the board member on $30,000 a year has nowhere near the same level of support. These businesses do not have the same 'economic moats' or competitive advantages of the big boys. Non-executive director roles at that end of town require more hands-on involvement. Inspecting the mine, chatting with the customers, knowing the staff and really understanding the business are all part of the role. If there's a problem, there may be only one or two directors around to sort it out.

And then there are the cosy directorships which look comfortable at the start …

I sat in on the Independent Commission Against Corruption (ICAC) interviews of Senator Arthur Sinodinos on 3 April 2014. It was amazing to see a Senator of the Australian Parliament shredded by counsel assisting the inquiry, Geoff Watson, who said things like, "Listen to me … Let's just focus" and "Will you concentrate!" and "Oh, just answer my question". It has been well documented in the media that the Senator was unable to answer many of the questions. He admitted to being busy 'transitioning' to the Senate in 2011 when he should have known the extent of the dire financial straits of the company while paying $17,000 a month to Liberal Party lobbyists.

The full five hours of transcripts, covering 146 pages, are here from the morning and here from the afternoon. ***Selected verbatim extracts from ICAC are included in the full version of this article on the website.***

You be the judge, but before condemning the Senator, any director should consider how well they could answer the same questions about their company. The Senator was a Director of Australian Water Holdings from October 2008 to November 2011, as either Deputy Chairman or Chairman for the whole period.

What's the major lesson from all this?

You can read through all 146 pages but the most useful lesson is in the last line extracted, from Arthur Sinodinos's silk, Tony Bannon SC. Bannon was admitted to the bar in 1982 so he has a wealth of experience. He claims that only one potential director in 100,000 does due diligence on a company before accepting a board appointment. Unlikely, but that's what he said.

Unless you're invited onto the Board of the Commonwealth Bank or BHP, make sure you are in that 0.001%.

What's going on in Australian equities?

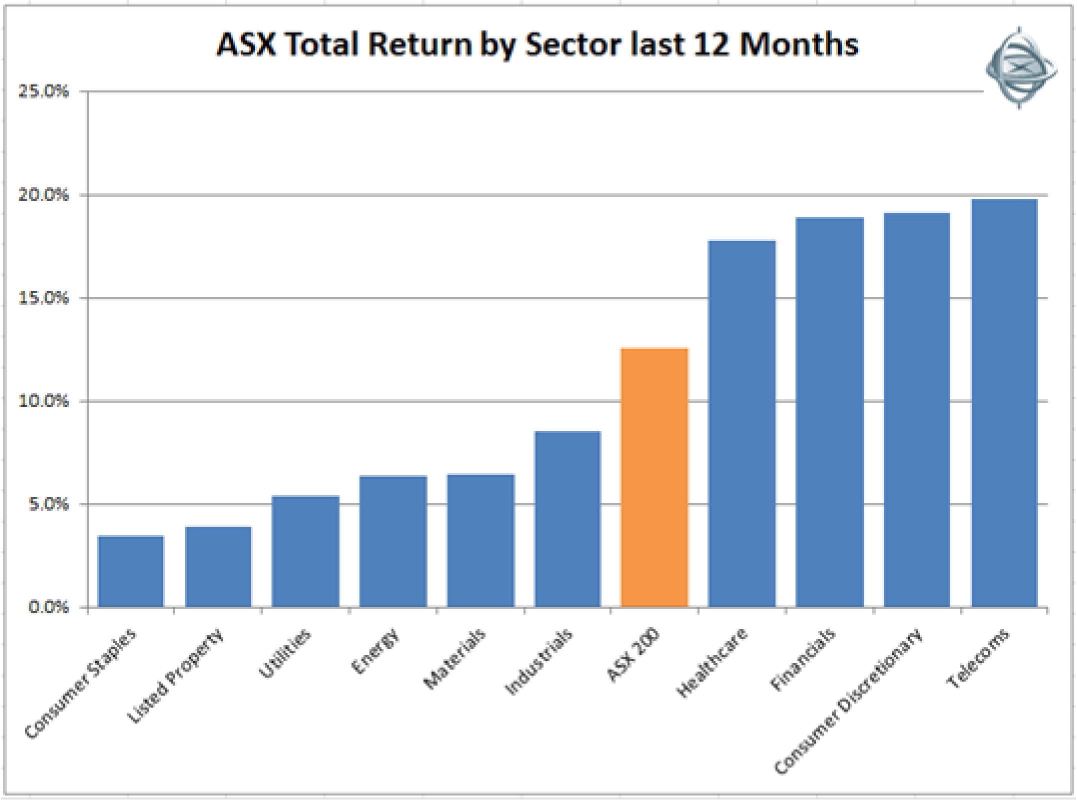
Hugh Dive

Managing a diversified equity portfolio is sometimes similar to being a farmer in that at any stage you are likely to be 'harvesting' or selling good stocks that are now over-valued and 'planting' or buying companies that appear undervalued.

When you look at the collection of stocks in any portfolio, it is both unlikely and probably undesirable to face a situation where all the stocks are dramatically ahead of the index and also ahead of our valuations. This turn of events would probably indicate a lack of selling discipline by the fund manager. Furthermore if this was the case, the following month or quarter could show those very same stocks all down simultaneously as well.

Over the last 12 months the ASX 200 has given investors a total return (price appreciation plus dividends) of +12.5%. As you can see from the chart there has been a significant dispersion of returns amongst the 11 sectors that make up the ASX.

In this piece we present an overview of the sectors in the market, as well as looking at those securities that have performed well over the last 12 months and those that have lagged.



What's working?

Telecoms have been the best performing sector over the past year with heavyweight Telstra (+17%) finally increasing dividends and capturing mobile market share. This performance from Telstra was eclipsed by the second tier players such as TPG (+105%) and iiNet (55%) which have benefited from strong customer growth.

Consumer Discretionary has benefited from investors looking to capitalise on a recovery in Australian consumer spending. However, unlike telecoms there has been a wide dispersion in returns amongst this sector. Previous market darlings like The Reject Shop (-43%), Wotif.com (-43%) and Myer (-20%) have struggled over the year. Alternatively investors have bid up RealEstate.com (+77%) and Harvey Norman (+19%) to take advantage of a housing market recovery.

Financials continued their run of providing solid returns to investors mainly due to falling bad debts boosting bank profits. Bank returns were understandably tightly clustered as they are influenced by similar dynamics with ANZ (+20%) the leader and Westpac (+18%) bringing up the quite respectable rear. Sizzle in the Financials sector was provided by companies like Henderson (+97%) and Macquarie (+63%) whose profits are directly linked to bullish equity markets.

What's lagging

Consumer Staples was the worst performing sector in the market as reasonable performances from Woolworths (+10%) and Wesfarmers (+7%) were dragged down by a collection of other companies like Treasury Wines (-34%), Metcash (-30%), Graincorp (-25%) and Coca-Cola (-19%) which fell due to a range of stock-specific issues.

After being the glamour sector in 2012, Listed Property has turned in a rather pedestrian performance, essentially tracking the sector's distribution yield. If an investor's focus is on owning trusts whose earnings come from collecting recurring rents such as IOF (+11%) and SCA Property (+6%) rather than development profits, they should be happy with this development. Some portfolio returns were assisted by the takeover of Commonwealth Office (+18%).

As a sector, Utilities returned 5% over the last year. Regulated utilities like electricity and gas distributors SP Ausnet (+15%), Envestra (+15%) and Spark (+9%) were generally higher due to tariff increases. Electricity retailers like AGL (flat) struggled during the year due to elevated levels of competition for customers and discounting eroding margins.

What's missing?

Typically any piece discussing the ASX mentions the rock diggers, as this is a large part of the index and for Australian equity fund managers, correctly picking the resources over or underweight is a key determinant of relative performance. Whilst as a sector over the last year, Materials trailed the index returning 6%, the main miners, BHP (+12%) and Rio Tinto (+13%), have mostly matched the index.

Hugh Dive is Head of Listed Securities at Philo Capital Advisers.

Personal investors need credit reporting too

Ramani Venkatramani

Before a bank will lend to a personal borrower, a full credit check is done against records with the reporting agencies. If you miss a credit payment on a credit card, mortgage or utility, a black mark lurks in your records for the lender to assess. So why isn't there a similar arrangement for personal depositors when lending money to financial intermediaries?

Institutions have ready access to intimate financial details on borrowers, but when the roles are reversed there is nothing similar. Available information is often received too late, usually coming after a failure. In the interim, the investor is subjected to the usual advertising, orchestrated by the institution in self-interest.

In establishing and maintaining an orderly market, the current credit reporting on retail borrowers serves a useful role, by allowing lenders to rate borrowers according to their history. Without it, good borrowers will subsidise the bad, with lenders increasing the risk premium or even declining requests outright.

From March 2014, the system has been further refined. Now positive information, such as timely servicing of credit obligations will also be reported, providing a more complete picture of borrowers (see creditsmart.org.au). Good quality borrowers should be able to negotiate better credit terms as a result.

This is fair enough, but just as retail borrowers access credit from lenders, the lending industry itself accesses credit from ordinary savers through deposits, debentures, and bonds, as well as more complex intermediation such as insurance premiums for risk transfer. While we see borrowers as diverse individuals, it is easy to forget that lenders represent individuals too in the ultimate analysis: shareholders, investors, financiers and counter-parties and employees.

Financial intermediation - the process of converting retail savings into retail borrowings - serves a critical need to oil the wheels of commerce. Most regimes have put in place controls such as capital, governance, risk management, disclosure, external audit and prudential oversight to facilitate order, consumer protection and market confidence.

However, just as some retail borrowers default in their obligations for a range of reasons – from temporary financial difficulty, borrowing beyond prudent capacity, lack of testing for interest increases, even deliberate unwillingness to meet obligations - so do financial intermediaries.

'Pretend' capital that fails to absorb losses as it should, poor governance beset with unacceptable conflicts of interest and duty, skewed risk management that ignores the business downside, non-existent or obfuscating disclosure, failed audit processes and ineffective oversight have all contributed to the many reported failures. Storm, Westpoint, Australian Capital Reserve etc. are poignant reminders. Reported failures must remind us that problems develop over time, and at any time there are a range of circumstances which may inexorably lead to failure. Things do not happen overnight.

As all human activity involves humans, regardless of legal fictions such as partnerships, joint ventures and corporations, the unavoidable impact of human foibles lurks: negligence, placing self-interest ahead of fiduciary duty, a false confidence of being able to get away with default, fraudulent intent, and plain greed. Operational risk and environmental changes complete the cocktail.

Reported failures and near failures tell the same story: poor asset liability management where liabilities are assumed to be rolled over indefinitely, exorbitant asset valuations, inability to withstand market volatility, including extreme events. Piling rules onto existing abused rules might whet regulatory appetites, leading to false complacency.

To restore balance, intermediaries who access public savings for lending should be subject to the same discipline as borrowers. Savers should be able to know, on demand, their credit history: complaints, delays in payments, disputes and their outcomes, so that they may proceed on objective data, rather than rumour or blind faith as at present.

This suggestion may be opposed because premature information may spread panic, destroy confidence, cause a run and precipitate a crisis. Difficult circumstances may then become real disasters. Confidence and market stability will suffer. This exposes the uninformed customer to significant risks.

Another likely objection is the business confidentiality of the intermediary. The objection can be countered using the very rationale now relied upon by privacy use to facilitate credit reporting (see www.oaic.gov.au): in balancing social objectives versus individual privacy, some loss of privacy must be countenanced. Likewise, in protecting investors, some dilution of business confidentiality is appropriate. Let us treat the lending goose on a par with the retail gander.

The current prohibition against directors trading whilst insolvent has not helped victims of collapsed institutions in sufficient time, going by the empirical evidence. Post mortem reports cannot reduce the grief.

At what point in the various reported failures should the clueless investor have had some signals of impending trouble? More importantly, at what time should we reasonably warn consumers not to risk their money in a business that is spiralling towards extinction? With memories of the GFC fading, it is easy to forget the lessons of finance and real estate investors and off-the-plan buyers getting burnt.

This can and should be overcome by designing objective parameters, similar to a traffic warning system, of green (solvent, normal); amber (some difficulties, being worked through); red (invest at your peril). Greater granularity could be achieved through additional layers of colours that signal, for example, qualified audits, regulatory intervention, external shocks etc.

Traditionally, rating agencies provided an assessment of various products issued by intermediaries, but even this has declined for retail products as agencies now need a license. In practice, this was always inconsistent in the retail market, unlike the wholesale market where it is standard practice. Many issuers of retail products are not rated at all, including some of the notable failures in Australia where advisers have been driven by excessive commissions. Where they are rated, the ratings have not always reflected the underlying credit worthiness of the issuers, especially keeping pace with changing issuer fortunes. Negligence, incompetence and outright complicity have all been noted. The Parliamentary Inquiry into the Trio Super Fraud illustrates the weaknesses well.

It is clear that the current reporting system is skewed towards lenders and against investors. This is symptomatic of our enforcement culture in finance. Too often, we see intermediaries being prioritised over consumers, such as when fictional legal constructs are placed ahead of 'flesh and blood' humans.

The first step is to recognise the glaring anomaly, and debate how it might be addressed. Our financial engineers, who have devised derivatives upon fuzzy derivatives, must surely be equal to the challenge.

It should not be beyond the wit of man to devise a rating method. An impartial agency that will mandate data and make them available publicly would have social benefits more than the effort. David Murray's Inquiry would do well to explore this.

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