Superannuation, beyond the fringe.

Law Council of Australia Superannuation Lawyers Conference (Adelaide February 28th 2014)

Living to Age 120, the Pensions Dilemma (Barry Rafe, Actuary)

Here are some statistics on life expectancy.

You can argue that humans have been on earth for at least 100,000 years. Of all those humans who have ever been alive, half that is 50% of all the people who have ever lived to age 65 are *currently alive.*

For all except the last 3,000 years of our human history our average life expectancy was about 25 to 30. Most humans died in agony with no teeth, many at the hand of other humans.

Even in the 1600's in Europe, you had a 50% chance of dying at the hands of another human being.

The average global life expectancy has doubled over the past 100 years. Your life expectancy is currently increasing at 6 hours per day.

If you are age 65 and healthy (which is the code they use for not obese) then you have a 50% chance of living until past 100.

A 2002 United Nations report states that:

"Population ageing is unprecedented, without parallel in human history...Population ageing is enduring: we will not return to the young populations that our ancestors knew...Population ageing has profound implications for many facets of human life."

Underfunding of retirement is a global issue.

Chapter 4 of the International Monetary Fund's April 2012 Global Financial Stability Report highlights the potentially significant global financial implications of longevity risk, that is, the risk that people may live longer than expected, and shows its magnitude – amounting to 25% – 50% of 2010 Global GDP, if people live three years longer than expected which they state is in line with underestimations in the past.

In Australia, this problem is well understood and policymakers have been focused on the issue for a number of years. Treasury's Intergenerational Report 2010/12 identifies the future increases in Commonwealth Government spending (expressed as a % of Australia's GDP) from our ageing population, especially in the areas of health costs (from 4% to 7% of GDP) and Age Pensions (from 2.7% to 3.9% of GDP).

Australians are already **one of the longest lived populations on the planet, and** our longevity is steadily improving.

By 2050, almost a quarter of the Australian population will be aged over 65 compared to 14% now.

The chance of an Australian born now living to age 65 is the same as the chance of a baby born 100 years ago living to age to 1.

The best three predictors of mortality age, gender and walking speed!! Walking speed is a good predictor of health.

We have a perception problem – people don't realise how long they are going to live.

Public commentary on life expectancies is normally driven by the annual release of the Australian Bureau of Statistics reports. These 'reported' life expectancies are a snapshot that capture past longevity improvements but make no allowance for expected future **improvements.**

The life expectancy at birth in 2010 = 70 males, 84 females.

HOWEVER once you reach 65 you have already outlived some people, so **the average retiree at 65 can expect to live longer than population average.**

Underestimating life expectancy will have major implications for retirement incomes policy. An effective retirement incomes policy should take into account the uncertainty that an individual faces in understanding the financial implications of their own longevity.

It should also anticipate that the **economy-wide costs of providing for older people could be** significantly higher than currently projected.

Investment is the biggest risk.

Australia has been slow to develop the products to protect financial implications of longevity. Part of the reason is that there were tax disincentives. These have now been removed.

Two products that offer protection are life time annuities and deferred lifetime annuities.

With a lifetime annuity, there is a lump sum paid to purchase an income stream for life. The income stream may be indexed and it may pay a benefit on earlier death. The more additional features it has the more it costs.

A deferred age annuity pays an income but it only starts at a certain time in the future for example, you may purchase a deferred annuity at 60 that starts to pay at 80 if you are still alive.

Investment managers try to match assets to liabilities – for example if you have a liability due in 4 years time that needs certain payments along the way, try to get an asset with the same cash flow pattern. Then no matter what happens to interest rates, you'll be able to pay your liabilities.

Longevity liabilities are very long term, with regular payments, often indexed. There are no assets currently available to match these – there is an investment mismatch risk that is greater than most other products.

Closest is shares BUT the regulator requires that significant capital is required to back them due to volatility. To provide a proper hedge, life insurers need more long dated Govt and corporate bonds to be issued. No moves so far that we know of to do this.

Insures are taking on this risk, backed by reinsurance. So they are finding assets or offsetting risks.

Pandemic insurance. Reinsurers cover the risk of mass deaths through pandemics. Can offset the risk of living longer against the risk of dying sooner en masse.

In practice, the Government provides the financial safety net. We all have a feeling of security if issued by Government HOWEVER Problems

- Governments also go broke. We have seen the problems in Europe and the need for severe austerity measures including the lifting of the retirement age and the reductions in age pensions in some countries.
- Wealthy live longer so poor are subsidising the rich

There is an argument for compulsion. But again that significantly disadvantages people in poorer health who are often from the lower socio-economic groups. So already at a disadvantage with their retirement funding.

It's almost certain that the private sector will play a dominant role in providing product and insurance solutions to Australia's retirees. And if that's the case, legislation and public policy needs to be flexible enough to allow innovation in this space.

I'll leave you with a final thought, as an ex product developer myself.

If I was the product developer of an annuity products that was being issued today, this is what would be keeping me awake at night.

Scenario –Imagine that we have the technology in 20 years time for a brain to be suspended in a vat or downloaded to a computer. This person can exist there, hooked into the NBN, participate in the world through the internet . Perhaps she's even doing some consulting work.

QUESTION – Is this person entitled to an Age Pension? If they bought an annuity product, does the provider have the ability to stop paying out ?

We're living in interesting times. And we may be living in them for much longer than we thought. Thank you.

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