September 2014

Finding the gold in the silver economy
How the over 45s will reshape financial services

78%

Percentage of net household wealth that is owned by over 45s

2 to 1

The ratio of over 45s to under 18s

47

The average age of the Australian customer for financial services

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Contents

Overview

Most companies still consider Australia's ageing population as a problem to be solved, especially in relation to their workforce.

But rather than a problem, the growing over 45s demographic in fact represents one of the greatest untapped economic opportunities of the coming decades.

The reason is simple: the over 45s will be the major force in wealth, spending and workforce growth of the future.

They own the majority of Australia's wealth – 78 per cent – and are the fastest growing demographic segment of the economy. The over 45s already outnumber the under 18s by a factor of nearly two to one and over the next twenty years the age of the average customer will increase from 47 to 50.

And this not just an Australian phenomenon. Falling fertility and rising longevity are leading to ageing populations globally. People are simply living longer and therefore working longer and spending longer.

However very few companies even acknowledge ageing population as an opportunity, let alone have strategies to take advantage of it.

Some industries such as retail, technology and entertainment are starting to take the over 45s segment very seriously and are reaping the rewards. Others, such as financial services have been much slower to respond.

Over the next decade competition in this growing demographic will be fierce and businesses that don't have a plan to target this market will be left behind.

This report examines the ageing phenomena and looks at the implications for the financial services industry. It outlines how products, services, distribution channels and advice will need to change in order to meet the needs of ageing Australians.

Whilst the challenges ahead for the industry are significant, there are also substantial opportunities for those businesses that adapt and respond to meet the evolving needs of this growing market.

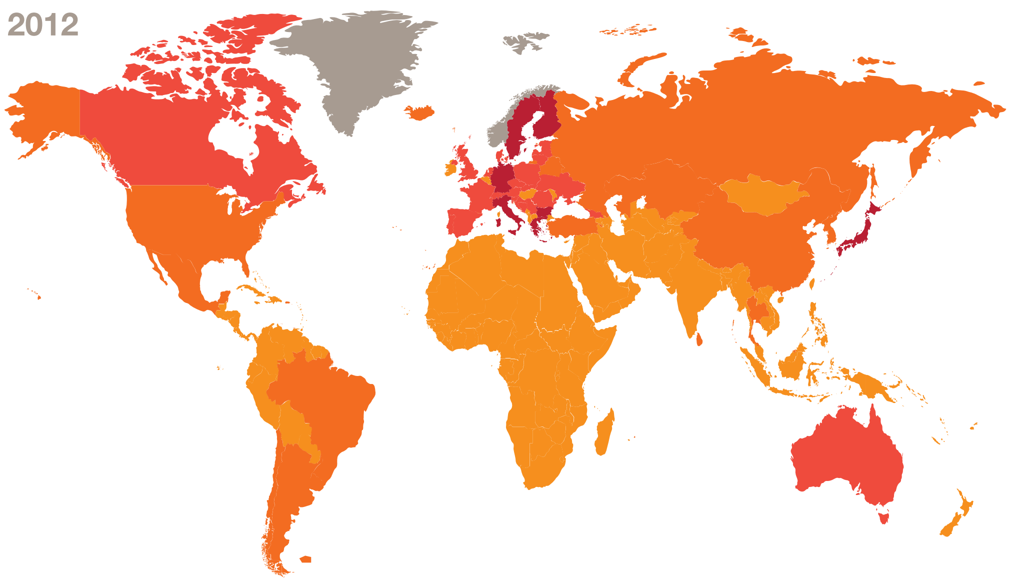
Ageing, wealth and workforce

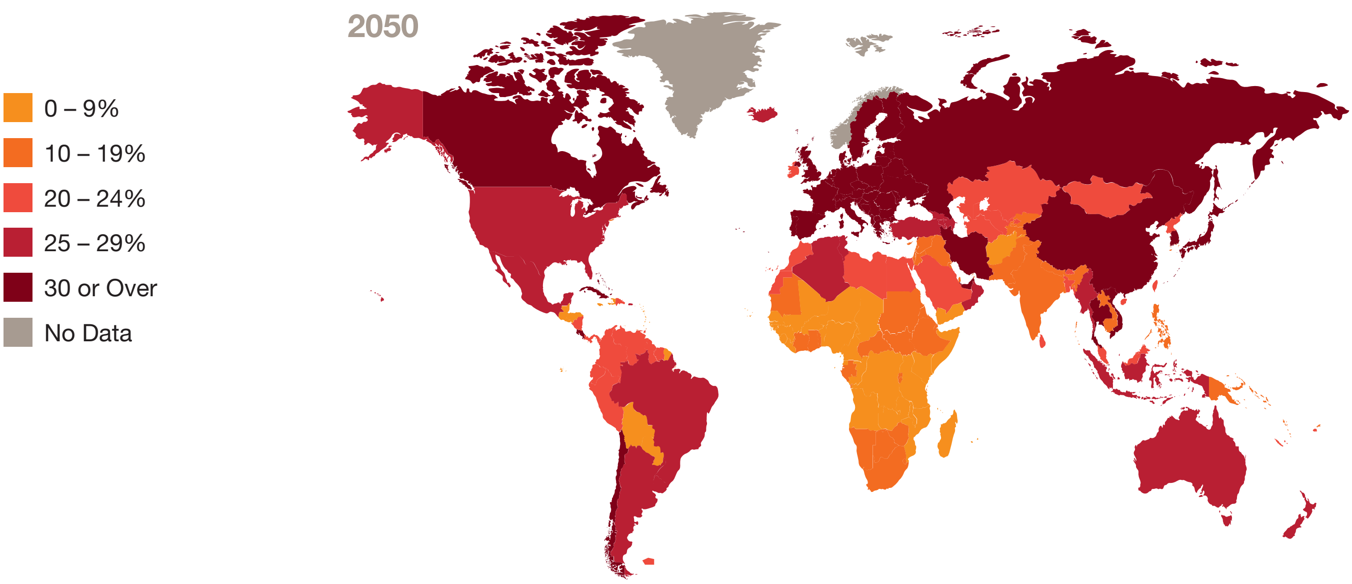
The ageing of human populations worldwide is one of the most significant megatrends facing business and governments, both now and into the coming decades. By 2050 there will be 2 billion over 60, exceeding the number of children (under 15) for the first time in human history. Asia has more than half (55 per cent) of the world's older persons (largely due to China's one child policy) followed by Europe (with 21 per cent).[1]

Australia will experience a similar trajectory. In the next twenty years nearly half of our population will be over 45. The population of over 45s is expected to grow by 4 million to over 13 million, whereas 18-35 year olds grow by less than 1 million to just 6 million. In 2035 the average customer in Australia will be 50, up from 47 now.

Figure 1: Projected percentage of population where 1 in 5 or more is aged 60 and over in 2012 and 2050 [1]

The ageing population is a global phenomenon and every bit as significant as climate change, except that it is certain, the causes are known and it is not reversible.





[1] United Nations Population Ageing and Development 2012

Living longer

So what's behind this unprecedented demographic shift? Put simply, we are having fewer children and we are living longer. Advances in nutrition, health and safety over the last 100 years have seen mortality rates plummet and life expectancy soar.

Infant mortality rates are now less than 4 per cent of what they were in the late 1800s. Since the mid-1960s mortality rates for over 65s have more than halved.

In 2014 the life expectancy at birth is 93 for men and 94 for women, 35 years more than what it was at the turn of the century when the Age pension was first introduced.

> ***That is, life expectancy has increased by over eight hours every day since the turn of the century and over the next 50 years, is still expected to increase by nearly three hours every day.***

We have only ever under-estimated improvements to longevity in the past so we can expect that our future forecasts for life expectancy may also be understated.[2]

But because life expectancy is only an average measure, half the population will live longer. Those in higher socio-economic categories can expect to live up to five years longer than average[3], and 1 in 5 will live up to eight years longer.

> ***It's not unreasonable to say that for many people 45 really will be the new 25, and 85 the new 65.***

Spending big

Whilst the negative impacts of ageing are widely debated–such as pressure on health and social services–the opportunities are largely ignored. And one of the most important is the fact that the over 45s will be the major force in wealth and spending over the coming decades.

Not only do the over 45s own the vast majority of wealth in Australia–more then 78 per cent[4]–but international studies have shown that they are spending it faster than younger generations. For example, over the past 10 years, a US study showed that spending by over 50s increased by 45 per cent, compared to a six per cent increase for the under 50s[5].

Of the $1.8 trillion invested in superannuation today, 60 per cent or $1 trillion is held by the over 50s, who will move into a drawdown phase over the next 20 years.[6] This presents business–and particularly financial services–with significant opportunities for growth in both the provision of advice and financial products. Potentially, it may also impact capital markets by reducing the demand for investments providing higher capital growth compared to investments providing greater income security.

Figure 2: Life expectancy at birth[7]

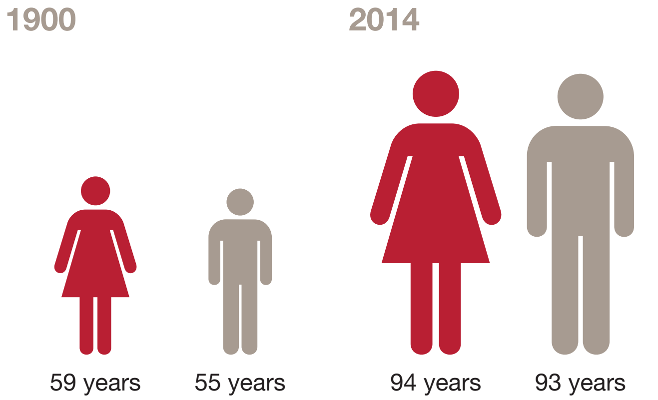
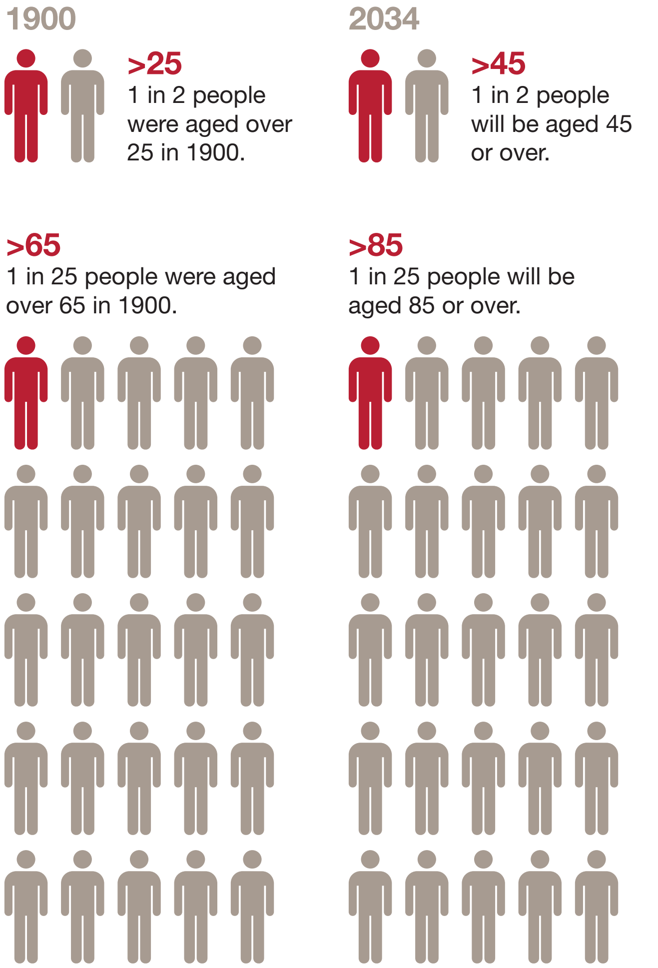


Figure 3: Age projections towards 2034



2 The University of New South Wales Australian School of Business Research Paper No. 2010 Longevity Risk Management and the Development of a Life Annuity Market in Australia, John Evans & Michael Sherris 2010

3 ASFA White paper - Part 4 May 2013 page 13

4 HILDA Household wealth and and distribution 2011-12 survey 6554.0

5 U.S. Bureau of Labour Statistics

6 Actuaries Institute Australia's Longevity Tsunami 2012 Page 11

7 Australian Life Tables 2005-2007 with future mortality improvements (from past 25 years)

Working on

Another major opportunity created by ageing population is workforce. Half of the potential workforce growth over the next 20 years will come from the over 45s, compared to just 10 per cent from 18-25 year olds. In 10 years, 1 in 4 Australian workers could be over 65.[8,9]

This shift is being driven by the fact that people are working longer due to increased life expectancy, financial necessity and changing attitudes about retirement.

More and more, the over 45s are participating in work activities that are a mix of paid, non-paid, full-time, part-time and contract-based. And these will continue as people age well into their 70s, in line with our longer healthy life expectancy. Some of us will chose to work longer for the benefits of staying active and engaged. But many will do so for financial reasons, given the high level of savings required to fund 30-40 years of retirement.

Globally, 1 in 3 people in their 60s still work. In the mature economies of North America and Europe this figure increases to 1 in 2. In the United States one in five people in their 70s have some form of paid work.[10]

But Australia still has some catching up to do. The average age of retirement for recent retirees is currently 62 for men and 60 for women.[11] The number of males working reduces from 8 in 10 under age 60 to less than 2 in 10 over 65. The number of females working reduces from less than 7 in 10 under age 60 to 1 in 10 over 65.

Our mature age (over 55) workforce participation rate of nearly 6 in 10 is lower than that of the United States, the United Kingdom and Canada, which are close to 7 in 10.[12]

There are good reasons to lift our performance. Even a relatively small increase in mature age participation from 6 to 6.5 in 10 will boost the economy by a projected $48 billion in 2050 and increase retirement savings for individuals.[13]

When considering how best to service the silver economy of the over 45s, think about the workforce opportunities.

If you were selling a new product to a 20 year old, would you staff the shops and call centres with 50 year-olds? The average age for customers for most products is already 50, yet call centres, retail outlets are still often staffed with 20 year-olds.

A similar strategy with recruitment can also add value, a more age diverse recruitment team can reflect a more diverse workforce overall.

A global bank had success staffing call centres and tellers with over 45s. Queues developed in front of the over 45 tellers but not the 20 year old tellers. Like attracts like – customers want to deal with people they feel they can relate to.

Just as the over 45s represent one of the greatest untapped economic opportunities for the financial service sector, this very same group of people can provide the workforce that can capitalise on the opportunity.

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8 ABS Series 3222.0 Table B9 Population projections by age and sex Australia

9 Suncorp Superannuation Rise of the Grudge Workforce: A research report 2013

10 The New Age_The Lab

11 ASFA White paper – Part 4 May 2013 page 8

12 Australian Government Intergenerational Report 2010 Page 29

13 Deloitte Increasing participation amongst older workers: The grey army advances 2012

Being productive and innovative

So the concept of retirement as we know it today will vanish.

For many, this will become a time when they can select a portfolio of activities that they enjoy and which helps fund their living costs during these years.

Companies will increasingly target the over 45s but not just to cover workforce shortages, but because older workers are more productive.

Overseas studies are showing that older workers have higher productivity due to: lower error rates, significantly lower turnover, greater ability to understand complex problems, higher motivation, and more empathy with customers.

Manufacturers such as Lockheed Martin have found that the costs associated with redesigning jobs, tools and practices to accommodate older workers are offset by improved performance.

Even the popular myth that entrepreneurs are mostly young 'whiz kids' is wrong. In the United States the highest rate of entrepreneurship has shifted to the 55 to 64 age group.

And older entrepreneurs have higher success rates when they start companies compared to their younger counterparts. People over 55 are almost twice as likely to found successful companies as those between 20 and 34.[14]

Just as there is a growing awareness by companies of the tangible benefits to business of gender diversity, so will this apply to age diversity.

[14] Newsweek Innovation grows among older workers 2010

How is business responding?

Despite the inevitability of our population ageing, few companies have strategies in place to maximize the opportunities this presents. And those that don't have a plan will be left behind as competition in the over 45s demographic will be fierce in the next decade.

Businesses need to radically re-think their approach towards ageing and start developing products, services, shop fronts, recruitment teams and workplaces specifically designed to appeal to the over 45s.

Whilst the financial services sector has been slow to respond to this demographic other industries such as retail, technology and entertainment are starting to take it seriously.

For example, Kaiser, one of Berlin's biggest supermarket chains, has fitted out its elderly-friendly stores with brighter lighting, extra-wide aisles that can better accommodate mobility scooters, non-slip floors and even emergency call buttons.

Coca Cola has made a very deliberate attempt to embed anti-ageism policies throughout the company and has seen a resultant increase in the number of workers over 40.

It's important to recognise that the over 45s are not a homogenous group and different products and services will be required for people in each generational segment. But there are significant rewards for those industries and business that get it right.

"Any company wanting to grow their business in the next 10 years better have a strategy for marketing to those 50-plus," warns Matt Thornhill, founder of baby-boomer-focused market research company Boomer Project.

Technology for the Zoomers

"Today's older generation is primed to buy and consume new technologies like no previous group of seniors," says David Kelly, president of US-based technology research company Upside Research. Many 50-plus customers "have been using personal computers and Sony Walkmans since they were 20 or 25 years old," he says. "They've spent years updating their cellphones, buying MP3 players, installing GPS navigators in their cars and shopping for the latest gadgets."

Combine that tech history with this demographic's colossal size (now more than 91 million) and its trillions in spending power – and it adds up to a massive sales opportunity for tech companies, most of which have not courted older adults before.

What an ageing population means for financial services

Because over 45s are now expected to live for much longer than they have before, new financial products and different advice models are needed to assist them manage their financial resources for a much longer period of time.

The financial services sector has a unique opportunity to help the growing number of Australians living through the stage of life beyond 45 – a stage sometimes referred to as the 'third age'.

Funding the third age

Unfortunately most Australians will not have sufficient savings or superannuation to independently fund their entire third age. Even with continued work, the majority will be at least partially reliant on the Age Pension.

80 per cent of retirees currently receive all or part of the Age Pension and in 40 years' time, 75 per cent of retirees are still expected to receive all or part of the Age pension. However, the number on a full Age pension is expected to reduce from 60 per cent to 35 per cent.[15]

Figure 3: Annual personal living costs[16]

The ASFA Retirement Standard benchmarks the annual budget needed by Australians to fund either a 'modest' or 'comfortable' standard of living in the years post-work.

$23,300	$33,400	Required for a 'modest' lifestyle, which is 'better' than the Age Pension but still only able to afford basic activities and lifestyle.
$42,200	$57,700	Required for a 'comfortable' lifestyle which includes leisure and recreation, a good standard of living, being able to buy household goods when needed, private health insurance and occasional travel.
$21,500	$32,400	The maximum Age Pension.

So the Age Pension will remain a key component of retirement income for most Australians and will therefore continue to influence all financial decisions taken in retirement. Financial advice and products will need to take Age Pension issues into account, such as asset and income tests, gifting rules and regulatory and policy changes over time. People will look to financial service providers to act as a one-stop shop to understand and coordinate interaction between personal savings and government support.

And when it comes to funding aged care and health costs towards the later part of the third age, most Australians will be reliant on housing wealth. But even this is not as reliable as it used to be. In 2010 the number of homeowners approaching retirement with mortgage debt was 1 in 3, up from 1 in 6 in 2002.[17]

So not only will there be a greater demand for financial products and services in the coming decades, but the nature of those products and services will vary as people progress through the third age.

The early years of the third age will be ones of part-time work, leisure and investment needs, whilst the later years will be about funding longevity, health and aged care.

Figure 4: Projected future level of savings

$300-380k

The projected superannuation account balance (in today's dollar) under a mature Superannuation Guarantee system, where a worker on $65,000 pa receives 9.5% (gradually increasing to 12%) Superannuation Guarantee contribution for the next 35 years. The current average superannuation account balance for men is $72,000 and for women $40,000. The current average superannuation payout on retirement for men is $198,000 and for women $113,000.

$15-20k per year

The maximum annual income that could be funded from this level of savings (ie 300-380k) for a 65 year old, ignoring any debt and/or expenses to be met[18].

The compulsory superannuation contribution will not generate sufficient savings to replace the Age Pension. For this reason, the majority of workers will continue to be at least partially reliant on the Age Pension in their older ages.

[15] IGR Report Page 60 2010, based on Treasury projections

[16] ASFA Retirement Standard December 2013: The figures assume that the retiree(s) own their own home and relate to expenditure by the household.

[17] 2 CPA Where has all my super gone? Kelly 2012

[18] 6.5% investment return in accumulation, 5.5% investment return in retirement, 3.75% salary inflator and deflator, 35 years accumulation and ASIC Money Smart Retirement calculator

Key issues during the early years (45-75)

Investment volatility is one the key risks facing people in the early years of the third age, as their savings are likely to have peaked.

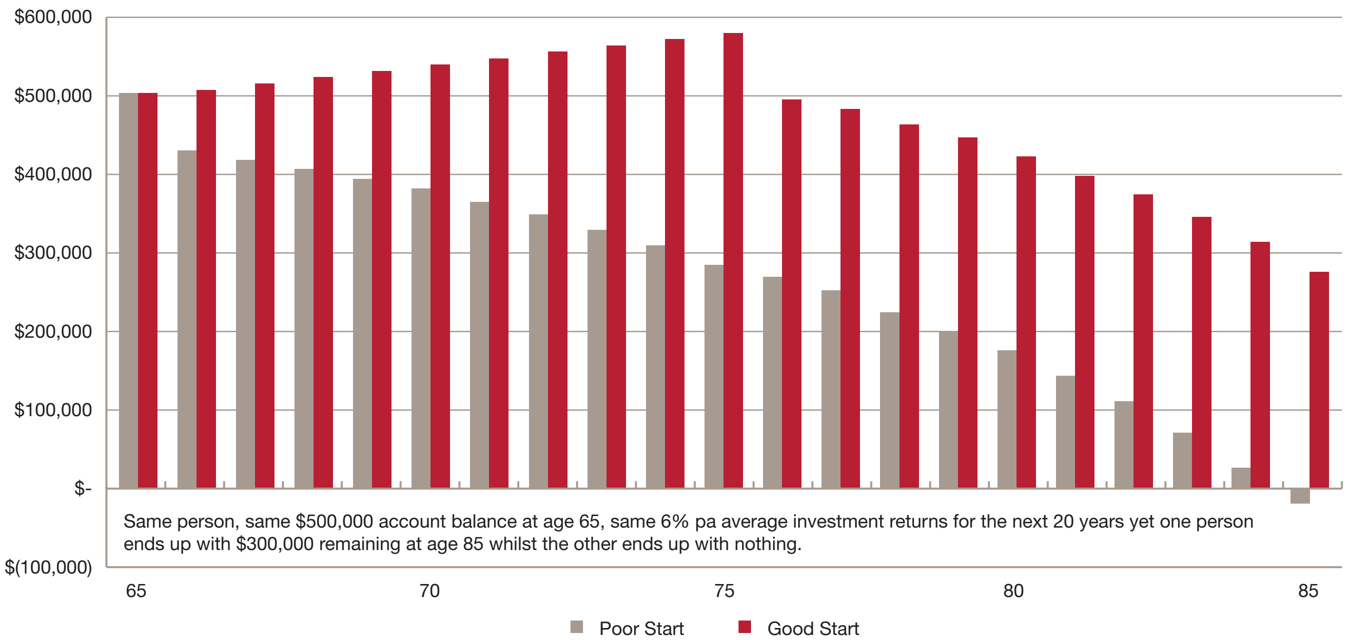
For example, if someone was unlucky enough to experience poorer investment returns in the early years when their savings had peaked, the impact is far greater than if the poor returns occurred later when savings were reduced.

People will therefore seek investment options that provide access to growth-style returns for 20-30 years whilst minimizing the volatility that is inherent in these same investments.

Another important issue during the early years of the third age is managing fluctuating income as people adjust to changing patterns of work. This provides financial service companies the opportunity to explore and develop products, whether savings or insurance, which will work in conjunction with fluctuating personal incomes. During periods of work, people will want to minimize the drawdown on their savings, so the ability to dial up and down income from savings will be paramount. For this reason, lifetime annuities providing fixed indexed annual incomes will better serve the later years of the 3rd age rather than the early years.

Ultimately, the opportunity for financial services is about understanding the unique needs of their older customers – work versus leisure, health, longevity and managing intergenerational demands – and helping them develop a plan for financial security as they age.

Figure 5: Impact of poor investment returns when experienced early or later in the lifecycle



Based on a 6 per cent per annum drawdown of account balance. Poor start has a negative 8 per cent return for year 1, 5 per cent per annum returns for years 2-10 and 8 per cent returns for next 10 years. Good start has 8 per cent per annum returns for years 1-10, negative 8 per cent return for year 11 and 5 per cent per annum returns for next nine years. These investments returns are based on historical returns for typical default superannuation investment strategies.

Key issues during the later years (75+)

In the later years of the third age, retirees will be increasingly frail and living alone. As women live longer than men, the older generation will also be increasingly female. Women already outnumber men by over 2 to 1 over the age of 90.

Currently, half of all women and 2 in 10 men aged over 75 live alone. This is likely to increase in the future due to increasing rates of divorce and single occupancy living. For example, over the past 30 years the proportion of people aged 15-44 who lived alone tripled, and over the past 20 years the rate of divorce after 20 years of marriage doubled to nearly 30 per cent.[19]

Because it costs more to live as a single than as one-half of a couple, divorce leaves many people wondering how they will fund their older years. In these circumstances, the need for a 'trusted advisor' for both financial advice and financial products will be greater than ever.

The need for aged care and accommodation rapidly increases after age 85 due to the likelihood of dementia (over 20 per cent) and disabilities requiring assistance with daily living (over 50 per cent).

Figure 6: Long term and residential care

3 out of 5 men and 3 out of 4 women aged 65 will experience disability severe enough to require long term care in their lifetime.[20]

1 in 3 men and 1 in 2 women will enter residential care in their lives.[21]

But unfortunately the cost of aged care is rising. And as older people are often asset rich and income poor, they will increasingly rely on household wealth to fund their care and health expenses in later life.

- 80% of over 65s own their home
- 60% of net wealth for 65-74 is in the home
- 70% of net wealth for over 75s is in the home [22]

Those people with greater income, such as self-funded retirees, will have to pay a greater proportion of aged care costs. The Living Longer Living Better package which commenced 1 July 2014, stipulates that self-funded retirees will be responsible for accommodation and personal living care costs, and the government will provide for health care costs.

Self-funded retirees could be paying $8,500 per year for home care, and from $60,000 to over $100,000 (some of which can be paid by a lump sum) and anything from $70,000-$200,000 per year for in home private care. Products and advice to assist the release of housing and other asset wealth will be critical for this group of people. [23]

The opportunity for financial services in the later part of the third age is again about understanding the unique needs of customers at this stage of life–health, aged care, government support and family support–and providing simple, trusted and age-appropriate services and advice.

There will be enormous opportunities for financial service advice and products to manage longevity risk, release housing equity and facilitate downsizing. Investment and inflation protection, as well as access to emergency cash for health needs will also be important.

[19] Australian Institute of Family Studies

[20] Productivity Commission Report, Caring for older Australians, Pages 41 and 44 August 2011

[21] CEPAR ARC Centre of excellence in Population Ageing Research November 2012

[22] HILDA survey 6554.0 2013

[23] $5,000pa of the home care costs and $25,000pa of the residential care costs are subject to a lifetime limit of $60,000

Responding to the market

Population ageing will impact all aspects of our lives, from economic growth, taxation and capital markets to savings, consumption and how we work.

The financial services sector has generally been slow to respond to the evolving needs of older customers. However, organisations that do adapt will find themselves with a strong competitive advantage over the next decade.

But there will no single easy solution to capturing the over 45s market as this segment is not a homogenous group. Different products and services will be required for people in different stages of their journey through the third age. It will be different for couples compared to singles, and high net worth individuals compared to others.

Advice will need to be more sophisticated to take into account major risks. This means not over simplifying key issues such as investment returns by only referring to ‘average return’, or longevity by only referring to the ‘average life expectancy’. Advice will need to be genuine advice, not just product selling.

Financial services companies will also need to consider a range of other factors in order to meet the needs of ageing customers.

Figure 7: Factors to consider in meeting the needs of ageing customers

Technology

Over 45s are increasing tech-savvy and will be big users of digital and mobile technologies.

Brand

Over 45s do not see themselves as a homogenous group. Marketing should be based on attributes, not age.

Using age as a differentiator

When 5% of the population was aged over 65, using age as a proxy for competence, health and ability to drive may have been reasonable, but when 25% of the population is over 65, age will no longer be a sound proxy for these attributes.

Products for all ages

Products and services that are typically simple, trusted and convenient end up being sought by all customers, not just the older ones.

Figure 8: In the past: There were limited Financial Services product options and advice stopped when the savings ran out

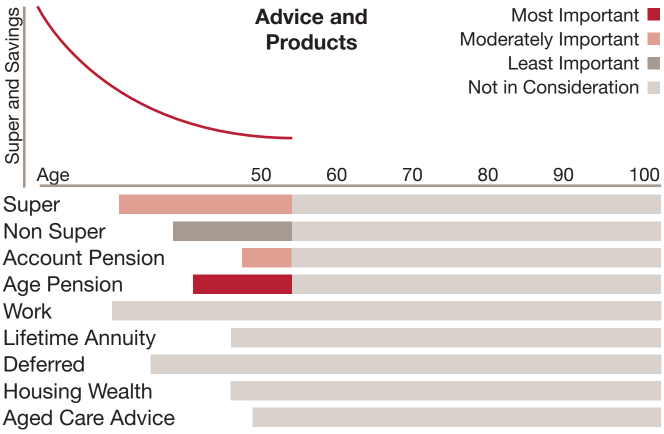
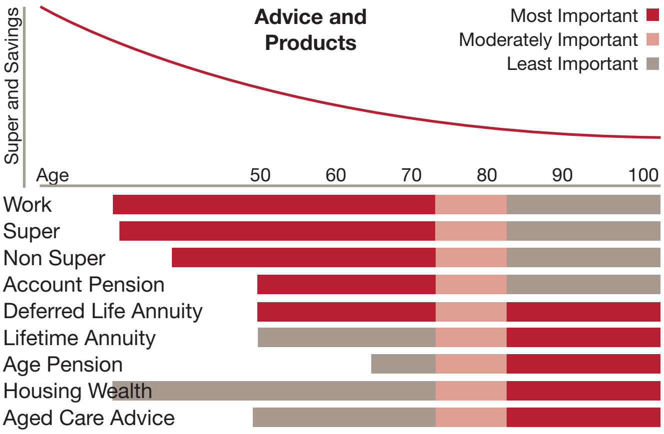


Figure 9: In the future: There will be a wider range of Financial Services product options and advice will be required throughout the third age



The fact that we are living longer is something worth celebrating. But as the structure of our population changes so too must our approach to businesses, in order to survive and thrive in the silver economy. Financial services companies that want to stay ahead of this curve need to be developing their strategies to engage the over 45s now.

> ***“It is not the strongest or the most intelligent who will survive but those who can best manage change.” -*** Charles Darwin

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