Prepare for Change

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Prologue

In this paper I present data to show the intergenerational change that the Australian financial services industry is facing over the next 5 years. I must admit that while I had a general idea that there was a shift happening in the workforce, as I did the research, I realised that at least in terms of the “Baby Boomers”, it is happening now and picking up pace. Perhaps after 30 years in the wealth management industry where superannuation was created specifically to solve the looming problem of funding the retirement of the Baby Boomer generation, I had never really stopped to think enough about what would happen when they got there. But here we all are, and we need to think about it.

To think about this change, I present in this paper a narrative that shows that we are at the end of the Boomers phase and the beginning of the Millennial/GenZ phase with GenX, as usual, largely ignored. But while marketers, media, and politicians love to talk about “Baby Boomers” and “Millennials” because they are good for creating a target group to focus on, our lives are also bigger than our categories and it keeps moving on and deals with change. Likewise, the wealth management industry will deal with the Boomers retiring, the transition of GenX to being the elders of the workforce, and the rise of the Millennials/GenZ. The way it will do this is to change its products and services, and in today’s digital work that means through changes in technology.

With almost universal participation in some form of investment through superannuation and over 35% of Australian adults holding investments on an ASX Chess Account, direct and indirect investment in shares in publicly traded companies was a bedrock of the Baby Boomer retirement preparation phase, and it will continue to be the bedrock of wealth management for all the generations that come after it. But it is also true that attitudes and expectations do change over time, and so I also explore the rise of the cryptocurrency phenomenon and use it to discuss some ideas about how products and services need to evolve as the new Millennial/GenZ investors move in and the Boomers move out.

The Generations

We commonly use the term “Generations” to describe what are more precisely called “demographic cohorts”, and the definition of these cohorts is a somewhat arbitrary window of time within which the members of the cohort are born, and the focus can differ across countries. This paper uses the definition provided by Australian Bureau of Statistics, which is [1]shown in table 1.

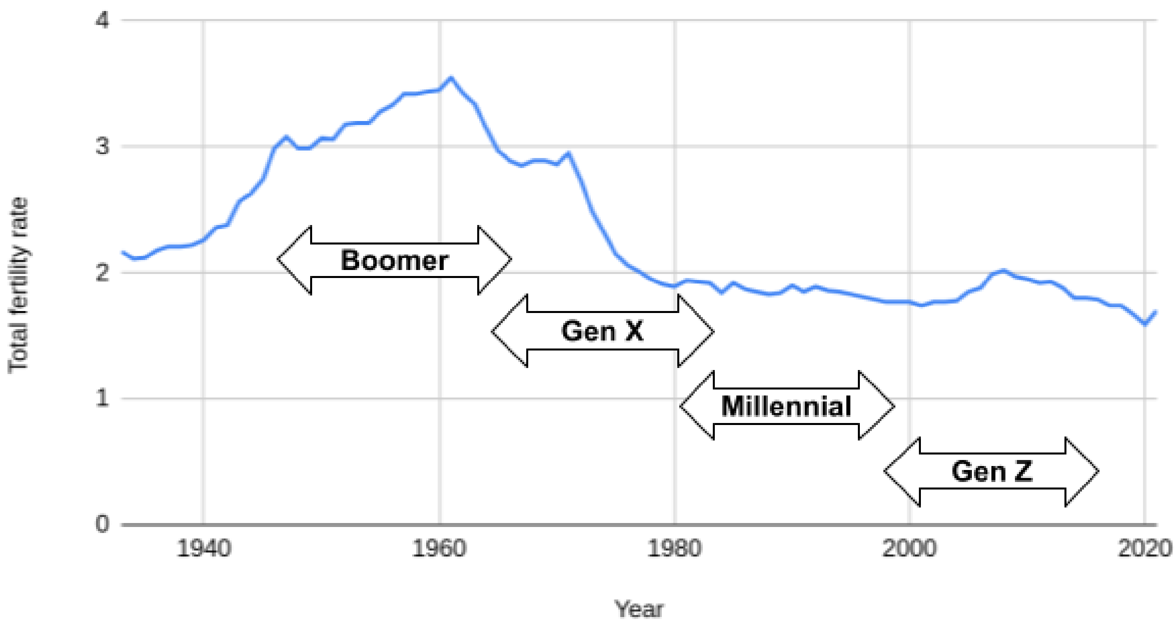
Table 1. Generational Cohort Birth Windows

	Birth Window		
Cohort	From	To	2023 mid point
Baby Boomers	**1946**	1964	68
Gen X	1965	1980	51
Millennials (Gen Y)	1981	1996	35
Gen Z	1997	2012	19

The defining characteristic of the table is the commencement of the reconstruction era that started in 1946 after the end of World War 2 in 1945, and in fact the whole concept of tracking arbitrary generations in our social and business discourse is anchored on that epoch. From that point forward the Boomer generation is generally accepted to be a 20-year generational period, and then each generation is a subsequent 15 year generational period. In other words, they are arbitrary, but they work for us to cluster our thinking about groups. For example - we know that Boomers remember Sputnik and the Man on the Moon, Gen X remembers growing up worrying about building home fallout shelters and AIDS, Millennials can only remember things about themselves, and Gen Z can’t remember anything because they have the internet to do it for them. My point is that we can over generalise, but they are a generally useful tool.

1 https://www.abs.gov.au/media-centre/media-releases/2021-census-shows-millennials-overtaking-boomers

Figure 1. Australian Fertility Rate



The best way to understand why the Baby Boomer generation was so consequential and why the tracking of generations started to get focus around them is to look at the total fertility rate shown in Figure 1[2]. The total fertility rate in simple terms is the average number of babies born per woman, and the key number to focus on is 2, because that is the replacement rate where biological parents at the very least leave behind another person to replace them when they pass. As you can see from the chart, in Australia the period from 1946 to the mid-60s was highly expansionary to the population in terms of births per family with that period literally seeing one child for mum, one for dad, and one or two more for the growth of the country. This is why it is called "the baby boom". However, the chart also shows that from 1961 onwards, the year the contraceptive pill was introduced, the birth rate has fallen steadily to the point where it is now below the replacement rate of 2 births per woman. This means that without immigration, Australia's population would have contracted every year since 1978 (it did touch the line in 2008).

The burst in the birth rate that created the Baby Boomers meant that the Baby Boomers were the largest demographic cohort by number, outnumbering each of the other cohorts. This over-representation of one demographic cohort has been characterised as a "bubble" in the population numbers, which is why the "Baby Boomer bubble" has been a constant fixture in discussions about generations and their needs and wants. And for good reason too, as up until now the Baby Boomers have been the largest and most consequential demographic cohort in Australia since the post war era started. The boom required more resources such as larger houses, schools, hospitals and cars, the economy expanded rapidly as it consumed to catch up

[2] https://www.abs.gov.au/statistics/people/population/births-australia/latest-release

to the needs of the new generation, and the infrastructure of the country grew to support it all. Then as the Boomers grew up, they needed education resulting in an expansion of the university system, and as they moved into work the workplace had to accommodate a workforce that was not just larger from population growth but was also larger because the post war era embraced feminism and women's rights meaning that women were also available for work.

At this point we can also add to this population boom and economic growth the fact that improvements in the areas of general healthcare and medical technology also meant that life expectancy was also increasing, and so governments became aware of the growing need to plan for the fact that pension and aged care systems were going to have to digest age care demands that were simultaneously going to be more expensive and over longer time frames than what the previous pension system was designed to support. This meant saving for retirement needed to be made a priority which gave rise to the "Superannuation System" that has become the bedrock of financial services in Australia today.

The Cusp Of Intergenerational Change

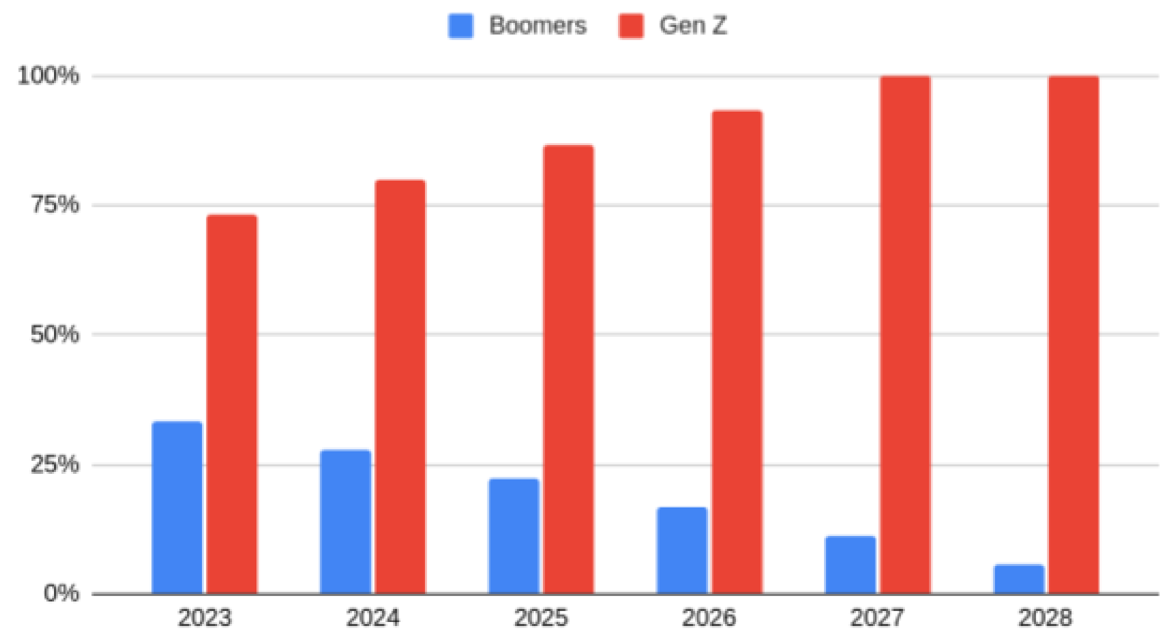
I believe it is fair to say that the Baby Boomer bubble has been the defining force that has cleared all before it, and its members have also collected resources and wealth as the systems changed to accommodate them and their looming retirement and aged care. But that was then, and this is now - and right now the Baby Boomer bubble is starting to deflate before our very eyes. Table 2 shows the percentage of each cohort that will be of working age during our 5 years forward looking planning period and Figure 2 shows the same data for only the Gen Z and Boomer cohort[3].

Table 2. Percent of Cohort of Working Age over 5 Year Strategic Window.

					Strategy Window									
	The Beginning				% Of Working Age						The Beginning of the End			
Cohort	1946	1965	1981	1997	2023	2024	2025	2026	2027	2028	2029	2045	2061	2077
Gen Z					73%	80%	87%	93%	100%	100%				
Millenials					100%	100%	100%	100%	100%	100%				
Gen X					100%	100%	100%	100%	100%	100%				
Boomers					33%	28%	22%	17%	11%	6%				

[3] https://www.abs.gov.au/statistics/people/population/population-census/2021

Figure 2. Boomer and Gen Z Cohorts of Working Age over 5 Year Strategic Window



What do these working age numbers tell us? First, it tells us that within 5 years all Baby Boomers will be eligible for retirement and the Baby Boomer bubble will have all but deflated out of the workforce by 2028. And it doesn't stop there - in 2029 the first of the Baby Boomers will reach their statistical age of death[4] (Men 81, Women 85) which means that the Baby Boomer bubble will start to deflate completely. The impact of this on the wealth management industry is that first, Baby Boomer superannuation balances will start to deflate out of the superannuation system through retirement consumption followed by disbursement through the inheritance process, second, GenX are now the group preparing for retirement and they will become the large balance superannuation account holders, and third, with Gen Z fully deployed into the workforce the predominant demographic groups needing to be serviced in by the industry will be Millennials/Gen Z.[5]

Some Impacts of Intergenerational Change

Financial Flow Changes

The exit of the Boomers from the workforce means that for the first time in its history, the retirement system is going to see retirement phase withdrawals coming from its largest accounts

[4] https://www.aihw.gov.au/reports/life-expectancy-death/deaths-in-australia/contents/life-expectancy
[5] https://www.abs.gov.au/media-centre/media-releases/2021-census-shows-millennials-overtaking-boomers

as those in the 60-64 age group have an average balance of $323,000 compared to the younger generations where those in the 30-34 age group have an average balance of $45,000[6].

While it is hard to predict the future and how the money will flow from where, to whom, and where it will end up, we can make inferences based on what we see in the superannuation balance and housing data that we know today. If we start with superannuation balances, we find that the facts don't really match the prevailing narrative that super is an inheritance tax planning device. Some of the most comprehensive research is provided by the Association of Superannuation Funds in Australian (AFSA) and their research shows that while it is true that there are some very large accounts, Australian Tax Office (ATO) data in 2018-19 showed that there were only 322,200 accounts with balances above $1M.[7] This number will have increased given investment returns since that time, however the system favoured the older participants as they had the benefit of a period when contribution limits were not as restrictive as they are for today's participants, and so the younger generations are less likely to be able to accumulate such large balances, in inflation adjusted terms. Regardless, these accounts are outliers that can be ignored when looking at the mechanics of the whole system given that the total number of superannuation accounts is 23.3 million.

If we look at the ASFA data on the group that will retire and leave the system over the next 20 years, the average balance across genders for those in the 60-75 year old group is just under $400,000, however it is highly skewed by the larger balances. If we look at the median, the balance across genders in this group is approximately $180,000, which means that 50% of account holders in this age group have $180,000 or less[8] in their retirement savings accounts. In other words, the larger share of the flow of money will be completely out of the system. This also corresponds with research from ASFA which shows that 80% of those who died over 60, and 90% of those over 80, had no super at death[9].

The question arises as to where this money will flow? If we look at Australian Bureau of Statistics research into home ownership across the generations[10], we see that only 19.4% of Baby Boomers own their home outright, with 46.4% still having a mortgage, and 30.2% renting. While the value of their properties will have increased in capital value, it is not a stretch to

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6 https://www.superannuation.asn.au/ArticleDocuments/402/Superannuation%20Statistics%20November%202022.pdf.aspx

7 https://www.superannuation.asn.au/ArticleDocuments/270/2022_Superannuation_Account_Balances_Research.pdf.aspx

8 https://www.superannuation.asn.au/ArticleDocuments/270/2022_Superannuation_Account_Balances_Research.pdf.aspx

9 https://www.superannuation.asn.au/ArticleDocuments/359/2103-Super-balances-just-before-death-Paper.pdf.aspx

10 https://www.abs.gov.au/articles/back-my-day-comparing-millennials-earlier-generations#housing

assume that retirement funds will be used to pay down mortgages, especially if a large cash balance reduces access to pension entitlements.

Another tailwind behind the money leaving the system is the increasing cost of living and the impacts of high inflation as the global economy transitions through a regime change away from cheap money and low inflation, to higher interest rates and high inflation. Recent AFSA research[11] shows inflation added 9% for singles and 7.8% for couples to the balance needed to have a comfortable retirement. The balances required to have a comfortable retirement are now estimated at $690,000 for couples and $595,000 for singles. These numbers will compound again in 2024 as we already know that inflation is still high. An uncomfortable reminder about the thief that is inflation is that these numbers assume an annual investment return of 6%. This means that at this time of high inflation, retirement accounts are going backwards in real terms. At this time you have to save more to stand still, while you are also living in the present with increasing living expenses.

Finally, let's deal with the assumption that organic growth from future contributions and market returns will replace the older accounts with the younger accounts. The mandated contribution level is 10.5% and will continue increasing by 0.5% every year until it reaches 12% from 1 July 2025. The net total amount in superannuation has been clouded by recent events with COVID impacting savings rates (they were higher due to less consumption), and early access to super (this reduced some balances), however net contribution flows had been stable at around $10Bn[12] per annum prior to that time and have recovered to slightly above this since the COVID period. Total benefits payments have been increasing and have increased from $20Bn to $25Bn per annum from 2018 to 2022. There was a net -3% decrease in total assets from 2021 to 2022 caused by volatility in financial markets. So in summary - at this time the system is still in net positive contributions with positive inflows being supported by increases up to 12% in the mandated participation rate, we have seen flat to decreasing returns, benefits payments out of the system are increasing, and inflation is going to put pressure on the cost of living. Among all this volatility all we can say with certainty is that there is change happening, and that more monitoring is required to track how the system and regulators respond to the changes that have been identified in this paper.

Culture Changes

I think it is important to note that as the Baby Boomers are leaving the workforce, the values and motivations of their generation are also leaving with them. It also follows then that the values of the new Millennial and Gen Z generations are going to ascend. Once again, it's a generalisation but no one would be surprised if I said that Boomers expected work environments and those who worked for them to be rigid and hierarchical and social life to be kept separate from work, while Gen Z expects work environments to be fluid and accommodate their lifestyles and they will blend social and online lives into their work. This alone is a significant cultural change, yet it

[11] https://www.superannuation.asn.au/media/media-releases/2023/media-release-21-march-2023

[12] https://www.apra.gov.au/sites/default/files/2023-02/Quarterly%20superannuation%20performance%20statistics%20highlights%20December%202022.pdf

is also added to an environment where the new generations live in an economic world that is far different and difficult than what the Boomers experienced. Consider the following issues that we can see already. First, Baby Boomers exiting the economy creates significant costs for the remaining generations as they stop providing free services such as family-based childcare, and they also require increased medical care. As an example, while accounting for only 21% of the adult population, half of Baby Boomers have a long-term health condition which accounts for 34% of all adults in the population that have a long term health condition[13]. These are costs that will need to be paid for by the younger generations. Add to this that the Millennial/GenZ generations also have far more grim income and financial prospects than those who came before them. A recent Pew Research study found that when asked how children in their country will fare financially when they grow up, a median of 70% of adults across 19 countries (72% in Australia) say they will be worse off than their parents.[14] The recent burst of inflation plus the focus on stifling wages growth that reduces their purchasing and savings power could mean that their prospects are even more difficult. The superannuation industry does not escape this change - a 2017 study by the Financial Services Council also found that even though 70% of Millennials had a superannuation account, they are uninterested and unengaged with it.[15] And so in summary we have a new generation entering the system that has low expectations of being able to build wealth, strong indicators that suggest that it is indeed true that they have lower economic prospects, and they are also disengaged. This indicates that there will be a considerable cultural shift in how and why the younger generations engage with the wealth management industry, and how the industry attempts to engage with them.

Technological Change

I have made the case that we are now on the cusp of considerable change as work and wealth shifts between the generations. I believe it follows then that because the wealth management industry is a technology intensive industry, it also means that these changes will result in significant changes to the type of technology the industry uses, and the way its customers use it. This is the point where many people say that cryptocurrencies and blockchain will play a considerable role in this change, and I think that is true. But not how you might expect - I believe that people overestimate the impact of potential new flows of cryptocurrency in the system, while they simultaneously underestimate the valuable lessons for future service offerings that can be learnt from them.

I have written in considerable detail about the way cryptocurrencies work[16], the decentralised finance (Defi) phenomenon[17], and the way regulators are learning to regulate and control

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[13] https://www.abs.gov.au/media-centre/media-releases/2021-census-data-more-half-baby-boomers-have-long-term-health-condition

[14] https://www.pewresearch.org/fact-tank/2022/08/11/large-shares-in-many-countries-are-pessimistic-about-the-next-generations-financial-future/

[15] https://www.fsc.org.au/resources/1200-fsc-millenials-report-2017/file

[16] https://www.horyzon.co/team/Horne_26-1.pdf

[17] https://www.horyzon.co/team/Horne_26-4.pdf

cryptocurrencies in the financial system[18]. None of my research, including my own enthusiastic participation in the crypto ecosystem, suggest to me that cryptocurrencies or blockchain technologies are going to impact the financial services industry in any revolutionary way. This does not mean that I think they cannot be added as additional assets, should the market find them valuable assets. The assets and the technology have and can continue to be added to the existing system, but they and their technology are in no danger of replacing the system. However cryptocurrencies are also an extraordinary ecosystem that shows us new ideas such as new ways to interact with money (Web3 transacting), identity management (Wallets), social interaction (Twitter/Discord/Twitch), reputation through ownership (Non Fungible Tokens or NFTs), and seamless integration with other online ecosystems such as online games which thanks to Millennials and Gen Z is now more than double the size of the movie industry.[19] The new generation of “digital native” users also brings with them their new values where the ideas of inclusion, diversity, and the environment are also blended into the way features are implemented, the continuous conversations that occur as the platforms evolve, and products such as cryptocurrency social funding. Add advanced artificial intelligence technology with media and image generating AI and the cryptocurrency space gives us a window into what future users are going to look for in the financial services industry.

We know that technology will change, and there are plenty of new ideas to ponder, however the question is where will the change be developed and for whom? The end user market - investors and their advisers - are users of technology, not developers, and so the rate and type of technological changes that are manifested into the market is dependent upon how fast the investment houses and platforms, old and new, adapt to the needs of the new generations of investors. There is an inherent conflict built into this change dynamic in that technology requires a large capital investment in pursuit of future benefits, yet the weight of assets and hence the current business case is in operational improvements for improving efficiency for the older and retiring generations that have the larger balances, and less impetus to meet the demand for innovation and new products and services in the younger generations that have small balances.

New technology is also always disruptive, as can be seen by cryptocurrencies forcing themselves into the conversation despite regulators and entrenched players first ignoring the assets, and now actively attacking and blocking them. Service enhancement using AI is also likely to be disruptive as conversational and large language model (LLM) AI inevitably finds its way into the investment advice and servicing processes. This means that while the current industry is defined by their service models for the older generations with larger balances in traditional product and service models, there is a wave of transformative technological change starting to happen from back-office product change, through middle-office aggregation and product functions, and into the front-office customer service areas where human interaction is increasingly replaced with machine interaction.

[18] https://www.horyzon.co/team/ofac-20122022.pdf
[19] https://www.statista.com/

Getting Practical About Change

At this point I have presented two narratives about change. The first narrative is that there is change happening in demographics which will create changes in the structure of work and wealth management, and it will also create some changes in the expectations of customers as the attitudes of younger generations replace the attitudes of the old. The second narrative is that there is change happening in the product and technology area, the most obvious being the rise of cryptocurrencies and their use in youth culture. So, what are the practical things we can focus on today and as we think about our plans in light of these changes? First, let's keep it simple with Figure 3 showing a simplified value chain of the wealth management industry from investment creation, primary and secondary markets, aggregation, and legislative wrapper platforms all the way through to the end user which can be an Adviser, Investor, or both together.

Figure 3. Wealth Management Product & Service Delivery Structure

Now we can think about outcomes in each segment based on the changes we can see coming.

- Investments: Changing demographics and culture will mean that investment types will need to change with them. This means changes ranging from a preference for ESG, greater access to investment structures such as private equity, through to the introduction of crypto assets, including Central Bank Digital Currencies (CBDCs).
- Markets: The structure of primary and secondary markets is not going to change in any meaningful way which means that as a mature segment of low change the main drivers will be consolidation and technology efficiency from well capitalised and patient participants.
- Platforms: Platforms will be a mix of stability and change. Their interfaces to markets and their aggregation functions will continue to require investments in scale and efficiency, while their interfaces to end user systems will need to adapt to the demands of change from those providing services and data to end users.
- Users: Those providing services directly to Users will see the greatest need for technology change as the world of Advisers and Investors becomes completely mobile, information, compliance, and education needs for new investment and new demographic types require support, and digital transformation brings opportunities like AI and new media.

In summary, change will continue across the whole value chain, as it always does, and the lenses of demographic and technology changes are useful tools to help us focus effectively on areas of both efficiency and opportunity.

Prepare for Change

There is no doubt that a lot of change is coming soon, however we can also look back and see that the wealth management industry has always adapted quickly to new technologies to improve products and services. It started with information processing technology for cost and scale, then online technology in the 90s and mobile technology in the “noughts" to improve service, and today we have social media platform integration so that people can also communicate, research, and get better service from the industry on the platforms that they use to live their digital lives. We can also see that collective and direct investment in shares of old and new companies through public exchanges has been the bedrock of the products and services that create and distribute wealth to new generations of savers. Our industry has, and will continue to be able to, deal with change.   But with all that said, the key point of this paper is that I would like you to realise, as I did as I wrote it, that it may be happening faster and with higher impact than we may realise. The older generations are about to leave the system, the younger generations face different challenges than those that came before them, and the transition to the digital world is continuing apace. Yes, the wealth management industry and equity capital markets are proven at adapting to help the economy find new ways to create capital and increase wealth, but I also think it is essential that industry participants become more active in understanding and discussing the changes that are now taking place and engage across the value chain to plan and execute change.

Participants need to prepare for change because the boomer boom is over.

Acknowledgements

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