

May 2008

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Where is my cash safe?

In this time of banks going under, it is common for us to be asked by a client where their cash is safest. The following is my personal view.

The Building Societies which are owned by their members have fairly restricted corporate governance. This will determine the amount they can lend against the amount they can borrow, and so there must be some matching of the money lent with money held on deposit. As a result they are much less likely to be affected by the 'Credit Crunch' problems.

Another place to look is Northern Rock which is backed by the Government, although this may not last and presently the interest rates offered are only competitive when you include the first year bonus.

Banc Assurance

A number of banks have become weak because they have moved away from banking basics. A good example close to home is RBS having to raise more cash.

Banking basics is when a bank takes a certain amount from customers on deposit and then lending against that deposit. 'Banc Assurance' (banc is not a spelling mistake) uses a different business model to boost short term bank profits. In this scenario the bank encourages depositors to take money out of deposit accounts and to put it somewhere else, such as a very expensive investment or insurance product.

Everyone knows that the in-house bank advisers ask for the IT department to give them a list of all the current accounts with a substantial deposit, the advisers then phone the customers one by one and say "why don't you put your cash on the stock market?", or "why don't you put it into an insurance bond?" etc.

Initially, this is great for the bank's profits because the bank gets 5% initial commission, but longer term it doesn't work because they have to develop extremely exotic strategies to continue with their traditional lending. When a 'credit crunch' develops the bank is in trouble.

Perhaps the good news to come out of the 'Credit Crunch' is that it may signal the end of, or a significant reduction of Banc Assurance. In the longer term this will help stop consumers being flogged very expensive and poor quality investment products.

Michael Barr 25 04 2008

Insuring your greatest asset

Not many people try to arrange insurance for good events, and our whole mindset is based on arranging for a payment after you have had some bad luck.

If you take out an insurance policy on your house and if it burns down or you are burgled or flooded, your insurance arranges a payment to arrive when you need it most.

But what if you have some good news – your son or daughter is accepted by a top University, or you are told there is a probability you are going to live to the age of 95 or 100; have you made provision?

The answer in many cases is ‘probably not’ because we are temperamentally more inclined to insure against bad luck or a tragic events, rather than insuring against good news.

Living longer

Some people make great excuses for not planning for a long life. These include comments such as “everyone in my family dies young” or “a friend of a friend died two weeks into his retirement” etc but these are lame excuses when we look at the evidence of increasing life expectancy.

Insurance against longevity is easy to obtain: it is called a ‘pension fund’ or an investment portfolio - a collection of savings, ISAs, and general investments. The problem that comes with the good luck of living longer is that of making the insurance pot big enough to last you out, so you do not run out of money.

When it comes to living longer, there is a huge need for extra money compared to fifty years ago, when the age of 70 was a genuinely good innings.

The marching cohorts of longevity

If you have ever thought about assessing your life expectancy, it is likely that you will be underestimating how long you have got left to live.



Getting nerdy

If you want to get a bit nerdy about life expectancy you should talk about the fact that most insurers base their life expectancy calculations on something called the 1992 Cohort series. This is a benchmark based on actuarial experience of mortality in 1992.

.....the cohorts of life expectancy march onwards.

...

The tables were revised in 1999 due to a sudden increase in life expectancy beyond 65. Many assumed at the time this sudden increase was a one off event and would not be repeated. It soon became obvious that rather than slowing down since 1999, the improvements in life expectancy have increased at an even greater rate.

Annuity rates

An increase in life expectancy has tremendous importance to those thinking about pensions and buying annuities. For example, outstanding annuity policies in the UK total an estimated £100 billion and adding just one additional year of life expectancy requires insurance companies to add £3 to £4 billion to their reserves.

Personal planning

When we prepare a life long cash flow for a client it seems perfectly reasonable to assume living to be 100 – we want to make sure savings do not run out – but is 100 long enough? Should we be revising that figure upwards?

As one client very clearly put it:

“So the question is how long am I going to reasonably live for, and is the money going to run out?” You’ve got to assume you are going to live for a long time because obviously the alternative is to say – I will have to go and kick the bucket in 10 years time or whatever. If you fail to snuff it at the required time, you’ve got a big problem because you have used up all your money and you are now probably in your early dotage and there is nothing you can do about it. So there is really only one way you can possibly go and that is to assume you are going to be around for quite a while.”

Reducing expectation of life

No one knows how long the improvement in life expectancy can continue. We are often told the younger generation, due to their sedentary life style and poor eating habits, may have a shorter life expectancy than the previous generation. There must be a limit to the extent which medical science can invent treatments to prolong life, and surely poor funding in the NHS combined with an ageing population, will start to fight so that prolonging life at all costs will no longer be affordable.

Whatever your feelings, life expectancy is one sum we do not want to get wrong – we do not want our clients running out of money before they run out of life!

A little monkey business

Once upon a time in a village, a man appeared and announced to the villagers he would buy monkeys for £10 each.

The villagers seeing that there were many monkeys around, went out to the forest and started catching them. The man bought thousands at £10 and as the supply started to diminish, the villagers stepped up their efforts.

He announced he would now buy at £20. This renewed the efforts of the villagers and they started catching monkeys again. Soon the supply diminished even further and people started going back to their farms. The offer increased to £25 each and the supply of monkeys became so low that it was an effort to even see a monkey, let alone to catch one.

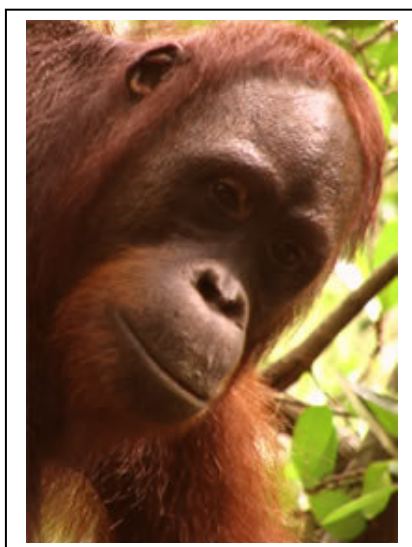
The man now announced that he would buy monkeys at a staggering £50 each. However, since he had to go to the city on some business, his assistant would now buy the monkeys on his behalf.

In the absence of the man, the assistant said to the villagers. "Look at all these monkeys in the big cage that the man has collected. I will sell them to you at £35 and when he returns from the city, you can sell them to him for £50 each."

So the villagers collected up all their savings and bought all the monkeys from the assistant before he went away to join the man in the city.

After a time... the villagers realised they would never see the man, or his assistant, ever again, only monkeys everywhere!

Now you have a better understanding of how a stockbroker works.



Michael Barr & Co Ltd has nominated an orang-utan as an honorary fund manager. The orang-utan provides an entertaining way of explaining some of the "secrets" to ensure investors have a successful experience.

[For more information about our honorary fund manager go to:-](#)

www.michaelbarr.org.uk