Allianz **Demographic Pulse**

www.allianz.com No 1|2011 (January)

United States face **retirement tsunami**

Will it hit Europe and Asia next?

Dwindling state pensions, rising longevity and increasing personal responsibility for sufficient retirement savings – baby boomers all over the world face similar challenges and the United States is a laboratory for these trends. Whether or not they have the retirement they hope for is up to baby boomers themselves.

Around the globe, this “power generation” is facing one of the most pronounced retirement income challenges in history. The task is threefold.

First with the shift from defined benefit (DB) to defined contribution (DC) saving schemes, longevity risk is increasingly placed onto individuals’ shoulders. Most

In the United States there is a widespread belief that a retirement crisis is at hand

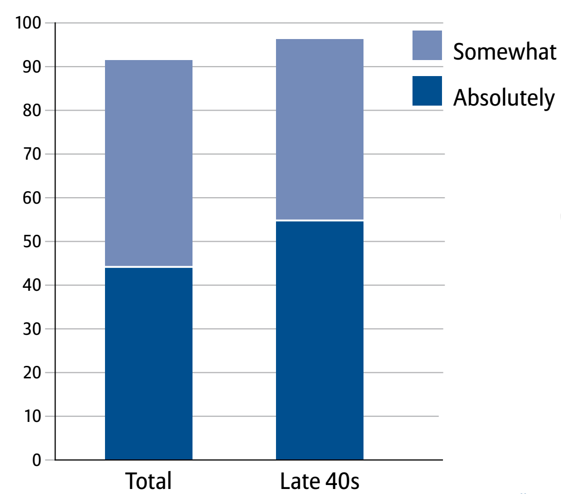


Image © Anthony Richardson, 2010 / shutterstock.de

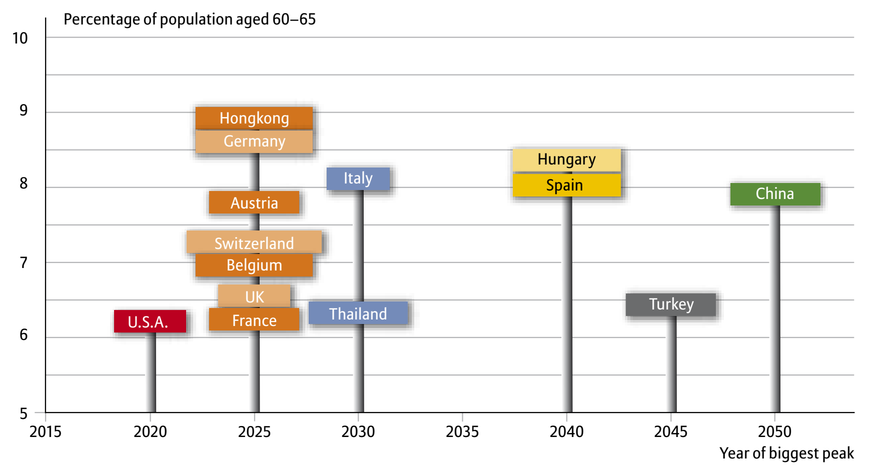
* Source: Allianz *Reclaiming the Future* Study/Larson Research

A huge majority of boomers think there is a retirement crisis* social security systems in Europe used to feature generous Pay-As-You-Go approaches in the public pillar, yet recent reforms reduced this generosity and increased the importance of non-public pillars. In the United States, the home of DC, less than 10 percent of companies still offer DB plans and in the UK, the number of DB pension funds open to new members has decreased to 27 percent[1] in 2009. Hong Kong has reformed its pension system as well, intending to have a mandatory DC plan as the main pillar for retirement provisions.

Second, individuals experience the pleasure and the pain of increasing life expectancies. When Chancellor Otto von Bismarck introduced one of the first nation-wide social security system in Germany in the late 19th century, life expectancy for men amounted to 45 years while the retirement age was 70 years. Today, men can expect to live to age 72.3 in Europe (68.4 in Asia; 77.8 in North America)[2] and will probably live even longer in the future. Time spent in retirement and the required funding will therefore grow unless the retirement age is increased proportionally. To mitigate the effects of this development, Germany, the Netherlands and the UK raised their retirement age to at least 67 years. France increased the earliest retirement age from 60 to 62.

The third challenge savers face is investment risk. The shift from DB to DC transfers the responsibility for investment decisions onto the saver and during market downturns like the recent financial crisis, DC plan participants can suffer heavy losses. In the United States, where DC schemes are widely used, savers lost 30 to 40% of their value virtually overnight[3] and although some European countries require plan providers to offer minimum guarantees, exposure to investment risk increased for Europeans savers as well. While markets are currently recovering, the continued volatility has stirred some deep-seated fears for many people.

United States first to face "baby boomer tsunami" – but Europe and Asia follow closely



Source: UN World Population Prospects, 2008

The rectangles show the year with the highest percentage of the population in the pensionable age (60–65) in the respective countries

As the above graph shows, baby boomer entry into retirement will peak at different points in time across the countries. The United States acts as a trailblazer and is followed by Central European countries and Hong Kong. Southern and Eastern European countries as well as Thailand will succeed a few years later.

When entering into retirement, the sheer magnitude of baby boomers will significantly increase the number of people dependent on contributions from the working population and will thereby accentuate the above mentioned issues.

Consequently, current US developments can serve as a crystal ball for other nations and *Reclaiming the Future*, the study developed by Allianz Life, helps understand what we see in it.

The study digs deep into the changing attitudes and examines baby boomers' preparation for and expectations of retirement in the United States. More than 3,200 US adults, aged 44–75, were surveyed to discover the unique needs, perceptions, and strategies that define this generation's need to rethink retirement. It also looked into consumer and financial professional attitudes toward annuities and their role in providing lifetime income.

Retirement crisis at hand

One of the most striking findings of the *Reclaiming the Future* study was the almost universal agreement that the United States is facing a retirement crisis. When asked, "Do you believe there is a retirement crisis in this country?" an overwhelming 92 percent of the respondents answered affirmatively. Among those in their late 40s, that number rose to 97 percent.

While this finding points to a startlingly universal concern, the study revealed even greater significance in the personal ripple effect it had on many respondents. The realization that there is a crisis has left them feeling unsure of their own retirement in two primary areas: preparedness and adequacy of savings.

Respondents' confidence in their retirement preparedness was shaky, at best. Among those aged 44–54, more than half (51 percent) said they feel unprepared for retirement. The study's participants also

1 Source: Pension Policy Institute
2 UN World Population Prospects, 2008
3 Investment Company Institute, *Enduring Confidence in the 401(k) System*, U.S. Retirement Assets, January 2010

expressed concerns about their savings. Overall, 57 percent said they are worried that their nest egg may not be large enough in retirement. In fact, 47 percent are afraid of not being able to cover their basic living expenses in retirement.

Americans affected deeply

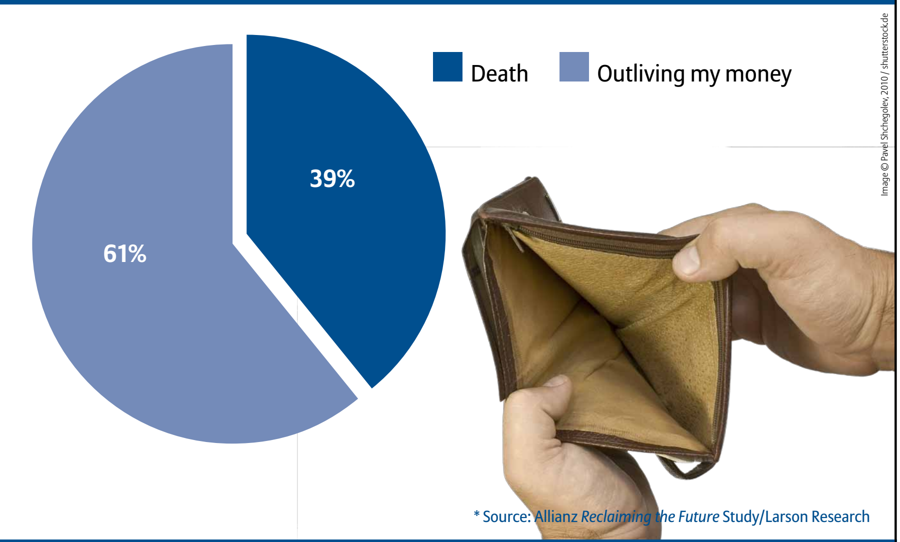
Adding to the fears about savings is the market uncertainty of the past two years. The recent downturn affected many Americans deeply – and they are continuing to feel those effects today. Of the people surveyed, 56 percent of those aged 44–54 agree that the "recent market events created major questions around when, and whether, I can retire." Yet, despite these fears, the global retirement market is expected to grow to $45 trillion until 2020 – led by the United States, where pension assets are expected to grow at 3.6 percent compound annual growth rate to reach 20.9 trillion by 2020. Increasingly, these assets will come from the 401(k) plans of US workers since the shift from defined benefit to defined contribution plans has led to an individualization of retirement savings. This trend toward increased savings and more responsibility for those savings indicates that Americans are beginning to take control of their retirement planning, but data from the study suggest that they are still uncertain about their retirement income and whether or not it will be there when they need it.

Increasing life expectancies mean that Americans are spending more years in retirement. Unfortunately – as pension plans disappear and Social Security benefits dwindle – they're also funding more of their own retirement. The result – Americans are increasingly at risk of outliving their assets.

Outliving assets

Consumers are aware of this risk – when surveyed, an average of 59 percent of all age groups reported worrying about longevity. The study tackled the question by asking, "which do you fear the most: outliving your money in retirement or death?" A surprising 61 percent of the respondents said they were more scared of outliving their assets than they were of dying. Among people aged 44–49, that number climbed to 77 percent. And a whopping 82 percent of those in their late 40s who had dependents were more afraid of outliving their money than they were of death.

Most Americans fear outliving their retirement income more than death



* Source: Allianz *Reclaiming the Future* Study/Larson Research

Question: Which do you fear most? Death or outliving money in retirement? *

The study also explored other areas of retirement insecurity, asking respondents to consider which is likelier: getting their full due from Social Security or getting struck by lightning. More than one-third (39%) said it's more likely to be hit by lightning. This all points to the reality that retirement planning in the United States needs to change, and boomers need more options to help ensure the safety of their retirement savings. When planning for retirement, Americans must now address three challenges. First they must look beyond defined benefit plans or Social Security for their retirement income. Second, they must guard against outliving their assets. And third, they must find a way to protect their assets from market downturns.

With these themes as a backdrop, the *Reclaiming the Future* study asked consumers to consider the features that would be most important to them, if they could build the ideal financial product. The individuals surveyed were allowed to choose from a wide selection of variables that included high returns, low fees, access to money, and so forth.

Reclaiming the future

The most-selected feature was "the ability to create a stable, predictable standard of living throughout retirement." In second and third place, respectively, was the "ability to provide a guaranteed income stream for life" and "guaranteed not to lose value." When asked to choose between high returns or guarantees, 69 percent of those surveyed said they'd prefer a product that was "guaranteed not to lose value," while only 31 percent chose a product whose goal was "providing a high return."

An overwhelming 80 percent of the people surveyed preferred a product with 4 percent return and a guarantee against losing value over a product with 8 percent return and vulnerability to market downturns. When asked to choose between putting money into an annuity-like product (moderate growth opportunity, monthly income, guaranteed for life, but limited access to the lump sum) vs. a similar instrument that provides total access but risks running out of money, 56 percent chose the annuity-like product.

Despite the desire for the benefits these products can provide, the study showed that a surprising 54 percent of the respondents expressed distaste for the word "annuity." Perhaps this is because more than 50 percent formed their opinion of annuities more than 10 years ago. Another 28 percent of respondents said they formed their opinion between 10 and 20 years ago. And of those respondents, 64 percent admit that they haven't researched annuities in the years since.

Distaste for the word annuity
At the same time, for those that own annuities, 76 percent are happy with their purchase, citing the protection of their nest egg, protection from market downturns and guaranteed income for life as the key benefits. In fact, consumers ranked annuities highest in satisfaction among all financial instruments, beating out mutual funds at 38 percent, stocks at 36 percent, US Savings Bonds at 35 percent and CDs at 25 percent. (Gold and precious metals came in first, with a satisfaction rating of 62 percent)

An unprecedented number of Americans are preparing to retire, and they will face unprecedented challenges. Once-reliable sources of retirement income will disappear. They'll risk outliving their savings. And they'll be more vulnerable to market downturns.

There are options
As the Allianz *Reclaiming the Future* study has demonstrated, Americans are aware of this looming crisis – and they are scared. Fortunately, there is hope. As the study also demonstrated, Americans do have options as they face these challenges and plan for retirement. Further, the study also found that annuities may be one of the most relevant of these options: Only annuities can offer the combination of principal protection and income for life.

Editor: Katie Libbe, Allianz Life Minneapolis

Publisher: Allianz SE, Königinstrasse 28, 80802 Munich, Germany | Claudia Mohr-Calliet, claudia.mohr-calliet@allianz.com I http://www.allianz.com

Why does Allianz care about demography?
As a global financial service provider, Allianz believes demographic change to be of crucial importance. Identified as one of the major megatrends, demographic change will hold the key to many upcoming social challenges, whether with regard to health, old-age provision, education, consumption or capital markets.

Why does it matter to journalists and the public?
Demographic change is challenging today's societies in many ways: People are getting older, and this raises the issue e.g. of long-term care and dementia. Furthermore in the future there will be a significant decline in the workforce in all of the world's markets, triggering for example a challenge in pension funding. Only information, awareness and discussion on the topic will help to change attitudes, behavior and situations, so hopefully solve urgent needs and come up with innovative solutions.

What are the benefits of Allianz Demographic Pulse?
Allianz Demographic Pulse is based on the latest research into various aspects of demographic change. Conducted and written by Allianz experts, it highlights current and globally relevant demographic data and provides an insight into their impact on worldwide economies and societies. To ensure up-to-date coverage of major developments in this field, Allianz Demographic Pulse is published on a regular basis, thus providing ongoing and detailed information about a major trend that is shaping the world we live in.

More publications at:

Allianz Group Economic Research & Corporate Development
https://www.allianz.com/en/economic_research/publications/index.html

International Pensions at Allianz Global Investors
http://publications.allianzgi.com/en/PensionResearch/Pages/PensionResearch.aspx

Allianz Knowledge Site
http://knowledge.allianz.com/

Do you have any comments, suggestions or questions? We look forward to your feedback!
Please contact: Claudia Mohr-Calliet,
++49 89 3800 18797
claudia.mohr-calliet@allianz.com