PROJECT M

GLOBAL PENSION ATLAS

LOCAL EXTRACT

GERMANY

In a manner best be described as "Germanic," Europe's economic giant has been slowly and methodically working to address the demographic challenge to its pension system.

By Maximilian Zimmerer, CEO of Allianz Lebensversicherungs-AG, Stuttgart

Actor Johannes Heester died on Christmas Eve 2011 in Starnberg at the age of 108. In some ways, his story mirrors the challenges facing the German pension system and its retirees. Heesters spent 43 years in retirement, working almost to the very end.

If projections hold true, Heesters may not be all that unusual one day. The median life expectancy at birth in Germany is expected to increase from 80.6 today to 84.9 by 2050 (UNDP 2010) and researchers at the Max Planck Institute for Demographic Research in Rostock and the United Kingdom's Cambridge University believe that in 60 years, living to 100 will be the norm. An amazing evolution, indeed, but longer life expectancies would overstretch the pension system unless reforms are undertaken.

On average, Germans today spend almost as much time in the workforce as they do out of it. Entering at age 19, men can expect to spend an average of 16 years in retirement and women 22 years (OECD 2011).

COUNTERPLAY

Germany was the first nation to introduce old-age social insurance back in 1889 and the country has long been one of Western Europe's prime examples for a pension system dominated by the public pillar. To address the sustainability of its earnings-related, pay-as-you-go (PAYG) system In the face of severe demographic change, the German government has implemented several reforms and initiatives targeted at achieving a more balanced structure of old-age income and to keep its workforce employed longer.

In terms of the **first (public) pillar pension system**, the subsidized part-time employment scheme for older workers was withdrawn at the end of 2009. Beginning in 2012, the legal retirement age will gradually increase from 65 to 67 by 2029, making Germany one of only a few European states to raise its legal retirement age above 65; the others being Denmark, Norway, Italy (although with a very long horizon), Spain and the United Kingdom. Others as the Netherlands or Ireland are considering raising it above 65. ☞

The pension retirees receive will also reduce in the future as it depends on a formula that includes adjustment for sustainability, which is negatively affected by the rising old age dependency ratio. This is expected to almost double from 30.8 to 56.5 by 2050 (UNDP 2010). Such a sustainability adjustment can be found elsewhere, as in the Japanese, Swedish and Finnish systems.

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To compensate for the shortfall in retirement income, the government introduced reforms in both the **second (occupational)** and **third (private) pillars**. These included subsidies and tax advantages that apply to both pillars and included the introduction of the Riester Rente, in 2002, and the Rürup Rente, in 2005.

Insurance has always been a prominent feature of the market and this remains true. Traditionally, the German occupational pension environment has been driven by life-insurance as well as pension commitments, for which companies build up reserves. Pensionskassen, a special type of life insurance sponsored by one or more companies, were one of the most popular pension provision vehicles.

The pension fund is a more return oriented system that allows **both** defined benefit plans as well as defined contribution plans with gurantees.

IS IT ENOUGH?

Germany has taken significant moves to confront its aging challenge and ensure the sustainability of its public pension system. However, how its citizens will actually fare in retirement will increasingly depend on occupational pensions and personal investments.

Longer working lives will play a key role. The German Council of Economic Experts already fears the increase of the legal retirement age to 67 is not enough and recommended an increase to 69 by 2060. Yet, further extending the retirement age will depend on the ability to retain elderly people within the workforce.

In 2000, only 56.4% persons aged 55-59 and 19.6% of those 60-64 were gainfully employed. The German Federal Ministry of Labor and Social Affairs (BMAS) launched several programs to promote more and better jobs for its older workers. The figures now stand at 71.5% and 41% respectively (Eurostat 2012) Initiatives that encourage life-long training and initiatives that aim to adapt work place conditions to elderly workers are slowly beginning to pick up momentum.

With an estimated 75% more people likely to be leaving the job market in the next decade than entering, there would seem many opportunities for the 65+ crowd in the future (OECD 2010). According to the Federal Employment Agency, 180,000 Germans between the ages of 65 and 74 took on some form of post-retirement employment in 2011. For many, it's a case of financial necessity. For others, like Heester, it may just be because they enjoy what they are doing.

GERMANY – PENSION SUSTAINABILITY INDEX RANKING

Germany ranks 19th out of the 44 countries on the Allianz Global Investors 2011 Pensions Sustainability Index.* The country has undertaken reforms to prepare for the further aging of its population, but the results have amounted to holding the line.

The most significant reform has been an increase in the retirement age, which takes effect from 2012. Other systematic changes, such as those to the future replacement rate, go in the right direction in terms of the sustainability of the state pension system.

However, convincing measures to compensate for the expected fall in income of future retirees have not been introduced, which increases the likelihood of future welfare demands to alleviate old age poverty. These in turn could place significant pressure on public finances.

These facts mean Germany appears in the middle rankings of countries on the index, ranking in the same band as Poland and Austria. The reforms have been enough for Germany to maintain, but not improve its overall position from the 2009 listing.

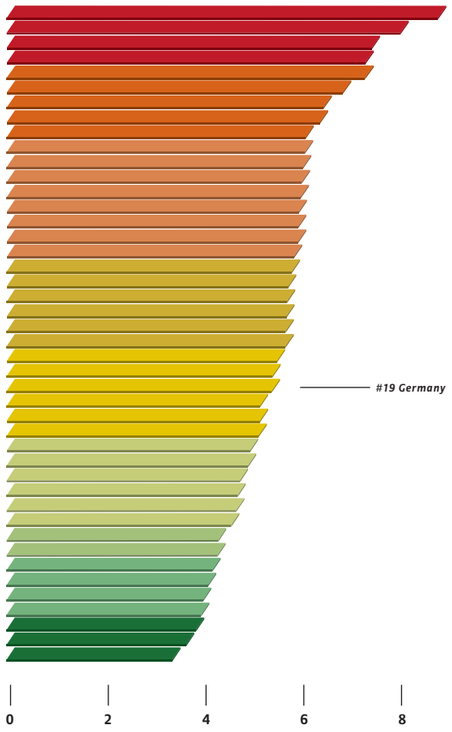
PRUDENCE IN FINANCES

In terms of its debt, Germany belongs to a group of countries that have a high ratio of government debt to GDP of over 80% at the end of 2010. The average ratio of the 17 eurozone countries is 85.1% with Greece topping the table at 142%, followed by Italy at 119%.

While Germany has a reputation for being stabile and prudent in terms of its public finances, its high debt level still scores negatively against it on the PSI. In terms of the pension system itself, the fiscal burden is medium to high compared to other countries, but the reforms initiated are positive in that they mean that the debt will no increase as strongly in the future.

Germany already has one of the highest old-age dependency ratios. In Europe, it is the second highest after Italy and it is the third highest worldwide, two places behind Japan. The population is expected to age well into the future.

ALLIANZ GLOBAL INVESTORS – 2011 PENSION SUSTAINABILITY INDEX



Scale from 1 to 10: 1 minor need for reforms, 10 high need for reforms

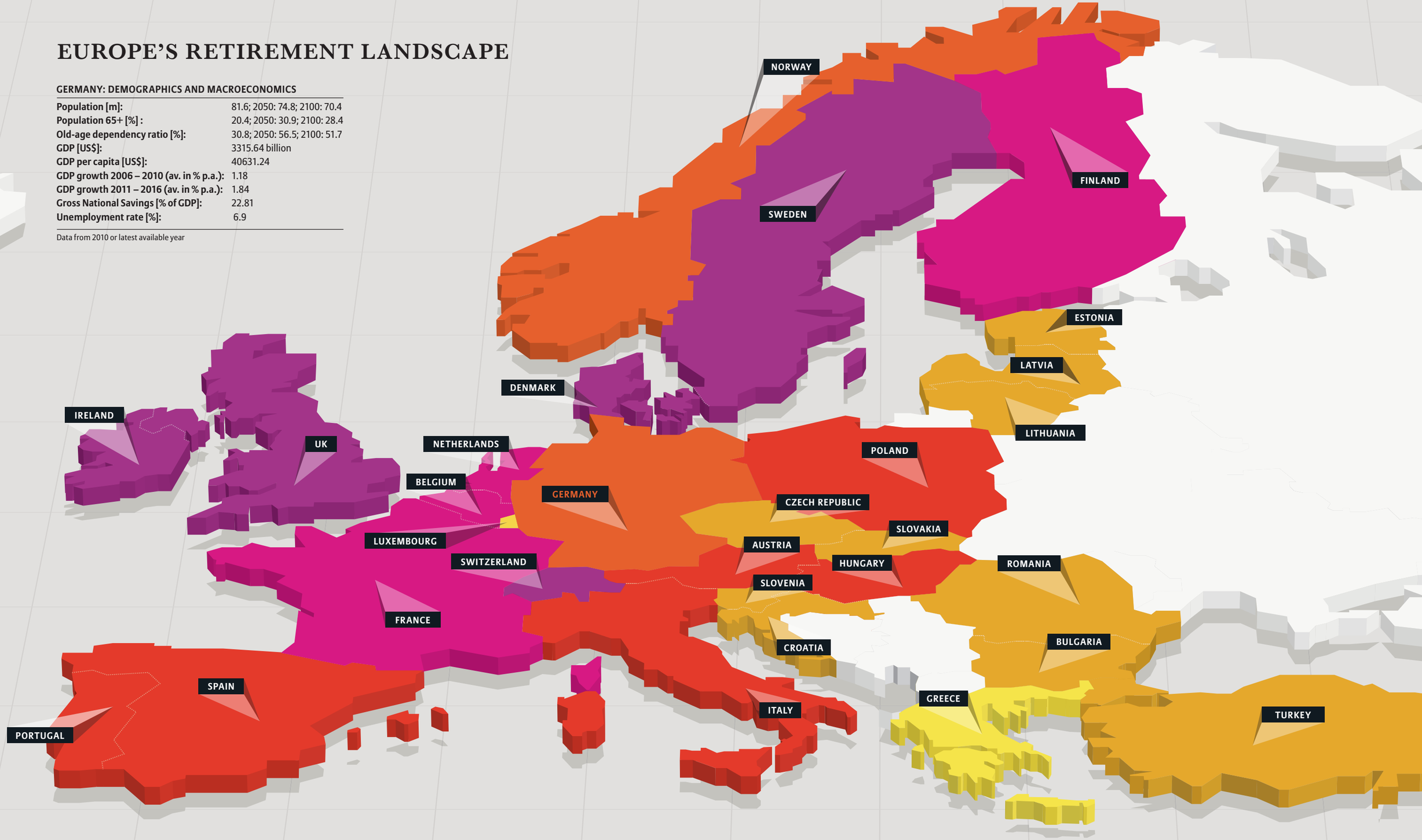
Source: Allianz Global Investors
* Refer to the *Global Pension Atlas 2011* for full details.

EUROPE'S RETIREMENT LANDSCAPE

GERMANY: DEMOGRAPHICS AND MACROECONOMICS

Population [m]:	81.6; 2050: 74.8; 2100: 70.4
Population 65+ [%] :	20.4; 2050: 30.9; 2100: 28.4
Old-age dependency ratio [%]:	30.8; 2050: 56.5; 2100: 51.7
GDP [US$]:	3315.64 billion
GDP per capita [US$]:	40631.24
GDP growth 2006 – 2010 (av. in % p.a.):	1.18
GDP growth 2011 – 2016 (av. in % p.a.):	1.84
Gross National Savings [% of GDP]:	22.81
Unemployment rate [%]:	6.9

Data from 2010 or latest available year



Less than 10% pension assets as % of GDP, mostly DB and hardly changing
GREECE

Less than 10% pension assets as % of GDP, mostly DB and changing towards DC
LUXEMBOURG

Less than 10% pension assets as % of GDP, mostly DC or substantial shift towards DC
BULGARIA
CROATIA
CZECH REPUBLIC
ESTONIA
LATVIA
LITHUANIA
ROMANIA
SLOVAKIA
SLOVENIA
TURKEY

10 to 50% pension assets as % of GDP, mostly DB and hardly changing
N/A

10 to 50% pension assets as % of GDP, mostly DB and changing towards DC
GERMANY
NORWAY

10 to 50% pension assets as % of GDP, mostly DC or substantial shift towards DC
AUSTRIA
HUNGARY
ITALY
POLAND
PORTUGAL
SPAIN

More than 50% pension assets as % of GDP, mostly DB and hardly changing
N/A

More than 50% pension assets as % of GDP, mostly DB and changing towards DC
BELGIUM
FINLAND
FRANCE
NETHERLANDS

More than 50% pension assets as % of GDP, mostly DC or substantial shift towards DC
DENMARK
IRELAND
SWEDEN
SWITZERLAND
UNITED KINGDOM

Further information on the logic of this map can be found in the* Global Pensions Atlas 2011*, available at http://publications.allianzam.com/

WESTERN EUROPE: BREAKING FROM THE PENSION TRAP

While reform activity has been evident worldwide, it has been particularly marked in western Europe, where almost every country has undergone significant changes in their pension systems since 1995.

European nations have a history of state pensions stretching back more than 120 years, but the systems implemented in each country differed substantially in their aims. Some, such as that in the United Kingdom, were designed to protect citizens from absolute poverty. Others, like those in Germany and Greece, aimed to keep citizens living in retirement at a comparable standard to their active years in the workforce.

However, as the later decades of the 20th century progressed, European governments realised that they faced a common and growing issue that compelled them to undertake fundamental reforms. The issue has sometimes been referred to as "Bismarck's pension trap" (see right) and a 2010 Green Paper released by the European Commission on pensions, explained the reasons behind the urgency.

Life expectancy in Europe has risen by five years in the last half-century – and a further rise of seven years could occur by 2060. Combined with low fertility rates, this greying of the population will affect almost every aspect of European society. In economic terms, its impact will be felt from growth and productivity, to demand, infrastructure, innovation and labour markets.

Critically, it could also strain public finances as increasing numbers of retirees rely on the public purse for a large portion, or even all of their retirement income. Reforms undertaken in western Europe were essentially aimed to improve the sustainability of the public pension systems and relieve pressure on public finances.

BISMARCK'S PENSION TRAP

- *Germany was the first modern nation to introduce an old-age social insurance (pension). William the First wrote to parliament at the request of Chancellor Otto von Bismarck, explaining "Those who are disabled from work by age and invalidity have a well-grounded claim to care from the state."*
- *The system, introduced in 1889, set retirement at 70 years of age. Average life expectancy was then 35.6 years for men, 38.4 for women. In 1916, retirement age was lowered to 65, which has been a default applied in many countries since then.*
- *Today, life expectancy in Germany is 77.3 years for men and 82.5 years for women – and rising. Like many countries, Germany faces the question of how to support growing numbers of retirees without bankrupting the economy. With retirement set at an arbitrary age rather than disability, an increasing number of otherwise fit and active people are withdrawing their human capital from the economy.*
- *This has been referred to as "Bismarck's pension trap." The goal of the Iron Chancellor was actually to purchase social peace through a limited redistribution of income. He personally believed that as long as a person was fit enough to work, he or she should, in principle, arrange for their own protection, regardless of age.*

Traditionally, most western European countries were textbook examples of the dominance of public pay-as-you-go (PAYG) pension systems. In an effort to spread the load of retirement income, governments initiated the far-reaching reforms to create a multi-tiered structure for retirement provision. Generally speaking, these reforms have been successful and helped place national systems on a much more sustainable footing.

OUTLOOK

Lord Adair Turner, chair of the Financial Services Authority in the United Kingdom, believes the notions of a pension crisis in Europe are now overstated. According to Lord Turner, "The argument is that Europe is facing a crisis of aging and that it is failing to deal with it. I believe more has happened in the way of reform than we sometimes think and, at least in terms of the figures, a lot of progress has been made." *

Yet, while similar demographic pressures have driven European nations to undertake reforms, the pace of the demographic changes differs significantly within each country. In turn, this has affected the tempo of the reforms within each country and means the pensions landscape in Europe still remains bewilderingly diverse.

This is clearly reflected in the *Global Pension Atlas 2011*, which shows European governments responded to the question of sustainability with a decided move from PAYG systems to funded systems in most western European and Scandinavian countries. Consequently, a substantial amount of pension assets (at least 10%, if not more than 50% of GDP) has been accumulated into funded assets and a strong move from DB to DC practices has also been recorded in the region.

* Quoted in "Paradigm Lost" *PROJECT M* #07, 1/2011

A QUESTION OF ADEQUACY

- *With people living longer and in greater numbers, adequacy (the ability of individuals to maintain their living style to a reasonable level after retirement) is becoming an important question for governments, companies and citizens. In Europe, adequacy was a central theme in the* European Green Paper on Pensions *issued in July 2010.*
- *László Andor, European commissioner for employment, social affairs and inclusion, told* PROJECT M *that the question of pensions needs to be addressed, because to maintain the successful European model in face of changing demographics will mean the choice between "poorer pensioners, higher pension contributions or more people working more and longer."*
- *The commission believes states must consider: increasing retirement age and linking it with life expectancy; reducing early retirement; supporting the development of complementary private savings to enhance retirement incomes; the impact of pension payments on long-term sustainability and adequacy of public finances.*
- *More than 1,700 responses to the Green Paper revealed that any interference by the commission into national pension systems is unwanted. In addition, some countries define adequacy differently, as living above the poverty line. The issue is not likely to go away, especially as the Commission only recently published its* White Paper on Pensions *as a response.*

RELATED INFORMATION

- *Germany Financial assets continued to rise,* International Pension Issues 2011, Allianz Global Investors
- *Defining the Direction of Defined Contribution in Europe,* International Pension papers 4/2009, Allianz Global Investors
- *Western Europe: Fiscal pressures – ageing costs still on the horizon,* International Pension Issues 3/2009, Allianz Global Investors
- *Funded Pensions in Western Europe,* International Pension Studies 2008, Allianz Global Investors

For further information, please visit

www.allianz.de/vorsorge
www.projectm-online.com

FURTHER READING

- *Global Pension Atlas 2011*, Allianz Global Investors
- *Pension Sustainability Index 2011*, International Pension Papers, Allianz Global Investors (forthcoming)
- *Retirement assets on the rise again*, International Pension Papers 3/2010, Allianz Global Investors
- *Demographics in Focus: Ageing*, International Pension Issues 2 /2010, Allianz Global Investors
- *Pension Trends in Emerging Markets – The Rise of DC Plans and Its Consequences*, International Pension Papers 2/2008, Allianz Global Investors

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- "Retirement saving made simple," #09, 3/2011
- "Paradigm Lost," #07, 1/2011
- "The New Age of Retirement," #07, 1/2011
- "Secure Future," #07, 1/2011
- "Voting Gray," #07, 1/2011

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