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Allianz Demographic Pulse

A world without life insurance?

The financial crisis and the resulting low capital market interest rates seem to be proving a real test for both life and pension insurance. But their critics often fail to recognize not only how important life insurance companies, with their long-term focus, are to the capital market, but also the fact that life insurance is, presumably, the most important tool for providing cover against what are known as biometric risks. Biometric risks are all risks that are directly related to the life of an insured. Essentially, these include the following: (premature) death, longevity, occupational incapacity, disability, accidental death, disability as a result of an accident, serious illness and long-term care. Not least for this very reason, life insurance remains a crucial part of occupational and private retirement provision and an important component of the financial assets portfolio of ageing societies.

The world is aging

In 2050 every 5th person will be aged 60 and over

Sources: Allianz / United Nations

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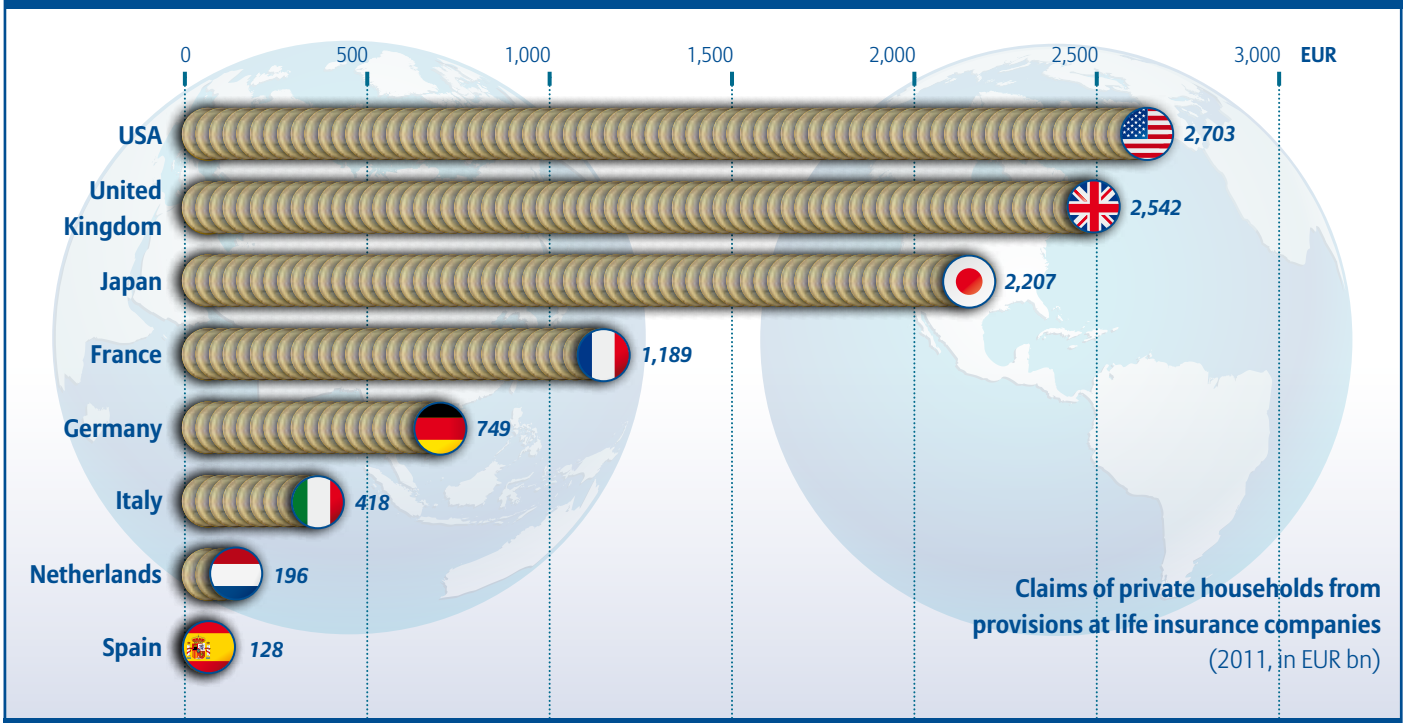
Life insurance forms an important part of asset formation



Worldwide, the claims of private households from provisions at life insurance companies total more than EUR 10 trillion.

Sources: Allianz / Eurostat, Board of Governors of the Federal Reserve System, Bank of Japan, Deutsche Bundesbank.

Life insurance is coming under fire: critics claim that the returns are too low, the investment policies of life insurers are too conservative and the product is outdated anyway.
It is true that the guaranteed minimum return on life insurance policies has been reduced in many countries only recently. The responsible authorities and ministries deemed this move to be a necessary one in a climate of sustained low interest rates due to the loose monetary policy used by central banks across the globe in an attempt to soften the blow of the financial and debt crisis. In Germany, for example, the Federal Ministry of Finance cut the maximum technical interest rate to 1.75% with effect from January 1, 2012. This provision only applies, however, to new policies taken out as of January 1, 2012 and does not affect existing policies. Furthermore, the actual returns are higher because the guaranteed minimum return only constitutes part of the funds that the investors actually receive. In Germany, for example, total returns on life insurance policies are expected to average 3.9% in 2012.[1]

Without life insurance, a lot of things would be different ...

The question as to whether a return of almost 4% is too low or appropriate given the current environment can be hotly disputed. What is far more decisive is the fact that life insurance policies are not just pure investment products, but rather serve to cover biometric risks. The best way of demonstrating this is to imagine, for a moment, that this sort of product never existed. Imagine that there is no life insurance to provide relatives with financial protection if the policyholder dies, and no pension insurance to guarantee the payment of lifelong pensions. Sufficient financial protection for a family, or partner, in the event that the main wage earner dies while he/she is still young, for example, would be much more difficult to obtain. And it were not for pension insurance, some of us would have to watch our standard of living plummet in old age – if our personal savings are used up after a pre-defined period and we are left only with the state pension to live on.

> Without pension insurance, some of us would have to watch our standard of living plummet in old age.

Total premium income exceeds EUR 1.7 trillion

In light of the above, it comes as no surprise that life insurance remains a key component of the investment portfolios of private households. Last year, the life insurance premiums paid worldwide totaled the equivalent of more than EUR 1.7 trillion; which roughly corresponds to the gross national product of the UK[2]. In 2011, each German citizen spent an average of EUR 1,042 on life insurance, while each US citizen spent the equivalent of EUR 1,270 and each Japanese citizen as much as EUR 2,183. A large part of the life insurance products purchased serve as a means of retirement provision. In the US, for example, around two thirds of all premiums were attributable to the purchase of pension insurance and a good third to endowment term life insurance. In Germany, more than 50% of all premiums were to endowment life insurance and

1 Cf. Association of German Insurers (GDV): „Lebensversicherung bleibt attraktives Vorsorgeprodukt" (life insurance remains attractive provision product).

2 UK GDP totals EUR 1,737 bn. Premium calculation based on Allianz data.

pension insurance, with term life insurance playing only a minor role.[3]

In addition, life insurance policies are often also key to make the dream of homeownership come true.

In fact, the proportion of life insurance policies taken out to secure loans, especially real estate loans, is relatively small: in the US, a mere 0.2% of all life and pension insurance premiums[4] were destined for this purpose in 2011, while in Germany, out of the total life insurance policies (more than 90 million) that had been taken out by the end of 2011, only 1.9 million were builder's risk insurances and 2.9 million were residual debt insurance policies.[5] **Nevertheless, taking out this sort of policy is often a prerequisite that has to be fulfilled before an individual can buy property or build his or her dream home.**

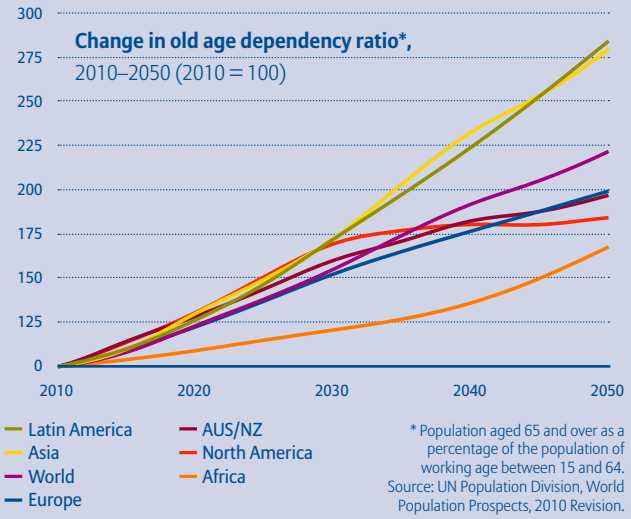
More than EUR 10 trillion of the global financial assets of private households are claims from provisions at life insurance companies

As a result, the receivables of private households from provisions at life insurance companies are also high: at the end of 2011, they totaled more than EUR 10 trillion worldwide,[6] a value that corresponds to **four times Germany's GDP** and one tenth of the total financial assets of private households. In the US alone, the total receivables of private households from life insurance companies totaled the equivalent of EUR 2,703 bn at the end of 2011, meaning that each US citizen had invested the equivalent of around EUR 8,640 of his/her total financial assets in life insurance on average.[7]

> In China, claims on life insurance policies already account for almost 11% of the total financial assets of private households.

In Japan, the average per capita claims vis-à-vis life insurance companies were more than twice as high at the equivalent of EUR 17,407 at the end of last year; the total amount of all receivables corresponded to the equivalent of EUR 2,207 bn.[8] Compared with this amount, the EUR 764 bn of German households appears almost modest, but the per capita figure nevertheless comes in at around EUR 9,410.[9] Life insurance is becoming an increasingly popular way of covering biometric risks and accumulating assets on the world's emerging markets, too. In China, one of the world's fastest growing life insurance markets, claims on life insurance policies already account for almost 11% of the total financial assets of private households.[10] If nothing else, this trend reflects the rising demand for private provision.

The population in the emerging markets is ageing rapidly



* Population aged 65 and over as a percentage of the population of working age between 15 and 64.
Source: UN Population Division, World Population Prospects, 2010 Revision.

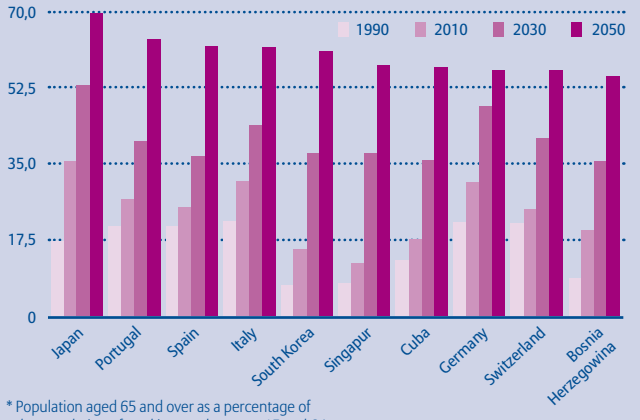
Ageing is a global challenge

As societies become older and older due to rising life expectancy on the one hand and lower birth rates on the other, the demand for funded occupational and private provision will continue to rise in the future. If we look at what is happening in the wider world, we realize that this applies not only to Germany or Italy, but also to the new eastern European EU member states, and to countries like China, South Korea and Singapore.

The Asian tiger states rank among the most rapidly ageing economies in the world. In South Korea, for example, the old age dependency ratio, i.e. the ratio of the population aged 65 and above to the number of people of working age (between 15 and 64), is likely to have increased four-fold from the current level of a good 15% to just under 61% by the middle of the century, meaning that it is likely to outstrip the ratio for Germany, where the increase in the statutory retirement age to 67 has taken the edge off the increase in the old age dependency ratio to around 56%. **By 2050, the number of over-65s worldwide is set to have trebled to almost 1.5 billion. By then, the number of very elderly people aged 80 years**

Japan, South Korea and Singapore will rank among the countries with the oldest populations in the world

Old age dependency ratios,* 1990–2050 (in %)



* Population aged 65 and over as a percentage of the population of working age between 15 and 64.

Source: UN Population Division, World Population Prospects, 2010 Revision.

3 Cf. III and the German Federal Financial Supervisory Authority (BaFin). At the end of 2011, there were a total of 37.5 million pension policies, 10.8 million of which were Riester policies and 1.5 million of which were for basic pensions. Cf. GDV: „Die deutsche Lebensversicherung in Zahlen" (the German life insurance in figures) 2012, p.34.
4 Cf. III, Facts about life insurance.
5 Cf. GDV: „Die deutsche Lebensversicherung in Zahlen" (the German life insurance in figures) 2012, p.14.
6 Cf. Allianz Group Economic Research and Corporate Development: Allianz Global Wealth Report 2012.
7 Including pension fund credit at life insurance companies. Cf. Board of Governors of Federal Reserve System: Flow of Funds Accounts of the United States. (…) tables B.100 and L.225.
8 Cf. Bank of Japan: Flow of Funds and UN Population Division: World Population Prospects, 2010 Revision.
9 Cf. German Bundesbank: Financial accounts for Germany – 2006 to 2011.
10 Cf. Peoples' Bank of China: Financial Stability Report 2012, p. 91.

or older is likely to have risen from a good 115 million today to 402 million; with around 3.2 million of them likely to be aged 100 or over.[11]

Funded retirement provision becoming increasingly important

These ratios alone show that private provision will become more and more important, especially if the younger generations of the future are not to be forced to carry an excessive burden when it comes to financing the pensions of, and healthcare spending on the pensioners' generation.

Private pension insurance also helps to protect individuals from poverty in old age. After all, given that sovereign debt levels are already high and in light of the sheer number of "baby boomers" who are set to reach retirement age over the next few years, further state pension cuts are on the cards in most countries – either directly, in the form of moves to lower pension levels further, or indirectly, in the guise of measures to lift the retirement age. What is more, without cover for their own longevity risk, many people will be forced to accept a lower standard of living in old age, despite having personal savings set aside for this purpose. This happens when private investment capital has been used up, leaving individuals with only their state pension to live on.

Without cover for their own longevity risk, many people will be forced to accept a lower standard of living in old age, despite having personal savings set aside for this purpose.

Despite all of the information available to the public, the average investor has not only a preference for the present, preferring EUR 100 today over EUR 105 in a year's time – which stops many people from starting to build up private provision early on – but also tends to look to his or her parents and grandparents when it comes to judging future life expectancy.

11 Cf. UN Population Division: World Population Prospects, 2010 Revision.

INSIGHTS

Change in the overall framework for life and pension insurance in Germany at a glance

Despite the ups and downs on the financial markets - life insurance remains reliable

Life insurance policies mean stability, and have done so for more than 100 years. They make long-term investments and guarantee secure returns on the capital invested.

New unisex rates for life insurance.

In the future, men and women will pay the same rates. This is based on the EU Equal Treatment Directive dating back to 2004. The Directive demands equal treatment for men and women in the access to and supply of goods and services.

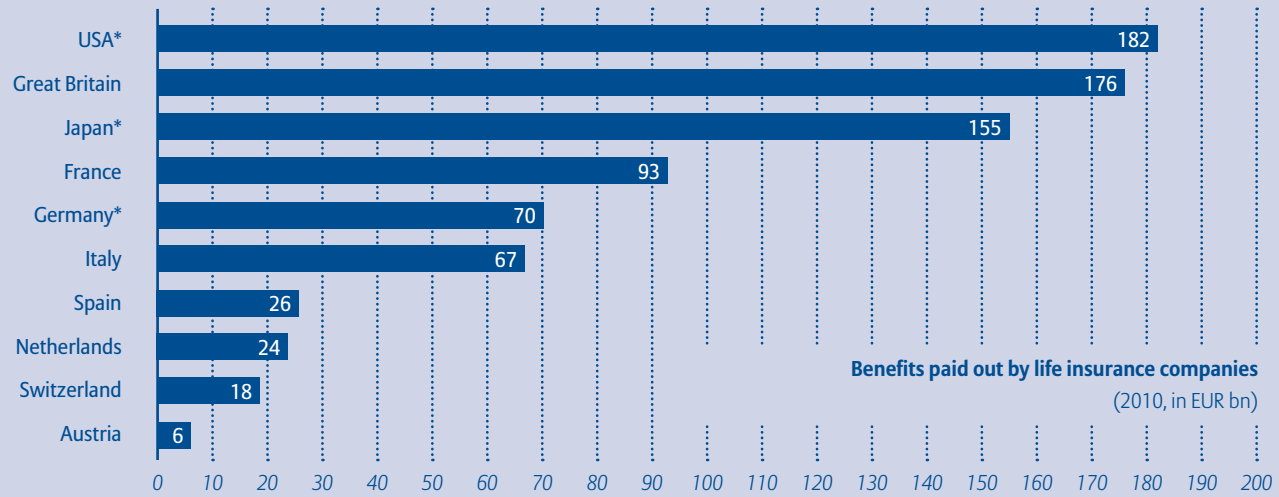
New supervisory law provisions based on Solvency II.

Solvency II aims to harmonize the supervisory law regarding insurance. The focus is on protecting policyholders in the event of the insolvency of individual insurance companies. The new EU Directive, which is to be transposed into national law by the end of March 2013, focuses on adequate and verifiable risk management.

Reduction in guaranteed interest rate for life insurance to 1.75%.

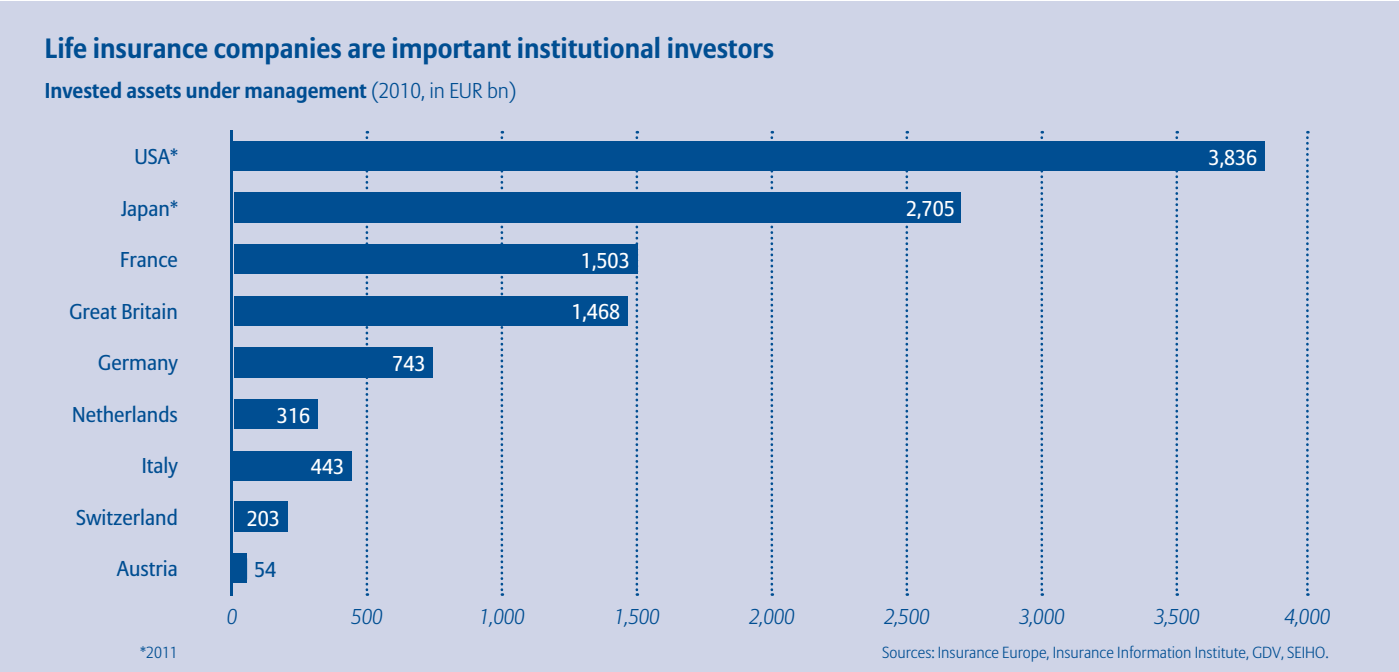
The reduction has been made due to the current period of low interest rates in a historical comparison and is ultimately in the interest of consumers: the move is designed to prevent insurers offering their customers excessively high interest rates which they are then unable to pay in the future. The returns on life insurance policies comprise the guaranteed interest rate, the profit share, the participation in the valuation reserves and the final profit

Benefits paid by life insurers secure standard of living in 2010



*2011

Sources: Insurance Europe, Insurance Information Institute, GDV, SEIHO.



In doing so, the fact that a pensioner couple retiring at 65 today lives four years longer on average than the generation 30 years before them is disregarded. A 65-year old man in Germany, for example, can expect to spend another 18 or so years in retirement; a 65-year old woman now has an average further life expectancy of almost 21 years. Further rises are to be expected.

Benefits paid by life insurers in the EU recently totaled more than EUR 500 bn

Life insurers already play an important role in helping to secure their customers' standard of living: in 2010, the benefits paid by life insurance companies in the EU totaled EUR 515 bn. German life insurance companies alone paid out total benefits worth EUR 70.4 bn in 2011, with more than EUR 3.9 bn being paid out to surviving dependents. This corresponded to one third of the payments made by the statutory pension insurance system.[12] The benefits paid out in Japan were more than twice as high, coming in at the equivalent of around EUR155 bn, and in the US, they totaled the equivalent of EUR 182 bn.[13]

> Even in turbulent times, the profit share offered by life insurance policies remains attractive

With their long-term investment policies, life insurance companies help to stabilize the capital markets

Since the benefits have to be paid using the assets managed for the policyholder, the investment regulations for life insurance companies are appropriately stringent. Due to the long investment horizon – someone who starts saving in a pension insurance policy at the age of 30 may still be receiving regular pension payments 70 years down the line – life insurance companies are required to invest the majority of the funds they manage in long-term, secure investments which offer lower returns than high-risk products per se. By way of example, at the end of 2011, German life insurers held less than 4% of their total investments in shares.[14] In 2008, this rather conservative investment policy spared the customers of German life insurers the sort of hefty losses incurred, for example, by customers of British life insurers, which invest far more in equities. In the meantime, the investment regulations that apply in the UK have now also been tightened up.

The important role played by life insurers on the capital market becomes obvious if we look at the volume of investments accumulated: at the end of 2011, life insurers in Germany managed funds to the tune of EUR 743 bn. In the EU as a whole, the total amount came in at around EUR 5,400 bn. In Japan and the US, too, life insurers were major institutional players on the capital market, with funds under management worth the equivalent of EUR 2,705 bn and EUR 3,836 bn respectively. With their long-term investment policies, which are ultimately reflected in the maturities of their liabilities, life insurance companies help to stabilize the capital markets.

Conclusion: Life insurance remains a key component of private provision

Despite all of the criticism, life and pension insurance will remain key components of private provision in the long term, not least due to our rapidly ageing populations. There is no doubt that the current period of low interest rates is putting pressure on policyholder returns and, as a result, on the income they will receive, in the long run, from their private pensions in old age. The same, however, can also be said for other investment products – which, unlike life insurance, do not offer protection against life's risks.

12 Cf. GDV: „Die deutsche Lebensversicherung in Zahlen" (the German life insurance segment in figures) 2012.
13 Including health insurance, see III.
14 Cf. GDV.

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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 issues of long-term care and dementia, amongst others. Furthermore, in the future there will be a significant decline in the workforce in all of the world's markets, triggering challenges in areas such as 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.

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Do you have any comments, suggestions or questions? We look forward to your feedback!

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