

Press Release



U.S. pensions: assets growing strongly but retirement risks also increasing

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A new report from Allianz Global Investors AG (AllianzGI), one of the world's largest asset management companies, reveals that the U.S. pension landscape is in a state of transition and that as a result the population will be exposed to evermore retirement risks.

Key findings of the study include:

- The U.S. pension system is in a state of transition, which can be identified by three trends:
 - > Less generous social security benefits due to demographic developments
 - > The continuing shift from defined benefit (DB) to defined contribution (DC) pension plans
 - > A structural change from company pension plans towards individual plans
- The U.S. population is exposed to increasing retirement insecurity, five main drivers can be identified:
 - > Insufficient coverage
 - > Poorly-targeted tax incentives
 - > Rising health care costs
 - > Current economic conditions
 - > Neglected asset decumulation
- The U.S. has the largest and most developed funded pension market which is estimated to grow between 3 - 5.8% p.a. and reach between \$25.5 trillion and \$36 trillion by 2020.

Retirement at Risk: The U.S. Pension System in Transition investigates the problems arising from declining Social Security benefits and the evident shift in the occupational pensions landscape in the U.S. – namely the shift from defined benefit to defined contribution plans. It also gives a broad overview of the growth in U.S. household financial assets (driven by efforts to build pension entitlements) and provides projections on how pension assets in the U.S. could develop over the next decade.

Social Security in the U.S. is in bad shape. Over the coming two decades around 78 million baby boomers will enter retirement reducing the worker-per-beneficiary ratio from 3.2 today to 2.2 in 2030. However, the situation is less severe than in other industrialised countries, such as Japan or Western Europe, as migration will keep the U.S. population growing, however at a decreasing rate. If there is no reform to Social Security's financing and benefit formulas then the U.S. government will have to take on new debt, raise taxes, or reduce other expenditures once the Social Security trust fund assets are exhausted. Instead, according to the Social Security Board of Trustees, Social Security could be brought into actuarial balance by either reducing benefits by 20%, increasing payroll taxes by 15.6% or a combination of the two.

Brigitte Miksa, Head of International Pensions at AllianzGI, says, "Even in a country that is only modestly affected by demographic change, an aging population does not come without cost."

The shift from DB to DC raises major challenges for future financial security. The first is actually participating in an employment-related pension plan. In contrast to DB plans, most DC plans operate on

a voluntary basis and this voluntary participation is considered to be the main reason behind the low coverage of workplace pension plans. Almost 50% of the total workforce in the U.S. does not participate in an employer-sponsored pension plan. While the Pension Protection Act tackles employee inertia by introducing auto-enrollment, it ignores the question of access, which is the foundation of broader coverage.

Furthermore, asset balances in DC accounts are far from sufficient, and medical inflation may erode the nest eggs of many retirees. Healthcare costs are estimated to skyrocket to \$4.3 trillion (19.5% of GDP) by 2017 compared to \$2.1 trillion in 2006. The demand for employer-sponsored health care may crowd-out voluntary employer contributions to existing pension plans.

For the baby boomer generation, financial security is foremost about distributing pension wealth prudently. Intelligent decumulation strategies and sustainable spending patterns will be key. They require investment strategies that not only target returns but include appropriate risk management strategies and that take account of individual characteristics such as age, life expectancy and target retirement date.

Despite these challenges, the research highlights that the U.S. pensions market holds a lot of promise. At year-end 2007 total pension assets for U.S. households were \$17.3 trillion – the largest and most developed pension market worldwide. In the coming years, the build-up of financial assets is likely to remain dynamic, with growth driven by efforts to build up pension entitlements. Shifts in the financial portfolio of households are expected as baby boomers begin restructuring assets to generate a largely secure, regular flow of income for retirement. This can already be seen by the booming demand for annuities.

U.S. household assets are expected to grow to just over \$75 trillion by 2020 (4% p.a.). Due to projections of Allianz Group Economic Research and Development, investment in funds are likely to see the strongest growth, continuing the trend in institutionalising private investment. Though the share of insurance and pension funds will probably remain broadly stable, Individual Retirement Accounts (IRA) assets will grow strongly, helping to further increase the share of pension assets to 45% by 2020. U.S. pension asset levels are expected to be between \$25.5 trillion taking account of the current economic crisis and \$36 trillion by 2020.

Brigitte Miksa concludes: “Current economic conditions may impact long-term pension saving by tempting people to draw-down pension assets to alleviate financial hardships such as mortgage financing problems. However, even the most pessimistic scenarios foresee a large accumulation of pension wealth of min. \$25.5 trillion in the coming decade.”

With the shift from DB to DC and the related move from highly standardised company pension plans to individual responsibility, attention will have to move beyond pure asset accumulation to a focus on the entire life-cycle and the sustainable spending of retirement income. The key challenge is the integrated management of the different risks associated with long-term investments such as market risk, inflation, longevity as well as health risks.

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