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THE "SELF-MADE PENSION"

USING GUARANTEED INCOME TO HELP SECURE YOUR RETIREMENT

The 2008 financial crisis and ensuing recession have awakened many investors to a new reality about managing and protecting their money. Retirement savings have been particularly hard hit, mostly because of the large sums Americans have invested in equities through self-directed retirement plans. The sudden drop in retirement wealth has left many investors wondering if they will ever be able to retire confidently. Fortunately, today's investors have access to a breed of products designed to guarantee a reliable income for life. Used as part of a balanced retirement plan, these instruments can help you create a "self-made pension" that keeps paying you no matter what life brings, while protecting you from some of the biggest threats to your financial well-being in retirement.

Read Inside

- Understand the various risks to your retirement
- Learn strategies you can use to protect your retirement income
- Discover why a guaranteed minimum withdrawal benefit should be an integral part of your retirement portfolio

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The "Self-Made Pension": Using Guaranteed Income To H

How confident are you that your investments and income will see you comfortably through retirement? If you're like most investors, your answer today might be very different from just a couple of years ago.

According to a survey in *Money* magazine,[1] 90% of investors surveyed are changing the way they manage money and 94% say the recession will have a lasting impact on how they handle their finances. Says one investor, "If I don't create a way to be in control of my earnings for the rest of my life, I'm a fool." Clearly, doubt and fear have driven many people to cut spending, pare back debt, reduce expectations and make sacrifices.

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Even if you haven't had to change your current standard of living, your retirement outlook may be very different today. Rather than planning how you'll pursue your interests, you may be considering serious steps, such as postponing retirement or dipping into retirement savings to meet current expenses, like college costs. One thing is clear: When it comes to money, safety and security have taken center stage.

Are Your Goals Still Within Reach?

"Any large decline in the stock market is reason for concern, but this one (2008) is particularly worrisome," read a report published by the Urban Institute.[2] "Over the past 25 years, employment-based pensions have been shifting from traditional defined benefit plans that require employers to manage retirement savings to defined contribution plans that place the investment responsibility on workers." As a result, there are more savings than ever in retirement accounts, with the bulk of these retirement assets invested in the stock market.

According to the Institute's research, this means the stock market crash of 2008 could take a large bite out of the income retirees are able to generate from their retirement savings. Higher-income households (those with about $100,000 in annual income according to the U.S. Census Bureau) — who typically have more invested in the stock market — will feel the greatest negative impact if the market does not fully recover its losses.

This can leave you wondering if you can have the retirement lifestyle you've envisioned. Will you be able to afford the same things you can today and treat yourself to an occasional indulgence? What about having a cushion of liquidity for the unexpected? Will you have enough assets to leave an inheritance for heirs or charities, or to help children or grandchildren financially during your lifetime?

Clearly, market declines can threaten to derail your retirement dreams. If the market turns against you in the 10 or so years before or after you retire, the effects can be even more detrimental. Fortunately, there are steps you can take today that may help protect your portfolio from market downturns and other risks, including inflation and the good chance you'll live longer than your life expectancy. Adequate planning, coupled with innovative retirement income strategies, can make the difference between an uncertain future and a secure retirement.

elp Secure Your Retirement

A New Approach to Retirement Planning

Certain strategies, such as withdrawing a fixed percentage of your retirement savings each year, can provide a measure of predictability. But they cannot guarantee reliable income throughout your lifetime. And, while asset allocation is valuable, especially in managing risk while you accumulate assets, it too can fall short as you begin to draw down your savings. Today, financial professionals are increasingly adopting a different approach called "product allocation."

Moshe Milevsky is executive director of the Individual Finance and Insurance Decisions (IFID) Centre and associate professor of finance at the Schulich School of Business at York University in Toronto, Canada. Milevsky's research supports allocating retirement investments to three product silos.[3]

THREE PRODUCT SILOS	
1. Traditional Investments	Stocks, bonds, mutual funds and other conventional accumulation-based instruments.
2. Pensions and Immediate Annuities	Pensions and income annuities that offer a lifetime income.
3. Innovative Guaranteed Income Products	Financially engineered products that offer guaranteed lifetime income, such as a variable annuity with a guaranteed minimum withdrawal benefit, (GMWB), often referred to as a living benefit.

This paper is focused on the third category: a variable annuity with a GMWB. Unlike Social Security, pensions and fixed income annuities, this type of guaranteed income can rise if the market performs well, but will never fall below an established minimum as long as withdrawals do not exceed the allowed amount. A variable annuity with a GMWB also allows you to choose from a variety of investment options. Variable annuity fees and charges include Mortality and Expense Risk fee and Administrative charge, surrender charges, annual fee, and investment option management fees. Additional fees may apply to optional benefits selected. You can give any remaining policy value to your heirs as an inheritance.

No matter what happens with the markets, you can have genuine security that you'll have a guaranteed income for as long as you live.

A retirement portfolio that includes a variable annuity with a GMWB can provide income for life like a "self-made pension." No matter what happens with the markets, you can have genuine security that you'll have a guaranteed income for as long as you live. Keep in mind that all guarantees are backed by the issuing insurance company.

The Risks to Retirement Income

The major risks to your retirement lifestyle really come down to one thing: the unknown. How long will you live? Will your health hold up? What will happen in the economy? What's the future direction for taxes? How will the financial markets respond?

"A lot of people don't have very good information about what their expenses will be during retirement," says Olivia S. Mitchell, professor of insurance and risk management at Wharton University.[4] "We know from our research at the Pension Research Council that there's a substantial underestimation of the need for long term care and nursing home insurance. People also don't understand what medical costs may be in retirement. And many people don't focus enough on the risk posed by inflation."

Health Care: Often Underestimated

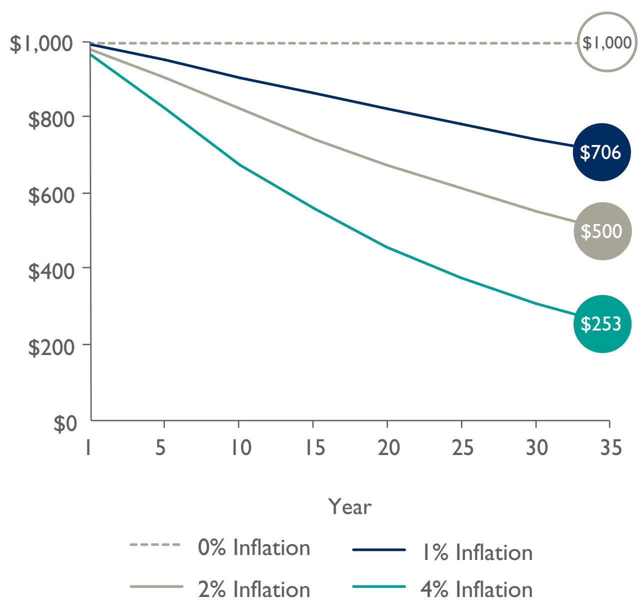
Top of mind for many investors, health care costs (including long term care) are among the primary reasons people run short of money in retirement. Most people underestimate their future health care needs.

The National Retirement Risk Index shows that 44%[5] of Americans were at risk of not being able to maintain their standard of living throughout retirement. If you include health care costs, the share of at-risk households rises to 61%[5], and incorporating long term care insurance drives the index up 64%.[6] That means more than two-thirds of us won't have enough money in retirement to live the way we do now. Health care is one of the primary culprits.

Inflation: The "Silent" Risk

The chart below shows how inflation can erode your buying power over time. Based on these numbers, at a 4% inflation rate, a $1,000,000 retirement portfolio would purchase only $253,000 in goods and services after 35 years. If you're making regular withdrawals and using those assets, imagine how quickly your buying power would decline.

Inflation: The "Silent" Risk



Source: Asset Allocation and the Transition to Income: The Importance of Product Allocation in the Retirement Risk Zone by Moshe A. Milevsky and Thomas S. Salisbury. September 27, 2006.

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Longevity:
The Unexpected Reality of How Long you Could Live

Perhaps the most neglected facet of retirement planning is longevity risk. "People tend not to think about mortality. It's not a question people willingly face," Mitchell said. "When people do think about mortality, at best they think about life expectancy. But they may not understand that about half of all people live longer than their life expectancy. Women especially can live into their 90s or even reach their 100th birthday."

Consider a healthy couple entering retirement. There's a 50% chance at least one of them will live beyond age 92, and a 25% chance one will live beyond 97. When you're making plans to stretch your money throughout retirement, it may be wise to assume a longer lifespan.

Taxes:
Still Uncertain

If you're in today's top income tax bracket, you could wind up losing more than one-third of your income to taxes each year. Though there are many strategies for managing the impact of taxes, especially as you withdraw funds during retirement, many investors would likely agree the greatest risk is that tax rates will be higher in the future. Clearly, taxes are a risk you should monitor and manage throughout retirement.

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Long Odds

LIFE EXPECTANCIES FOR A 65-YEAR-OLD MALE AND FEMALE

MALE Healthy at age 65

50% Chance of living beyond age

85

25% Chance of living beyond age

92

FEMALE Healthy at age 65

50% Chance of living beyond age

88

25% Chance of living beyond age

94

COUPLE Healthy at age 65

50% Chance of living beyond age

92

25% Chance of living beyond age

97

Source: Wharton Financial Institutions Center Policy Brief: Personal Finance. Investing Your Lump Sum at Retirement by David F. Babbel and Craig B. Merrill. August 14, 2007. Used with permission.

Sequence of Returns: Why it Matters

Sequence-of-returns risk is the possibility that market downturns occur close to when you start making withdrawals from your retirement savings, forcing you to attempt to recoup losses while drawing down assets. This risk is greatest during the five to 10 years before and after retirement begins.

According to the *Journal of Financial Planning*, "a series of ill-timed downturns in the market could drastically increase the longevity risk faced by investors, forcing them to dramatically decrease their retirement standard of living. In the absence of cash flows, the sequence of returns is not important. In retirement, outgoing cash flows make the sequence of returns very important." [7]

Milevsky's research (co-authored by Thomas S. Salisbury) provides a hypothetical example.[8] **(See adjoining chart)** Two portfolios started in 1985 with $100,000 were subject to $9,000 annual withdrawals (ignoring inflation). Both experienced close to the same average return and risk (measured by standard deviation) during the 21 years between January 1985 and January 2006. Those who have studied Markowitz will note that these portfolios would be in the same location on the "efficient frontier," which plots risk vs. return.

The final outcome for these two portfolios is quite different. The first portfolio, which is invested in Fund A, runs out of money by the year 2000. The second portfolio, invested in Fund B, ends up much better, with nearly as much wealth (in nominal terms) as it had in January, 1985. Why does this enormous difference in outcomes exist, even though the funds had similar risk/reward profiles?

The answer lies in poor markets during the early years. Fund A experienced returns of -10.71%, 0.79% and -6.90% in years one through three, while Fund B earned very strong returns in the first three years. In the long run, they both earned an average of about 8% per year, with the same degree of risk. Even though Fund A earned approximately 38% in year four — making up nicely for the first three years — while Fund B lost over 14% in year four, Fund A was unable to catch up. The damage was done. Since no one can predict the direction of the markets with certainty, sequence-of-returns can make a large difference on how long your assets will last in retirement.

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Sequence of Returns:
A Tale of Two Funds

MILEVSKY'S HYPOTHETICAL EXAMPLE FOR PRODUCT ALLOCATION				
Year	Fund A	Balance	Fund B	Balance
1985	**-10.71%**	$80,293	**17.37%**	$108,374
1986	**0.79%**	$71,924	**11.63%**	$111,973
1987	**-6.90%**	$57,964	**37.35%**	$147,719
1988	38.18%	$71,093	-14.41%	$117,436
1989	-5.97%	$57,849	10.15%	$120,352
1990	29.73%	$66,051	20.87%	$136,469
1991	13.87%	$66,209	-9.77%	$114,138
1992	-13.90%	$48,003	39.82%	$150,585
1993	34.87%	$57,740	32.50%	$190,523
1994	-1.52%	$45,894	-8.55%	$165,225
1995	-4.20%	$34,967	-5.62%	$146,932
1996	24.81%	$34,641	23.53%	$172,510
1997	-11.37%	$21,702	9.48%	$179,856
1998	34.08%	$12,754	4.20%	$178,407
1999	11.14%	$5,175	11.19%	$189,367
2000	14.30%	**$0**	-1.58%	**$177,372**
2001	-1.82%	$0	-11.06%	$148,760
2002	-9.26%	$0	-7.98%	$127,890
2003	14.75%	$0	10.38%	$132,163
2004	7.25%	$0	7.45%	$133,005
2005	5.96%	$0	-14.44%	$104,803
Standard Deviation	**16.60%**		**16.60%**	
Arithmetic Mean	**7.81%**		**7.74%**	

Source: Asset Allocation and the Transition to Income: The Importance of Product Allocation in the Retirement Risk Zone by Moshe A. Milevsky and Thomas S. Salisbury. September 27, 2006.

Protecting Your Portfolio

Taken together, these risks can pose a major threat to your "dream" retirement. Fortunately, retirees and pre-retirees can benefit from tools designed to help minimize these risks.

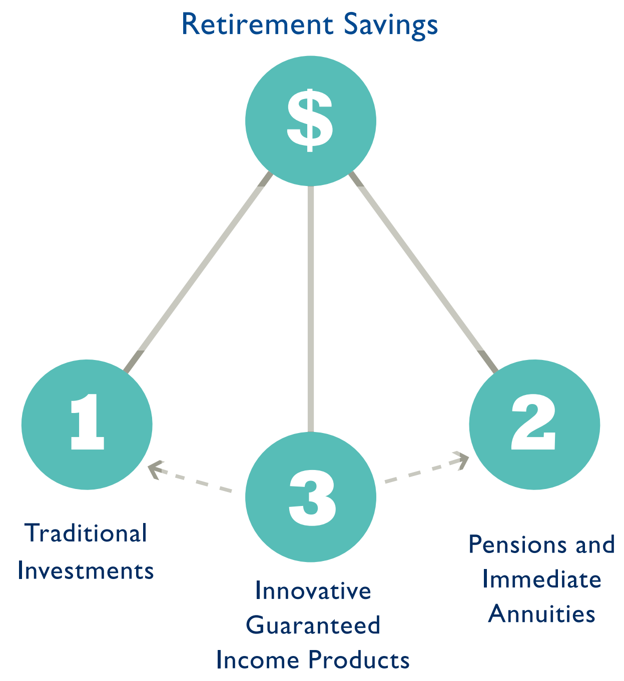
Production Allocation is Step One

Traditional asset allocation strategies that slice the portfolio pie into stocks, bonds, and cash, can help cushion a portfolio from market risk, and are valuable as you accumulate wealth. However, they cannot ensure an income stream throughout retirement. That goal can be accomplished through product allocation.

Product allocation is the next step in the evolution of asset allocation, designed specifically for people close to or in retirement. Rather than allocating a pool of money among asset classes, you also incorporate guaranteed income products. According to Milevsky, product allocation can be accomplished with three product silos:

1. **Traditional Investments,** including separately managed accounts, exchange-traded funds (ETFs), mutual funds and other conventional accumulation-based instruments. Throughout retirement, you systematically withdraw these assets, attempting to make them last as long as possible. And, you use asset allocation to achieve a desired return with an acceptable degree of risk.
2. **Pensions and Immediate Annuities,** including defined benefit plans and fixed income annuity products (or payout annuities). In exchange for fixed income payments, you give up liquidity, investment control, and in some cases, the ability to leave any of these assets to heirs.
3. **Innovative Guaranteed Income Products** that offer income for life, exposure to stock market gains and losses, and control. They are also designed to leave remaining assets as an inheritance. Because these instruments offer income for life, this category — which currently includes deferred variable annuities with living benefits like a guaranteed minimum withdrawal benefit (GMWB) — can provide protection against sequence-of-returns risk.

Three Silos of Product Allocation



The GMWB silo "swings like a pendulum between the pure pension and the pure investment categories depending on market conditions."[9] When times are good, the account behaves like a stock or mutual fund and increases in value. When the markets are falling, the pendulum swings in the other direction and behaves more like an income annuity or pure pension, providing a steady income stream.

How much money you should allocate to each category depends on your expected retirement age, gender, health status, desired spending rate and inflation assumptions.

How the GMWB Works

At first glance, the second and third categories appear similar, in that both offer a lifetime income guarantee. However, there are important differences. With immediate annuities, you purchase an annuity contract with a lump sum payment and, in return, the insurance company promises to pay you an income stream for as long as you live.
On the other hand, the GMWB is a rider to a variable annuity contract. You get ongoing access to your money and can control how your assets are invested. In fact, most providers offer a number of investment options, including stocks, bonds, asset allocation portfolios, international investments and cash. While GMWBs may have certain limitations with some providers, variable annuities generally provide a wide range of choices that allow market participation.

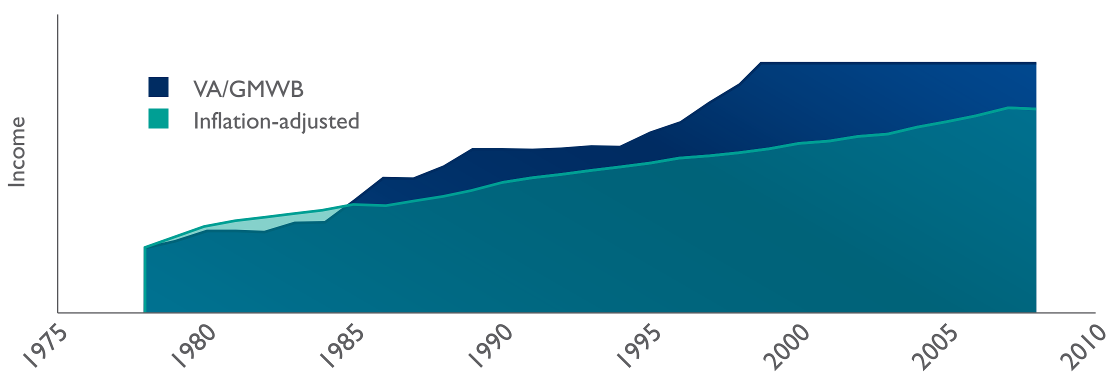
The GMWB guarantees you will receive income for as long as you live — even if your policy value goes to zero — provided you don't take more than the guaranteed withdrawal amount in any year, which could decrease or stop your guaranteed income. If the market performs well, the benefit base (the basis for calculating your guaranteed withdrawal amount) may be stepped up, resulting in an increase in your guaranteed amount. With some GMWBs, if you make no withdrawals in the first years, you may earn a bonus that will increase your guaranteed income.

The chart below illustrates how the GMWB works with a variable annuity contract. It shows the guaranteed income stream assuming an investor bought a VA+GMWB contract at the end of year 1978, and the inflation-adjusted equivalent for comparison. The guaranteed income never decreases, and steps up when the contract value exceeds the current benefit base. As you can see, the stock market crash in year 2000 and the market crisis in 2008 do not reduce the annual income, and the guarantee keeps the income level consistent throughout that period.

What About Fees?

GMWB riders assess a fee in addition to variable annuity charges. These may be calculated as a percentage of policy value or benefit base. Consider, however, that more than 93% of investors surveyed by AllianceBernstein indicated they'd like a guaranteed source of income throughout retirement, and about 90% of respondents said a guaranteed source of retirement income would make the biggest difference in feeling confident in retirement.[10]

Income from a VA & GMWB



The GMWB at a Glance

FEATURES OF GMWBs
■ Retain control of your assets and how they are invested by allocating them among variable annuity investment options.
■ Stay invested in the stock market throughout retirement to help your investments better keep up with inflation.
■ Withdraw the guaranteed amount each year, no matter how the investment options performed or how long you live.
■ Receive a bonus on the benefit base if you don't make withdrawals in early years with certain products.
■ Get a benefit base step-up, which will increase the withdrawal amount in years when market performance is positive.

Quality Counts

Like all insurance, the guarantee behind guaranteed income is only as good as the company making the promise. When choosing an insurance company to provide lifetime income benefits, you can feel more confident in your decision if you look for a company with:

- **Deep Experience:** Some insurance companies have been in existence for over a century. These companies have weathered market and economic cycles and accumulated valuable knowledge and expertise that they can apply to helping you build a product allocation strategy.

- **Financial Strength:** The strongest insurance companies will have A or better ratings from A.M. Best, Standard & Poor's, Moody's and Fitch. Many companies post their ratings on their company websites. These will help you gauge the strength of the company's balance sheet, cash flows and liquidity.

Conclusion

Investors today face a greater need than ever for a product that can provide lifetime income during retirement. While the traditional approach of asset allocation may help you build wealth in your income-earning years, a product allocation approach can more adequately address the risks that threaten your financial security as you draw down your assets in retirement.

A variable annuity with a GMWB rider can be a key component of a "self-made pension," and the one part of the product allocation picture that gives you the opportunity to benefit from market gains and the security of a guaranteed income. It also provides the potential to leave an inheritance to future generations.

A variable annuity with a GMWB rider can give you the confidence to invest even when you're uncomfortable with the markets — and enable you to make decisions based on your financial needs and goals rather than emotions. Talk to your financial professional to learn more.

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