Perspectives

# Rethinking **what's ahead** in retirement

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ENT-1154-N

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# Rethinking what's ahead in retirement

Americans face an era of transformation with a new emphasis on guaranteed income as they prepare for retirement.

## Introduction – the new reality

Many people have no idea where to find **GUARANTEES** in the financial marketplace.

The world of retirement planning is on the precipice of a new reality. The era of retirees being rewarded with a gold watch and lifetime pension after 35 years of work with a company has virtually disappeared. A combination of unpredictable markets, the erosion of defined benefit plans, the uncertainty about Social Security, and longer life expectancies means a new paradigm is emerging in retirement planning, challenging long-held beliefs in financial planning. This shift creates an opportunity to help Americans redefine how they plan for retirement and generate guaranteed income for life, a benefit unique to annuities.

The market turmoil of 2008 and early 2009 cemented a deep-seated crisis of confidence about how to truly create retirement security. If one polled Americans in 2007 about whether large investment firms – the pillars of American finance – could be brought to their knees in a matter of weeks, few would have answered yes. The "shock and awe" of the financial crisis contributed greatly to this rapid shift in how Americans view retirement.

The financial crisis is not the only driver of this shift. The sense of insecurity also comes from the worrisome state of the government retirement system in the United States, which reached an unsettling milestone in 2010. For the first time since 1983, Social Security payouts exceeded the amount paid in by workers.[1]

Individuals are also coming to terms with the decline of the defined benefit plan, a once-common source of guaranteed lifetime income. During the last 30 years, it appears that most employers have determined that a defined benefit plan is too costly and carried too much long-term financial risk for the company. They moved instead to tax-advantaged savings plans (e.g., 401(k) plans) for their workers, thereby shifting the responsibility for retirement security and longevity risk from corporations to their employees. Unfortunately, most Americans have not yet truly comprehended this new risk that they now own.

As millions of baby boomers enter or are near retirement, they are coming to realize more than ever that they must learn how to convert assets into guaranteed retirement income. Many people have no idea where to find guarantees in the financial marketplace. Options do exist, so boomers will need to learn as much as they can about new forms of retirement solutions offered in the private sector, and begin taking action.

The depth of fear about Social Security and retirement funding should startle both financial leaders and policymakers. But this should not be considered a polarizing political issue. It's a math problem that will only get worse if left unanswered. When more than half of Americans who are just 15-20 years from retirement believe they are more likely to be hit by lightning than to receive their full due from the government, the need to act and educate is irrefutable.[2]

[1] "The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," 2014.

[2] Allianz Life Insurance Company of North America, The Allianz ***Reclaiming the Future*** Study, 2010.

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# The evolution of retirement

The mindsets and buzzwords that characterize how a generation views saving and investing for retirement have evolved from one generation to the next. These mindsets are built on the personal experiences of that generation, imprinted deeply on their psyches, with each generation typically emphasizing one aspect of the retirement question over another.

A confluence of factors is forcing boomers to **READJUST** their financial beliefs.

As we look back in time, we see that all approaches and beliefs about retirement are not equal. Today's generation of baby boomers is experiencing a confluence of factors that are forcing them to readjust their financial beliefs and expectations, including:

- A realization that they will soon need to replace their paycheck with other sources of income.
- The severity of the financial crisis and Great Recession – and the significant hit on their retirement nest eggs – that undermined their once-steady faith in the equity markets as a solution to their retirement problems.
- A series of challenges – e.g., a lack of savings and guaranteed income – that are forcing the next generation of retirees to look for solutions different from those that worked for their parents.

Financial professionals have helped their clients accumulate wealth in preparation for retirement, something still important for younger baby boomers and subsequent generations. The fact remains, however, that a vast group of people in their late 50s and early 60s are now reaching the retirement income planning phase when they now must rely on their investment assets for income.

Looking back at attitudes about retirement during the past 70 years, three broad shifts in mindset have occurred.

## The first wave – "guarantees" and "safety"

Shaped by lifetime events such as the Great Depression and World War II, the so-called "greatest generation" generally took a cautious approach to financial planning, investing, and preparing for retirement. The buzzwords for this generation were "guarantees" and "safety."

This sense of caution and concern is not surprising, given that attitudes toward investing were greatly informed by a series of momentous events:

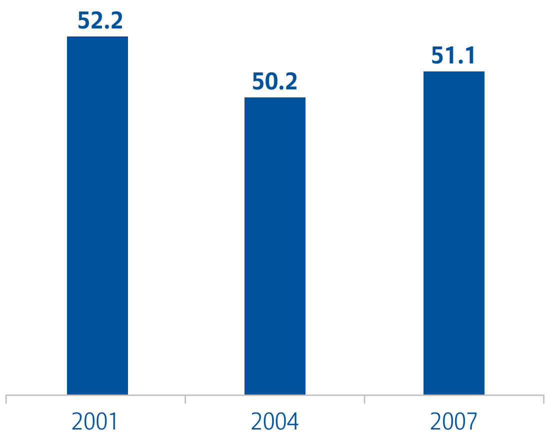
- The 1929 stock market crash that led to the creation of the Securities and Exchange Commission and new securities laws to regulate investment markets.
- The financial collapse and insolvency of banks (where people lost their savings) that led to the creation of the Federal Deposit Insurance Corporation in 1935 to protect bank savings.
- The inception of Social Security in 1935 to provide a base level of financial support in retirement.

The greatest generation stayed away from **EQUITY** markets.

These government interventions and the insecurity about markets in general led many of this generation to want rock-solid guarantees and safety in both their financial planning and career choices. The high unemployment of the Great Depression led many to value a job for a lifetime, and be attracted to companies that offered a defined benefit (DB) plan in the form of an employer-sponsored pension to provide their retirement security.

This is the generation that may have stayed at a company for 35 years and received the gold watch at retirement. Whether they knew it or not, the result of their choices was a formula for retirement income known as the "three-legged stool." One-third was derived from Social Security, another third from employer plans, and one-third from personal savings. This model worked fairly well for 30-40 years.

## Percentage of families with stock holdings




U.S. Census Bureau, Statistical Abstract of the United States: 2012.

Their generally cautious attitude and the guarantees underlying two-thirds of their retirement income (Social Security and defined benefit plans) led members of the greatest generation to stay away from equity markets. In 1952, long after the great stock market crash of 1929, stockholders represented only 4% of the American population, a number that increased to just 13% by 1980, in the midst of the era when baby boomers entered the workforce.[1]

By avoiding the stock market and mutual fund investing, this generation was less interested in having control of their retirement assets and instead was comfortable allowing the government (in the form of Social Security) and their employer (in the form of pension plans) to provide the guarantees and security that they preferred. In addition, the third leg of the stool (i.e., personal savings) often took the form of bank savings and certificates of deposit, which provided FDIC insurance on savings or fixed annuities that provided a guaranteed rate of return. Guarantees and safety oriented their decision-making, and banks and life insurers provided the bulk of their retirement planning products.

[1] T. Caplow, L. Hicks, and B. Wattenberg, *The First Measured Century: An Illustrated Guide to Trends in America, 1900-2000*, American Enterprise Institute for Public Policy Research, 2001.

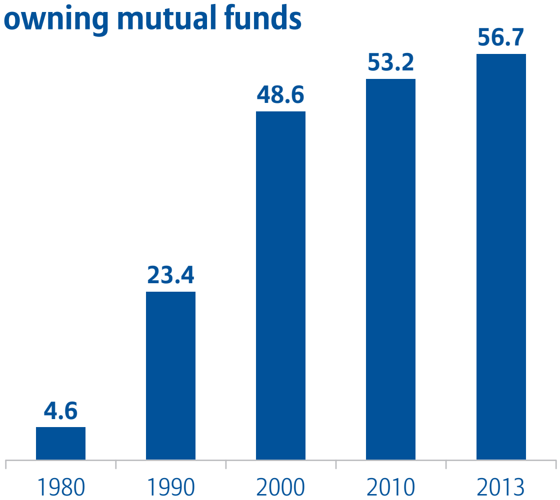
## The second wave – "rate of return" and "control"

Boomers focused on increasing their **RATE OF RETURN**.

Like many things they touched in society, the baby boomers approached the management of their assets in a decidedly different way from their parents. Growing up in primarily favorable economic times and energized by solid economic growth for most of their early working years, baby boomers were mostly fearless and emboldened as investors. Instead of seeking guarantees and safety, the buzzwords for this generation were "rate of return" and "control."

For the better part of the 1980s, 1990s, and 2000s, boomers focused on increasing their rate of return in order to accumulate more wealth. They wanted more say in how their money was invested.

### Percentage of U.S. households owning mutual funds




Investment Company Institute, "Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2013," ICI Research Perspectives, Vol. 19, No. 9, October 2013.

Significant advances in information technology enabled this sense of control. Technology provided new ways to track investments virtually instantaneously and execute personal financial transactions at amazing speed and low cost. With the cost of commissions down, day trading became prevalent. Many boomers felt empowered that they could create long-term financial security better than the government or those managing pension assets.

This was also the era when new self-directed retirement savings vehicles, such as employer-sponsored defined contribution (DC) plans (typified by the 401(k) plan, which effectively started in 1981 when the IRS issued proposed regulations) and individual IRAs (modified and made more relevant beginning in 1981), began to assume prominence in the marketplace. DC plans allowed employers to shift the retirement plan's longevity risk and responsibility from their balance sheet to the employee, while still attracting talent via a match of what an employee contributed to the plan. Outside of these plans, individual IRAs empowered individuals to invest in nearly any type of investment for their own personal retirement, giving control to the individual.

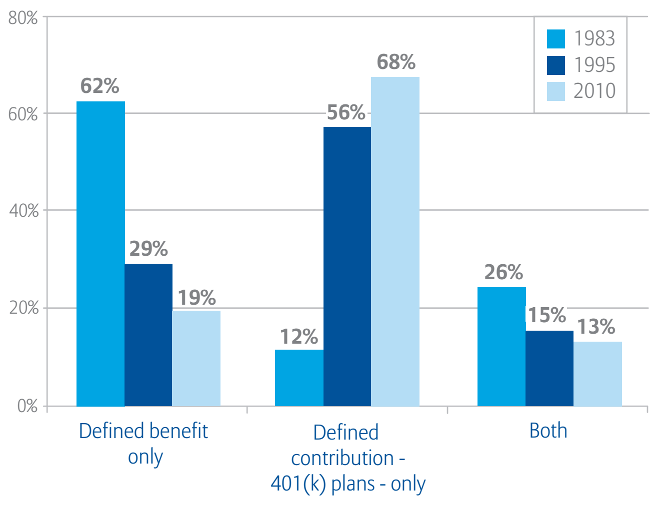
With the help of employers who educated their staff about DC plan options, mutual funds became the investment of choice for baby boomers. As seen in the adjacent chart, household ownership of mutual funds rose dramatically from almost 5% in 1980 to nearly 49% in 2000. Mutual fund ownership in the country as of mid-year 2013 topped $15.4 trillion.[1]

[1] Kimberly Burham, Michael Bogdan, and Daniel Schrass, "Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2013," Investment Company Institute, October 2013, Vol. 19, No. 9, p. 3.

As the trend toward greater personal control took hold, employers cut back on DB-based guaranteed pension plans. As the following table shows, in the early 1980s, most workers were covered by DB plans, and 26% were covered by both a DB-based plan and a 401(k) plan. Over the next three decades, the DB-based plans eroded significantly, and the responsibility of building sufficient savings (through a workplace plan) to meet a major portion of retirement income needs shifted from employer to employees. This has created a gap in longevity protection that is still not widely recognized by Americans today. Perhaps even more worrisome is the fact that the percentage of Americans who are not covered by either a DB or DC plan has remained constant at an average around 50%.

As a practical matter, this shift means that stock and bond investing, mutual fund accounts, and real estate investments have become more prevalent with this generation. Bank and insurance products, on the other hand, were mostly off the radar as safety and guarantees took a back seat to achieving higher rates of return and having personal control.

## How long will traditional pension plans continue to exist?




Alicia H. Munnell, "401(k) plans in 2010: An update from the SCF," Center for Retirement Research at Boston College, no.12-13, July 2012.

A gap in **longevity** protection is still not widely recognized.

## The next wave – "lifetime income" and "guarantees"

In the wake of the 2008 financial collapse, the next wave of retirement has emerged. As in the past, the shift in attitudes has happened because of powerful and compelling experiences that had hit the American psyche. Memories of the Great Recession have not faded quickly (especially as many were still feeling its effects) just as the greatest generation never let go of beliefs formed from their experiences of the Great Depression.

Having taken on greater personal responsibility for retirement and with the era of retirement bearing down on them, boomers were seeing a new, harsh reality – controlling one's investments could result in greater uncertainty about the future in terms of income, the value of one's portfolio, and longevity risk.

This reality hit home in the first decade of the new millennium. Most baby boomers began investing after the last dramatic and sustained market decline, the 47% drop in the Standard & Poor's 500® Index that occurred in 1973 and 1974.[1] After that point, particularly between 1982 and 1999, stocks enjoyed an unprecedented level of growth. In this case, uncertainty was welcome as most saw their portfolios accumulate faster than the historical averages would have predicted.

[1] *Stock Trader's Almanac*, 2014.

Twice in a decade, the tables turned dramatically. From 2000 to 2003, the stock market (as measured by the S&P 500® Index) lost over 40% of its value. Then, after recovering from that drop and reaching new heights, the market lost 57% of its value, this time in a span of 17 months (October 2007 to March 2009).[1] This was a seminal moment for those nearing retirement, who had a good portion of their nest egg invested in the stock market. As a result, many were forced to scale back their expectations or even delay retirement in order to rebuild their lost savings.

Prior to the financial crisis, it is doubtful that many consumers would have questioned the benefits of a "buy-and-hold" strategy. It was taken as gospel that equities would gain in value if held for more than a few years. Yet for almost a two-year stretch dating back to January 2008, the 10-year average annual return of the S&P 500® Index had been in negative territory.[2] Likewise, most boomers assumed they would be able to sell their home if they wished for a tidy profit. That notion has also changed.

What has occurred is nothing short of a decisive shift in the financial mindset for all Americans, but especially for those in or near retirement. According to The Allianz ***Reclaiming the Future*** Study (conducted in May 2010), 54% of those aged 44 to 49 said they felt unprepared for retirement. Among the entire baby boomer group surveyed, a desire to lock in guarantees, in lieu of higher returns, had emerged. According to this survey, if given a choice, 80% of baby boomers would have selected an investment with a 4% return and a guarantee against losses compared to one that paid 8% interest, but was subject to market downturns.

In short, the new buzzwords for aging baby boomers have become "lifetime income" and "guarantees."

What has occurred is nothing short of a **decisive shift** in the financial mindset of all Americans.

[1] Robert Rich, "The Great Recession of 2007-09", Federal Reserve Bank of New York, November 22, 2013.

[2] "The Callan Periodic Table of Investment Returns," Callan Associates, 2014.

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# Potential land mines dotting the retirement landscape

The risks that lie ahead for new and pending retirees are often ones not talked about, though they have been on the radar for some time. Taken as a whole, they add to the sense of urgency about finding targeted solutions to help overcome the challenges. Yet, many boomers have not been fully educated about them.

Here are some key risks Americans need to prepare for as they finalize plans for retirement.

## Longer life expectancies

In 1939, before America entered World War II, average life expectancy was just over 63 years of age for both men and women.[1] This means that when Social Security was implemented with an eligibility age of 65, the average American would not live long enough to access the benefit.

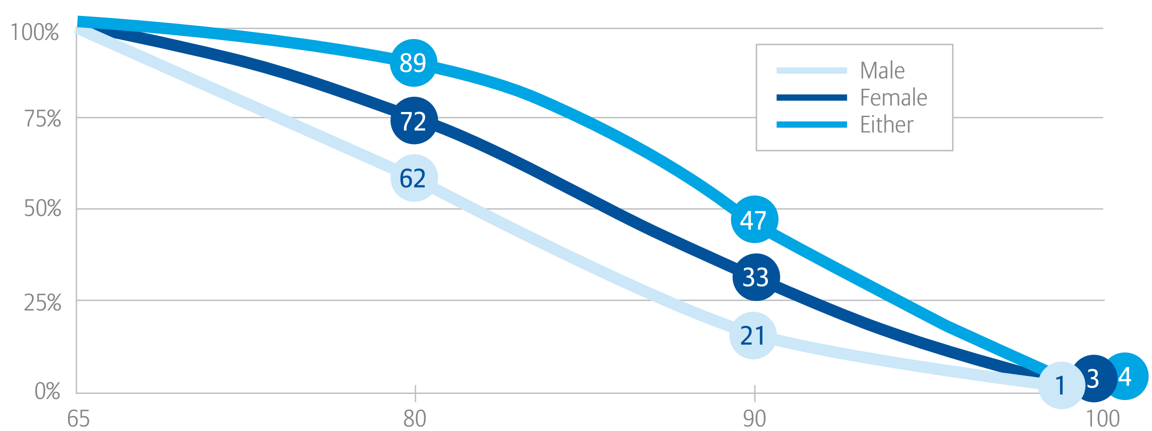
In 2013, men had a life expectancy of 76 years, while women's life expectancy had reached 81 years.[2] These numbers represent a remarkable triumph for our society, as it may be the fastest increase in life expectancy in the course of human history. It also means, however, that retirement will last much longer than just a few decades ago.

Life expectancy remains unpredictable in an age when new medical technologies may extend life even longer than today. What we do know, however, are the actuarial probabilities to help us measure life expectancy in the aggregate. So for a married couple age 65, an 88% chance exists that at least one of the two will reach age 80; a 45% chance exists that one will survive to age 90. In other words, that couple faces a one-in-four chance that one of them will be in retirement for three decades or longer.

How many Americans are prepared to fund their retirement for this length of time?

**Retirement will last longer**

Probability of 65-year-olds surviving to select ages




Note: "Either" assumes lives are independent.
Source: J.P. Morgan Asset Management, "Retirement Insights Guide to Retirement," 2014, p.6.

[1] Laura B. Shrestha, "Life Expectancy in the United States," CRS Report for Congress, March 3, 2005. "CRS Compilation from National Center for Health Statistics (NCHS)," United States Life Tables, 2002, National Vital Statistics Reports, vol. 53, No. 6, November 10, 2004.

[2] "Deaths: Final Data for 2013," Division of Vital Statistics, 2013.

## The sustainability of Social Security as we know it

As individuals plot out their potential sources of retirement income, the annual statement from the Social Security Administration provides an estimate of monthly benefits for which they will qualify depending on the age at which they begin drawing on Social Security. If one reads the news on Social Security, questions are increasing as to whether these estimates will remain valid.

As noted previously, when Social Security was created in the 1930s, the average person was not even expected to reach the full retirement age of 65. Though life expectancies have grown dramatically since then, the age at which benefits are paid out of Social Security has not risen to a comparable degree.

Moreover, the system may not be able to support beneficiaries as it did in the past. Most notable is that the ratio of workers paying into the system to support each beneficiary has declined dramatically since 1950, and will continue to decline into the future.

With the balance between contributors and recipients shifting so dramatically, changes to the system seem inevitable. The result could be that government support of retirement may be less than many expected through increases in eligibility age, a reduction in benefits, or a combination of both. This is supported by The Allianz ***Reclaiming the Future*** Study, which found that nearly half of 44- to 49-year-olds felt they had a better chance to be struck by lightning than get their full due from Social Security.

Regardless of what happens to the system, Americans need to factor into their planning the idea that Social Security may pay out differently from what is projected today.

### Ratio of workers to beneficiaries

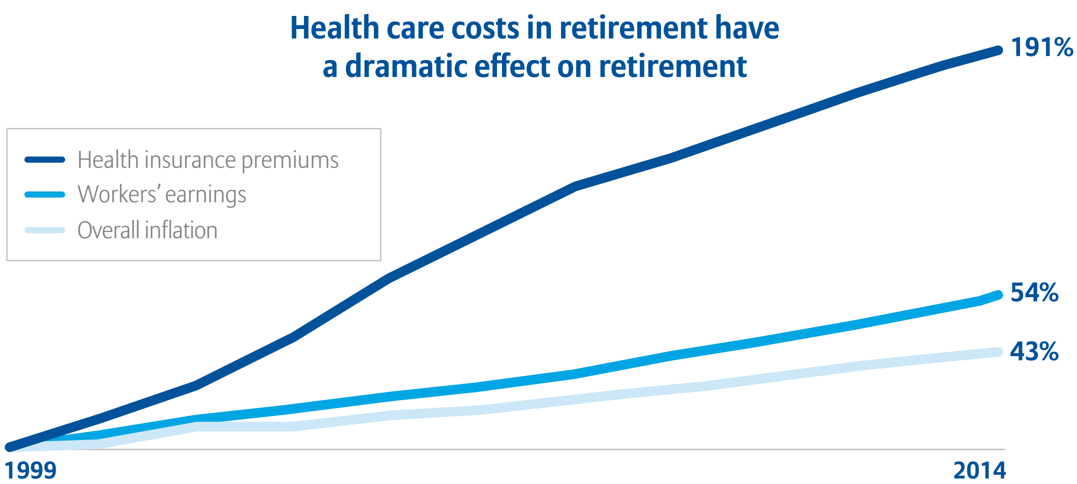

"The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," 2014.

## Rising health care costs

While wages have generally kept up with modest overall inflation during the last decade, at least one area of the economy has experienced far more significant cost increases – health care.

Compared to the 43% increase in the Consumer Price Index from 1999 through 2014, health care premiums rose 191%. The harsh reality for baby boomers is that health care expenses tend to become more significant as they grow older. This is adding a notable cost factor for retirees.

Despite the rising awareness of escalating health care costs, solutions have yet to be found. Even the far-reaching health care reform legislation enacted in 2010 and 2012 failed to address the two largest drivers of rapid inflation in health costs – obesity and smoking. Recent trends are likely to continue.




"Cumulative Increases in Health Insurance Premiums, Workers' Contributions to Premiums, Inflation, and Workers' Earnings, 1999-2014," Kaiser Family Foundation/HRET Survey of Employer-Sponsored Health Benefits, September 10, 2014.

## The hidden risk – how sequence of returns affects a portfolio

One of the tantalizing and more easily understood concepts for investors is the average rate of return (either for the market as a whole or for specific investments). For example, the average annual return of the S&P 500® Index from 1994 to 2013 was 11.13%.[1] Yet the range of returns varied dramatically from 37.6% in 1995 to -37.0% in 2008. Averages do not account for the variability of investment performance.

This is not an issue for consumers who are not adding to or drawing down their investments. But for those adding to, drawing down assets, or taking income from their holdings, the variability of performance can have a huge impact.

[1] "The Callan Periodic Table of Investment Returns," Callan Associates, 2014.

Consider the hypothetical case of a retired couple with a $1 million nest egg and plans to withdraw 5% per year ($50,000), adjusted for inflation (using a hypothetical average of 3.5% based on 100-year average of 3.3%) each year. If the portfolio generates a steady annualized return of 6% per year, the couple could count on their distributions lasting for 30 years.

> The **SEQUENCE** of a portfolio’s returns has a large impact on how long assets will last.

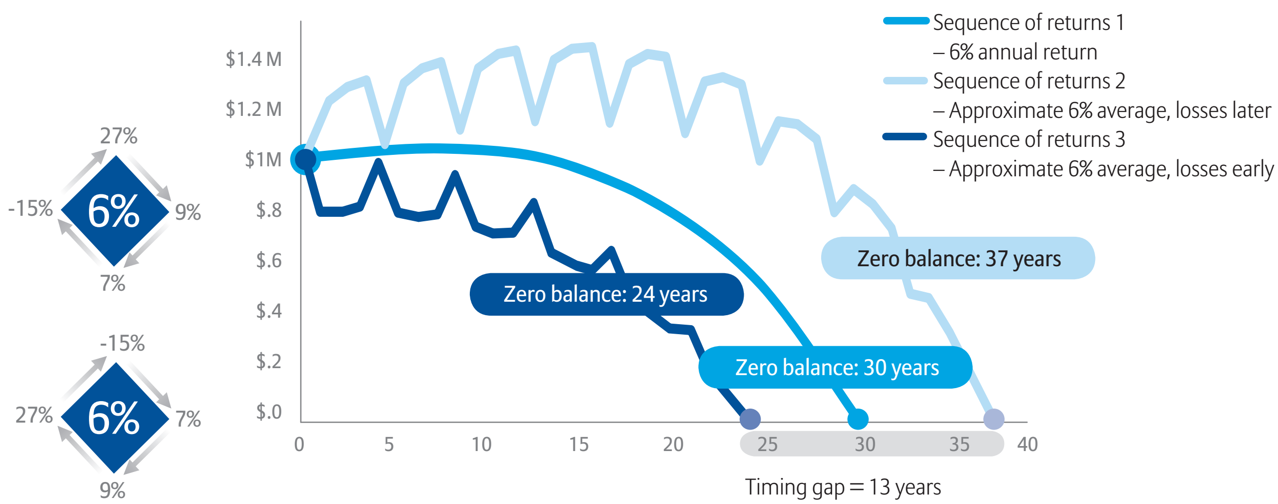
The operative word is “steady,” which we know does not happen with markets. What this couple’s portfolio will actually reflect is a series of returns, with the sequence of those returns having a large impact on how long the assets will last.

So what happens if the portfolio moves up and down every year? As an example, we can still keep the 6% average return over 30 years, but add four distinct rate-of-return values cycling every four years to see what would happen. The four values would show the portfolio earning 27% in year one, 9% in year two, 7% in year three, and -15% in year four. The rotation begins applying these market returns to the portfolio while withdrawing $50,000 per year, adjusted for inflation, until the value hits zero. We then compare that result with the reverse sequence rotation starting with -15%, then 7%, 9%, and 27%. The chart below shows that, with compounding, the different sequencing of returns represents a 13-year difference in how long the money could last.

What we see is that the money could run out much more quickly than anticipated, or could be extended if investments perform better in the early years. The problem is the unpredictability of variable investments in the short run. While it is hard enough to accurately project an average annual return over an extended period of time, it is essentially impossible to project specific returns each year and determine how they will affect a distribution strategy.

No matter how accurate one may be in projecting an “average” return, it provides little assurance that retirement income goals will be met if the sequence of returns happens to work in an unfavorable way.

## Sequence of returns matters




This is a hypothetical example and is not intended to project the performance of any specific investment or index. It is not possible to invest directly in an index. If this were an actual product, the returns may be reduced by certain fees and charges. Withdrawals are subject to ordinary income and, if taken prior to age 59½, a 10% federal additional tax.

# 3 Searching for guarantees in retirement income

A long-standing era in retirement planning may be coming to an end. This is the era of the famed "three-legged stool" referred to earlier, the generally equal mix of income generated by three sources:

- Government (via Social Security)
- Employers (through defined benefit plans)
- Individual savings

The bulk of personal assets right now do not come with **GUARANTEES**.

The first two legs are becoming increasingly wobbly, while the third – personal assets – is by necessity taking a bigger role in keeping the stool upright. Unfortunately, unlike the other two legs of the stool, the bulk of these assets right now do not come with guarantees.

## Social Security

Given strong anti-tax sentiment, a quick fix of Social Security does not appear likely. Without a fix, the Social Security system has estimated that the OASI and DI Trust fund will be depleted and unable to pay scheduled benefits in full on a timely basis in 2033.[1] After that, the system will rely entirely on the direct payments of workers to fund beneficiaries, and it is assumed that some reduction from current benefit levels will occur.

In fact, the trend worldwide and even at the state level within the United States is for government cutbacks to retirement programs. Pension reform and increases in the retirement age are taking hold across many parts of Europe. Germany raised its retirement age from 65 to 67 in 2007.[2] The International Monetary Fund has urged Spain to increase its retirement age from 65 to 67.

[1] "The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," U.S. Government Printing Office, Washington, 2014, p.4.

[2] Melissa Eddy, "After Tightening Pensions, Germany Eases Rules for Some," *The New York Times*, June 30, 2014.

## Employer plans

The era of big corporate defined benefit plans also appears to have ended, with little likelihood that corporations will change course and begin reinstating such plans, especially as accounting rules now require the funding status of pension plans to appear on corporate balance sheets. Like government, employers are looking for ways to reduce costs. CEOs cannot print money to pay bills, but instead must prove to shareholders that they are good stewards of the company's money. This pressure is unlikely to boost interest in guaranteed retirement income benefits for employees at most firms.

## Individual savings

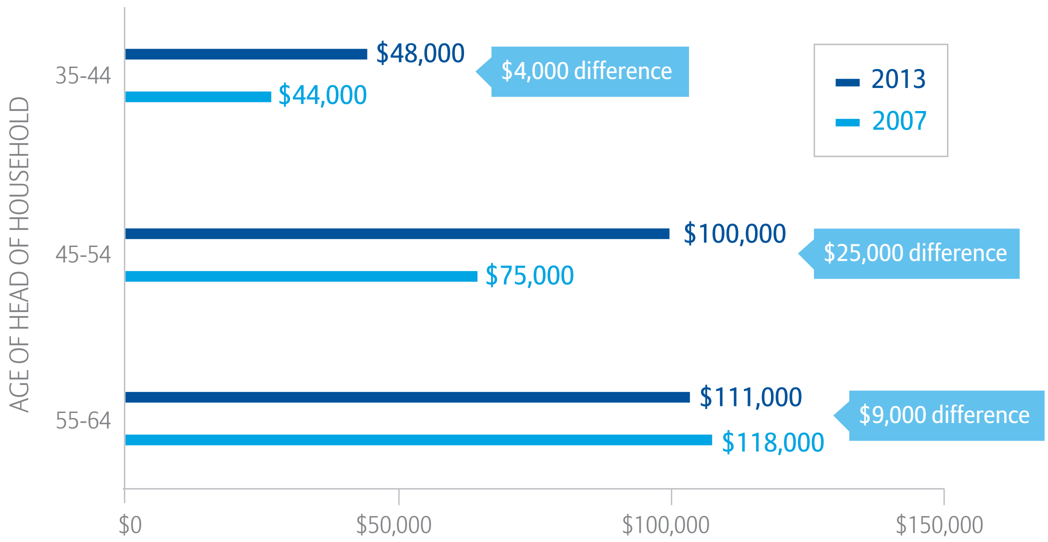
Individuals now have to accept greater responsibility for their own retirement security. The market downturn linked to the Great Recession gave pre-retirees a first-hand "feel" for the pitfalls of a nonguaranteed retirement as well as a powerful motivation to rethink how they position their assets for retirement.

Many people lost a significant portion of their retirement savings during the downturn. The losses were biggest for those closest to retirement – a logical outcome given that these people tend to have accumulated the most money.

The impact of the downturn along with the slow recovery has kept 401(k)/IRA accumulations below the recommended levels, especially for people aged 55-64. The median balance for this age group was $118,000 in 2007 and decreased to $111,000 in 2013.[1] Median balances for younger households have actually increased since 2007. Those aged 45-54 had a 33% greater balance in 2013 than 2007 – $100,000 vs. $75,000. Those aged 35-44 also had a greater balance in 2013 than in 2007 – $48,000 in 2013 compared to $44,000 in 2007. However, the decrease in the balances of the age group 55-64 is alarming because of their proximity to retirement and for many people, 401(k)s are the only supplement they have to Social Security.

Americans have begun to come to grips with a striking reality: It is nearly impossible to feel secure about retirement income if most of it is not guaranteed.

**Median 401(k)/IRA accumulations of households with account balances from 401(k) plans by age group**




Sample excludes households not working and those that have only an IRA.
Sources: Author's calculations from the 2007 and 2013 SCF.

[1] Alicia H. Munnell, "401(k) Plans in 2013. An update from the SCF," Center for Retirement Research at Boston College, Number 14-15, September 2014.

## The rise of the retirement solution

What are boomers looking for as they prepare to enter the next stage of life? The answer, as suggested earlier, is lifetime income and guarantees.

Many in the industry have typically followed a strategy of adjusting an asset allocation mix based on the person's age. That allocation process often overlooked the concept of devoting a portion of assets to products that provide guarantees.

Only in recent years has a new focus been placed on finding a source of income that is guaranteed for life. As boomers enter retirement and try to personally secure new sources of reliable income that will be sustainable regardless of how long they live, they are increasingly interested in retirement solutions.

Among the alternatives being considered – but that do not provide guarantees – are systematic withdrawal plans or tactics using target date funds. These tactics often take an arbitrary approach of projecting the income stream that will be needed for, say, 20 years. For those 65-year-olds who are looking for an income solution for a set period of time, these options may be suitable. But, of course, the reality is that no one knows how long they will live.

What is being missed is the retirement solution based on annuities where a client can purchase a guaranteed income stream with their own assets.

## Pooling risk

A fundamental activity an insurance company undertakes is to "pool" risk – and it can be risks of all types, such as the risk of having one's property damaged or stolen or the risk of dying too soon, while protecting one's family financially.

In the case of retirement, insurers are in a unique position to pool overall longevity and financial risk and are thus able to give people the opportunity to guarantee a stream of income that can last throughout retirement, even if they live beyond age 100 (there were more than 53,000 centenarians in America in 2010).[1] By 2029, more than 20% of the U.S. population will be over age 65.[2]

Only insurers that offer annuities can pool and thereby reduce the biggest risk of retirement – outliving one's assets. Insurers offer lifetime income guarantees. Guarantees are based on the financial strength and claims-paying ability of the issuing company.

Mutual fund companies or brokerage firms, on the other hand, cannot do this and in fact are required by regulators to avoid using the word "guarantee" when connected to their investment offerings. Though banks offer FDIC-insured products that guarantee a rate of return, they cannot offer ways of guaranteeing a stream of income for life.

The easiest way to understand this concept with respect to retirement is to see how insurers pool risk in the world of auto insurance. Americans who own cars pay for insurance to protect against loss. If an owner of a $50,000 car buys no insurance and wants to take on the exposure alone, he or she is liable for the entire $50,000 of any potential loss. If two people take on the risk, each is willing to pay $25,000 if one car is lost. Spreading the risk among 10 people reduces the exposure to $5,000. If 20 drivers pool their risk, each is on the hook for just $2,500 if one of those 20 autos should be lost.

The concept of pooling risk to protect retirement is the same. In this case, the risk is the possible exhaustion of personal savings before the end of life.

> Only insurers that offer **annuities** can pool and thereby reduce the biggest risk of retirement – outliving one's assets.

[1] U.S. Census Bureau News, "Older Americans Month: May 2014," U.S. Department of Commerce, March 25, 2014.

[2] United States Census Bureau, "The Baby Boom Cohort in the United States: 2012 to 2060, Population Estimates and Projections," issued May 2014.

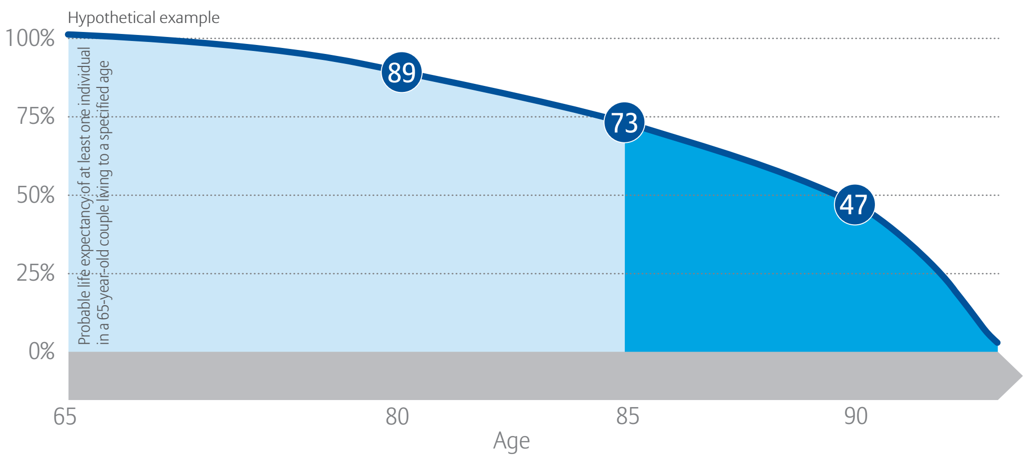
## Closing the income gap

To illustrate this, let's build on the life expectancy probability chart mentioned earlier, and consider how long 20 years of investment income could last for a couple ages 65 or older. As you can see in the first hypothetical chart below, after age 85, their assets would be totally depleted. This is the brighter blue area in the chart and it is the unfunded area of retirement. At this point, the couple would need to rely almost exclusively on income provided through Social Security.

However, if we then look at pooling risk to take away that longevity risk for the consumer, we see in the next hypothetical example that the insurer is able to cover the gap of living beyond age 85. With a guaranteed benefit in an annuity, for those who die before they've received 20 years of income, their annuity contract value would go to their beneficiaries. For those who live longer, the pooled assets in the insurer's general account provide for a longer benefit. This is how insurers can guarantee income for life. They pool the risk of a large group of people to help pay for the people who live longer. Guarantees are based on the financial strength and claims-paying ability of the issuing company.

There may be no greater financial threat facing consumers today than the risk of outliving one's assets. More than ever, Americans have been left to their own devices to resolve this challenge. Annuities offer a similar level of protection for retirement that auto insurance does for a car owner.

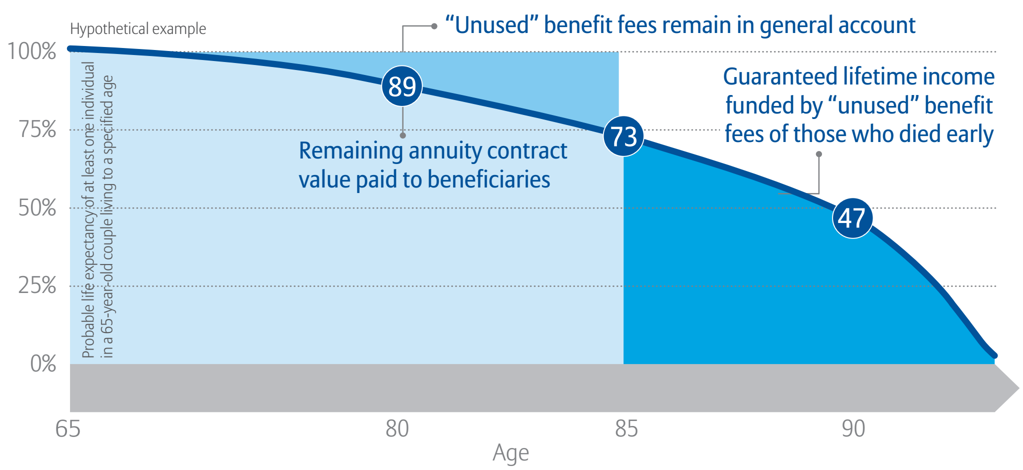
### 20 years of investment income




Based on data from J.P. Morgan Asset Management, Retirement Insights, "Guide to Retirement[SM]," 2014 edition, p.6.

### Income guaranteed for life

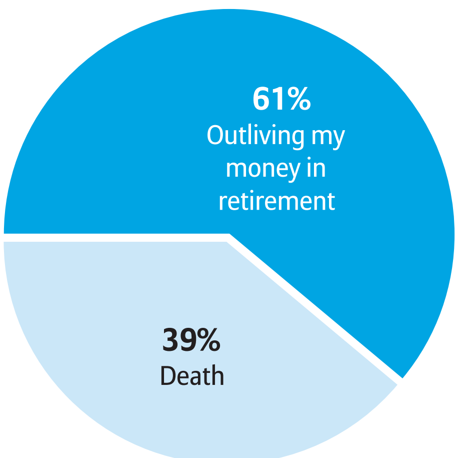
The insurer's advantage – pooling of risk • Guaranteed lifetime income (not annuitization benefits)



# 4 New attitudes – new opportunities

Baby boomers are increasingly becoming aware of the risk of outliving one's assets. In The Allianz ***Reclaiming the Future*** Study, boomers indicated that their greatest fear in retirement is not death, but the risk of outliving their assets. While 39% feared the grim reaper, 61% said "outliving my money in retirement" was a bigger fear.

**Which do you fear most?**




The Allianz ***Reclaiming the Future*** Study, 2010.

The **IDEAL FINANCIAL PRODUCT** that consumers want is, in fact, what an annuity has to offer.

This fear is not only gripping older boomers who are near retirement and may be dealing with severe portfolio shock just when they need to start tapping their savings. The study also shows that the concern is even more pronounced for the youngest of the boomers who may still have 20 years of work and wealth accumulation ahead of them. For those aged 44 to 49 who were married and with dependents, the fear of outliving assets more than death jumped to 82%.

Boomers are not alone in this desire to know more about how to maintain income for life. Financial professionals now recognize the need to make adjustment. According to a 2012 survey of 1,042 financial advisors conducted for the Life Insurance Marketing Research Association (LIMRA), advisors indicated that the top three primary areas in which they prefer more training are:[1]

1. Estate planning techniques
2. How to address Social Security claiming strategies
3. Tax advice

Advisors who provide formal written plans to their clients are more likely to offer these services.

## Annuities by another name

Change is clearly under way in the world of financial planning for retirement. Individuals, financial professionals, and government regulators are publicly stating a desire for guaranteed retirement income solutions, with annuities playing a central role. The problem, however, is that the word "annuity" continues to have a negative perception in the general public based on attitudes formed about the products 10 to 20 years ago.

The Allianz ***Reclaiming the Future*** Study found that of the 15 different attributes of financial products that survey respondents were asked to rate, the top five most important were:

1. Stable, predictable retirement standard of living
2. Guaranteed income stream for life
3. Guaranteed not to lose value
4. Protection against market downside
5. Don't need to think about it, stable, and predictable

In short, the ideal financial product that consumers want is, in fact, what an annuity has to offer – even if they do not realize that these are the attributes of annuities. Also noteworthy is that the lowest-rated of the 15 characteristics was "the opportunity to participate in market upside."

[1] *Advisor Perspectives in Retirement Planning,* LIMRA, 2012.

The problem, however, is that misperceptions about annuities continue to dominate. The Allianz ***Reclaiming the Future*** Study also showed that 54% of consumers expressed distaste for the word "annuities," even though they described the exact features and benefits of annuities as what they were looking for. Just when consumers might be interested to learn about and benefit from annuities, uttering the word itself could be comparable to letting the air out of a balloon.

Many consumers admitted that their biased view against annuities was based on information from 10 to 20 or more years ago. One in four said they determined their perception of annuities more than 20 years ago. And of those respondents, 64% admit they have never researched to learn more about annuities since forming their views. These negative views may be reinforced by commentators in the media who have reflexively attacked annuities, often without understanding them.

## Happiness is an annuity owner

For those who have a knee-jerk reaction against annuities, a surprising fact from the Allianz study is that an informed owner of an annuity is a happy consumer:

- 80% of annuity owners are happy with their purchase because of the guarantees and protection they benefit from. This ranks second-highest in satisfaction among all financial products.
- Yet 46% of respondents say their financial professional has not presented an annuity as an option.
- Another 19% are not certain whether an annuity was ever recommended.

Annuities can help meet long-term retirement goals by offering tax-deferred growth potential, a death benefit for beneficiaries during the accumulation phase, a guaranteed steam of income during retirement, and income benefits that are either built-in or available as an optional income rider that may have an additional cost.

> The demand and need for guaranteed lifetime income planning and long-term security will only grow in coming years.

Annuities have fees, expenses and charges, and limitations and risks that should be carefully considered. Annuity guarantees are backed by the financial strength and claims-paying ability of the issuing insurance company.

Conversations about annuities often have to start with the basic benefits the product provides rather than discussing the name itself. All too often, retirement planning discussions never start because the financial professional's visceral reaction against the word "annuity" preempts the conversation. This has to change, if only to allow the consumer education process to continue so that a fully informed decision may be made about guaranteeing lifetime income.

New ways of describing an annuity are emerging that better reflect what the product can provide consumers. "Longevity insurance" and "retirement insurance" are just two that are increasingly used to help consumers more easily understand the benefits of this product set.

Consumers also need to be reminded that taking no action is not an option, given the dramatic new pressures building up on retirement systems. The model of retirement that they may have adopted and fully believed in just a few years ago may not be appropriate in the future. Since guarantees from the government or employers have been reduced, consumers need to be made aware of other sources of guaranteed income, which is a long-term education process.

Lastly, it is important to emphasize that annuities are not the only solution and may not be appropriate for every financial challenge a consumer faces today. Many of the negative impressions of annuities were created by those who oversold the product or tried to portray it as something it was not. Achieving a healthy understanding of the role an annuity plays in an overall portfolio is the appropriate step consumers need to take.

The world of retirement planning has changed.
The fundamental perceptions of how best to prepare for retirement in an increasingly uncertain economy and world have also changed. Whether or not consumers, educators, politicians, the media, government officials, or business leaders want to accept or acknowledge this structural change, one thing is certain – the demand and need for guaranteed lifetime income planning and long-term security will only grow in coming years.

# True to our promises …
# so you can be true to yours.®

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Through a line of innovative products and a network of trusted financial professionals, Allianz and Allianz Life of NY together help people as they seek to achieve their financial and retirement goals. Founded in 1896, Allianz, together with Allianz Life of NY, is proud to play a vital role in the success of our global parent, Allianz SE, one of the world's largest financial services companies.

While we pride ourselves on our financial strength, we're made of much more than our balance sheet. We believe in making a difference with our clients by being true to our commitments and keeping our promises. People rely on Allianz and Allianz Life of NY today and count on us for tomorrow – when they need us most.



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