

## WHAT YOU SHOULD KNOW ABOUT VARIABLE ANNUITIES

**A**s part of their retirement and investment plans, many Americans have variable annuities. Before you buy a variable annuity, you should know some of the basics—and be prepared to ask your financial professional questions about whether a variable annuity is right for you.

### WHAT IS A VARIABLE ANNUITY?

A variable annuity is a contract between you and an insurance company. The insurer agrees to make periodic payments to you, beginning either immediately or at some future date. You purchase a variable annuity contract by making either a single purchase payment or a series of purchase payments.

You should carefully review a prospectus provided by the insurance company or your financial professional before purchasing the annuity. The prospectus contains important information about the annuity contract, including fees and charges, investment options, death benefits, and annuity payout options. You should compare the benefits and costs of the annuity to other variable annuities and to other types of investments, such as mutual funds.

The prospectus should discuss the range of investment options offered by the variable annuity. The value of your investment as a variable annuity owner depends on the performance of the investment options you choose. The investment options for a variable annuity are typically mutual funds that invest in stocks, bonds, money market instruments or some combination of the three. But variable annuities differ from mutual funds in several important ways.

### VARIABLE ANNUITY CHARACTERISTICS

First, variable annuities let you receive *periodic payments* for the rest of your life (or the life of your beneficiary). This feature protects against the possibility that you will outlive your assets after you retire.

Second, variable annuities have a *death benefit*. If you die before the insurer has started making payments to you, your beneficiary is guaranteed to receive a specified amount. Your beneficiary will get a benefit from this feature if, at the time of your death, your account value is less than the guaranteed amount.

Third, variable annuities are *tax-deferred*. That means you pay no taxes on the income and investment gains from your annuity until you withdraw your money. You may also transfer your money from one investment option to another within a variable annuity without paying tax at the time of the transfer. When you take your money out of a variable annuity, however, you will be taxed on the earnings at ordinary income tax rates rather than lower capital gains rates.

*Remember:* Variable annuities are designed to be long-term investments to meet retirement and other long-range goals. Variable annuities are not suitable for meeting short-term goals because substantial taxes and insurance company charges may apply if you withdraw your money early.

### HOW VARIABLE ANNUITIES WORK

A variable annuity has two phases: an *accumulation phase* and a *payout phase*.

During the *accumulation phase*, you make purchase payments, which you can allocate to a number of investment options, usually mutual funds. The money you allocate to each investment option will increase or decrease over time, depending on its performance. In addition, variable annuities often allow you to allocate part of your purchase payments to a fixed account. A fixed account pays a fixed rate of interest.

During the accumulation phase, you can typically transfer your money from one investment option to another without paying tax on your investment income and gains. Nevertheless, the insurance company may charge you for transfers. If you withdraw money from your account during the early years of the accumulation phase, however, you may have to pay “surrender charges.” You also may have to pay a 10 percent federal tax penalty if you withdraw money before the age of 59 1/2.

At the beginning of the *payout phase*, you may receive your purchase payments plus investment income and gains (if any) as a lump-sum payment, or you may choose to receive them as a stream of payments at regular intervals (generally monthly). During the payout phase, your annuity contract may permit you to choose



between receiving payments that are fixed in amount or payments that vary based on the performance of mutual fund investment options.

Some annuity contracts are structured as *immediate annuities*, which means that there is no accumulation phase and you will start receiving annuity payments right after you purchase the annuity.

### DEATH BENEFIT

A common feature of variable annuities is the *death benefit*. When you die, a person you select as a beneficiary will receive the greater of: (i) all the money in your account, or (ii) some guaranteed minimum (such as all purchase payments minus prior withdrawals). Some variable annuities allow you to choose a “stepped-up” death benefit. Under this feature, your guaranteed minimum death benefit may be based on a greater amount than purchase payments minus withdrawals.

The purpose of a stepped-up death benefit is to “lock in” your investment performance and prevent a later decline in the value of your account from eroding the amount that you expect to leave to your heirs. This feature carries a charge, however, which will reduce your account value. Variable annuities sometimes offer other optional features, which also have extra charges.

### VARIABLE ANNUITY CHARGES

You will pay several charges when you invest in a variable annuity. Be sure you understand all the charges before you invest. *These charges will reduce the value of your account and the return on your investment.* You should ask your financial professional to explain to you all charges that may apply.

### TAX-FREE 1035 EXCHANGES

Section 1035 of the U.S. tax code allows you to exchange an existing variable annuity contract for a new annuity contract without paying any tax on the income and investment gains in your current variable annuity account. These tax-free exchanges, known as 1035 exchanges, can be useful if another annuity has features that you prefer, such as a larger death benefit, different annuity payout options or a wider selection of investment choices. You may be required to pay

surrender charges on the old annuity, however, if you are still in the surrender charge period.

### BONUS CREDITS

Some insurance companies are now offering variable annuity contracts with “bonus credit” features. These contracts promise to add a bonus to your contract value based on a specified percentage (typically ranging from 1 percent to 5 percent) of purchase payments. Frequently, insurers will charge you for bonus credits, however.

### ASK QUESTIONS BEFORE YOU INVEST

Financial professionals who sell variable annuities have a duty to advise you as to whether the annuity is suitable to your particular investment needs. Don't be afraid to ask them questions. And write down their answers so there won't be any confusion later as to what was said.

Variable annuity contracts typically have a “free look” period of 10 or more days, during which you can terminate the contract without paying any surrender charges and get back your purchase payments, which may be adjusted to reflect charges and the performance of your investment. 🔄

