SEC
Office of Investor Education and Advocacy

INVESTOR BULLETIN

Variable Annuities—An Introduction

This SEC Office of Investor Education and Advocacy Investor Bulletin provides some basic facts about variable annuities and how they work. Variable annuities are complex products, and this Investor Bulletin focuses solely on the basics. For more in-depth information about variable annuities, see our companion publication, Variable Annuities: What You Should Know, available at www.sec.gov/investor/pubs/varannty.htm.

What is a variable annuity?

A variable annuity is an investment product with insurance features. It allows you to select from a menu of investment choices, typically mutual funds, within the variable annuity and, at a later date—such as retirement—allows you to receive a stream of payments over time. The value of your variable annuity will depend on how your investment choices perform.

What should I do before I invest in a variable annuity?

- Know how they work. Before you buy a variable annuity, know how it works, look up key terms you might not be familiar with, figure out how you'll be charged, and be prepared to ask your financial professional questions about whether the product is right for you.

- Get the details—read the variable annuity prospectus. Different products have different features. Ask your financial professional for the variable annuity prospectus, which will describe the product you're considering in detail. Read the prospectus carefully, and ask questions about what you don't understand. The prospectus—which should be available free of charge—contains important information about much of what's described in this Investor Bulletin, including charges, investment choices, death benefits, payout options, and other features.

- Understand that they are not appropriate for short-term investors. Variable annuities are long-term investments for retirement savings purposes and other long-range goals. They are not a good choice for short-term investing. If you take out your money too early from the variable annuity, substantial taxes and insurance company charges, among other things, may apply.

- Realize that you could lose money. Variable annuities involve investment risks, just like mutual funds do. If the investment choices you selected for the variable annuity perform poorly, you could lose money.

What's different about a variable annuity?

Although variable annuities usually are invested in mutual funds, they are different from mutual funds in important ways:

- Variable annuities allow you to receive periodic payments. A variable annuity allows you to receive **periodic payments** for the rest of your life or for the life of your spouse.

- They offer a range of features, but be prepared to pay extra for them. For example, most variable annuities offer a death benefit, which means that if you die before the insurer has started making payments to you, a person you have named as a beneficiary will receive a specified amount. But you'll pay for this feature during the time you own the product. Same with other features such as optional "riders," including so-called "guarantees," which are discussed in more detail below. Consider whether these features are right for you and are worth what you're paying for them.

- Earnings are tax-deferred, but there are penalties for early withdrawal. You pay no taxes on any income and investment gains on the investments that you hold in the variable annuity until you withdraw your money. But when you take your money out, you will be taxed on the earnings at **ordinary income tax rates** rather than at lower capital gains tax rates associated with other investments, like mutual funds. In addition, you may face a 10% federal income **tax penalty** if you withdraw the money before you are 59½ years old. Finally, if you're putting a variable annuity into a tax-advantaged account, like an IRA or other retirement account (*e.g.*, a 401(k) plan), you'll get no extra tax advantage.

> The tax rules that apply to variable annuities can be complicated—before investing, you may want to consult a tax adviser about the tax consequences to you of investing in a variable annuity.

How is my money in a variable annuity invested?

You allocate your payments (during what's called the "**accumulation phase**") to the investment choices available through the variable annuity. For example, you might direct 40% of your payments to a bond fund, 40% to a U.S. stock fund, and 20% to an international stock fund. The money you direct to each mutual fund investment choice will increase or decrease over time, depending on the mutual fund's performance. In addition, variable annuities often allow you to direct part of your purchase payments to a **fixed account run by the insurance company**. A fixed account, unlike a mutual fund, pays a fixed or minimum rate of interest.

Ask your financial professional for the prospectuses of the investment choices available through the variable annuity before you decide how to invest your money. Consider these important questions for each investment choice you are thinking about: (1) investment objectives, (2) fees and expenses, (3) risks and volatility, and (4) how the fund fits into your overall investment strategy.

How do I get my money out of the variable annuity?

When you begin to take money out of the variable annuity, that's called the "**payout phase**." At the beginning of the payout phase, you can elect to receive the value of your variable annuity all at once. Or, you can choose to receive a stream of payments—for example, for a period that you select (say, 20 years) or for a specified person's lifetime (such as your lifetime or the lifetime of you and your spouse).

What are living benefits?

Many variable annuities offer features designed to provide some protection from investment losses. These features are sometimes called "living benefits." They may also have names such as "guaranteed minimum income," "guaranteed minimum withdrawal," "guaranteed lifetime withdrawal," or "guaranteed minimum accumulation" benefits. Some such features provide that you will be able to receive a specified level of payments, regardless of the performance of your investment choices.

You pay extra for these features, so be sure what you choose is right for you, and worth what you're paying for it. Our variable annuity publication—*Variable Annuities: What You Should Know*—has more information about these features generally, and the product prospectus will have more information on how the particular living benefit you are considering works.

Caution!

You should consider the financial strength of the insurance company selling the variable annuity. This could affect the company's ability to meet its obligations to you under a living benefit, or to meet other obligations, such as a death benefit or a fixed account obligation.

Living benefits are complex and often have limitations and conditions. For example:

- You may be forced to select only certain investment choices, which may limit the return on your investment.
- Withdrawals can reduce the amount that would otherwise be paid under the living benefit.

What will I pay to invest in a variable annuity?

You pay 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.** Often, they will include:

- Surrender charges—Withdrawals made within a certain period after your purchase payment (usually within six to eight years, but sometimes 10 years or longer) will usually have a "surrender" charge deducted from the amount you withdraw.
- Mortality and expense risk charge—This charge is based on the value of your account—usually around 1.25% of the value of your account *per year*. It pays for the death benefit, and is sometimes used to pay the insurance company's costs to sell the contract—like commissions.
- Investment option expenses—Expenses for the investment choices you select.
- Charges for other features—Special features, such as a living benefit, an enhancement to the basic death benefit, or long-term care insurance, often cost extra.

Read the variable annuity prospectus and ask your financial professional to explain the charges that may apply. **We've highlighted some of the key ones here.**

What are tax-free exchanges?

Under U.S. tax law, you can exchange a variable annuity contract for a new annuity contract without paying any tax on any income and investment gains in your current variable annuity. These exchanges might be useful to you if you own a variable annuity but another annuity has features that you prefer, such as a larger death benefit, different annuity payout options, or different living benefits.

Exchanging your original variable annuity for a new one may have drawbacks. For example, when you surrender the old variable annuity, you may have to pay surrender charges. (Remember—exchanging your original variable annuity contract for a new annuity contract ***generally is considered a withdrawal***.) Also, a new surrender charge period generally begins when you exchange into the new variable annuity. This means that, for a significant number of years, you typically will have to pay a surrender charge if you withdraw funds from the new variable annuity. In addition, features under the original contract, such as the death benefit and living benefits, might be better than you might have under the new contract. And the new variable annuity may have higher fees and charges than the old variable annuity, which will reduce your returns.

Caution!

Before you exchange one variable annuity product for another, compare both carefully.

If you decide to do an exchange, you should first consult your financial professional or tax adviser to make sure that the exchange will be tax-free.

See our variable annuity publication—*Variable Annuities: What You Should Know*—for more information about what you should think about, including a checklist of questions to ask yourself before you make your investment decision.

What are bonus credits?

Some insurance companies give you a credit that is added to your variable annuity contract value based on a percentage (typically from 1% to 5%) of your purchase payments. Sometimes the bonus is limited to money you put in initially or during the first year of owning the contract.

Caution!

Variable annuities with bonus credits may have a downside—like higher expenses, higher surrender charges, and longer surrender charge periods—that can outweigh the benefit.

Also, some products take back the bonus under certain conditions, for example, if a death benefit is paid, or if you make a withdrawal.

Ask questions before you invest—in anything

Don't be afraid to ask the financial professionals who are trying to sell you a variable annuity whether the product is right for you. Keep asking them questions until you are satisfied with their answers. And write down their answers, so there won't be any confusion later as to who said what.

Remember: Before purchasing a variable annuity, learn as much as possible about how it works, the benefits it provides, and the charges you will pay.

For More Information

Other SEC Online Resources (available at http://www.sec.gov)

Variable Annuities: What You Should Know—Contains more detailed information on topics like expenses, exchanges, tax treatment, and living benefits than what's in this bulletin.

Invest Wisely: An Introduction to Mutual Funds—Basic information about investing in mutual funds. Much of this information applies to variable annuities as well.

Mutual Fund Investing: Look at More Than a Fund's Past Performance—Describes some of the factors you should consider in choosing a mutual fund.

The Office of Investor Education and Advocacy has provided this information as a service to investors. It is neither a legal interpretation nor a statement of SEC policy. If you have questions concerning the meaning or application of a particular law or rule, please consult with an attorney who specializes in securities law.

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