



# VARIABLE ANNUITIES

Quick Guide

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**This quick guide was prepared by Truebridge.**

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# Variable Annuities

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An annuity is a contract between you and an insurance company whereby you agree to give the issuer principal and in return the issuer guarantees\* you fixed or variable income payments over time. While annuities are not insurance policies, they are issued by insurance companies.

Annuities are long-term, tax-deferred investments intended for retirement planning. You can fund it in a lump sum or a little at a time, and all capital in an annuity grows and compounds tax-deferred until you begin making withdrawals. (Withdrawals of earnings or other taxable amounts are subject to income tax and, if made prior to age 59½, may be subject to an additional 10% federal penalty tax. Early withdrawals have the effect of reducing the death benefit and contract value.) Unlike retirement plans, however, there is no limit as to how much you can invest in annuities (unless it is a qualified plan), and you generally do not have to begin withdrawals until at least age 85 (unless it is a qualified plan).

The large number of annuity products on the market today can make selecting the right annuity a confusing process. But in fact, there are only a handful of different types of annuities. When selecting an annuity, you will be presented with several choices:

**Timing of payout**—immediate or deferred: In an immediate annuity, the investor begins to receive payments immediately. This is usually for investors who need immediate income. In a deferred annuity, the investor receives payments starting at some later date, usually at retirement.

**Investment type**—fixed or variable: Fixed annuities are invested primarily in government securities and high-grade corporate bonds. They offer a guaranteed\* rate over a period of one or more years, as stated on the contract. Variable annuities enable you to invest in a selection of sub-accounts. These sub-accounts are tied to market performance and are therefore subject to investment risk (unlike fixed annuities), and are often modeled after publicly traded mutual funds.

In addition, annuities can be (1) “single premium,” meaning only an initial deposit is permitted into the contract, and any additional deposits would require a new contract, or (2) “flexible premium,” which permits periodic or regularly-scheduled additions, including automatic withdrawals from a bank account. Variable annuities are almost always structured as flexible premium annuities.

Variable annuities have the potential to make your money grow by participating in the stock market. Your

money accumulates tax-deferred in professionally managed sub-accounts. Historically (past performance is no guarantee of future results), a variable annuity invested in a stock sub-account over the long term provides better protection against inflation than a fixed annuity, but also involves a greater degree of risk. Variable annuities are considered securities under federal law, and can be offered only by agents who are licensed and who have passed specific securities exams.

Variable annuities provide many of the benefits of fixed annuities—including tax-deferred earnings and a choice of payouts, plus the opportunity to make unlimited contributions if the annuity is not part of an IRA or qualified retirement plan. In addition, they offer the potential for greater returns and the opportunity to make your own decisions about how to allocate your assets among investment categories. Variable annuities allow you to use strategies like dollar-cost averaging, and some even offer automatic portfolio rebalancing to maintain your preferred level of risk.

With variable annuities, many things can vary or change: the rate of return that you earn, the amount of income you receive if you annuitize (take a guaranteed lifetime or term-certain payout), and how your money is invested. What remains constant with all annuities, fixed or variable, is the opportunity to select income guaranteed\* to last for your lifetime.

Deferred variable annuities differ from fixed annuities in another important way. Your retirement savings go into individual “sub-accounts” held by the issuer separately from its other assets, rather than into its “general” account (except for any money you put in a fixed account option).

Your money in these individual sub-accounts is invested in the investment portfolios you choose. As a result, your retirement savings in these accounts are shielded from the issuing company’s creditors. Some states protect your savings from your creditors as well. However, these funds are subject to investment risk, and both income and principal can and will fluctuate.

Deferred annuities feature an **accumulation phase**, during which funds may be invested and balances grow tax-deferred, and a **payout phase**, when the funds are distributed.

Immediate annuities, as noted above, are appropriate for investors who need to begin receiving their income immediately, and want a dependable stream of regular income.

With a variable annuity, when the owner annuitizes and chooses the form of payout, the payments can be either fixed or variable (depending on account performance during the payout period). Choices include a lifetime income, or a different term can be chosen if preferred. For example, using a ten-year “term certain” payout would usually result in larger periodic payments, but the payments would end after ten years. Other choices that impact the payout amount include whether the payout will cover two people (until the death of the survivor), and whether the amount paid will be reduced after the first death, if two people are covered. These are choices that need not be made until it is time to begin the payout phase, which can usually be deferred until at least age 85 (unless it’s a qualified plan). You can also make earlier periodic withdrawals

without annuitizing (subject to early withdrawal penalties and surrender charges, if any).

It is very important to understand that once the decision is made to annuitize, you are relinquishing control of your money to the insurance company. Generally, in exchange for the company’s promise to pay you income based on the option you have chosen, you can no longer withdraw lump sums or change your payout schedule.

\*Guarantees are backed by the claims paying ability of the issuing insurance company.

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## Individual Retirement Annuities

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Variable annuities can also be purchased as part of a retirement plan. In this instance, an individual can contribute to an individual retirement annuity in his or her own name. Spousal individual retirement annuities can also be established. Note that generally, restrictions and limitations will be the same as those for Individual Retirement Accounts (IRAs). Both types of IRAs can be established, subject to the maximum IRS-allowed contribution and deductibility limitations. Minimum distribution requirements must also be met.

If you are considering a variable annuity for a qualified investment plan, please note that the tax deferral is unnecessary. However, annuities provide other features that may be available to you. Qualified annuities may be subject to plan restrictions. The investor should contact the plan administrator for details.

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## Do Your Homework First

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Before you put money into a variable annuity, be sure you’ve educated yourself with regard to the limitations and restrictions that will impact your investment.

### Insurance Company

Be sure that the company issuing the annuity has a solid financial underpinning—i.e., it will be able to meet its obligations. You want to be sure the company will stand behind your investment over the long term. Check ratings of insurers from services such as AM Best, Moody’s, Standard & Poor’s, Duff & Phelps, and Weiss Research.

### Fees

Variable annuities come with several charges that you will be paying—these charges will reduce your return and thus the value of your account. Some common charges include:

- **Surrender charge**—if you withdraw money within a certain period after purchase (typically six to

eight years), the insurer may impose a “surrender” charge. This fee, which is a percentage of your investment, usually decreases each year until it disappears.

- **Administrative and mortality risk fees**—the insurer deducts charges to cover its record-keeping costs and the risks it assumes. This can be in the form of an account maintenance fee that you pay annually and/or a percentage of your account.
- **Fund expenses**—the funds in which you can invest also will charge investment management fees that come out of your account value.
- **Other fees**—there may also be fees for special features that the issuer offers, such as a stepped-up death benefit or long-term care insurance (see below for details on these features). So in total, it is not uncommon for variable annuities to come with annual fees. You should pay attention to the total fees you will be paying to make sure that they are reasonable and that you are comfortable with the

overall fee structure. However, don't focus on any one fee, but rather, evaluate the total picture, including potential performance.

Also, keep in mind that, subject to certain exceptions including death, you will be assessed a 10% penalty for withdrawal of earnings prior to age 59½. Remember, annuities are meant to be long-term investments.

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## Getting Started

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As noted above, when you buy a variable annuity, you will need to allocate your money among a number of investment choices. These investment portfolios are structured like mutual funds, either designed specifically for the annuity company or are similar versions of existing funds designated for retirement accounts. Although the names of the investment portfolios may be similar to those of mutual funds available generally to the public, they are not the same funds but are more like “clones” of these funds. It is important to note that, unlike mutual funds, variable annuities involve additional fees, such as mortality fees and administrative fees.

As the investor, you must choose among the ones that the issuing company offers, much as you would with a 401(k) or 403(b) retirement plan. Typically, there

will be a number of offerings, possibly including stock portfolios, a money market account, a government bond portfolio, a corporate bond portfolio, and a guaranteed account (fixed account), which is similar to a fixed annuity investment. When deciding which portfolios (sub-accounts) to choose within a variable annuity, always remember that financial professionals recommend that you diversify among different types of investment classes using a technique known as asset allocation. You will need to do some research in this area on your own, or work with your financial professional in order to reach the best decision that works for your goals. Your financial institution should have an investment consultant who can help explain your choices, and who may be able to guide you toward an allocation that meets your individual need.

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## Additional Features and Options

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Here are summaries of some additional options that are made available by some variable annuity issuers. It should be noted that this is not an all-inclusive list, and that some of these features are optional and come with an additional cost that will reduce your account value.

### Guaranteed Death Benefit

Many investors are attracted by the death benefit variable annuities provide, which is based on the claims-paying ability of the insurance company that issues the contract. It means that if you die before you begin to receive income, your beneficiaries will receive, at the minimum, the amount you put into the annuity less any withdrawals you may have made. With some contracts, in fact, investment gains are locked in regularly so that your beneficiaries receive more than your investment, even if the value has dropped back down at the time of your death. (This is known as a “stepped-up” death benefit, and usually comes with an additional cost.)

The assurance the death benefit provides can provide a sense of security, and encourage you to invest in stock portfolios, thus increasing your chances of

building a larger annuity value. In the same vein, the death benefit may also reassure people who are otherwise reluctant to invest in equities at all.

### Living Income Benefit

**IMPORTANT NOTE:** Additional options for Variable Annuities are subject to qualification requirements, other limitations and the terms as offered in the prospectus.

This feature guarantees a minimum monthly payment if your investment drops in value due to poor stock market performance. Some companies offer a living income benefit that guarantees that your monthly income will never drop below 80% of your first payment.

### Dollar-Cost Averaging

With many variable annuities, you can take advantage of dollar-cost averaging. By making equal purchases on a regular schedule, you may end up paying less than the average price per unit for the purchase. That happens because you buy more units when the price is lower.

With a variable annuity, you can dollar-cost-average two ways:

1. You can add money to your annuity on a regular schedule by making additional purchases
2. You can put a lump sum into the fixed or money market account option within the variable annuity and arrange to have it moved gradually into one or more of the investment portfolios

Dollar-cost averaging does not assure a profit and does not protect against loss in a declining market. In order to use this technique successfully, you will need to continue to make purchases through periods of low price levels.

## Transferring Money between Portfolios

Another major appeal of variable annuities is that you can make tax-free transfers within your account among the portfolios your annuity offers. For example, if you want to increase the percentage of your retirement savings in more aggressive growth stocks, you can shift money from a balanced or money market portfolio into the stock portfolio. Or, you might want to readjust your asset allocation from time to time. This flexibility lets you have continuing control over your retirement savings. The earnings in the sub-account you're taking money out of, which have grown tax-deferred, can be transferred, without tax, into another sub-account.

## Equity-Indexed Annuities

Technically, this is a form of a fixed, rather than a variable annuity, but your return is tied to a stock index (e.g., the S&P 500) that provides the opportunity to earn a return that is better than the traditional fixed annuity. The purchaser does not choose investments, but is able to participate in the stock market to some degree, with a guaranteed minimum return (typically around 1% to 3%).

One confusing feature of an equity-indexed annuity (EIA) is the method used to calculate the gain in the index to which the annuity is linked. There are several different indexing methods that companies use. Because of the variety and complexity of the methods used to credit interest, it may be difficult to compare one EIA to another.

It is possible to lose money in an EIA, since some companies guarantee a minimum return of only 90% of the premium plus the guaranteed annual interest rate. As with all annuities, early withdrawal can also result in a loss.

EIAs carry more risk (but more potential return when the stock market rises) than a fixed annuity, but because of the guaranteed interest rate, they have less risk (as well as less potential return) than a variable annuity.

## *A Note about Taxes*

Obviously, one of the most attractive features of annuities is the potential tax-deferred growth that occurs during the accumulation phase. It should be noted, however, that when money is withdrawn or distributed, not on a regular basis, all or a portion would be taxed at ordinary income tax rates rather than as capital gains or dividends. This will be the case if you make systematic or periodic withdrawals, and a 10% penalty tax generally applies to withdrawals of earnings made before age 59½.

On the other hand, if you annuitize, only the portion of the money distributed that relates to earnings, as opposed to principal, will be taxable. In this instance, a portion of your income would be considered a "return of principal" and would not be taxable.

Investment return and principal value of an investment will fluctuate, and an investor's shares, when redeemed, may be more or less than their original cost.

## *Are Variable Annuities for You?*

Let's look at some of the questions that you should ask yourself when deciding whether to invest in a variable annuity:

- **Are you investing for the long term?** You should have at least a ten-year time frame for this money. Also remember that withdrawals prior to age 59½ are subject to penalties.

- **Have you considered the other alternatives that may be available to you?** If you are eligible for a retirement plan at work that offers a company match or pre-tax contributions, you may want to first use this vehicle for your ongoing retirement investments.
- **Are you contributing to a traditional or a Roth IRA?** Again, you may want to consider this avenue before considering a variable annuity.
- **Are you in a position to benefit from tax-deferred growth?**
- **Do you desire a guaranteed income for life in retirement?** If so, an annuity would meet this need. On the other hand, you may have less available to leave to your heirs.
- **Are you comfortable with the risk that your account value may decrease, and with making your own investment decisions (or working with a professional to help you)?** If yes, then a variable annuity may be an appropriate choice.
- **Do you have additional money in a taxable account that you can afford to invest for your retirement, or have allocated for retirement?** If so, an annuity can be an excellent choice for such funds.
- **Are you self-employed?** If so, an annuity may be an additional source of retirement income other than Social Security. In the early years of a business, you may be investing all of your capital into the business and not have sufficient cash to contribute to a

retirement plan. In later years, you may not want to establish a retirement plan for your business since you will likely have to cover all of your employees under such a plan. In this situation, an annuity offers a good alternative way to save for your retirement.

**IMPORTANT NOTE:** A self-employed individual can still choose to fund his/her personal IRA without having to contribute to the retirement plans of employees, if any.

- **Do you expect to be in a lower tax bracket after retirement?** If so, then an annuity would become more attractive.

If you are approaching retirement, or are already retired and want a steady income with the continued potential for growth, consider an immediate variable annuity. Income amounts can fluctuate with portfolio performance.

Consider all of these points in coming to your decision. It may well be that, depending on the specifics of your own situation, a deferred or immediate variable annuity may be an appropriate choice for a *portion* of your retirement savings. Remember that you should always keep at least three to six months of living expenses in liquid funds available for emergencies and shorter-term needs.

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## Summary

**Y**ou should now have enough information to have an idea about whether a variable annuity may be an investment choice that you should consider. Remember to review some of the main points that have been covered here as you move on to the next step: tax-deferral, long-term investing, comfort with risk and decision-making, growth potential before and/or after retirement, and other alternatives for your money. Work with your financial professional to reach the best decision for you—but remember, the most important thing is to save and to do so in a regular, disciplined manner.

**IMPORTANT NOTE:** Variable annuities are intended for long-term retirement planning goals/purposes. Variable annuities are subject to investment risk, including the possible loss of the principal amount invested, and will fluctuate in value. Your heirs may receive more or less than you paid when you redeem your units. For complete information on variable annuities, including all charges and expenses, please request a prospectus from your investment professional. Variable Annuities are not FDIC insured, may lose value, and offer no bank guarantee. ♦