



2009

ANNUITY FACT BOOK

A guide to information, trends and data in the annuity industry.



Insured Retirement Institute

The Evolution of Annuities

- 1759 The first annuity in America is offered by a Pennsylvania company to Presbyterian ministers and their families.
- 1912 The Pennsylvania Company for Insurance on Lives and Granting Annuities is the first American company to offer annuities to the general public.
- 1930s Annuities become popular as concerns about the overall health of the financial markets prompt many to purchase products from insurance companies, which are seen as stable institutions.
- 1930s New Deal programs encourage individuals to save for their own retirement. The group annuity market for corporate pension plans begins to develop.
- 1952 The first variable annuity is issued by TIAA-CREF for use in college and university qualified retirement plans.
- 1959 In *SEC v. Variable Annuity Life Insurance Company*, the Supreme Court holds that variable annuities are subject to federal securities regulation.
- 1960 The first non-qualified variable annuity policy becomes available through the Variable Annuity Life Insurance Company (VALIC).
- 1977 Revenue Ruling 77-85 is issued stating that individual investments in an annuity cannot be directed by the owner.
- 1979 Revenue Ruling 79-335 is issued eliminating the tax-free step up in basis at death for variable annuity contracts.
- 1980 Revenue Ruling 80-274 is issued ruling that bank CDs cannot be wrapped in an annuity.
- 1980 The guaranteed minimum death benefit (GMDB) is introduced.
- 1981 Revenue Ruling 81-225 is issued stating that publicly traded mutual funds cannot be the underlying investments in a non-qualified annuity.
- 1982 The Tax Equity and Fiscal Responsibility Act of 1982 allows annuities to keep their valuable tax-deferred status, retains the exclusion ratio which treats annuitization payments as part return of principal and part return of taxable earnings, and changes the taxation of withdrawals from principle first to income first.

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Insured Retirement Institute

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As part of a comprehensive retirement plan, annuity payments (along with Social Security and pension income) can be used to cover essential living expenses. The amount of each annuity payment reflects the fact that some annuitants will not live as long as others. This “risk pooling” allows insurance companies to make annuity payments that are larger than would be possible through a systematic withdrawal plan where an individual retiree periodically withdraws funds in amounts that give reasonable assurance that he or she will not run out of money. Thus, annuities can serve to both reduce the risk of running out of money in retirement and increase the amount of each income payment received.

Who Are the Parties to an Annuity Contract?

Most annuity contracts – and all commercial annuity contracts – are issued by life insurance companies. When the purchaser completes the application to buy an annuity, the contract owner, annuitant, and beneficiary are designated and identified as such in the contract.

Contract Owner

The owner of an annuity contract pays the premiums. He or she has certain rights under the contract, such as the right to make contributions, withdraw part or all of the contract value, or change the parties to the contract. The owner is usually an individual or couple, but can also be a non-natural person such as a trust or a partnership. Special tax rules apply to annuities owned by non-natural persons.

Annuitant

The annuitant is the person upon whose life annuity payments are based. Often, the annuitant is also the contract owner so payments continue as long as the owner is alive. It is also possible for two people, such as an owner and spouse, to be designated as joint annuitants so that income can continue throughout either of their lives. This type of annuity is called a joint and survivor annuity. While in most cases payments are made to the contract owner or annuitant, funds also can be paid to a third party referred to as a “payee.”

Beneficiary

The beneficiary is the person designated under the contract to receive any payments that may be due upon the death of the owner or annuitant.

Respective Rights of the Parties

Because annuity contracts can offer a great deal of flexibility in setting up income payments, the respective rights of the owner, annuitant, and beneficiary can vary. For example, under one insurer’s contract, the owner may be entitled to receive annuity payments. Under another insurer’s contract, the annuitant may be the party entitled to receive annuity payments.

What Types of Annuities Are Available?

There is a wide variety of annuities available today to meet the specific needs of each individual. With a deferred annuity, assets accumulate tax deferred until distributions are made, usually during retirement; with an immediate annuity, the contract owner converts assets into income and starts receiving payments right away. Fixed annuities accumulate savings or distribute income at guaranteed rates and in guaranteed amounts; variable annuities accumulate savings or distribute income based on the performance of the underlying investment options chosen by the contract owner. Annuities can be part of an IRA, a qualified retirement plan such as a 401(k) or 403(b) (a “qualified” annuity), or purchased with after-tax dollars (a “non-qualified” annuity). The following is a more detailed look at various types of annuities.

Deferred Annuities: A Way to Save Money for Retirement

Many people buy annuities because they want their money to grow tax deferred while they are saving for retirement, and they want a guaranteed income stream once they retire. This type of annuity is called a deferred annuity. A deferred annuity contract has two phases—an accumulation or savings phase, and a payout or retirement income phase.

In the accumulation phase, the owner pays premiums (also referred to as purchase payments) into the contract with a view to accumulating assets. Some contracts are purchased with a single payment and thus are called single premium contracts. Other contracts allow payments to be made at any time and thus are called flexible premium contracts. During the accumulation phase, the owner can surrender the contract or take one or more partial withdrawals.

In the payout phase, the owner (or other designated payee) receives income. When he or she wants payments to begin, the insurance company starts sending checks on a regular basis, typically monthly. The effective date of payments is called the annuity starting date or the annuity commencement date. In certain circumstances, the insurance company will allow annuity payments to be commuted for a lump sum equal to their present value.

Immediate Annuities: When You Want to Receive Money Right Away

An immediate annuity (also called a payout or income annuity) is purchased with a single premium and annuity payments begin right away. (There is no accumulation period.) If the owner chooses to receive monthly payments, they usually start at the end of the first month, but may be scheduled to start any time within one year after purchase. An immediate annuity can be purchased using retirement savings, for example from a 401(k) plan and/or personal savings, as a way to create guaranteed income payments during retirement. It can also be purchased using money from other sources, such as an inheritance or the sale of a business.

Annuity Payments Can be Made in Many Different Ways

Annuity payments can be made over the lives of one or more individuals or for a specified number of years, e.g., for 10 or 15 years. Life annuity payments typically end when the annuitant dies, but various types of guarantees are widely available. For example, you can purchase a life annuity with 10 years of payments guaranteed. Under such an annuity, the payments will continue for the longer of 10 years or the annuitant's life. In addition, insurers offer annuity payments that provide that if the annuitant dies before annuity payments equal to the premiums paid for the contract have been paid, the contract beneficiary will receive a lump sum equal to the difference between the sum of the annuity payments and the premiums paid. As there are a number of payout options offered by companies, the owner should work with his or her financial advisor to assure that the payment feature meets his or her particular financial condition and needs.

Figure 1-1 *Annuity Industry Total Sales—Deferred vs. Immediate*
(dollars in billions)

Year	Deferred	Immediate*	Total
1999	\$158.0	\$6.7	\$164.7
2000	181.4	8.6	190.0
2001	177.4	10.2	187.6
2002	207.1	11.2	218.3
2003	204.5	11.3	215.8
2004	205.9	11.7	217.6
2005	200.8	11.8	212.6
2006	222.8	12.8	235.6
2007	242.0	13.0	255.0
2008	249.4	14.7	264.1

*Includes structured settlements.

Source: Morningstar, Inc. and LIMRA International

Inflation-Protected Annuities

An inflation-protected annuity (IPA) is similar to an immediate annuity but payments are indexed to the rate of inflation. Initial payments will usually be smaller than they would be without the inflation protection. Even at a moderate rate of 4%, inflation reduces the purchasing power of one dollar to fifty cents in approximately 15 years. IPAs guarantee a real rate of return at or above inflation. Very few life insurance companies offer true IPAs for sale in the United States (largely due to the difficulty of hedging the inflation risk). However, consumers can buy immediate annuity contracts available that provide pre-determined annual increases in the amount of annuity payments, e.g., 3% each year for the life of the contract.

Fixed Annuities: Guaranteed Investment Performance

With a fixed annuity, the owner is guaranteed at least a minimum rate of investment return. The insurer declares a specific credited rate of return based on the investment performance of its general account assets. In the case of a deferred fixed annuity, the

insurance company guarantees a minimum interest rate (also known as a minimum credited interest rate) on payments made by the owner during the accumulation phase. In many cases, an insurer will credit interest at a higher rate than the minimum for varying periods. This type of interest is often referred to as "excess interest." The owner's purchase payments are invested in the insurance company's general account. When the annuity reaches the payout phase, the dollar amount of the annuity income payments is determined based on payment rates guaranteed at the time the deferred annuity was issued (or the insurer's current payment rates, if higher) and are guaranteed for the selected payout duration, e.g., the owner's life or a specified period of years.

Generally, fixed annuities involve less investment risk than variable annuities because they offer a guaranteed minimum rate of interest. The minimum rate is not affected by fluctuations in market interest rates or the company's yearly profits. Some people like the security of knowing that their annuity payments will never vary or that they will receive at least a minimum amount of credited interest. Although they are less risky, fixed annuities generally offer less investment flexibility and less opportunity for growth than variable annuities.

Indexed Annuities: Market-Linked Investment Performance with a Guaranteed Minimum Rate of Interest

An indexed annuity is a fixed annuity that typically provides the contract owner with an investment return that is a function of the change in the level of an index, such as the S&P 500, while guaranteeing no less than a stated fixed return on the investment. These products are designed for investors who want to partake in the benefits of a market-linked vehicle with a protected investment floor if there is a downturn in the benchmark index. Some indexed annuities also offer riders that guarantee income for life, even if the annuity value declines to zero.

Individual indexed annuity contracts have various interest crediting features. These include:

- *Crediting method*—the method used to measure the change in the underlying index (e.g., point-to-point or annual reset).
- *Participation rate*—the percentage of the calculated index gain credited to the contract owner as interest. This can be guaranteed or eligible for reset.
- *Spread/Margin*—the percentage by which the gross index gain is reduced before being credited to the contract owner as interest.
- *Cap*—the maximum index-based interest credited to the contract owner. This can be guaranteed or eligible for reset.

Figure 1-2**Annuity Industry Total Sales—Indexed Annuities**

(dollars in billions)

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
\$5.0	\$5.5	\$6.8	\$11.8	\$14.4	\$23.1	\$27.2	\$25.4	\$24.8	\$26.9

Source: LIMRA International

Variable Annuities: Investment Performance Based on Portfolios Chosen by the Owner

With a variable annuity, contract owners are able to choose from a wide range of investment options called subaccounts, each of which generally invests in shares of a single underlying mutual fund or, in some cases, in a “fund of funds,” which is a mutual fund that invests in several other mutual funds or in exchange-traded funds (ETFs). Variable annuity contract owners are able to direct the allocation of their contract value among subaccounts that correspond to a wide range of underlying mutual funds, such as equity funds, bond funds, funds that combine equities and bonds, actively managed funds, index funds, domestic funds, and international funds. Unlike mutual funds sold to the public, the mutual funds that underlie subaccounts are available only to investors in variable annuities, variable life insurance contracts, and in some cases, 401(k) plans, IRAs, and certain other investors permitted by applicable tax laws and regulations. Assets in a variable annuity can be transferred between subaccounts tax free. As a result, investment decisions can be made based on an investor’s needs and strategy without worrying about the tax implications.

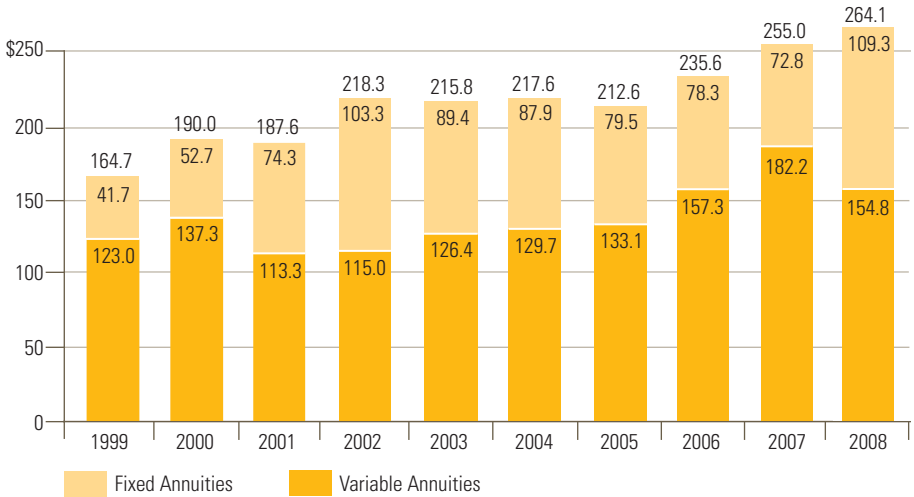
As with mutual funds, the investment return of variable annuities fluctuates. During the accumulation phase, the contract value varies based on the performance of the underlying subaccounts chosen. During the payout phase of a deferred variable annuity (and throughout the entire life of an immediate variable annuity), the dollar amount of the annuity payments may fluctuate, again based on how the portfolio performs.

Unlike mutual funds, annuities offer a wide variety of guarantees to protect a contract owner’s investment. Death benefits provide principal protection in the event a contract owner dies during a market downturn. Living benefit features protect against investment and/or longevity risk by providing guarantees that cover income, accumulation, and withdrawals for either a fixed number of years or for life.

In addition to variable investment options or subaccounts, many variable annuities offer a fixed account or fixed investment option. This means that during the accumulation phase of a deferred variable annuity, the owner can allocate payments not only to one or more variable investment options, but to a fixed interest option as well. The money allocated to the fixed option goes into the insurance company’s general account. A minimum rate of interest is typically guaranteed for a period of one or more years.

During the payout phase of some contracts, only fixed annuity income payments are offered. Other contracts provide fixed and/or variable payouts. Providing both types of payouts allows contract owners to take on the added risk associated with variable investment options while accumulating assets, and to manage their level of risk during retirement by choosing to have the rate of return guaranteed for at least some portion of their income payments.

Figure 1-3 *Annuity Industry Total Sales—Fixed vs. Variable*
(dollars in billions)



Source: Morningstar Inc. and LIMRA International

Qualified Plans vs. Non-Qualified Plans

Annuities can be used in tax-qualified retirement plans, such as IRAs, pension or profit sharing plans, 401(k) plans, 403(b) plans, and certain governmental plans. These annuities are called qualified annuities and are typically funded with pretax dollars. (Some qualified annuities are purchased with after-tax dollars for use with “Roth” accounts under which the annuity payments and other withdrawals are tax free if certain tax rules are satisfied.) Annuities that are not used in qualified plans are called non-qualified annuities and are purchased by members of the general public with after-tax dollars.

In 1952 the first variable annuity in America was designed and developed by TIAA-CREF, a financial services group, for qualified retirement programs. As such, the variable annuity was available only as an investment within a tax-qualified plan until 1960 when the first publicly available variable annuity outside a qualified plan was developed and brought to market by the Variable Annuity Life Insurance Company or VALIC.

An annuity used in a qualified plan can provide contract owners with the same insurance benefits offered by non-qualified annuities, such as guaranteed death benefits, guaranteed living benefits, and guaranteed income payments for life. It does not, however, provide any additional tax-deferred treatment of earnings—tax deferral is provided by the qualified plan itself. (Other tax aspects of qualified and non-qualified annuities are discussed in the chapter on *Regulation and Taxation of Annuities*.)

Figure 1-4 *Annuity Industry Total Sales—Qualified vs. Non-Qualified*

(dollars in billions)

Year	Qualified			Non-Qualified			Total
	Variable	Fixed	Total	Variable	Fixed	Total	
1999	\$62.9	\$15.6	\$78.5	\$60.1	\$26.1	\$86.2	\$164.7
2000	70.8	15.4	86.2	66.5	37.3	103.8	190.0
2001	60.4	19.0	79.4	52.9	55.3	108.2	187.6
2002	66.0	31.1	97.1	49.0	72.2	121.2	218.3
2003	74.1	26.5	100.6	52.3	62.9	115.2	215.8
2004	78.4	26.2	104.6	51.3	61.7	113.0	217.6
2005	82.4	28.3	110.7	50.7	51.2	101.9	212.6
2006	96.0	29.4	125.4	61.3	48.9	110.2	235.6
2007	112.0	31.6	143.6	70.2	41.2	111.4	255.0
2008	101.3	44.8	146.1	53.5	64.5	118.0	264.1

Source: Morningstar, Inc. and LIMRA International

Private Annuities

In the United States, all commercial annuities are issued exclusively by insurance companies. A “private” annuity is not issued by an insurance company. Rather, it involves the transfer of property (such as real estate) from an individual or a revocable living trust in exchange for an unsecured promise by the transferee (an individual or a non-insurance entity, such as a trust) to make a periodic stream of fixed payments. The tax treatment of private annuities is complex and differs from the tax treatment of commercial annuities.

Private Placement Annuities

Private placement annuities are variable annuity contracts that are not registered under federal or state securities laws. They are available exclusively to investors who meet certain minimum net worth and income levels under such laws. The types of investment options available under private placement annuity contracts often include hedge funds, commodities, managed accounts, and other kinds of private equity offerings.

Charitable Gift Annuities

With a charitable gift annuity, a donor transfers cash or property (including appreciated property) to a charitable organization in exchange for income payments for life or joint lives, with no guarantee period. The federal tax law imposes specific requirements on the relationship of the amount donated and the value of the promised annuity stream.

The charity can fund its payment obligations using its own assets, or it can fund them by purchasing a commercial annuity.

What Fees and Expenses Are Associated With Annuities?

A fixed annuity typically does not impose direct expense charges on the contract owner, other than surrender charges (charges for cancellation of the contract during its early years) for deferred fixed annuities. The spread, or difference between what the issuing company expects to earn and what it commits to pay out, is intended to cover the insurer's expenses. A variable annuity, on the other hand, involves direct expenses in the form of insurance charges and indirect expenses in the form of management and other fees and expenses associated with the underlying mutual funds in which the variable annuity subaccounts invest.

Insurance, Administrative, and Distribution, Charges

The fees and charges commonly associated with variable annuities include mortality and expense risk charges (M&E fees), administrative charges, and distribution charges.

In most contracts, the M&E fee pays for three important insurance guarantees:

- The ability to choose a payout option that provides an income that cannot be outlived at rates set forth in the contract at the time of purchase;
- A death benefit to protect beneficiaries;
- The promise that the annual insurance charges will not increase.

The administrative and distribution charges pay for all of the services involved in the maintenance of variable annuity contracts, such as the preparation of contract statements and mailings and other customer services. Some variable annuities also impose an annual contract fee that is similar to the annual account maintenance fee imposed by many IRAs. This fee generally ranges between \$30 and \$40 per year. Most insurers waive this fee for contracts with an accumulation or contract value of at least a certain amount (e.g. \$25,000).

Mutual Fund Fees and Expenses

Underlying mutual funds incur investment management fees and operating expenses, and in many cases, distribution charges known as “12b-1 fees,” which are named after the SEC rule that governs them. Investment management fees for the mutual funds that underlie the subaccount investment options in variable annuities are, on average, lower than those charged for publicly offered mutual funds. These lower fees have the effect of offsetting, to some extent, the insurance charges. In 2008, the average total expense difference between variable annuities and mutual funds was 1.18%. (See the chapter on *The Real Cost of a Variable Annuity* for a comparison of variable annuity and mutual fund fees.)

Surrender Fees

If a contract owner decides to cancel a deferred annuity during the early years of the contract, surrender charges may apply. These charges, if applicable, generally begin in a range from 5-7% of the amount invested and decline to zero over a period of time, such as five to seven years. Surrender charges are structured differently for different annuity products. (See the following section, "How Are Variable Annuity Sales Charges Structured?")

Unbundled Fees

Some variable annuity contracts permit purchasers to select from a menu of optional product features, each of which usually has an associated charge. This unbundling approach gives customers the ability to select and pay for only those features they want.

Optional features, referred to as riders, include, for example, enhanced guaranteed death benefits and guaranteed minimum living benefits. These riders typically have a separate, additional fee. (For more details, see the chapter on *Saving for Retirement*.)

Premium Tax

A few states impose premium taxes on variable annuity purchases. These taxes range from 1-4% depending on the state of residence but, in most cases, do not exceed 2%.

How Are Variable Annuity Sales Charges Structured?

B-Share Variable Annuities

Most variable annuity contracts are B-share products. They are offered with no initial sales charge, but cancellation of the contract during its early years may trigger a withdrawal charge known as a surrender charge. These charges typically range from 5-7% of premium in the first policy year, and subsequently decline to zero, generally after five to seven years (known as the surrender charge period). Some annuity contracts impose surrender charges only during the initial surrender charge period that begins after the contract is purchased, while others associate a new surrender charge period with each subsequent premium payment.

Surrender charges underscore the long-term nature of the annuity product. As long as contract owners remain committed to accumulating money for retirement through their variable annuity, they generally will not incur these charges. In addition to surrender charges, B-share contracts have annual M&E and administration fees.

A number of insurers have begun to offer other types of charge structures to meet different investor needs. The following are the most common.

A-Share Variable Annuities

Like A-share mutual funds, A-share variable annuities have up-front sales charges instead of surrender charges. Sales charges are calculated as a percentage of each premium payment.

A-share variable annuities offer breakpoint pricing, which means up-front sales charges decrease depending on the cumulative amount of purchase payments that have been made. In addition, assets that a contract owner has in other products in the company's product line may be recognized in the cumulative payment amount used to determine the breakpoint pricing. A-share contracts often have lower ongoing M&E annual fees than annuities with surrender charges.

C-Share or No-Surrender-Charge Variable Annuities

C-share, or no-surrender-charge variable annuities, offer full liquidity to owners at any time, without any up-front or surrender charges (although tax penalties may apply to withdrawals before age 59½). There are, however, ongoing M&E and administrative fees.

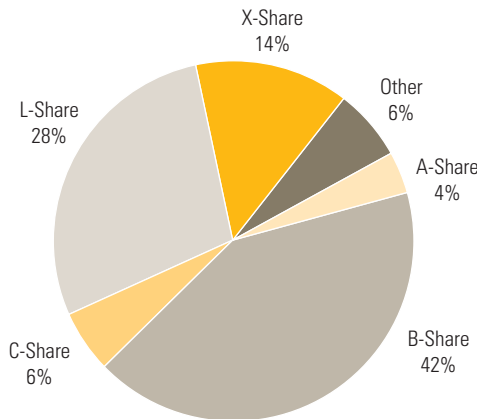
L-Share Variable Annuities

L-share variable annuities have no up-front sales charges. They typically have relatively short surrender charge periods, such as three or four years, but may have higher ongoing M&E and administrative charges than other share classes.

X-Share (Bonus) Variable Annuities

X-Share variable annuity contracts credit an additional amount or bonus to the contract value, which is calculated as a percentage of purchase payments added to the contract at or subsequent to contract issue. This category does not include contracts that credit additional amounts to the contract value after a designated period, sometimes referred to as “persistence bonuses.” There are ongoing M&E and administrative fees which tend to be higher than B-share contracts. In addition, the bonus is often subject to recapture, or being taken away, in certain circumstances, such as death or surrender of the contract within a specific number of years after the bonus is credited, or return of the contract during the initial “free look” period of the contract.

Figure 1-5 Variable Annuity Share Class Distribution
(Non-Group New Sales—12/31/08)



Source: Morningstar, Inc.

How Are Variable Annuity Commissions Determined?

Broker-dealer firms are paid a commission by insurance companies when they sell variable annuity contracts. The amount of compensation depends upon the issuing insurer, the relationship the broker-dealer has with the insurer, the types of annuities sold, the amount of money invested in the annuity, and the manner in which commissions are paid. Commissions can be paid in full at the time the annuity is sold, as a level commission over the life of the contract or some other period, or as a smaller amount at the time of the sale with a trail commission paid each year thereafter for a period of time.

Registered sales representatives are, in turn, paid a commission when they sell an annuity contract. Commissions paid to representatives are generally less than the full amount paid to the broker-dealer and may or may not be on the same basis. Also, certain management personnel, such as branch managers, may be paid for sales made by representatives over whom they have supervisory responsibility.

In addition to commissions, the broker-dealer may receive other forms of compensation from insurance companies such as lodging, travel, and meals at insurance company sponsored meetings. Some broker-dealers also receive monetary and other support to conduct client and educational seminars.

Insurance companies attempt to recoup the commissions and other compensation they pay through the various fees, charges, and deductions within the annuity contract, including any sales load that may be imposed, but no one charge is specifically earmarked to pay commissions.

How Is the Value of a Variable Annuity Measured?

The value of a contract owner's variable annuity is equal to the sum of the contract owner's account values in all of the variable investment options or subaccounts plus the value of any amounts allocated to available fixed account options, if any.

Each subaccount has a unit value, which is similar to the net asset value (NAV) of a mutual fund. The unit value measures the numerical worth of the assets in a subaccount, per unit of the subaccount owned. The unit value increases or decreases, respectively, with the positive or negative investment performance of the underlying mutual fund in which the subaccount invests, and is reduced by insurance charges and the fees and expenses of the underlying mutual fund. Unit values vary among the subaccount options inside a variable annuity. A contract owner's account value allocated to a particular subaccount is equal to the number of units of the subaccount owned multiplied by the current unit value.

Unit values apply to variable annuities in both the accumulation phase and the payout phase. Although the specific unit values differ between the accumulation and payout phases, the concept is the same. During the payout phase, contract owners are entitled to receive a determined number of units of benefit, which translate into an income payment amount based on the unit value at the time of payment. The unit value and resultant income payment may increase or decrease due to investment performance.

For fixed annuities and fixed account options within a variable annuity, the concept of unit value does not apply. Instead, premium contributions are credited with stated rates of interest that result in dollar increases in the underlying account value.

Insurance Company Ratings

Annuity guarantees are subject to the claims-paying ability of the issuing insurance company. It is therefore important to consider the financial soundness of a company before making a purchase. Companies are rated by one or more of the following independent industry analysts: A.M. Best Company, Standard & Poor's™, Fitch Ratings, and Moody's Investors Services. The ratings do not apply to the underlying mutual funds, which are subject to market risk and will fluctuate with changes in market conditions. Ratings can differ somewhat among the analysts, so it is useful to check the ratings from at least two analysts.

