



How Is My 401(k) Plan's Group Variable Annuity Priced?

ANNUITY BASICS. An annuity is an insurance company product designed to provide supplemental retirement income, in the form of a guaranteed stream of payments beginning at a specified time and lasting for a specified period. Payments to an annuity experience gains and losses during the Accumulation Phase, and are liquidated, or *annuitized*, during the Annuity Phase. Insurance companies offer Fixed Annuities and Variable Annuities on both an individual and a group basis.

Fixed Annuity: In a Fixed Annuity, investors pay premiums to the insurance company's General Account on which the insurance company guarantees the rate of return as assets accumulate and the amount of payout as assets are annuitized. The insurance company bears all of the investment risk.

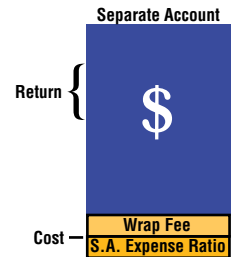
Variable Annuity: In a Variable Annuity, the investor has an opportunity to allocate contributions in various investment options called Separate Accounts. Investors can allocate payments to any or all of the variable accounts offered. Detailed information about the variable accounts and their risk can be found in the prospectus. The objective is to achieve growth that matches or exceeds inflation. For this potential advantage, the investor assumes the investment risk and as such the product is considered a Security and must be sold by prospectus.

GROUP VARIABLE ANNUITY. When 401(k) Plans came into being, insurance companies realized the Group Variable Annuity (GVA) was readily adaptable to hold 401(k) assets and keep appropriate records of participant account activity. Insurance companies have a long history of providing *turn-key* products to small-businesses sponsoring 401(k) plans. Insurance companies sell their 401(k) products directly through agents they employ, or indirectly through independent agencies they contract with.

PRICING. 401(k) products for GVAs are priced based on revenues generated from the underlying separate account investments. Separate Account investments can be managed by an employee of the insurance company, or *sub-advised* by an outside asset manager. If the insurance company manages the Separate Account, it earns revenue

from the assets. Separate Account management fees and other expenses are calculated as a percentage of the Separate Account, similar to the *expense ratio* of a mutual fund. The Separate Account *Unit Price* reflects these management and other embedded expenses and is based on the *Net Asset Value* (NAV/share price) of the underlying mutual fund.

Separate Accounts of insurance company 401(k) products are created and then wholly invested in mutual fund type accounts (from *name-brand* investment management companies) outside of the insurance company. Sponsors and participants must understand that even though the fund names may be the same as the publicly traded retail mutual fund, they are investing in the Separate Account, and not the actual retail mutual fund. The fund may have its own unique portfolio holdings, operating expenses and results. The results may differ from the similar publicly traded fund.



In order to profitably offer name-brand mutual fund type accounts, provide participants and sponsors with internet-based investment services, and provide 24-7 customer service, insurance companies price their product with an asset based charge often called a *Wrap Fee*. Insurance companies also negotiate revenue sharing arrangements with the fund families within the 401(k) Group Variable Annuity. Revenue sharing allows the insurance company to receive revenue from the money earned by the fund's management charges. It is crucial to understand that the Wrap Fee directly affects investment performance because it is in addition to the Separate Account's underlying expenses. The Wrap Fee will generally decrease as plan assets increase, and may also be offset by revenue sharing. Also, fees may be added to make up for funds that do not share revenue. In addition to the Wrap Fee and fund expenses, there will often be flat dollar amount annual Plan and Per-Participant Accounting Charges.

Sponsors and Participants must also be aware that data analysis services (Morningstar, Ibbotson...) are not reliable sources of information on Separate Account funds. They may have good data about underlying fund management style, but any analytics like Morningstar Star Ranking and the like will not be accurate because they have not taken into account the separate account Wrap Fee and its impact on performance.

SAI
SECURITY ADMINISTRATORS, INC.

BINGHAMTON OFFICE:
105-107 COURT STREET
P.O. BOX 1625
BINGHAMTON, NY 13902-1625
(607) 771-1180

SYRACUSE OFFICE:
SUITE 3D
650 JAMES STREET
SYRACUSE, NY 13203
(315) 474-8331

© Copyright 2007 Security Administrators, Inc. All rights reserved

This publication is intended for general information purposes or to support the promotion or marketing of the Company's products and does not constitute legal or tax advice. This publication is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed on the taxpayer under the Internal Revenue Code or any other applicable tax law. Taxpayers are advised to seek tax advice based on the taxpayer's particular circumstances from an independent tax advisor. There are various income, gift and estate tax consequences of utilizing life insurance within a qualified plan. A decision to purchase life insurance within a qualified plan should be made after considering the tax results and your non-tax needs for insurance. We recommended that you discuss your situation with your tax and legal counsel before purchasing an insurance product within a qualified plan.