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Understanding Index Annuities

An index annuity is a type of annuity that typically provides the contract owner an investment return based on a formula linked to the change in the level of one or more published equity-based indexes, such as the Standard & Poor's 500 Composite Stock Price Index™ (S&P 500) that tracks the performance of the 500 U.S. largest publicly traded securities. An index annuity provides a guaranteed minimum accumulation value and may also offer death benefit protection as well as a variety of payout options, although it is possible to lose money when investing in an index annuity. These products are designed for investors who want a protected investment floor with the ability to partake in the benefits of a market-linked vehicle.

Index Annuities Crediting Strategies

While the general structure is similar for all indexed annuities, the index used, the formula that determines the index rate, and the guaranteed minimum value can vary among the company and product selected. Some of these include:

Crediting Method – The method used to measure the change in the underlying index (e.g., point-to-point or annual reset). **Example**: If the underlying index equals 1,000 on the date of purchase and equals 1100 on the first anniversary date of purchase, then the change in the index (1,100 – 1,000 = 100) divided by the index value at purchase (1,000) equals 10%.

Participation Rate – The percentage of the calculated index gain credited to the contract owner as interest, which may be reset annually. **Example**: If the participation rate is 90%, then a 10% change in an index would result in a 9% credit (90% x 10% = 9%).

Spread/Margin – The percentage by which the gross index gain is reduced before being credited to the contract owner as interest. **Example**: If there is a 2% spread or margin, then a 10% change in an index would result in an 8% credit (10% – 2% = 8%)

Cap Rate – The maximum index-based interest credited to the contract owner, which may be reset annually. **Example**: If there is a 6% cap, then if the underlying index increased by 10% in a year, the credit to the contract would only be 6%.

Performance Rate: The amount you receive on an index strategy end date is based on the index return and the index strategy.

Step-up / Trigger Rate - The step-up / trigger rate is a rate of return for an index segment that is typically declared at the beginning of the index term and is used to determine the segment maturity value if the index return for the index term is zero or positive. If the index value is greater than or equal to zero on the end date, the performance rate is equal to the step-up / trigger rate. If the index value is less than zero on the end date, the segment value will be equal to the invested premium in that segment or the stated limited protection for that segment. As performance rates will vary by insurance company and contract, please review the disclosure documents for the particular index annuity you are considering.

Features of an Index Annuities

A. Tax-Deferred Earnings

Like other types of annuities, earnings from a non-tax-qualified index annuity grow on a tax-deferred basis. This means that income tax that would have been paid on any interest, dividends or capital appreciation is deferred until you make a withdrawal from the index annuity contract. Therefore, investments may grow faster in an index annuity than in a taxable investment vehicle with a similar rate of return because money that would have been used to pay taxes on earnings remains invested and continues to grow and compound. It is important to note, however, that when you withdraw your money from a non-tax-qualified index annuity, you will be taxed on the earnings at ordinary income tax rates rather than the lower tax rates applicable to capital gains. And, if you take the withdrawal before you attain age 59½, you may be subject to an additional 10% federal tax penalty. The benefits of tax deferral may outweigh the costs of an index annuity only if you hold it as a long-term investment to meet retirement or other long-range goals.

B. Death Benefit

Generally, when the owner (or annuitant, as specified in the disclosure documents or contract) of the index annuity dies, the beneficiary is taxed on all appreciation when the death benefit is received. This is different from investments held in a taxable account that may receive a stepped-up cost basis (i.e., the value of the account at the owner's death including all appreciation).

Index annuity contracts allow for the payment of the current contract value to your named beneficiary (or multiple named beneficiaries) upon your death. Typically, contracts may also include, as a standard death benefit, the greater of a return of premium less any withdrawals or the current contract value.

Some contracts also offer “enhanced” death benefits for an additional charge. For example, one enhanced death benefit includes the allowance to periodically “lock in” your investment performance. Another enhanced death benefit may guarantee a minimum rate of return on the value of your contract.

The earnings-enhanced death benefit is another optional death benefit that may be available. This feature entitles the named beneficiary to a death benefit that is increased by an amount—typically 25% to 40% of the earnings in the contract—that can be used to help offset taxes that may be due when the death benefit is paid.

The cost for these optional death benefits is typically up to 0.75% annually. Please review the disclosure documents to better understand the fees and features prior to investing.

There are some additional considerations that you should be aware of regarding index annuity death benefits:

- The death benefits described above may terminate once you elect an income option and enter the payout phase of the contract.
- Depending on the contract, death benefits may be payable upon the death of the owner, the annuitant or either.
- Withdrawals during the savings phase will reduce the death benefit.
- Contracts that include a return of account value death benefit as the sole death benefit option should only be purchased for their additional features such as optional living benefits, or the benefits of tax deferral on non-tax-qualified contracts and should not be purchased solely for death benefit protection.
- Most optional death benefits must be elected when the contract is issued and cannot be canceled.
- In a non-tax-qualified index annuity, earnings distributed as death benefits are taxed as ordinary income when received by the named beneficiary.

Morgan Stanley does not receive any additional compensation when a client selects an optional death benefit on their index annuity.

C. Living Benefit Options

Annuities are characterized by their ability to provide retirement income that cannot be outlived during the payout phase. Many index annuity products offer, on an optional basis, a “living benefit” that provides income guarantees to help protect your retirement income from declining markets during the savings phase (i.e., insurance for your purchase payments).

A Guaranteed Lifetime Withdrawal Benefit (GLWB”) is a basic type of living benefit available with an index annuity product. It is summarized in the chart below. Actual guarantees and corresponding fees will vary by contract. GLWB is available for an additional cost. Minimum holding periods and investment restrictions may apply. Deviations from these limitations may result in material reduction or termination of the benefit. As with any optional benefit, it is important to weigh the costs against the benefit when adding such riders to your contract. Read the disclosure documents carefully before selecting a living benefit.

LIVING BENEFIT OPTION	BENEFIT DESCRIPTION	ADDITIONAL CONSIDERATIONS
Guaranteed Lifetime Withdrawal Benefit (GLWB)	Generally, these benefits guarantee a return of your purchase payments over the lifetime of an individual or an individual and spouse through a series of annual withdrawals. Certain benefits may provide for a higher stepped-up benefit base via a 3% to 15% annual roll-up of your benefit base and/or an annual reset based on positive market performance.	During the withdrawal period, withdrawals in excess of the benefit withdrawal limit (3% to 7.5%) may negatively affect the guarantee. Additionally, some contracts require that all of your assets be allocated in specified investment options, and deviation from these investment options may result in material reduction or termination of this benefit. Generally, there is no waiting period to begin withdrawals, but liquidity limitations based on current age or before age 59½ may apply. Withdrawals not taken generally do not accumulate or carry over to the next year.

The cost for optional living benefits typically ranges from 0.40% to 1.20% annually. Please review the disclosure documents to better understand the fees and features prior to investing.

Morgan Stanley does not receive any additional compensation when a client selects an optional living benefit on their index annuity.

D. Contingent Deferred Sales Charge Waivers

Certain index annuity contracts offer Contingent Deferred Sales Charge (CDSC) waivers. These waivers allow you to withdraw from your contract without penalty or surrender charges. The CDSC waivers may vary by insurance company and contract and may not be available on all contracts. Please review the disclosure documents.

- Nursing Home / Extended Care Waiver: If you or the joint owner is confined to a nursing home or hospital you may withdraw up to 100% of the contract value free of surrender charges. Each insurance company and contract may have specific length of time requirements in order to qualify for the waiver. Restrictions may apply and are described in the disclosure documents.

- Terminal Illness Waiver: If you or the joint owner incur a terminal illness you may withdraw up to 100% of the contract value free of surrender charges. Each insurance carrier and contract may have specific length of time requirements in order to qualify for the waiver. Restrictions may apply and are described in the disclosure documents.

Costs Associated with Investing in Index Annuities

Typically, index annuities do not have upfront sales loads or ongoing expenses. However, there are often surrender fees if you need to access your money before the surrender period ends. The insurance company's costs are built into the spread margin, cap rate, participation rate, and/or other features of the contract. Your contract may be subject to surrender charge (also called a contingent deferred sales charge) in the first 5 to 10 years of the contract. You may also be subject to a fair value calculation (or interim value formula) should the contract be terminated early. Before purchasing an index annuity, please review the disclosure document for the specific early surrender charge schedule and / or fair value calculation.

Market Value Adjustment

Index annuities may allow for the adjustment of your current value (positive or negative) when you take a withdrawal(s) outside of a permitted window. This adjustment will be based on the relationship of market interest rates at the time of the withdrawal and the guaranteed interest rate of the index annuity. The general relationship is as follows: if interest rates move higher than the guaranteed rate at the time of the withdrawal, then you may receive less than your investment. Conversely, if interest rates move lower than the guaranteed rate at the time of the withdrawal, then you may receive more than your current investment's value.

How Morgan Stanley and Your Financial Advisor Are Compensated When You Buy an Index Annuity

REVENUE SHARING. Morgan Stanley Smith Barney LLC ("Morgan Stanley") offers clients a selection of index annuities from approved insurance companies. For each index annuity product we offer, we seek to collect from insurance companies a revenue sharing payment. Insurance companies currently pay fees on assets of up to 0.11% per year ($11 per $10,000) calculated quarterly, based upon the aggregate value of index annuity assets invested in contracts for which Morgan Stanley is designated as the broker-dealer or agent of record. Additionally, each insurance company pays an annual support fee of $500,000 to Morgan Stanley. Revenue sharing payments and product support fees are paid out of the insurance company's revenues or profits and not from a client's contract value. Financial Advisors do not receive additional compensation as a result of these revenue sharing payments.

COMMISSIONS. Each time an index annuity is purchased through a Morgan Stanley Financial Advisor, the insurance company pays Morgan Stanley compensation, based upon a standard schedule for all insurance companies, in the form of a commission, based upon the product selected and the investment amount. The commissions payable to Morgan Stanley are consistent for all insurance companies, regardless of the volume of business Morgan Stanley submits to the insurance company or the profitability of the policy to the insurance company. Further, no insurance company (or the parent or affiliated company of any insurance company) has any material interest in Morgan Stanley or its insurance licensed affiliates, Morgan Stanley Insurance Services, Inc. and SBHU Life Agency, Inc.

Morgan Stanley, in turn, pays a portion of the commission to the Financial Advisor. Financial Advisor commissions generally range from 0% to 5% of contributions and trails (annuity contract servicing payments) generally in the range of 0% to 1 % of index annuity assets. Morgan Stanley passes all or a portion of these trails on to the Financial Advisor. Annuity companies also pay Morgan Stanley an additional percentage of contributions generally not exceeding 0.75%. Upfront and trail commission payments are paid out of the insurance company's general account and do not represent an additional charge to you.

EXPENSE & DATA ANALYTICS FEES

Morgan Stanley seeks prepayment from approved insurance companies of up to $63,000 per year to help cover the costs associated with platform administration, regulatory compliance and other distribution responsibilities related to annuities. In addition, Morgan Stanley seeks reimbursement from approved insurance companies (or their parent or affiliated companies) or other service providers (collectively, "Providers") for the expenses incurred for various national, regional, and local training and education events and conferences held in the normal course of business. Providers independently decide if and what they will spend on these activities. Morgan Stanley also gives Providers the opportunity to purchase supplemental annuity sales data analytics. The amount of the fees depends on the level of data provided. The current fee is up to $60,000 per year for annuities products. Providers may also purchase sales data analytics from Morgan Stanley for other financial products they offer.

COMPENSATION FROM INSURANCE COMPANIES Morgan Stanley and its parent or affiliates receive from certain approved Providers compensation in the form of commissions and other fees for providing traditional brokerage services, such as fees for related research and advisory support, and for purchases and sales of securities for their own portfolios or the portfolios of sub-account investment companies. Morgan Stanley may also receive other compensation from certain approved Providers for financial services performed for the benefit of such companies. Morgan Stanley prohibits linking the determination of the amount of brokerage commissions and service fees charged to a Provider to the aggregate values of our overall client holdings of its products or to offset the revenue sharing or expense payments described above.

For additional information on a particular Provider's payment and compensation practices, please refer to the disclosure documents.

Additional Resources

Before purchasing an index annuity, investors should learn how an index annuity works, the benefits it can provide, and the fees and charges you will pay. Certain index annuities offered through Morgan Stanley's licensed insurance agency subsidiaries provide additional disclosure documents, which you should read carefully. Since the guarantees in each annuity depend on the financial strength and claims-paying ability of the annuity company, you should also evaluate the company's financial condition.

Investors should carefully consider the investment objectives and risks as well as charges and expenses of an index annuity before investing. To obtain disclosure documents, contact your Financial Advisor. The disclosure documents contain this and other information about the annuity. Read the disclosure documents carefully before investing.

Insurance products are offered in conjunction with Morgan Stanley Smith Barney LLC's licensed insurance agency affiliates.

It is not possible to directly invest in an index.