Morgan Stanley

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Understanding Index Annuities

An indexed 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), which tracks the performance of the 500 U.S. largest publically traded securities. An indexed annuity provides a guaranteed minimum accumulation value, and may also offer death benefit protection as well as a variety of payout options. 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. The index used, the formula that determines the indexed rate, and the guaranteed minimum value can vary among the annuity company and product selected. Some of these features 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 1000 on the date of purchase and equals 1100 on the first anniversary date of purchase, then the change in the index (1100 – 1000 = 100) divided by the index value at purchase (1000) 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%).

Spread/Margin — 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%.

Learning About Indexed Annuities

In order to be an informed investor in indexed annuities, you should do several things. Certain indexed annuities, offered through Morgan Stanley Smith Barney LLC's licensed insurance agency affiliates, provide an informational document known as a "prospectus" or other disclosure documents. You should read the prospectus or other disclosure documents carefully. Since the guarantees in each annuity depend on the financial strength and claims-paying ability of the annuity company, you should evaluate the annuity company's financial condition.

General information on annuities can be obtained from The American Council of Life Insurers website. Morgan Stanley's website can provide basic information on our annuity offerings.

Costs Associated with Investing in Index Annuities

Typically indexed annuities do not have upfront sales loads or ongoing expenses. The annuity 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 an early withdrawal charge (also called a contingent deferred sales charge) in the first 5 to 10 years of the contract. You should consult the prospectus or other disclosure document for the indexed annuity that you are considering for the specific early withdrawal charge schedule.

How Morgan Stanley Smith Barney LLC and Your Financial Advisor Are Compensated When You Buy an Indexed Annuity

REVENUE SHARING. Morgan Stanley Smith Barney LLC offers clients a selection of indexed annuities from approved annuity company families, or providers. For each indexed annuity product we offer, we seek to collect from providers a revenue-sharing payment. In 2012, providers paid fees on assets of up to 0.20% per year ($2 per $10,000) calculated quarterly, based upon the aggregate value of indexed annuity assets invested in contracts for which Morgan Stanley Smith Barney LLC is designated as the broker/dealer or agent of record. This rate may be subject to volume discounting (that is, as the number of assets increases, the basis point payment for those assets will decrease). Revenue-sharing payments are paid out of the provider's revenues or profits and not from a client's contract value. It is important to note that our Financial Advisors receive no additional compensation as a result of these revenue-sharing payments.

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

Morgan Stanley Smith Barney LLC, 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 .25% of indexed annuity assets. Morgan Stanley Smith Barney LLC passes all or a portion of these trails on to the Financial Advisor. Annuity companies also pay Morgan Stanley Smith Barney LLC an additional percentage of contributions generally not exceeding 0.80%. Up-front and trail commission payments are paid out of the provider's general revenues and do not represent an additional charge to you.

EXPENSE REIMBURSEMENTS. Morgan Stanley Smith Barney LLC may seek prepayment or reimbursement by approved providers, their parent or affiliated companies, or other service providers for the expenses incurred for various sales meetings, seminars and conferences held in the normal course of business and other administrative and compliance services.

COMPENSATION FROM PROVIDERS. Morgan Stanley Smith Barney LLC and its parent or affiliates receive from certain approved providers or their parent or affiliated companies compensation in the form of commissions and other fees for providing traditional brokerage services, including related research and advisory support, and for purchases and sales of securities for their own portfolios or the portfolios of sub-account investment companies. They also receive other compensation from certain approved providers or their parent or affiliated companies for financial services performed for the benefit of such companies. Morgan Stanley Smith Barney LLC prohibits linking the determination of the amount of brokerage commissions and service fees charged to an approved provider or its parent or affiliated company to the aggregate values of our overall variable annuity product sales or client holdings of these products or to offset the revenue-sharing or expense reimbursements described above.

For additional information on a particular provider's payment and compensation practices, please refer to the provider's product prospectus and/or other disclosure documents.

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

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

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