



March 15, 2019

Filed via *rule-comments@sec.gov*

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

**Re: RIN 3235-AK60
File No. S7-23-18
Request for Comment on Updated Disclosure Requirements and Summary
Prospectus for Variable Annuity and Variable Life Insurance Contracts**

Dear Chairman Clayton:

On behalf of our 38 million members and all Americans saving for retirement, AARP¹ writes today in response to the Security and Exchange Commission's (Commission) request for comment on Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts ("Disclosure Requirements"). We welcome the chance to be a part of this process and intend to play an active role in educating and engaging all Americans to help them make informed investment decisions that will impact their financial security.

A priority for AARP is to assist Americans in accumulating and effectively managing adequate retirement assets to supplement Social Security. The shift from defined benefit plans to defined contribution plans has transferred significant responsibility to individuals for investment decisions that directly impact the adequacy of the assets available to fund their future retirement needs. Unfortunately, the state of America's retirement landscape is cause for great concern. According to calculations by the Center for Retirement Research at Boston College, only about half of households, in

¹ AARP, with its nearly 38 million members in all 50 States, the District of Columbia, and the U.S. territories, is a nonpartisan, nonprofit, nationwide organization that helps empower people to choose how they live as they age, strengthens communities, and fights for the issues that matter most to families, such as healthcare, employment and income security, retirement planning, affordable utilities and protection from financial abuse.

mid-career, have retirement savings. For many people, the account balance in their 401(k) plan or Individual Retirement Account (IRA) represents the bulk of their personal savings.² The rest have little to no sources of retirement income other than Social Security³ and the “retirement income deficit” for American households continues to grow. Recent analysis by the Employee Benefit Research Institute (EBRI) showed that 47 percent of workers in 2017 reported that the total value of their household’s savings and investments, not just for retirement, was less than \$25,000 and 24 percent had less than \$1,000.⁴ Moreover, the average longevity for persons who retire at age 65 has increased until the mid-80’s.⁵ Finally, many Americans lack strong financial literacy skills,⁶ and results from financial education efforts have been mixed, at best.⁷ Given these trends, it is critical to do all we can to help Americans keep as much of their hard-earned savings as possible and to ensure that they make well-informed investment

² U.S. Gov’t Accountability Office, GAO 15-419, *Retirement Security: Most Households Approaching Retirement Have Low Savings* 8 (May 2015), <http://www.gao.gov/assets/680/670153.pdf> (to the extent that households have savings, they are not significant outside of retirement accounts).

³ Federal Reserve Bulletin (Sept. 2017), <https://www.federalreserve.gov/publications/files/scf17.pdf>.

⁴ Lisa Greenwald et al., *The 2017 Retirement Confidence Survey: Many Workers Lack Retirement Confidence and Feel Stressed About Retirement Preparations* (Mar. 21, 2017), https://www.ebri.org/pdf/briefspdf/EBRI_IB_431_RCS.21Mar17.pdf. This figure refers to the total value of their household’s savings and investments, excluding the value of their primary home.

⁵ According to Social Security, “[a] man reaching age 65 today can expect to live, on average, until age 84.3,” and, “[a] woman turning age 65 today can expect to live, on average, until age 86.7.” *Social Security, Benefits Planner | Life Expectancy*, <https://www.ssa.gov/planners/lifeexpectancy.html> (last visited Feb. 4, 2019).

⁶ Annamaria Lusardi et al., *Financial Literacy and Financial Sophistication in the Older Population: Evidence from the 2008 HRS* (Sept. 2009), <http://www.mrrc.isr.umich.edu/publications/papers/pdf/wp216.pdf> (“In view of the fact that individuals are increasingly required to take on responsibility for their own retirement security, this lack of [financial] knowledge has serious implications.”); see also FINRA Inv’r Educ. Found., *Financial Capability in the United States 2016* (July 2016), http://www.usfinancialcapability.org/downloads/NFCS_2015_Report_Natl_Findings.pdf (noting a downward trend since 2009 in financial literacy); Annamaria Lusardi & Peter Tufano, *Debt Literacy, Financial Experiences, and Overindebtedness*, 14 J. OF PENSION ECON. AND FIN. 332 (Oct. 2015) (only one-third of respondents correctly answered debt literacy questions concerning compounding of interest); Annamaria Lusardi & Olivia S. Mitchell, *Financial Literacy and Planning: Implications for Retirement Wellbeing*, Nat’l Bureau of Econ. Research Working Paper 17,078, at 6 (May 2011), <http://www.nber.org/papers/w17078.pdf> (one-third of survey respondents did not understand compound interest, one-quarter did not understand inflation implications and half did not know about risk diversification).

⁷ Susannah Snider, *Do Financial Literacy Courses Work?*, U.S. NEWS (Aug. 28, 2018), <https://money.usnews.com/money/personal-finance/family-finance/articles/2018-08-28/do-financial-literacy-courses-work>; Justine S. Hastings, Brigitte C. Madrian, William L. Skimmyhorn, *Financial Literacy, Financial Education And Economic Outcomes*, ANNUAL REV. ECONOMICS at 1; 5: 347–373 (May 2013), <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3753821/#R80>.

decisions for their financial situation.⁸ AARP has historically supported the development of rules and regulations that protect retail investors when they make investment decisions concerning their retirement monies. Such protections include -- but are not limited to -- clear, easy to understand, readable, and helpful disclosures. We believe that without such protections, it is difficult for individuals to effectively plan for a secure and adequate retirement.

I. FUND DISCLOSURES SHOULD FACILITATE INFORMED DECISION-MAKING.

AARP commends the Commission's effort to improve disclosures concerning variable annuity and variable life insurance contracts to reflect the way retail investors currently seek, receive, view, and digest information. In its proposed regulation, the Commission itself recognized the extreme complexity of variable contracts. Disclosure Regulation at 8, 21, 29, 30, 33, 53, 73, 89, 125, 126, 217, 281, 300, 307, 308. Chairman Clayton noted that providing this summary information is "particularly important in light of the long-term nature of these contracts and their potential complexity."

The Commission faces the enormous challenge of ensuring that variable contracts are fairly structured and sold, and that all consumers, not just the most sophisticated, understand the terms and conditions of these products. For most retail investors, the confusion and lack of understanding surrounding variable contracts poses tremendous risk to their financial security. Disclosure Regulation at 302-03 (more than 80 percent of investors have incomes under \$100,000). For example, the Commission should clarify that all insurance products where the value of the contract will vary depending on investment performance are included within the parameters of this proposal. Ensuring retail investors understand how much of the fixed annuity contract is variable is important because investors may assume that investment performance has no impact on the value of such a contract, when clearly it does. Given this complexity, the Commission should require a disclosure stating that if a retail investor does not understand the terms of the variable contract, they should not invest in it until they do so.

AARP generally has been in favor of layered disclosures as long as the summary information provides essential information for investors in a form that will facilitate informed decision making.⁹ The initial summary disclosure must provide information to

⁸ See, e.g., Jay Goodliffe et al., *The Cost of Retiring Poor: Cost to Taxpayers of Utahns Retiring Poor* (Jan. 2015), <http://www.aarp.org/content/dam/aarp/ppi/2016-03/cost-to-taxpayers-of-utahns-retiring-poor.pdf> (increases in retirement savings will prevent substantial increases in costs associated with existing public programs); Aleta Sprague, *The California Secure Choice Retirement Savings Program 5* (Apr. 26, 2013), <http://www.retirementmadesimpler.org/Library/CAretirementFinal4.26.13.pdf> (noting that retirees without adequate retirement savings will rely on the federal and state social safety net).

⁹ Regardless of whether the investor learns about variable contracts through an investment professional, the disclosure obligation runs to the investor, not the person who sells the product.

the retail investor that is necessary for the investor to make an informed decision as to whether to make the investment at all and how the investment operates, including the total fees and expenses of the investment. Disclosures about the underlying portfolio companies and investments should also be accessible. In order to assist investors in comparing products, issuers should be required to put tables of content in the initial and updated summary prospectuses and the appendix. Most crucially for layered disclosure to fulfill its promise, investors must be told explicitly of their rights to request and obtain additional information about these products. Without this explicit notice, the concept of layered disclosure becomes camouflage to reduce issuers' costs without any benefit for the investor.

A. Information Should Be Clearly Written to Enhance Readability and Comprehension.

Retail investors should be empowered to make informed decisions – they should understand their options and what they are selecting, especially when their hard-earned savings are on the line. The best method for determining whether disclosures facilitates informed decision making is to test the disclosure. AARP urges the Commission to test its summary prospectuses and other required disclosures to make them more user-friendly and ultimately more valuable resources for retail investors.¹⁰ It is very difficult to produce disclosures of complicated materials that are readable and helpful.¹¹ The format should be concise¹² and written in plain language, with key data points emphasized in a standardized format. Standardization makes information easy to compare. The enclosed information must be carefully organized and presented in order to optimize comprehension. The behavioral economist, Shlomo Benartzi, recently noted that “[P]eople make decisions based upon the immediately available information – what we see at first glance—and forget that there might be more relevant information that isn’t visible.”¹³ An error that Noble Laureate Daniel Kahneman refers to as the “what you see is all there is.”¹⁴ AARP recommends that the text in fund disclosures be simply written and avoid technical terms unless such complex terms are clearly defined. The

¹⁰ For example, when AARP proposed its 401(k) fee disclosure form, it had been tested and revised over an extended period; even then, between 22% to 30% of readers had problems with the form. C. Thayer, *Comparison of 401(k) Participants' Understanding of Model Fee Disclosure Forms Developed by the Department of Labor and AARP* at 5, 10 (Sept. 2008), https://assets.aarp.org/rgcenter/econ/fee_disclosure.pdf.

¹¹ *Id.*

¹² Although concise usually means shorter, AARP does not believe that the Commission should dictate word or page limits, assuming it does not permit issuers to add whatever information they want.

¹³ Shlomo Benartzi, *The High Financial Price of Our Short Attention Spans*, WSJ (Oct. 21, 2018), <https://www.wsj.com/articles/the-high-financial-price-of-our-short-attention-spans-1540174321>.

¹⁴ *Id.*

disclosure should be written for the purpose of informing the retail investor, not simply to meet a legal standard. Based on our experience, the format of disclosure forms, as well as the terminology used, can have a substantial impact on comprehension.¹⁵

Behavioral science has shown that when faced with a complicated choice, people often simplify by focusing on only two or three aspects of the decision.¹⁶ The less they are able to frame the decision in narrow terms, the more likely they will end up overwhelmed, undecided, or procrastinating.

AARP commissioned a report in 2007 to determine the extent to which 401(k) participants were aware of fees associated with their accounts and whether they knew how much they actually were paying in fees. The report revealed participants' lack of knowledge about fees, as well as their desire for a better understanding of fees. In response to these findings, the report suggested that information about plan fees be distributed regularly and in plain English, including a chart or graph that depicts the effect that the total annual fees and expenses can have on a participant's account balance.¹⁷ Although standardized presentation of information is important so that investors can compare that information, the information presented must be the information that investors need. Although the Department of Labor (DOL) 401(k) fee disclosure form standardized information concerning investment performance and fee disclosures, one of the complaints about the DOL's form is that it separated the display of this information, making holistic comparisons difficult for retail investors. AARP submits that the information needs to be standardized so that investors can compare different variable contracts, but also other investments.

Layout and design elements can be used to enhance understanding. Side by side comparisons may be helpful, but the material should be simplified and reduced to the main elements. For example, using bold type, underlining, bullets, and borders to highlight significant data may enhance comprehension by drawing attention to it. A form that is perceived as easy to understand and helpful is more likely to be used to weigh the advantages and disadvantages of available options and to make informed decisions than one that is more confusing. The Commission has previously used some of these concepts to require standardized formatting and use of terminology, as well as providing model language and documents. The studies prepared for the Commission are consistent with AARP's position that testing of forms is necessary to ensure that investors understand disclosures. See SEC Staff, *Study Regarding Financial Literacy Among Investors* (Aug. 2012) ("SEC 2012 Financial Literacy Study"), <http://www.investor.gov/publications-research-studies/sec-research> at 6, 33, 36-7, 76, 84, 93, 113,

¹⁵ See n. 10, at 4, 26.

¹⁶ Daniel Read et al., *Choice Bracketing*, 19 J. RISK & UNCERTAINTY 171, 171-73 (1999).

¹⁷ *Id.*

120, 162; Siegel & Gale LLC, *Investor Testing of Mutual Fund Shareholder Reports* (Feb. 9, 2012), <https://www.sec.gov/comments/s7-08-15/s70815-3.pdf>. Many of the questions the Commission asked in its proposal can only be answered by testing.¹⁸

B. The Use of the Initial Summary Prospectus Should Be Mandated and the Required Content Enhanced.

1. The use of the initial summary prospectus should be mandated.

If the purpose of the Commission's proposal is "to help investors make informed investment decisions," then mandating the use of the summary prospectus is crucial to achieving that purpose. Without a mandate, there is no incentive for the industry to use the summary.

The variable contract summary prospectus is designed to be a succinct summary of the contract's key terms and benefits and most significant risks, making it easier to read and more understandable for investors. Disclosure Regulation at 23. Because it is succinct, investors might actually read the information which will hopefully result in better educated investors making more informed choices as to their financial needs. The Commission should require standardization of required information and format in which it is presented so that investors can compare products. If the Commission's purpose for this Disclosure Regulation is to ensure that retail investors understand the investment they are purchasing, there is every reason for the Commission to mandate the use of these summary prospectuses. AARP disagrees with the Commission's proposal to make the use of these summary prospectuses purely voluntary.

2. Content of Summary Prospectus

AARP agrees with the Commission that the content of the initial summary prospectus should consist of the following key disclosures:

- a contract overview (including basic information about the contract and benefits),
- a key information table (providing a summary of fees and expenses, risks, restrictions, taxes and conflicts of interest),
- a description of the standard death benefit,
- a summary of other benefits available under the contract,
- a description of the procedures for purchasing the contract,
- information regarding the possibility of contract lapse (for VLI policies),

¹⁸ We note the Commission's inquiry concerning other technological methods of providing information makes assumptions that investors use such technology. AARP suggests that no new technology should be used unless studied first to determine investor demographics and the technology's adaptation. One example, based on the Commission's proposal, is testing to determine how many people over the age of 50 use QR codes.

- information about policyholder rights and obligations, including contract surrenders, withdrawals or termination,
- a full fee table, and
- an appendix (in tabular format) with summary information about the underlying funds.

AARP provides more specific comments about some of these key disclosures below as well as suggestions for additional disclosures.

- a. Disclosures should focus on only one contract at one time.

A reader best understands disclosures when ideas and concepts are presented one at a time. By permitting the disclosures to discuss more than one contract and, indeed, even more than one class per contract, the information becomes unorganized, unfocused, and difficult to understand.

AARP agrees with the Commission's proposal to limit the initial summary prospectus' description to only one contract and urges the Commission to limit the description to only one class of a currently-offered contract. The disclosures should only provide information for the contract that the retail investor is considering investing in. AARP recognizes the potential work that this change may cause for issuers to create separate summary prospectuses for contracts that are currently described in a single statutory prospectus and ensure that the correct summary is delivered to each contract owner. We suggest that the effective date for this change be 24 months after the regulation's effective date in order to permit issuers to make system changes.

- b. Conflicts of interest should be disclosed.

As evidenced in the Commission's own study, retail investors believe disclosures concerning conflicts of interest are essential in making informed decisions concerning an investment purchase. See SEC 2012 Financial Literacy Study at iv, vi. This study and others¹⁹ demonstrate the reasons that such transparency is indispensable in

¹⁹ E.g., S. Kathi Brown, AARP Research, *Attitudes Toward the Importance of Unbiased Financial Advice* (May 2016), <http://www.aarp.org/research/topics/economics/-2016/attitudes-toward-unbiased-financial-advice.html> (almost 90% of retirement account holders ages 25+ believe it is important for financial advisors to give financial advice in a client's best interest); S. Kathi Brown, AARP Research, *Fiduciary Duty and Investment Advice: Attitudes of 401(k) and 403(b) Participants* (Sept. 2013), <http://www.aarp.org/research/topics/economics/info-2014/fiduciary-duty-and-investment-advice---attitudes-of-401-k--and-4.html> (93% of respondents favored requiring retirement advice to be in their best interest and 81% of respondents agreed that it is important to get investment advice about their retirement from an independent advisor who does not earn money based on their investments); S. Kathi Brown, AARP Research, *Fiduciary Duty and Investment Advice: Attitudes of Plan Sponsors* (Mar. 2014), <http://www.aarp.org/research/topics/economics/info-2014/fiduciary-duty-and-investment-advice---attitudes-of-plan-sponsor.html> (89% of plan sponsors favored best interest standard); ORC/Infogroup, *U.S. Investors & The Fiduciary Standard* (Sept. 15, 2010), <https://www.sec.gov/comments/4-606/4606-2748.pdf> (60% of

making informed investment decisions, especially where the purchase of such a complex and complicated investment as a variable contract. Moreover, not only are the operation and terminology associated with these products difficult for investors to understand, the prospectuses are often more than a hundred pages, especially where the product includes optional benefits. Indeed, the fact that the proposal itself takes numerous pages just to explain the manner in which variable contracts work says volumes about the complexity of the investment and the sophistication needed to understand it.

Because the Commission's discussion of compensation arrangements may be too complicated for some people, the Commission should require a disclosure as to whether the person selling the variable contract is acting in the best interest of the investor. Among the criteria for determining whether the purchase of an annuity is in the best interest of the investor are if there are compelling benefits to purchase the variable contract and if such contracts complement the whole financial picture of the investor.

c. Purposes of the contract

AARP notes that the Commission's concept of explaining the purpose of the contract, as suggested, is not particularly helpful to an investor without some comparative information. For example, if the purpose of the contract is "to provide or supplement the investor's retirement income," the purpose should also state that other types of investments or products can achieve the same result.

d. Revocation rights should be highlighted.

AARP agrees with the Commission that many investors may not be familiar with the "free look" period. This is one of the most crucial rights under variable contracts. AARP submits that investors should receive a single page – with no other information on it – informing them, if applicable, of state insurance law that provides for a "free look," the amount of time they have to retract their investment decision and the date upon which the clock starts ticking. The disclosure should alert investors of its existence and explain where they may obtain additional information about their rights and obligations, and this disclosure should be larger font size, bolded, and boxed so investors are drawn to read it. Given the complexity and sophistication of variable contract investments, older investors, after consultation with their financial advisers, accountants, or family members, may decide that the long surrender periods and higher fees may not make sense as an investment choice for them. The "free look" period may be the only time the investor may cancel the contract without paying significant surrender fees or tax penalties.

respondents believed that insurance agents already had a duty to make recommendations based on the clients' best interests).

e. Risks

AARP agrees with the Commission's listing of risks that are possible when purchasing a variable contract. We submit that disclosures should clearly state that the variable annuity places most, if not all, the investment risk on the investor, with minimal amounts on the issuer. Disclosures should state that consequently investors may not earn any money by investing in variable contracts, and indeed, depending on the contract, may lose their capital investment.²⁰ Finally, the Commission should include the fact that high fees increase the risk of losses.

f. Restrictions

If the contract permits the insurer to unilaterally amend any contract provision, disclosures should state that, and what are the investor's rights and obligations in those circumstances. More specifically, the disclosures should state whether the investor has any right to terminate the contract without penalty when unilateral changes are made.

- g. The Commission should require disclosures and methods so that investors can determine the total amount of fees and expenses they are paying, in addition to requiring that the issuer certify that the fees are reasonable.

Investors bear numerous ongoing fees, expenses, and other charges when investing in a variable contract, many of which are different than other types of investments.²¹ These fees and expenses include mortality and expense risk charges, administrative fees, fees for optional benefits selected by the investor, and underlying portfolio company fees and expenses. Variable life insurance contracts may also impose an additional insurance charge to cover the cost of the death benefit. Investors may also bear certain transaction-based charges, including surrender charges. Finally, many variable contracts also charge commission fees, separate and apart, from other fees and expenses.

Each fee and expense that all investors pay should be set forth in a chart with the percentage (if applicable) for the fee as well as the dollar amount for the actual amount

²⁰ While AARP does not have a problem conceptually to allow registrants to include the insurance company's financial strength rating(s) in the line-item regarding the claims-paying ability of the insurance company, we believe that the Commission should pick one rating company that all insurers use and also note that these ratings are made by for-profit companies and therefore may not be objective.

²¹ When the Commission references a 5% annual return, it is unclear whether that return is before or after fees and expenses. Any such reference in disclosures must explicitly state which it is; a 5% annual return with fees of 250 basis points is very different than a 5% annual return already accounting for fees.

of the investment.²² The percentage and dollar amounts should be tallied so investors can see how much they are paying. There should be an explicit disclosure (to mirror the disclosure in the appendix of underlying portfolio companies) that these fees do not include the fees and expenses of the underlying portfolio companies. The disclosure should state that to obtain the total amount of fees and expenses, the consumer must total the fees in this chart plus the fees for the underlying investments the investor chooses. An alternative to this would be to provide an interactive fee calculator so that the investor could calculate the total amount of fees that the investor would pay.

Surrender terms need to be clear and prominent, including penalties for early withdrawal or loans and tax consequences. The disclosure should state the date that is specific to that investor to notify the investor when he or she can access the annuity without penalty. This provision is especially important for older investors who may not realize the impact of the length of the surrender terms on their ability to access their contract for needs like large medical bills.²³ The disclosure should ensure that investors understand that variable annuities typically lack liquidity and can prevent them from using their monies due to prolonged surrender penalty periods.

AARP commends the Commission for its proposal for a summary disclosure for the underlying portfolio companies. We submit that a concise disclosure is needed. Because of the number of options for the underlying portfolio companies, even with the Commission's proposal, some investors will still find it difficult to understand key information due to the volume, format, and content of disclosures in the variable contract context.²⁴ AARP suggests that, similar to the DOL 401(k) fee disclosures, the summary disclosure for the underlying portfolio companies should include the following information in a chart form so that the investor can easily compare the different underlying investments: the name of the investment; the type of investment (e.g., stocks, bonds, real estate investment trusts, etc.); manner of investment (active verse passive); the investment objective; fees and expenses (as a percentage and dollar amount based on \$1) and the average annual total rate of return over one, five and ten years. There should be an explicit disclosure (to mirror the disclosure in the key

²² Although AARP agrees that raising the Example Amount from \$10,000 to \$100,000 is consistent with the variable contracts that are sold, investors want to know how much the investment is costing them.

²³ In April 2018, Fidelity estimated that "the average couple will need \$280,000 in today's dollars for medical expenses in retirement, excluding long-term care." Fidelity, *How to plan for rising health care costs* (Apr. 18, 2018), <https://www.fidelity.com/viewpoints/personal-finance/plan-for-rising-health-care-costs>.

²⁴ The Commission states that the "[v]ariable annuity contracts offer an average of 59 portfolio companies as investment options." Disclosure Regulation at n. 8. It is well known too many options lead to poor performance in 401(k) plans. See, e.g., Christopher Carosa, *How Many Investment Options Should 401k Plan Sponsors Offer?*, *FiduciaryNews.com* (Oct. 18, 2011), <http://fiduciarynews.com/2011/10/how-many-investment-options-should-401k-plan-sponsors-offer/> (reviewing studies on investment options in 401(k) plans which imply that less than ten options are preferred).

information section) that these fees do not include the fees and expenses for other charges of the variable contract. The disclosure should state that to obtain the total amount of fees and expenses, the investor must total the fees in this chart plus the fees for the underlying investments the investor chooses.

Finally, this disclosure should include a comparison of the fees and expenses for a balanced stock fund and term life insurance policy with the variable contract (assuming it has a death benefit). If retail investors can review such a comparison in a standardized format, they may make a more educated decision concerning the purchase of a variable contract, given their investment needs. This is especially true given that the large majority of investors in variable contracts have incomes under \$100,000. Disclosure Regulation at 302-03.

h. Tax consequences should be explained.

The disclosures should review the tax consequences of the purchase of a variable contract. The disclosures should clearly state that:

- purchasing an annuity in an IRA in order to defer income is unnecessary since the IRA already is tax-deferred;
- funding an annuity with tax-deferred dollars gives the investor no additional tax benefits since the variable contracts are not qualified retirement vehicles;²⁵
- funding an annuity with after-tax money provides that all future gains are tax-deferred, but any gains are taxed at a higher ordinary income tax rate than capital gains rates;²⁶
- any gains which are 100 percent taxable are distributed before the tax-free principal (annuities are generally taxed using LIFO);
- funding an annuity with after-tax dollars will defer investment income but may not result in paying lower taxes for numerous reasons including due to a significant Required Minimum Distribution from an IRA or 401(k) plan, an unforeseen rise in future tax rates; and/or paying higher ordinary income tax rates on all annuity gains (versus lower capital gains tax rates); and
- funding an annuity with after-tax dollars are disadvantageous if they are inherited by anyone but a spouse because the heir receives no step-up in basis on accounts with gain.²⁷

²⁵ If an investor is purchasing the variable annuity as part of his or her retirement plan, a reminder that all of the rules for tax qualified plans such as penalties for early withdrawals before age 59-1/2 and required minimum distributions still apply.

²⁶ Stocks owned directly qualify for a low federal rate (0% to 20%) on dividends and long-term capital gains. Stocks owned through an annuity get taxed at high "ordinary" rates.

²⁷ Assets held at death get "stepped up" in value. This means that if an investor places \$100,000 in stocks, then dies when the stocks are worth \$120,000, the \$20,000 gain is income-tax-free to both the

Such disclosures concerning tax consequences are important for investors so that they may review these investment choices as part of their retirement, tax or estate plans.

- i. The description of the death benefit should clarify that it is not the same as term life insurance.

The “insurance component” of a variable contract is misleading in terms of a lay person’s understanding of insurance. It is not insurance in the common sense of the word – that is, the protection of income in case of a breadwinner’s death. “Insurance” in variable annuities typically guarantees that investors will receive at least the amount initially invested into the annuity upon their death. Hence, the “insurance” only has value if the value of the investment has plunged dramatically versus the initial purchase amount. The disclosure should not refer to this death benefit as “insurance” or an additional benefit, but instead as a guarantee against loss. Requiring these products to be properly designated as a variable investment contract with a guarantee might be more accurate so that investors do not mistake these products for term life insurance.

- j. The consequences of taking loans or withdrawals should be explained.

Disclosures must include information about those contracts which permit the investor to access the cash value of their contracts by taking out loans and other withdrawals. That information may include whether surrender charges are applicable and if so the amount of the charge as well as the tax obligation the loan or withdrawal incurs. The disclosure should highlight that some contracts do not permit, or limit, withdrawals once annuitization begins. Finally, when an investor takes a loan or withdrawal, some contracts reduce the policy’s cash value and death benefit, and may require additional premium payments to keep the policy in force; disclosures should include this information.

- k. The grounds for, and consequences of, contract lapse should be specified.

Disclosures must clearly state the grounds for contract lapse. If late payment or non-payment is a ground, the disclosures should state if there is an ability to make up the payment. The disclosures should also explain what it means if the contract lapses, that is, the consequences to the investor if the contract lapses. Other investments generally do not generate a loss to the investor merely because the investor no longer continues to invest in a particular investment.

AARP submits that presenting this information in a summary, with the ability to obtain additional information as the investor so desires, will not only increase readability, but make it more likely that the information will actually be read. To that end, we do not

investor and his or her heirs. Conversely, the same stocks owned via an annuity will cause the heirs to pay \$20,000 of ordinary income and inherit these stocks at the same cost basis as the investor of \$100,000.

believe that the Commission should permit issuers to add whatever information they want; it will hinder standardization and the ability of investors to make an apples-to-apples comparison.

- I. The Commission should require the seller of the variable annuity contract and the retail investor sign a checklist.

AARP suggests that the Commission require that the seller of the variable annuity contract and the retail investor sign a checklist listing all of the disclosures required under the final regulation, including any required documents, fee summary, surrender and termination penalties, and right to request additional information. Such a checklist would ensure that retail investors know all of the disclosures to which they are entitled and prevent the seller from inadvertently failing to provide a disclosure.

3. If the Commission mandates the use of summary prospectuses, the effective date should be extended.

AARP understands that requiring the use of the summary prospectus will be a different way of doing business for the industry. And, we acknowledge that it took nearly eight years after the adoption of the mutual fund summary prospectus framework for 95 percent of industry to offer the fund summary prospectus. Consequently, AARP submits that the Commission should mandate the usage of the summary prospectuses, but there should be a rolling effective date based on the size of the company starting 24 months after the publication date of the regulation. For example, if the date of publication for the Disclosure Regulation is January 1, 2021, the first group would have to offer summary prospectuses on or before January 1, 2023.

C. The Use of The Updated Summary Prospectus Should Be Mandated, But Notifications Concerning Access to Additional Information Must Be Clearer.

If the Commission adopts AARP's suggestions to the initial summary prospectus proposal, similar changes to the proposal concerning updating the summary prospectus should be made for consistency. As previously stated, investors must know about changes to the contract, what their rights and obligations are under the contract, and if they have any options for rescinding the contract if changes are made that they feel are not in their best interest.²⁸ AARP reiterates its position that the Commission should require these summaries and establish the format and topics to be presented. The more standardization the Commission requires, the easier it will be for investors to compare

²⁸ The Commission should either require amendments to the statutory prospectus so that it is consistent with the updated summary prospectus or require language in the updated summary prospectus which permits the investor to sue upon the updated summary prospectus. Without these changes, investors lose protections.

products. AARP agrees with the Commission that an updated summary prospectus will be helpful to investors.

AARP notes that permitting the issuer to combine contracts in the updating summary prospectus will most likely confuse investors since there is no consistency between the initial and updated summary prospectus. AARP submits that, similar to the initial summary prospectus, the updating summary prospectus should only describe one contract.

D. The Commission’s “Access Equals Delivery” Approach, As Currently Conceived, Is Inadequate to Provide Investors Timely Access to Disclosures.

In its proposal, the Commission has adopted the “access equals delivery” approach to prospectus delivery. Although there is no doubt that this will lighten the disclosure burden on insurers,²⁹ the reality is that unless investors receive disclosures in hand, most do not review the disclosures. If the Commission believes that disclosures are crucial to retail investors’ decision-making process, then it needs to ensure that these investors not only have access to disclosures, but they actually receive them.

Under the Commission’s proposal, investors’ rights to access information as well as request information are buried under mountains of words. Investors must be notified of these rights separately so that they can make a decision whether they wish to take further action. If the Commission does not require a separate notification, at a minimum, the right to request additional information should be in a larger font size, bolded, and boxed.

AARP’s commends the Commission’s requirement that the variable contract initial and updated summary prospectus, statutory prospectus, and the contract’s Statement of Additional Information (SAI), be publicly accessible, free of charge, at a website address specified on or hyperlinked in the cover of the summary prospectus. See Dep’t of Labor, ERISA Advisory Council, *Successful Plan Communications for Various Population Segments* 12, 23 (2013), <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/about-us/erisa-advisory-council/2013-successful-plan-communications-for-various-population-segments.pdf>. The more opportunities, in different formats, that investors have to receive these disclosures, the more likely they are to review them. If the Commission wants investors to review these documents, they should not be incorporated by reference into the summary prospectuses.

²⁹ The proposed method to satisfy underlying fund prospectus delivery requirements could change the economics of existing participation and revenue sharing agreements between issuers and underlying portfolio companies. AARP agrees with the Commission’s proposal to require disclosure of revenue sharing on the registration form and notes that this area would be appropriate for inquiry at a hearing.

It seems reasonable to assume that investors would look to the insurer's website to find information about the product they were sold versus a third-party website; testing would confirm this. We strongly support archiving past contracts so that if there are questions about an investors' rights and obligations, they can find this information. We believe that the contracts should remain in archives until such time as there are no longer any contract-holders. AARP believes that the 90-day timeframe for the availability of online information seems too short, and suggests that a year would more helpful to investors. However, we note that if there is an archive requirement, the 90-day timeframe could make sense.

Any person who has access to the website should be able to permanently retain, through downloading or otherwise, free of charge, an electronic version of such documents, especially inasmuch as there is no cost to the issuer. The Commission should require that downloaded documents retain links that enable a user to move readily between related passages of multiple documents; without the links, the contracts do not provide complete information to the investors. The Commission also should require that all required on-line documents be in formats that are human-readable and convenient for reading and printing. Moreover, when any document is available electronically, it should be formatted appropriately to engage readability; the Commission should conduct a survey of investors to determine what devices they may use to read these documents.

AARP commends the Commission for its requirement that investors accessing the summary prospectus should be able to view the definition of special terms upon command; we suggest that this requirement be expanded to all definitions which will greatly improve the readability of this complex and lengthy document.

AARP does not object to the Commission's response rule of three business days after receipt of the request, by first-class mail or other means designed to ensure equally prompt delivery. Compliance with this requirement should be made a condition to reliance on the proposed rule. However, given the complexity of this investment, it is imperative that retail investors should receive all of the requested information the earlier of "the time of the "carrying or delivery" of the contract or 10 days in advance of the effective date of the contract so that they have adequate time to make an educated choice concerning the investment and have sufficient time to rescind the contract before the end of the free look period. See SEC 2012 Financial Literacy Study, *supra* note 38, at v-xix ("The key information that investors found useful and relevant before purchasing an investment product . . .") (emphasis added).

E. Reliance on The Great-West Line of No-Action Letters for Discontinued Contracts.

In addition to the Commission's requirements concerning disclosures for Discontinued contracts, AARP submits that investors be provided with information as to how to find additional concerning changes to these contracts and the positive and negative consequences of converting to a different product. AARP appreciates the dichotomy that the Commission has drawn between those insurers which rely on the Great-West line of no-action letters and insurers which do not.

F. Paper Disclosure Should Be the Default Delivery Method.

AARP urges the Commission to require funds to deliver a paper copy of their prospectuses or summary prospectuses unless the retail investor has affirmatively chosen to receive these documents electronically. Retail investors need access to this information in order to optimize their decision-making. Retail investors should always timely receive key information about their funds and benefits, including annual summaries of earned benefits, summary of plan terms and conditions, notice of changes, and explanation of fees in the form they want. Industry studies have found that individuals understand and retain financial information better on paper than in electronic form.³⁰ Developing research has also found that electronic delivery encourages individuals to make immediate decisions that often are not in their financial interest.³¹ The Commission should review the effects that its recent regulatory mandates related to electronic communication have had on consumer receipt and understanding of required financial information. Whatever future actions the Commission takes to enhance fund disclosures must be centrally focused on improving retail investors' ability to make investment decisions more efficiently rather than simply reducing issuer compliance costs.

In 2012, AARP commissioned a national survey of over 1000 retirement plan participants and found an overwhelming preference for receiving retirement documents in paper format rather than in electronic, with 66 percent of respondents ages 25 - 49 and 84 percent of those 50 plus preferring paper document delivery. This is not surprising given the complexity of the information to be reviewed. Similarly, Epsilon's 2012 Channel Preferences Survey found that paper mail was the top delivery choice and 73 percent of respondents stated that they do not open all emails.

³⁰ TIAA Institute, Financial Communications and Asset Allocation Decisions: The Effects of Reading Style, Financial Knowledge, and Individual Differences (June 2017).

³¹ TIAA Institute, Millennial Financial Literacy and Fin-tech Use: Who Knows What in the Digital Era (Sept. 2018).

In addition, millions of individuals simply do not use computers or do not have reliable broadband access. As of 2017, the Pew Research Center found that a third of individuals age 65 and older do not use the internet, only half have broadband at home, and only approximately 40 percent own a smartphone. Among all adults, a third do not have high-speed internet at home and 13 percent only own a smartphone. Disadvantaged populations have even less access – approximately only half of rural Americans, African Americans, and Americans with a high school degree or less have broadband internet at home.

With such discrepancies in access, it is crucial that important material be distributed in paper form and that electronic disclosure not become the default method of delivery. AARP supports default paper delivery of disclosures and supports the availability of electronic disclosures only when a participant chooses to opt into it. Default paper delivery with an option to receive electronic disclosures is consistent with consumer preferences, internet and broadband availability, and cognitive research.

G. Retail Investors Should Be Provided Adequate Time to Carefully Examine and Question the Material Disclosed.

Of particular importance to AARP is when the fund disclosures are delivered to the retail investor – consumers should be able to easily and reliably obtain timely information at least 10 days in advance of any investment decision or contract purchase. Ten days will also give retail investors sufficient time to request additional information as proposed. See section D, *infra*. When a retail investor fails to receive accurate and complete material regarding their accounts, or prospective accounts, then they are seriously disadvantaged and unable to make informed decisions about their financial security. Given the importance of these forms and potential actions by retail investors, the timing and method by which they receive information is significant. Investors should have clear and reasonable opportunities to review and discuss the fund disclosures with their financial advisor or portfolio manager. Information such as investment objectives, fees and expenses, strategies, risks, and performance are essential components that should be communicated to retail investors in advance of investing or purchasing fund shares. If documents are delivered electronically, it is essential that access to the documents remain available – sometimes indefinitely – since retail investors may need to reference them at a later date. The Commission should reexamine its document retention requirements to ensure that consumers will retain full access to all needed disclosures and materials.

II. CONCLUSION

AARP appreciates the opportunity to share its views on these regulations and we commend the Commission for its commitment to improving investor protections by enhancing disclosure requirements. We believe that the Commission should hold a hearing to provide it with the opportunity to gather further insights into this proposal. We look forward to working with you and your colleagues to ensure the Commission can develop meaningful improvements to variable contract disclosures. If you have any questions, please feel free to contact me or Jasmine Vasquez of our Government Affairs office at [REDACTED] or at [REDACTED].

Sincerely,



David Certner
Legislative Counsel and Legislative Policy Director

cc: Commissioner Robert J. Jackson, Jr.
Commissioner Hester M. Peirce
Commissioner Elad L. Roisman