Elizabeth Goldman, *Director*
Clinical Professor of Law
Securities Arbitration Clinic

[redacted]
Fax [redacted]
E-mail [redacted]

March 14, 2019

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-23-18

Dear Mr. Fields,

We submit this letter in response to the proposed Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts.

Why We are Commenting:

As members of the Securities Arbitration Clinic at the Benjamin N. Cardozo School of Law ("The Cardozo Clinic"), we write as advocates of small retail investors. We are a law school clinic staffed by students. Our clients are low and middle-income people with little or no assets beyond small investment portfolios or retirement accounts. We represent our clients on a pro bono basis on matters involving fraud, unsuitability, breach of contract . . . The majority of our clients are elderly and wholly unsophisticated in securities matters. In every year since the Cardozo Clinic was founded (in 2004), we have had clients who were sold unsuitable variable annuity products. These clients, most of whom were in their 70s or early 80s at the time of investment, were convinced by their brokers to invest the majority of their retirement funds and/or savings into variable annuity contracts. Many were frail and ill at the time of their investment and were more likely to need cash or at least liquidity in the short term than income in the long term. In all cases, it was virtually impossible for our clients to ever make a profit on their investments if they were annuitized and in all cases our clients sold their contracts at a loss.

Variable annuity products are among the most complex products that can be sold to unsophisticated, unaccredited investors. We have run the variable annuity contracts that our clients have purchased through the Flesch-Kincaid Index and other reading level assessment programs and have routinely found that these contracts are written in language that requires an advanced degree or at least a college level of comprehension. They all greatly exceed the difficulty of the language used in periodicals such as the *New York Times* and many advanced educational materials. Many of our clients suffer from mild cognitive impairment, early-stage dementia, and/or have limited educations and, for a number of them, English is not their native language. Having a simpler explanation of the variable annuity contract and fees associated may help investors with less sophistication better understand what they may be buying and the costs and consequences of doing so. We thank the Commission for making an effort to provide such an explanation.

As an example of the consequences when someone is unable to understand an annuity contract, one of our 74-year-old clients was advised to purchase a variable annuity contract with two riders. The first rider was sold to her as guaranteeing a 7% return. Our client had no previous investment history and did not understand the variable annuity product, much less the riders. Her broker told her that she could not take her money out for four years, but that during that four year period she would earn a guaranteed 7% annual return on her original investment. She was told that at the end of the four-year period she could take out the full amount of her original investment *together* with the 7% annualized return for that period. Trusting her broker, she invested virtually all of her retirement account into this product. She paid a hefty commission of several thousand dollars, over 3% in annual fees, and was subject to substantial surrender charges in the first four years of the investment. She later found out that the 7%, which she thought was a guarantee, could *never* be taken out in a lump sum. Once the contract annuitized, the payments for that annuity would be based on her original investment together with the 7% annualized return *if* that number exceeded the subaccount investment value (income "benefit" base). However, that base of funds would only provide a return if our client lived long enough to receive annuity payments sufficient to repay her in an amount equal to her principal and beyond. Considering that her annuity contract was scheduled to annuitize after a 14-year period, which coincided directly with the end of her life expectancy, it was almost impossible for that to happen. Since the annuity payout only amounted to 6% of the total income "benefit" base amount each year, given the time value of money, our client would have to live to be more than 100 years old in order to make back just the value of her original investment. Unfortunately, this is not an uncommon result for elderly investors due to the small annual payout percentage of the contract value after the annuitization period and the hefty fees and costs that are taken out of the subaccount investments during the accumulation phase.

Our client was also sold an "enhanced death benefit" rider. This rider allowed her much older spouse (whose life expectancy, according to actuary tables, was expected to end eight years before her own) to recover the standard death benefit, but had her paying for an additional feature that was highly unlikely to occur. The 'enhanced' death benefit provided the option to recover the greatest Contract Anniversary value prior to the deceased annuitant's 86th birthday. However, for this to occur our client (1) would have to die prior to annuitization; (2) would have to die prior to her much older husband; (3) would have had to suffer a significant loss in her the contract value near the time of her death; (4) and the contract value would have had to been greater on the specific anniversary date in a prior year. In reality, the fee for this rider likely nullified any possibility of gain.

Variable annuity products are among the highest commission products and have some of the highest fees of any products typically sold to small retail investors. The Cardozo Clinic agrees that a summary prospectus that is clear about how much an investor will pay in commissions, fees, and other charges may help inform otherwise unsuspecting investors of the high costs and risks of loss associated with these products, and might help them identify when such products are wholly unsuitable for them. But we believe that the Commission should also require variable annuity products to be accompanied by a clear statement that variable annuity products are high commission, high fee products and that other lower commission and lower fee products may provide similar results and protections for less money, and we also believe that brokers should be required to recommend alternatives to their recommendation for any variable annuity contract.

In order for any proposed summary prospectus to be meaningful, moreover, it has to be understandable. The Summary Prospectus for New Investors ("Summary Prospectus") that the SEC has endeavored to put together requires too high a level of comprehension. It scored a grade level of 11.5 on the Flesch-Kincaid Index, which means that it would require a college level of comprehension to understand, a level of education that many retail investors do not have.

The experiences and insights of Ms. B., a person who sought the Clinic's advice about a variable annuity product she had just sold to mitigate her losses,[1] are instructive. Ms. B., who is 63 years old, had sold her variable annuity shortly before she came to us, incurring a $10,000 surrender charge. She was sophisticated enough to understand that the high fees and limited sub-account choices in her annuity cost her so much in dollar outlays and lost opportunities that it made no sense to keep the annuity. After receiving three quarterly statements and "doing the math," she was able to figure out that despite the $10,000 surrender charge and the losses she incurred in the sub-accounts, she was better off selling the annuity than keeping it. Ms. B., who has a college degree and has invested on her own in the market for over 30 years, felt that the Summary Prospectus proposed by the SEC might have given her a "better clue" of "just how bad this thing was." However, despite being far more sophisticated than most of our former clients who have invested in variable annuity products, she was still confused by the defined terms. In addition, and of particular importance, she felt strongly that there should be better disclosure about the financial incentives that brokers have to sell variable annuity products to clients, namely that the actual amount of commissions paid to the broker should be directly disclosed to the customer in each case where a customer is buying a variable annuity product. Accordingly, the Cardozo Clinic recommends that the Summary Prospectus include a specific disclosure regarding the actual commissions paid to the broker on the sale. While this may vary by firm, it is a critical piece of information and there should be some mandatory mechanism for this disclosure.

We were also able to poll ten of our former clients and one current client regarding the proposed language in the Commission's proposed Summary Prospectus. While the Cardozo Clinic acknowledges that this is a very small sample, we believe their comments about the proposal provide some insight. We were able to locate twelve of our former clients who had been convinced by brokers to purchase unsuitable variable annuities. Two were in full-time care facilities and were suffering from dementia, so they were unable to answer our questions. The other ten, who range in age from 66 to 94, answered our questions on the Summary Prospectus to the best of their ability. Eight of the ten former clients polled indicated that they were still confused about "all of it," but were especially confused about how fees were incurred, what the "separate account" was, how the death benefit worked, and how withdrawals impacted their investment. Two of the ten former clients thought that charts could be helpful, but were still confused by the definitions provided, the headings used in the charts that are designed to explain fees and expenses, and much of the terminology used. One of our current clients, for whom English is not her first language, was unable to comment on the Summary Prospectus at all. In short, our clients didn't understand the document.

While we laud the SEC for its efforts in putting together the Summary Prospectus, not only did our clients struggle mightily to even understand it – and none really did -- they are unlikely to read it. One of our client's primary language is Spanish, another's is Russian; even the clients who speak English as their native language are unlikely to read an 8-10 page prospectus. Most of the time, the brokers just tell them that "it's good" for them or that they are

[1] This individual did not meet the Clinic's income and asset limits to qualify for representation.

just "watching out" for them, and the clients, mystified by the complexity of it all and desperate for some help and guidance, rely on the broker's representations.

To that end, we believe that there should be an initial questionnaire that helps investors determine whether an annuity makes sense for them. The broker should have to lay out fees, costs, benefits, actuarial tables, etc. so that investors could make informed decisions about whether this might be a viable option for them. Essentially, this document should answer the question "Is this product right for me?" It should be in language that is as straightforward as possible and should be written at a level that most investors would understand. Financial terms and jargon should not be included in this document and polysyllabic words should be avoided.

We also recommend that any Summary Prospectus that is ultimately approved be provided to investors digitally as well as in hard copy, that the document should be text searchable, and that if the reader "clicks" on a defined term, the definition of the term should automatically be shown to the reader. Although most of our clients are not computer literate (and most do not own a computer at all), increasingly, people will likely own and use computers and this feature could therefore be helpful to investors.

With respect to the currently proposed Summary Prospectus, we recommend the following changes:

Special Terms

Because the Special Terms are the first thing people see, they are likely to read them more diligently. None of our clients thought the existing Special Terms chart was helpful. It seemed like the definitions used other defined terms to explain many of the terms. The clearer the terms, the less difficult it will be to read the rest of the document. Therefore, we propose the following changes be implemented in the SEC's proposed Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts.

The definition of "Accumulation Phase" includes the term "premium payments," which is an undefined term, yet is referenced throughout the Summary Prospectus. "Premium Payments" should be defined and clarified. A typical investor often invests only once in an annuity product as a lump sum, and might not understand what this term is referring to. The definition of "Premium Payments" should state that it includes (1) the original amount the client invested [in the variable annuity product], and (2) any additional investments [in the variable annuity product] if the contract allows for additional investments and the client chooses to make additional investments.

The terminology for the phases of the annuity is not used consistently throughout the Summary Prospectus. The Overview of the Variable Annuity Contract Section describes the two phases of the contract as: the accumulation (savings) phase and the payout (income) phase. The Special Terms Section, however, refers and defines these same two phases as the accumulation phase and the payout phase, respectively. Then, in subsequent sections, for example, on page 8 of the Summary Prospectus, annuity (income) phase is used to refer to what the Summary Prospectus calls payout phase. We recommend that instead of using multiple variations of the two phases, the Summary Prospectus define and then incorporate in all subsequent references the terms: "Savings" phase and "Income Payout" phase.

The definition of Contract Value is confusing. It uses multiple Special Terms, some of which are redundant. We believe that the Separate Account should be referred to as the

"Investment Account [during the Savings phase]" and that Portfolio Companies should be referred to as "Investment Choices" within the Investment Account, or some other more clearly understandable term.

The Contract Value should be defined as follows: "The Contract Value is the total value of your Investment Accounts during the Savings phase. The Contract Value could increase or decrease if you deposit money or withdraw money from your Investment Account. The Contract Value can also go up or down depending on market performance. Every year during the Savings Phase, money will be deducted from your Contract Value to pay your annual fees. Once a Contract becomes annuitized, you will be in the Income Payout phase and you may no longer withdraw money as you wish. The only payments you will be entitled to receive are your Annuity Income Payments." (Fixed Account should be explained separately, if it is an option, and if it is simply being used as the base for the annuity as of the date of annuitization, that should be explained clearly as well).

The definition of "Fixed Account" should be updated to indicate that this may be an option. Not all contracts have this option. It should also specifically indicate if this option would require a separate rider agreement and additional fees and whether or not it is available as a lump sum withdrawal at any point in time.

The definition of "Death Benefit" should include the statement: "The Death Benefit ends once the Income Payout phase (i.e., annuitization) begins. If you die at any time after the Income Payout phase begins, no more money will be paid out to anyone." Since the Death Benefit provides no protection to the investor if the investor dies after annuitization, it is necessary to provide that information upfront or else that term is misleading to a prospective investor. If there are co-annuitants, the death benefit for co-annuitants should be explained separately.

The definition of "Investment Options" references two other defined terms. None of our clients understood this definition. This term should describe what "Investment Options" are, namely, one of a number of choices you can make for the Investment Account during the Savings phase. It is imperative that the definition of "Investment Options" mention where, under the contract, each "Investment Option" has an extra fee associated with it.

The definition of "Optional Benefit" should list the optional benefits, by name, that an investor can elect to purchase to supplement her investment and should state clearly how much each of them would cost and what exact benefit each provides. The "Optional Benefit" should make clear that these are the riders that can be purchased. The contract riders therefore should be titled "Optional Benefit" contracts rather than "riders" so that investors know what they are buying.

The definition of "Separate Account" is confusing and implies that this account is not associated with the "Contract" or the "Contract Value," when in fact it is how the "Contract Value" is directly calculated. Therefore, this should be renamed. We recommend use of the term "Investment Account during the Savings phase" in general, and for sub-accounts, the term "individual investment choices for the Investment Account during the Savings phase." We believe that this would more logically reflect its connection to the annuity product's account value for the potential investor. Furthermore, the definition needs to include a statement that explains that the principal investment and each subsequent premium payment is invested into the "investments that you choose to include in your Investment Account during the Savings phase, and that the value of these investments increases or decreases based on the performance of the market.

Overview of the Variable Annuity Contract

Question 1, Page 1:

The answer should also include a statement that: "You should not invest in this Variable Annuity Contract if you may need to withdraw money early or often because that will likely result in significant losses and penalties."

Question 2, Page 1:

In the Accumulation Phase section of this question, a bullet should be added in bold stating: "You must choose one of the two options before the Income Payout Phase begins."

In the Income Payout Phase section of this question, the last paragraph should explain that "the annuitant will no longer be able to withdraw money from the Investment Account that existed during the Savings Phase and that she would instead be limited to a specific sum determined under the contract for the Income Payout phase. The last sentence should also use the term "Income Payout Phase," as opposed to annuitization, if the term "Income Payout Phase" is what will be used throughout the prospectus for consistency.

Question 3, Pages 1-2:

Death Benefit

For consistency throughout the Summary Prospectus the word "basic" in this section should be changed to "standard" or vice versa. The section should also include a sentence stating: "All standard\basic death benefits end once the income payout period (annuitization period) under the contract begins."

Optional Benefits Occur During Your Lifetime

The language of this section is misleading for two reasons. First, people may not realize the adverse impact that withdrawing money from the investment has on the value of optional benefit riders, unless it explicitly says so. Second, certain optional benefits, like the guaranteed lifetime withdrawal benefit, can only be elected during the Savings (accumulation) phase and that should be made clear as well.

Important Information You Should Consider About the Contract

Accessing Your Money

Variable annuities generally impose surrender charges on contract owners who withdraw from the Contract Value during the period of time prior to annuitization. For example, in one of our cases, the variable annuity contract imposed a surrender charge during the first four years following purchasing the contract: 7% during the first two years, followed by 6%, and then 5% during the fourth year. Although the fee percentage and the number of years that a client will be subject to this fee varies between contracts, these fees are substantial. The Sample

Prospectus does attempt to explain surrender charges but more attention should be drawn to these fees. Namely, we recommend that information about the surrender charges not be written as parentheticals in the answer to the question "What are the primary features and options that this contract offers?" The answer currently states that investors have "full access to [their] money" and mentions the surrender charges in parenthesis. Practically, "full access" comes at a substantial price. Thus, to ensure that investors do not gloss over what is a burden on their "full access," information about surrender charges should appear in the paragraph as equally important sentences, should be bolded, and should not be placed in parentheses.

Variable annuities use complex terms to refer to surrender charges. For example, in one of our cases, the surrender charge was referred to as "contingent deferred sales charge." The meaning of a term such as "contingent deferred sales charge" is not intuitive and is too complex for an average investor to understand. We believe the term "withdrawal fee" would provide more clarity to investors.

In line with our suggestion about simplifying and clarifying information on charges, fees, and expenses, we recommend that the font in the footnotes pertaining to the Fees and Expenses Chart be emphasized, to draw investors' attentions to this information. Additionally, it should be made clearer that some fees and expenses are incorporated into the price of the shares in the sub-accounts, while others are deducted on an annual basis.

The bottom portion of the Fees and Expenses provides a useful estimated range of the lowest to highest annual fees that a potential investor could expect to incur. These estimation charts would benefit from a title such as: "This chart shows the range of fees you will pay each year." This would provide an extra signal to a potential investor that her specific cost can fall anywhere within that range.

Risks

We believe the Conflict of Interest Portion of the Table should be separated from this table and be given a stand alone section directly following the "Risks" table and preceding the "Standard Death Benefit" section. It is extremely important that potential buyers see clearly that Brokers receive higher than average compensation for the sale of this product compared to the sale of other similarly performing products because of the disproportionately high commission rate associated with the product, and because brokerage and investment firms often share the revenue generated from the operation of the contract. It is also important to see the risk of unnecessarily induced exchanges by deceptive brokers who want to churn the commission on the products. As stated above, before investing, we believe that brokers should have to disclose the full commissions that the broker-dealer and the representative would receive if they are able to convince the investor to buy the product.

Additional Information About Fees

To improve the readability of this section, we recommend that the 'Front-End Load' fee line be deleted. We also recommend that the table of the surrender charges gives an example for a 100,000 investment and that the table scheduling fees do the same. Our clients were confused by the tables and the example that followed them and didn't understand the connection between them.

Including a Section on Stream of Income Calculation

We also believe that investors would benefit if the Sample Prospectus included examples to demonstrate to investors how to calculate their expected streams of income. While the current Sample Prospectus provides a thorough breakdown of the fees, our client cases have shown that variable annuities are frequently unsuitable for individuals not only because of the associated high fees but chiefly because the income that they expect to receive each period after annuitization is not a large enough percentage of the accumulated assets for them to profit. For example, a variable annuity with an income stream that is calculated as 5% of the accumulated assets each period may mean that an investor must live well past his or her life expectancy before starting to earn a profit. In some cases, for example, we calculated that our clients would not start earning a profit from these income streams until they were 103, 104, and 105 respectively. Until that age, our clients would, plainly speaking, be merely withdrawing their own original investment made years before. Providing examples to investors to help them calculate their projected income each period will allow investors to make an informed decision on whether these income streams are: (1) enough to supplement their savings at retirement and (2) begin at a point soon enough and are an in an amount large enough to yield a reasonable chance at ever making a profit.

We have seen heartbreaking consequences for our client population as a result of their purchases of Variable Annuity Products. We have been successful at settling such cases, but, our clients are in the minority because they are able to get representation. The average small retail investor who is invested in these products doesn't realize it was a bad investment for them until it is too late. The average small retail investor does not have the money to obtain representation, and often does not have the wherewithal to file their own claims. We thank the Commission for attempting to address this problem and hope that moving forward the Commission will be able to provide a workable solution to the unsuitable promotion and sale of this product to investors who are never likely to get their original investment back, much less a profit.

Respectfully submitted,

Cardozo School of Law Securities Arbitration Clinic

Professor Elizabeth Goldman
Mariya Dekhtyar (student member)
Ethan Smith (student member)
Ilana Bier (student member)
Will Wong (student member)
Sari Bronner (student member) /s/
Trisha Aggarwal (student member) /s/
Matthew Rametta (student member)
Gladys Mozo (student member) /s/
Dih-Lin Wong (student member) /s/