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WHAT'S PUZZLING YOU . . . IS THE NATURE OF VARIABLE ANNUITY PROSPECTUSES[1]

RICHARD J. WIRTH*

INTRODUCTION

Legislators, regulators, and commentators have long held the notion that plain English would help create the informed consumer. And yet, despite these aspirations, we still find ourselves trying to save consumers from their seemingly uninformed decisions.

Jargon, legalese, and boilerplate are well-known sources of confusion,[2] as well as the complexity of regulations themselves.[3] As

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1. *See* THE ROLLING STONES, *Sympathy for the Devil*, *on* BEGGARS BANQUET (London Records 1968) (including the lyrics "But what's puzzling you / Is the nature of my game").

2. *See generally* 1-4 APPLEMAN ON INSURANCE 2d § 4.3 (2009) (analysis of READABILITY standards used in regard to INSURANCE POLICIES); Ann Young Black, *State Insurance Developments on the Regulation of Annuity Disclosure*, 2009 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 85, 87-95 (analysis of state mandated annuity disclosures); Michelle E. Boardman, *Boilerplate Versus Contract: Contra Proferentum: The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105, 1106 (2006) (consideration of equitable principles applied to insurance contract boilerplate); Gary O. Cohen, *Disclosure Reform for Variable Insurance Products and Underlying Funds,* 2005 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 3, 6-13 (overview of current developments); W. Thomas Conner, *Disclosure Reform for Variable Products: The Promise of New Technologies,* 2006 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 3, 57 (overview of current developments); MARY JANE WILSON-BILIK ET AL., *The Challenge of Annuity Disclosure Reform: Summaries, Profiles and Buyers' Guide*, 2010 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 1, 3-36 (overview of variable annuity prospectus simplification initiatives); Richard J. Wirth & Erin Schwerzmann, *A Spell-Binding Short Story of a Summary: Underlying Fund Summary Prospectuses Bound with a Variable Product Prospectus*, 2009 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 709, 711-19 (analysis of plain English attempts involving mutual fund and variable annuity summary prospectuses).

3. In *Improving Government Regulations*, Exec. Order 12,044, 43 Fed. Reg. 12,661 (Mar. 23, 1978), President Carter ordered that "regulations shall be as simple and clear as possible," *id.*, that every significant regulation should be "written in plain English," *id.* at 12,662, be "understandable to those who must comply with it," *id.*, and that existing regulations should periodically be evaluated, in part, on the basis of

a result, we still don't seem to provide the type of information that consumers want and need to make an informed decision.[4]

The premise of this Article is that plain English and suitability are both intertwined and equally needed to accomplish informed decision-making. Informed decision-making demands that consumers have enough of an understanding of what's for sale and what trade-offs are being asked of them in order to make an informed decision about whether or not to buy a product.

Working knowledge must be effectively communicated through a communication vehicle—whether taking the form of perhaps a prospectus and/or a sales agent. However, when such communication is not tailored to be best understood by the intended audience, or is muddled, it's not surprising that consumers might be confused, misinformed, or ultimately unhappy with their purchase decisions.

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whether there is a "need to simplify or clarify [the] language" of the regulation. *Id.* at 12,663. For a history of attempts to write regulations using plain English, see Joanne Locke, *A History of Plain Language in the United States Government*, PLAINLANGUAGE.GOV (2004), http://www.plainlanguage.gov/whatisPL/history/locke.cfm. *See generally* RUDOLF FLESCH, HOW TO WRITE PLAIN ENGLISH: A BOOK FOR LAWYERS & CONSUMERS (1979) (overview of efforts to translate Federal Trade Commission regulations into plain English); Rosemary Moukad, *New York's Plain English Law*, 8 FORDHAM URB. L.J. 451, 456-58 (1979) (New York was the first state to adopt requirements for use of plain language in consumer transactions, see N.Y. GEN. OBLIG. LAW § 5-702).

On October 13, 2010, President Obama signed the Plain Writing Act of 2010, Pub. L. No. 111-274, 124 Stat. 2861. By October 13, 2011, federal agencies were required to use "plain writing" (i.e., clear, concise, well-organized, writing that avoids jargon, redundancy, ambiguity, and obscurity which is also appropriate to the subject or field and intended audience) in all communications other than regulations (excluding rulemaking "preambles"). *See id.* §§ 3(2)(c), 3(3) & 4(b). On July 11, 2011, the Securities and Exchange Commission released its plan for meeting the requirements of the Plain Writing Act. *See* U.S. SEC. & EXCH. COMM'N, REPORT ON IMPLEMENTING THE PLAIN WRITING ACT OF 2010 (Jul. 11, 2011), *available at* http://www.sec.gov/plainwriting/plainwritingplan.pdf. The report confirms the Commission's commitment to use plain writing in no-action letters, exemptive and interpretive orders, self-regulatory organization rule-filing notices and orders, compliance and investor alerts, comment letters, answers to frequently asked questions, press releases, published speeches and correspondence as well as the establishment of a dedicated plain writing webpage at http://www.sec.gov/plainwriting.shtml. *Id.*

4. Andrew J. Donohue, Dir., Div. of Inv. Mgmt., U.S. Sec. & Exchange Comm'n, Remarks Before the National Association of Variable Annuities 2006 Compliance and Regulatory Affairs Conference (Jun. 26, 2006) [hereinafter NAVA Speech] (transcript *available at* http://www.sec.gov/news/speech/2006/spch062606ajd.htm). *See generally* Plain English Disclosure, Securities Act Release No. 33-7497, 66 SEC Docket 777 (Jan. 28, 1998), *available at* http://www.sec.gov/rules/final/33-7497.txt (discussing plain English principles).

In the current environment, we don't know exactly who we are writing prospectuses for, nor do we really know the financial literacy of our intended audience. Moreover, communications seem to have gravitated toward design-based disclosure (how does this work) rather than solution-based disclosure (how does this solve my problem), adding further confusion.

Once we understand the financial literacy of our intended audience and who should teach them what they need to know, we should make it easier to convey the working knowledge needed to make informed decisions. Technology can help. For instance, the ability to hyperlink from one communication vehicle such as a summary prospectus to a "statutory" prospectus (that is the currently used long-form prospectus version) might help consumers better understand working knowledge such as what's for sale and what trade-offs are being asked of them.

The time is at hand to resolve these issues. Regulators will continue to feel compelled to add more market conduct restrictions and disclosure requirements based on incidences of senior financial abuse and problematic sales; all while consumers and their sales agents move to less complicated and less controversial financial alternatives.

This Article first discusses the challenge of writing effective variable annuity prospectus disclosures for an undefined audience. Second, this Article examines why a lack of uniformity in industry jargon hampers comprehension. Last, this Article proposes that the use of technology can improve consumer comprehension and thus improve informed decision-making.

I. Raise the Water or Lower the Bridge?

A. *What Level of Financial Literacy*[5] *Should We Aim For?*

A fundamental question facing authors trying to effectively communicate is how to gauge whether their message can be under-

5. U.S. Gov't Accountability Office, GAO-11-614, Financial Literacy: A Federal Certification Process for Providers Would Pose Challenges (2011) [hereinafter GAO Financial Literacy Report], *available at* http://www.gao.gov/new.items/d11614.pdf.

> Financial literacy has been defined as the ability to use knowledge and skills to manage financial resources effectively for a lifetime of financial well-being. To make sound financial decisions, individuals need to be equipped not only with a basic level of financial knowledge but also with the skills to apply that knowledge to financial decision making. Thus, financial literacy encompasses both financial education–the process of improving consumers' understanding

stood by their intended audience.[6] When it comes to variable annuities, however, it is unclear *who* the intended audience is and *how* financially astute they may be. This makes it very difficult for any author to effectively convey the requisite working knowledge and hampers effective decision-making and recommendations.

The audience reading a current prospectus may include prospective contract owners, existing contract owners, competitors, beneficiaries, analysts, industry experts, regulators, sales agents, plaintiffs' attorneys and judges. How can an author realistically be expected to communicate an understandable message to so many different audiences with such divergent literacy levels?

Let's assume *arguendo* that the end consumers (contract owners) are our intended audience. What can we expect about their ability to understand what we are communicating? As the following discussion reveals, we don't really know very much about what to expect based on various views and standards describing their presumed financial literacy.

1. The Average 8th Grader

Most state insurance regulators require that insurance contracts be written at or below an eighth grade reading level[7] based

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> of financial products, services, and concepts–as well as consumers' behavior as it relates to their ability to make informed judgments.

Id. at 3.

6. *See* FLESCH, *supra* note 3, at 4-9; OFFICE OF INVESTOR EDUCATION AND ASSISTANCE, U.S. SEC. & EXCH. COMM'N, A PLAIN ENGLISH HANDBOOK—HOW TO CREATE CLEAR SEC DISCLOSURE DOCUMENTS 9-10 (1999) [hereinafter SEC HANDBOOK], *available at* http://www.sec.gov/pdf/handbook.pdf; *see also id.* at 9 (suggesting that prospectus writers "create a profile of [their] investors or prospective investors based on the following questions: What are their demographics–age, level of education, and job experience? How familiar are they with investments and financial terminology? What investment concepts can you safely assume they understand? How will they read the document for the first time? Will they read it straight through or skip around to the sections that interest them? Will they read your document and your competitors' side by side? How will they use the document while they own the security? What information will they be looking for later, and is it easy to find?").

7. *See* LIFE & HEALTH INS. POLICY LANGUAGE SIMPLIFICATION MODEL ACT IV-575-1 § 5(A)(1) (Nat'l Ass'n of Ins. Comm'rs 2011) [hereinafter NAIC MODEL ACT 575-1]. NAIC Model Act 575-1 is not applicable to any contract which is subject to federal securities laws. *Id.* at § 4(A)(1). *See generally* David Rossmiller, *Plainly Ambiguous: Have Plain English Laws Made Insurance Policies Less Ambiguous?*, OR. ASS'N OF DEF. COUNS. 9, 11 (Spring 2008), *available at* http://slabbed.files.wordpress.com/2009/05/rossmiller-on-plain-english.pdf (introducing new contract language is risky because it wipes out previous precedent).

> The court and the insurer, then, are like chess players at a tournament, moving their pieces across the board, trying to understand the meaning of each other's

on the Flesch Reading Ease Score.[8] This formula measures the average sentence length of a document in words and the average word length in syllables.[9] Putting those two numbers into an equation gives a result showing how a text rates on a readability scale ranging from easy to virtually incomprehensible.[10]

While widely used, readability formulas may not be reliable assessment tools when applied to technical or business prose.[11] Reliability may also be questioned because this formula was developed in the 1940s by matching popular magazine articles meant for adult readers to the same test passages that had been used by children.[12]

Even if we accept the efficacy of readability scales, would a middle-schooler from the 1940s be an effective yardstick for measuring comprehension today? After all, we may not be as smart

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> moves in the context of chess theory. But in this scenario, the audience at the tournament—consumers—knows how to play checkers only. The consumers are neither part of the game nor does anyone really expect them to understand it or pay attention to it.

Id.

8. NAIC MODEL ACT 575-1, *supra* note 7, at § 5(C) and associated Drafting Note. *See generally* RUDOLPH FLESCH, THE ART OF READABLE WRITING 128-156 (1949) (describing the Flesch Reading Ease Score methodology); FLESCH, *supra* note 3. The Flesch-Kincaid Grade Level test updated and modified the Flesch Reading Ease Score. *See Flesch-Kincaid Readability Test – History*, SPIRITUS-TEMPORIS.COM, http://www.spiritus-temporis.com/flesch-kincaid-readability-test/history.html (last visited Apr. 15, 2012). The Flesch Reading Ease and the Flesch-Kincaid Grade Level tests are available to users of Microsoft Office Word software. *See Test Your Document's Readability*, MICROSOFT.COM, http://office.microsoft.com/en-us/word-help/test-your-document-s-readability-HP010148506.aspx (last visited Apr. 15, 2012).

9. NAIC MODEL ACT 575-1, *supra* note 7, at § 5(B); FLESCH, *supra* note 3, at 21; *see* Forrest E. Harding, *The Standard Automobile Insurance Policy: A Study of Its Readability*, 34 J. RISK & INS. 39, 40 (1967); Janice C. Redish & Jack Selzer, *The Place of Readability Formulas in Technical Communication*, 32 TECH. COMM. 46, 46 (1985).

10. *See* FLESCH, *supra* note 3, at 21 ("If [the material] is too hard to read for your audience, you shorten the words and sentences until you get the score you want."). Simply stated, Dr. Flesch recommends that you take the following steps to achieve plain English:

> Avoid gobbledygook and legalistic words;
> Use personal pronouns like "you" and "we";
> Write math concepts using everyday words;
> Avoid defined terms and cross references;
> Provide examples wherever needed to clarify;
> Get rid of double negatives; and
> Use tabulation to avoid shredding logic transitions.

See generally FLESCH, *supra* note 3*;* SEC HANDBOOK, *supra* note 6, at 17-35.

11. *See* Redish & Selzer, *supra* note 9, at 47.

12. *Id.* at 48; *see* FLESCH, *supra* note 3, at 21; SEC HANDBOOK, *supra* note 6, at 57.

today[13] and those children are now seniors who seem to have their own struggles with these types of financial products.

2. Little Old Lady[14]

Whether sweet or shrewd, a "silver tsunami"[15] of consumers will increasingly need or want retirement products over the coming years.[16] This phenomenon has garnered attention from regulators[17] and charlatans[18] alike.

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13. *See, e.g.*, Donald P. Hayes et al., SCHOOLBOOK SIMPLIFICATION AND ITS RELATION TO THE DECLINE IN SAT-VERBAL SCORES, 33 AM. ED. RES. J. 489, 498-508 (1996) (noting that eighth grade reading materials of today are no more difficult than the fifth grade texts of 1945 and today's twelfth grade English literature text has a lower reading difficulty level than seventh or eighth grade readers of the prewar era); IRWIN S. KIRSCH, ET AL., NAT'L CTR. FOR EDUC. STATISTICS, ADULT LITERACY IN AMERICA—A FIRST LOOK AT THE FINDINGS OF THE NATIONAL ADULT LITERACY SURVEY 30-32 (3d ed. Apr. 2002), *available at* http:/www.nces.ed.gov/pubs93/93275.pdf (stating that older adults are less literate than middle-aged or younger adults presumably due, in part, to the fewer years of schooling). *But see* INSURED RETIREMENT INSTITUTE, IRI FACT BOOK 71 (2011) [hereinafter FACT BOOK] (asserting that the typical affluent variable annuity owner has a college education).

14. *See* Joseph F. Coughlin & Lisa A. D'Ambrosio, *Seven Myths of Financial Planning and Baby Boomer Retirement*, 14 J. FIN. SERVICES MARKETING 84-85 (2009) (stating that baby boomer women are better educated, have significant influence in making financial decisions and are increasingly likely to seek financial planning advice); *see also* FACT BOOK, *supra* note 13, at 71, 87-88.

15. James Crabtree, *How Will We Cope With Living Longer?*, FIN. TIMES WEEKEND MAG., Jul. 23, 2011, at 13, 16.

16. The first American baby boomer retired in 2011 and "[f]or the next 19 years roughly 10,000 more will retire daily, doubling the population over 65 to 72 million, or one in five Americans, by 2030." *Id.* Baby boomers control roughly $13 trillion in household investable assets, or over 50 percent of total U.S. household investment assets, and nearly one in every six Americans will be 65 or older by the year 2020. U.S. SEC. & EXCH. COMM'N OFFICE OF COMPLIANCE INSPECTIONS & EXAMINATIONS ET AL., PROTECTING SENIOR INVESTORS: COMPLIANCE, SUPERVISORY AND OTHER PRACTICES USED BY FINANCIAL SERVICES FIRMS IN SERVING SENIOR INVESTORS 1 (Sept. 22, 2008) [hereinafter PROTECTING SENIOR INVESTORS], *available at* www.sec.gov/spotlight/seniors/seniorspracticesreport092208.pdf; *see also* FACT BOOK, *supra* note 13, at 6-8, 13-16.

17. *See, e.g.*, FIN. INDUS. REGULATORY AUTH., REGULATORY NOTICE 07-43 (2007), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p036816.pdf; MODEL REGULATION ON THE USE OF SENIOR-SPECIFIC CERTIFICATIONS & PROF'L DESIGNATIONS IN THE SALE OF LIFE INS. & ANNUITIES 278-1, (Nat'l Ass'n of Ins. Comm'rs 2008); Christopher Cox, Chairman, U.S. Sec. & Exchange Comm'n, Address to the AARP National Convention: Life at Fifty-Plus (Sept. 6, 2007). available at http://www.sec.gov/news/speech/2007/spch090607cc.htm; Press Release, N. Am. Sec. Adm'rs Ass'n, State Securities Cops: Senior Investors Facing a Perfect Storm for Investment Fraud (Sept. 4, 2003), *available at* http://www.nasaa.org/7975/state-securities-cops-senior-investors-facing-a-perfect-storm-for-investment-fraud/; *see also* Shanda Patterson-Strachan, *Recent Developments in Annuity Enforcement Actions and Litigation*, 2007 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 667, 681-

Gerontology studies involving informed consent[19] in health management provide useful parallels, if not comparable insights, for wealth management. Applying some of these findings, seniors may have special challenges in understanding working knowledge such as: (a) diminished capacity to comprehend risk/consequence paradigms (most accentuated among the elderly);[20] (b) poor eye sight[21]

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82 (noting efforts directed to abuses against seniors). *See generally* Randall Doctor, *Significant Current Issues in State Insurance Regulation of Variable Products*, 2005 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 319, 323-25; Clifford E. Kirsch, *Practical Considerations Regarding Supervision of Annuity Sales*, 2007 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 563 (giving an overview of regulatory involvement in the sale of variable annuities). Commission examiners conduct special risk-focused examinations that may involve several firms reviewing the same focused risk area to determine if a compliance problem may be widespread or to identify trends in the securities industry. For example, some recent so-called sweep examinations have evaluated securities firms providing "free lunch" sales seminars to senior investors. U.S. SEC. & EXCH. COMM'N, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS AS REQUIRED BY SECTION 913 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (Jan. 21, 2011) [hereinafter SECTION 913 STUDY], *available at* http://www.sec.gov/news/studies/2011/913studyfinal.pdf; *see* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913, 124 Stat. 1376, 1824-30 (2010).

18. *See supra* text accompanying note 17; *see, e.g.*, ARIZ. ELDER ABUSE COAL., FINANCIAL EXPLOITATION OF THE ELDERLY–HOW FINANCIAL INSTITUTIONS CAN HELP (Mar. 2007), *available at* www.azag.gov/seniors/FinancialExploitationoftheElderly.pdf; *see also* Luis A. Aguilar, Commissioner, U.S. Sec. & Exchange Comm'n, Why Seniors Are More Vulnerable Now As Targets for Financial Abuse, Speech to the American Retirement Summit (March 15, 2012), *available at* http://www.sec.gov/news/speech/2012/spch031512laa.htm.

19. *See, e.g.*, Mayumi Mori, et al., *Understanding of Informed Consent by Elderly Patients*, 34 JAPANESE J. GERIATRICS 789 (1997) (noting the low comprehension of diagnosis and clinical condition of patients over age 60); Gerrie Schipske, *Understanding Informed Consent*, 10 ADVANCE FOR NURSE PRACTITIONERS, no. 8, 24 (2002), *available at* http://nurse-practitioners-and-physician-assistants.advanceweb.com/Article/Understanding-Informed-Consent.aspx, (explaining that even when properly understood, informed consent presents an array of ongoing problems and unanswered questions including how much information must be given to research subjects, and how much is too much; and how to ensure the full voluntariness of subjects' consent); Barbara Stanley, et al., *The Elderly Patient and Informed Consent*, 252 JAMA 1302, 1306 (1984) (elderly patients show significantly poorer comprehension of consent information and merit competency screening and special instructions); Rodney J. Vessels, *Protecting Aunt Alice–2008 State Developments in the Regulation of Annuity Sales in the Senior Marketplace,* 2008 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 343, 347–48 (giving an analysis of state mandated annuity disclosures to seniors).

20. *See, e.g.*, PROTECTING SENIOR INVESTORS, *supra* note 16, at 2-7, 20-22 (Sept. 22, 2008) (*as amended and updated by* U.S. SEC. & EXCH. COMM'N OFFICE OF COMPLIANCE INSPECTIONS & EXAMINATIONS ET AL., PROTECTING SENIOR INVESTORS: COMPLIANCE, SUPERVISORY AND OTHER PRACTICES USED BY FINANCIAL SERVICES FIRMS IN SERVING SENIOR INVESTORS - 2010 ADDENDUM, (Aug. 10, 2010), *available at* www.sec.gov/spotlight/seniors/seniorspracticesreport081210.pdf); AARP & THE FIN. PLANNING ASS'N, A FINANCIAL PROFESSIONAL'S GUIDE TO WORKING WITH OLDER CLIENTS, 26-

to read fine print or follow cross-references, and (c) diminished mental and physical capacity to effectively exercise contract elections and carry out contract formalities particularly over later life stages.[22]

Despite its appeal, a life stage based approach to disclosure could raise significant practical issues. For instance, tailoring disclosures based on the age-based capacity of each consumer would require multidimensional functional assessments. Even though prospectuses are sometimes translated into different languages in order to best communicate to particular consumer audiences, it would be hard to overcome the practical challenges associated with offering different prospectus versions based on whether the consumer was a member of the Greatest, Silent, Baby Boomer, or X generations. Therefore, one more realistic approach might be to address these life stage factors on a more generalized basis across a wide spectrum of older consumers.

3. Each Individual Reader

In many respects, generalizations about consumers (in other words, the so-called average consumer) are largely irrelevant if comprehension is to be measured on an individual-by-individual basis. Support for an individual-centric view can be found in the application of equitable remedies used to redress harm to a *particular* victim.[23] For instance, the cannon of *contra proferentum* is meant to give insurance companies an incentive to draft clearly by finding

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27 (2008) [hereinafter AARP/FPA GUIDE], *available at* http://assets.aarp.org/www.aarp.org_/articles/money/financial_planning/financial_professional.pdf; A.B.A. COMM'N ON LAW & AGING & AM. PSYCHOLOGICAL ASS'N, ASSESSMENT OF OLDER ADULTS WITH DIMINISHED CAPACITY: A HANDBOOK FOR PSYCHOLOGISTS, 38-47, 72-81. 114-121 (2008), *available at* www.apa.org/pi/aging/capacity_psychologist_handbook.pdf; Charles P. Sabatino, *Representing a Client with Diminished Capacity: How Do You Know It* And *What Do You Do About It?*, 16 J. AM. ACAD. MATRIMONIAL LAW. 481, 497-98 (2000); FIN. INDUS. REGULATORY AUTH., *supra* note 17.

21. *See* AARP/FPA GUIDE, *supra* note 20, at 30-31 (noting that drafters are encouraged to use large and clear print (i.e., at least 12-14 point Arial or Verdana fonts), contrasting colors, bullets, headlines and white space).

22. *See supra* note 19; *see also* Aguilar, *supra* note 18. *See generally* Engelman v. Conn. Gen. Life Ins. Co., 690 A.2d 882 (Conn. 1997) (applying the substantial compliance equitable doctrine with respect to beneficiary changes).

23. For instance, the "you take your victim as you find them" legal maxim (sometimes also called the "thin" or "eggshell" skull rule) generally holds a tortfeasor strictly liable for all consequences flowing from their actions regardless of whether the victim had any pre-existing vulnerability to injury. *See, e.g.*, WILLIAM LLOYD PROSSER, HANDBOOK OF THE LAW OF TORTS 261 (4th ed. 1971).

contract coverage through construing ambiguous language against the insurance company.[24]

Another source of support for writing in a way that every reader can understand comes from Dr. Flesch, an early and renowned proponent of plain English, as highlighted by the following directive:

> Next time you write for consumers, think of Mrs. Williams–poor, semiliterate and not very bright. Do I hear you say that Mrs. Williams is not typical? Of course she isn't, but that's exactly my point. In writing your Plain English piece, *don't* aim at the typical, "average" consumer. That would leave out 50 percent of your readers, those below the average in education, IQ, reading skill or business experience. They need Plain English most. Write for *them*.[25]

This approach creates several communication challenges. First, writing for every potential consumer at their specific financial literacy level might effectively force drafters to grossly oversimplify for the benefit of the least literate.[26] Second, precedent shows that judges will still insinuate themselves as interpreters and arbiters thereby leaving drafters with greater uncertainty whether their terms and conditions will ultimately be enforced.[27]

In this section, we have seen that prospectuses are read by a diverse array of audiences each with their own unique ability to comprehend working knowledge. We will continue to struggle to drive toward informed decision-making without further guidance about who our intended audience is and their expected financial literacy.

B. *How Much Does a Reader Really Need to Know?*

Have we placed too much importance on prospectuses to communicate working knowledge? In other words, is there so much design detail in prospectuses that readers have given up trying to

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24. *See, e.g.*, Vargas v. Ins. Co. of N. Am., 651 F.2d 838, 839-40 (2d Cir. 1981); Storms v. U.S. Fidelity and Guaranty Co., 388 A.2d 578, 580 (N.H. 1978); Boardman, *supra* note 2, at 1108.

25. FLESCH, *supra* note 3, at 9; *see* SEC HANDBOOK, *supra* note 6, at 10 ("[K]eep in mind that your least sophisticated investors have the greatest need for a disclosure document they can understand.").

26. *See* SEC HANDBOOK, *supra* note 6, at 10 ("While your audience will include analysts and other industry experts, you may want to keep in mind that your least sophisticated investors have the greatest need for a disclosure document they can understand.").

27. *See supra* note 24.

use them to make buying decisions? Recognizing that variable annuities are most usually sold with the assistance of a sales agent, can the industry and its regulators take any comfort that working knowledge is actually being effectively communicated to consumers through sales agents rather than prospectuses? Moreover, in a world where so much working knowledge is available through the Internet, may we now make some assumptions that consumers have the resources to do their homework before making their buying decision? If these points are valid, could that mean that today's prospectus has become largely irrelevant to informed decision-making?

1. Keep Your Prospectus in Your Glove Compartment

How much information about how a product works does a consumer realistically need to know in order to make an informed decision? Consider the following excerpt from a driver's manual:

> With the shift lever in "D" position, you can select the Sequential SportShift Mode to shift gears much like a manual transmission, but without a clutch pedal. . . . In Sequential SportShift mode, each time you push forward on the shift lever, the transmission shifts to a higher gear. . . . When you accelerate away from a stop, the transmission will start in first gear and then automatically upshift to second gear. You have to manually upshift between second and fifth gears. Make sure you upshift before the engine speed reaches the tachometer's red zone. The transmission remains in the selected gear (5, 4, 3). There is no automatic downshift when you push the accelerator pedal to the floor.[28]

How many of us really need to know these design intricacies in order to effectively drive our cars? In other words, don't most of us just want to know that if we simply move the gear shift to the letter "D," then we can move to where we want to go? Admittedly, some infovores may be enthralled by how the alternator interfaces with the gear shift differential to signal the drive shaft how to accelerate. For those folks, the driver's manual is right there in the glove compartment for their perusal.

Maybe then we should view a variable annuity as being like a vehicle to get you to a destination and a prospectus as being like your driver's manual—you did not make your buying decision because of the manual, but it may be comforting to know it is in the glove compartment if you have questions. But suppose instead that there were other ways to describe how your variable annuity got

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28. 2004 ACURA TL OWNER'S MANUAL 183 (Honda Motor Co. 2003).

you from here to there. Instead of elaborating on the mechanics of how a variable annuity works, perhaps prospectuses (and most certainly summary prospectuses) could describe how a variable annuity offers a solution such as providing some level of affordable financial comfort following cessation of the consumer's current working career.[29] In this sense, layered disclosure linking a summary prospectus to a statutory prospectus could provide a virtual bridge from solutions-based disclosures to design-based disclosures. As discussed below, the ability to navigate from solutions to mechanics holds much promise for demystifying these products for consumers and in some instances, the sales agents that sell them.

2. The Role of Sales Agents

As the old adage goes, insurance is a product that is sold and not bought. As such, a sales agent, whether made of flesh or transistors, interacts with consumers to *sell* a product. To do this, a sales agent must *first* make an informed decision whether or not to recommend a particular product to their client by educating themselves about product benefits and risks and *then* he or she must educate their client (i.e. the consumer) about such benefits and risks in order to fulfill suitability obligations to that client.[30]

Consumers may also be using the Internet more and more to educate themselves before making financial decisions.[31] Accordingly, sales agents must be better trained to successfully withstand

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29. *See* JOSEPH F. COUGHLIN, RETIRING RETIREMENT—HOW THE CONSUMER'S JOB OF LIVING LONGER WILL DRIVE ENGAGEMENT AND INNOVATION IN FINANCIAL SERVICES, 1 (Mass. Institute of Tech. AgeLab & The Hartford Fin. Servs. Grp. 2010), *available at* http://www.cusonet.com/sales/assets/021/33309.pdf ("Retirement, as defined today, should be retired. The industry must rethink how it can align its product, practice management, and technology strategies with what is realistic, relevant, and responsive to the baby boomer[s'] 'jobs' of longevity—not retirement.").

30. *See generally* FINRA Rule 2330(b)(1)(A)(i) (2011), *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=8824 (consumer must be informed, "in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty if consumers sell or redeem deferred variable annuities before reaching the age of 59½; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the insurance and investment components of deferred variable annuities; and market risk"); SUITABILITY IN ANNUITY TRANSACTIONS MODEL REGULATION 275-1 § 6(A)(1) (Nat'l Ass'n of Ins. Comm'rs 2010) [hereinafter MODEL REGULATION 275-1] ("The consumer has been reasonably informed of various features of the annuity, such as the potential surrender period and surrender charge, potential tax penalty if the consumer sells, exchanges, surrenders or annuitizes the annuity, mortality and expense fees, investment advisory fees, potential charges for and features of riders, limitations on interest returns, insurance and investment components and market risk.").

31. *See infra* note 78.

the challenges of validating or refuting a tech savvy consumer's (or those of their circle of trust) preconceived understandings about a product's benefits and risks.[32]

C. *Who then is the Ultimate Consumer Educator?*

One might view product issuers as being primarily responsible for teaching consumers about product benefits and risks through communication vehicles such as a prospectus and sales literature. However, sales agents and regulators may, at varying times, assume pivotal roles as consumer educators. Unfortunately, each member of this triumvirate may sometimes seem to be working with different lesson plans.

1. Train the Trainers

Considering how many sales are completed while sitting around the proverbial kitchen table, you might assume that sales agents are best positioned to act as lead educators. In fact, the importance of training sales agents has been supported by the National Association of Insurance Commissioners (NAIC) and the Financial Industry Regulatory Authority (FINRA).

The NAIC Suitability in Annuity Transactions Model Regulation fosters consumer education about basic features of annuity contracts.[33] Sales agents cannot ensure that their client has been reasonably informed unless they themselves have a sound understanding of the product being recommended. The model regulation requires product issuers to establish standards for product training as well as maintaining reasonable procedures to ensure compli-

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32. *See generally* Coughlin & D'Ambrosio, *supra* note 14, at 87-89 (explaining that financial advisors are necessary to decipher the "crush of available data and guidance" and "navigate longevity, not just financial security"); JOSEPH F. COUGHLIN & STEVEN PROULX, IN THE COMPANY OF STRANGERS: HOW CONSUMERS USE SOCIAL MEDIA TO EVALUATE FINANCIAL PLANNING AND ADVICE (Mass. Institute of Tech. AgeLab & The Hartford Fin. Servs. Grp. 2011) (studying how financial services consumers over age 45 frame their search for a financial advisor found that such prospective consumers use financial services websites, discussion boards and referrals from trusted spheres of influence to develop and test perceptions about planning, savings and investments); INSURED RET. INST., VARIABLE ANNUITY SUMMARY PROSPECTUS HIGH IN DEMAND BY CONSUMERS: AN EXAMINATION OF CONSUMER PREFERENCES, INDUSTRY PERSPECTIVES, AND IRI INITIATIVES 7 (June 2011) [hereinafter IRI SURVEY], *available at* http://www.irionline.org/pdfs/SP%20FINAL.pdf ("[Fifty-nine percent] of survey respondents indicated that they would be more likely to discuss [variable annuities] with their advisors if they were provided with a short summary prospectus written in clear, plain English.").

33. *See* MODEL REGULATION 275-1, *supra* note 30, at § 6(A).

ance.[34] As a result, sales agents cannot solicit the sale of a variable annuity unless they have completed both basic annuity training as well as each product issuer's training.[35]

FINRA has also recognized the importance of sales agent education in educating consumers. For instance, Conduct Rule 2330 (standards for purchases and exchanges of deferred variable annuities) complements the NAIC Suitability in Annuity Transactions Model Regulation in that it also requires that sales agents be trained on material features of deferred variable annuities.[36] Notice to Members 07-43 also shows FINRA's efforts to remind sales agents of their obligations to consider important factors such as diminished capacity and life stage when communicating with older consumers.[37]

This common theme of directly or indirectly educating the consumer about basic product features and risks can also be seen in many other state regulations.[38]

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34. *See id.* at § 7(B).

35. *See id.* at §§ 6(F)(1), 7(A). The requirements of Model Regulation 275-1 do not apply to sales made in compliance with FINRA suitability and supervisory requirements. *Id.* at § 6(H).

36. FINRA Rule 2330(b)(1)(A)(i) & (e) (2011), *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=8824.

37. FIN. INDUS. REGULATORY AUTH., *supra* note 17.

38. Many other regulations have an avowed objective to educate or derive indirect compliance through education. *See, e.g.*, ANNUITY DISCLOSURE MODEL REGULATION 245-1 § 1 (Nat'l Ass'n of Ins. Comm'rs 2010) [hereinafter MODEL REGULATION 245-1] (consumers must receive a disclosure document and Buyer's Guide at the time of solicitation). If proposed amendments to this regulation are adopted and implemented, sales agents would have to present a Buyer's Guide and disclosure document at the same time that they present any personalized product illustration. REVISIONS TO MODEL REGULATION 245-1 , AS ADOPTED BY THE LIFE INSURANCE AND ANNUITIES (A) COMMITTEE §6(C) (Aug. 3, 2011) (Draft dated Jul. 20, 2011) (source on file with author). If a sales agent is presenting illustrations when offering or even discussing a variable annuity, the agent must give the consumer a Buyer's Guide for annuities, a variable annuity prospectus and any FINRA approved personalized product illustration. *See id.* § 3(D); MODEL REGULATION OF THE USE OF SENIOR-SPECIFIC CERTIFICATIONS AND PROFESSIONAL DESIGNATIONS IN THE STATE OF LIFE INSURANCE AND ANNUITIES 278-1 § 1 (Nat'l Ass'n of Ins. Comm'rs 2010). Some regulations seek to educate the consumer through the mandated delivery of disclosures. *See, e.g.*, MODEL REGULATION 245-1, *supra*, at § 1 (disclosure document and Buyer's Guide); N.Y. Insurance Regulation No. 194 § 30.3, 11 N.Y. COMP. CODES R. & REGS tit. 11 § 30 (2011) (producer compensation and role disclosure); *see also* 15 U.S.C. § 78o(n)(1)-(2) (2011) (Where a broker or dealer sells only proprietary or other limited range of products, as determined by the Commission, the Commission may by rule require that such broker or dealer provide notice to each retail consumer and obtain the consent or acknowledgment of the consumer.).

2. Professor Regulator

As the quote below indicates, regulatory agencies have observed the growing need for improved financial literacy and have responded by developing various educational initiatives[39]:

> In the United States, a number of trends have emerged in recent years that underscore the importance of financial literacy. For example, . . . consumers are assuming greater responsibility for their own retirement savings, with traditional defined-benefit retirement plans becoming increasingly rare. Evidence suggests that many U.S. consumers could benefit from improved financial literacy. In a 2010 survey of U.S. consumers prepared for the National Foundation for Credit Counseling, a majority of consumers reported they did not have a budget, and about one-third were not saving for retirement. In a 2009 survey of U.S. consumers by the FINRA Investor Education Foundation, a majority believed themselves to be good at dealing with day-to-day financial matters, but the survey also revealed that many had engaged in financial behaviors that generated unnecessary expenses and fees and had difficulty with basic interest and other financial calculations.[40]

The Commission's Office of Investor Education and Advocacy (OIEA) has a robust outreach and education program that uses a multi-pronged approach to reach consumers.[41] This approach in-

39. GAO FINANCIAL LITERACY REPORT, *supra* note 5, at 3-9. In 2009, more than 20 federal agencies had initiatives related to improving financial literacy. The GAO identified 142 papers published since 2000 that addressed the value and effectiveness of financial literacy. *Id.*

40. *Id.* at 3.

> To lay the foundation for continued prosperity, we must expand the availability of financial products and services that are fair, affordable, understandable, and reliable. We must also strive to ensure all Americans have the skills to manage their fiscal resources effectively and avoid deceptive or predatory practices. . . . [O]ur Nation's prosperity will ultimately depend on our willingness as individuals to empower ourselves and our families with financial knowledge.

Id.; *see also* Proclamation No. 8493, 75 Fed. Reg. 17,847 (April 8, 2010) (Presidential Proclamation declaring National Financial Literacy Month).

41. SECTION 913 STUDY, *supra* note 17, at 128 n. 587; *see* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913, 124 Stat. 1376, 1824-30 (2010).

Regulatory efforts to study financial literacy and curb senior abuse have been coordinated with, and generally work in recognition of the actions of, the Consumer Financial Protection Bureau (CFPB) and the offices described below (even though these offices are more focused on consumer credit and not securities investing), whether through formal or informal inter-agency collaboration or as a result of joint participation on the Financial Literacy and Education Commission. *See* 20 U.S.C.

cludes targeting specific populations such as seniors.[42] The OIEA also regularly publishes investor alerts and bulletins to keep consumers informed about current issues that may affect them.[43] In 2010, these educational programs reached over 25,000 consumers in person through presentations and conference exhibits.[44] In addition, OIEA distributed approximately 330,000 publications and reached 10 million taxpayers through an IRS mailing.[45]

The Commission is also currently engaged in an assessment of financial literacy.[46] The study, expected to be reported to Congress in July 2012,[47] will consider ways to: (a) improve the timing, con-

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§ 9702(c)(1)(B) (2011). The Financial Literacy and Education Commission seeks to improve the financial literacy and education of consumers through development of a national strategy to promote financial literacy and education. *Id.* § 9702(b).

There are a number of parallels between the Commission's financial literacy goals and CFPB mandates.

First, Section 1013(d)(1) of the Dodd-Frank Act established a new Office of Financial Education within the Federal Reserve System's Consumer Financial Protection Bureau. Dodd-Frank Act § 1013(d)(1), 124 Stat. at 1970. This office is responsible for developing and implementing initiatives intended to educate and empower consumers to make better informed financial decisions. Dodd-Frank Act § 1013(d)(1), 124 Stat. at 1970. This office may coordinate its efforts with those of the Financial Literacy and Education Commission as a result of the participation of the Secretary of the Treasury on that commission. *See* 20 U.S.C. § 9702(c)(1)(A); *see also infra* note 51.

Second, the new Office of Financial Protection for Older Americans within the Consumer Financial Protection Bureau has responsibility for improving the financial literacy of individuals who have attained the age of 62 years or more (in this subsection, referred to as "seniors") on protection from unfair, deceptive, and abusive practices and on current and future financial choices, including through the dissemination of materials to seniors on such topics. Dodd-Frank Act § 1013(g)(1), 124 Stat. at 1973.

Third, the CFPB has, among other things, the authority to declare specific acts or practices to be unfair, deceptive, or abusive such as acts or practices that (1) materially interfere with the ability of a consumer to understand a term or condition of a consumer financial product or (2) takes unreasonable advantage of a lack of understanding on the part of the consumer concerning the material risks, cost, or conditions of the product or service. Dodd-Frank Act § 1031(d), 124 Stat. 2006.

Last, the CFPB also has the authority to prescribe rules to ensure that the features of any consumer financial product or service, both initially and over the term of the product or service, are fully, accurately, and effectively disclosed to consumers in a manner that permits them to understand the costs, benefits, and risks associated with the product or service in light of the facts and circumstances. In connection with this authority, the CFPB will also have the authority to issue model safe-harbor forms that employ comprehendible language, clear format and design, readable font, and succinct explanations. Dodd-Frank Act § 1032, 124 Stat. 2007; *see also infra* note 75 and accompanying text.

42. SECTION 913 STUDY, *supra* note 17, at 128 n.587.
43. *Id.*
44. *Id.*
45. *Id.*
46. Dodd-Frank Act § 917 (a)(1), 124 Stat. at 1836.
47. *See id.* § 917(b), 124 Stat. at 1836.

tent, and format of disclosures to consumers with respect to financial intermediaries, investment products, and investment services;[48] (b) increase the transparency of expenses and conflicts of interest in transactions involving investment services and products;[49] and (c) identify the most effective existing private and public efforts to educate consumers.[50] As part of this financial literacy study, the Commission will be conducting focus group testing to examine the effectiveness of certain mandated disclosure documents in communicating useful information to consumers.[51]

In summation, there are many ways that consumers are aided in their decision-making through better trained sales agents and publicly-available educational materials.[52] The Commission's study may provide better insights about what financial literacy levels we can expect from at least a retail mutual fund consumer audience; which may then indirectly lead to better disclosures and training. Hopefully, the Commission will work closely with offices within the

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48. *Id.* § 917(a)(2).

49. *Id.* § 917(a)(4).

50. *Id.* § 917(a)(5); *see also* Comment Request on Existing Private and Public Efforts To Educate Investors, Exchange Act Release No. 34-64306, 76 Fed. Reg. 22,740 (Apr. 22, 2011).

51. Lori J. Schock, Dir., Office of Investor Educ. & Advocacy, U.S. Sec. & Exchange Comm'n, Remarks at InvestEd Investor Education Conference (May 15, 2011), *available at* http://www.sec.gov/news/speech/2011/spch051511ljs.htm. The Commission shall also work in consultation with the Financial Literacy and Education Commission to increase the financial literacy of investors in order to bring about a "positive" change in investor behavior. Dodd-Frank Act § 917(a)(6), 124 Stat. at 1836; *see also supra* note 41; *infra* note 75. On January 18, 2012, the Securities and Exchange Commission also requested comment on information that retail investors need to make informed financial decisions on hiring a financial intermediary or purchasing an investment product or service typically sold to retail investors, including mutual funds. Press Release, U.S. Sec. & Exchange Comm'n, SEC Seeks Public Comment for Financial Literacy Study Mandated by Dodd-Frank Act (Jan. 18, 2012) *available at* http://www.sec.gov/news/press/2012/2012-12.htm; *see also* Aguilar, *supra* note 18. The author contends that focus group testing using different variable annuity summary prospectus templates (including variations experimenting with graphs, tables, charts and other graphic features) might be very worthwhile to help address many of the challenges described in this Article.

52. Federal agencies focusing on financial literacy include: *Financial Literacy and Education Commission*, U.S. DEPT. OF THE TREASURY, http://www.treasury.gov/resource-center/financial-education/Pages/Commission-index.aspx (last visited Apr. 15, 2012); the Department of the Treasury's Office of Financial Education and Financial Access, *see Financial Education and Financial Access*, U.S. DEPT. OF THE TREASURY, http://www.treasury.gov/resource-center/financial-education/Pages/default.aspx (last visited Apr. 15, 2012); THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, http://www.oecd.org (last visited Apr. 15, 2012); JUMP$TART COALITION FOR PERSONAL FINANCIAL LITERACY, http://www.jumpstart.org (last visited Apr. 15, 2012); and COUNCIL FOR ECONOMIC EDUCATION, http://www.councilforeconed.org (last visited Apr. 15, 2012).

Consumer Financial Protection Bureau that are looking at comparable literacy issues[53] to bring about a consistent and holistic approach to this critical aspect of consumerism.

II. The Tower of Babel

A. *Can We Have Comparable Plain English Disclosures Without a Common Vocabulary?*

Variable annuities typically include jargon unique to both the insurance industry and each product issuer. In fact, one exasperated commentator called the world of acronyms used to describe optional variable annuity benefits as veritable "alphabet soup."[54]

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53. The duties of the Office of Financial Protection for Older Americans within the Consumer Financial Protection Bureau include:

> (A) develop goals for programs that provide seniors financial literacy and counseling, including programs that—
>
> (i) help seniors recognize warning signs of unfair, deceptive, or abusive practices, protect themselves from such practices;
>
> (ii) provide one-on-one financial counseling on issues including long-term savings and later-life economic security; and
>
> (iii) provide personal consumer credit advocacy to respond to consumer problems caused by unfair, deceptive, or abusive practices;
>
> (B) monitor certifications or designations of financial advisors who advise seniors and alert the Commission and State regulators of certifications or designations that are identified as unfair, deceptive, or abusive;
>
> (C) . . . submit . . . any legislative and regulatory recommendations on the best practices for—
>
> (i) disseminating information regarding the legitimacy of certifications of financial advisers who advise seniors;
>
> (ii) methods in which a senior can identify the financial advisor most appropriate for the senior's needs; and
>
> (iii) methods in which a senior can verify a financial advisor's credentials;
>
> (D) conduct research to identify best practices and effective methods, tools, technology and strategies to educate and counsel seniors about personal finance management with a focus on—
>
> (i) protecting themselves from unfair, deceptive, and abusive practices;
>
> (ii) long-term savings; and
>
> (iii) planning for retirement and long-term care;
>
> (E) coordinate consumer protection efforts of seniors with other Federal agencies and State regulators, as appropriate, to promote consistent, effective, and efficient enforcement; and
>
> (F) work with community organizations, non-profit organizations, and other entities that are involved with educating or assisting seniors (including the National Education and Resource Center on Women and Retirement Planning).

Dodd-Frank Act § 1013(g)(3), 124 Stat. at 1973.

54. NAVA Speech, *supra* note 4 ("The proliferation and complexity of alphabet soup benefits available under variable annuity contracts—gmdbs, gmwbs, gmibs, to name a few—make it critically important that your investors understand what these benefits are, how they work from an investor's standpoint, and what they cost."); *see* W. Thomas Conner, *The New Generation of Guaranteed Retirement Income Products: Emerging Issues Under the Federal Securities Laws*, 2007 A.L.I.-A.B.A. Conf. on Life Ins. Company Products 485, 509-13.

TABLE 1: CONCEPT DESCRIPTION COMPARISONS

The following table shows some popular optional benefits and the varying descriptions used by different product issuers to describe them:

Sample:	A	B	C
Step-up[55]	On each contract anniversary as permitted, you may elect to reset the Annual Increase Amount to the account value.[56]	"On each contract anniversary prior to the owner's 91st birthday, an Automatic Annual Step-Up will occur, provided that the account value exceeds the Total Guaranteed Withdrawal Amount (after compounding) immediately before the step-up (and provided that you have not chosen to decline the step-up as described below)."[57]	An increase in the benefit base and/or the principal back guarantee and a possible increase in the lifetime payment percentage that is available each rider anniversary if your contract value increases, subject to certain conditions.[58]
Roll-up[59]	The annual percentage increase to a living benefit rider's "benefit base." Your "Roll-Up Benefit Base" initially has a value equal to the amount you first contribute or transfer into the Protection with Investment Performance Account. It is guaranteed to "rollup" each year (until age 95) by a percentage at least equal to recent average interest rates of 10-year Treasury notes plus 1.50% if you take no withdrawals from the Protection with Investment Performance Account during the year.[60]	The income benefit base—the amount on which the lifetime income payments are calculated—is guaranteed to increase by 10 percent simple interest annually for 10 years or until the first withdrawal, whichever comes first.[61]	Purchase payments (adjusted for withdrawals) compounded at 5% for 15 years (or up to your 80th birthday, if earlier).[62]
Deferral bonus[63]	"The amount added to your Payment Base on each Contract Anniversary while the Deferral Bonus Period is in effect if a Market Increase does not occur on such Contract Anniversary."[64]	"An increase in the value of an account if individual waits to initiate a contract feature."[65]	"An increase the benefit base (the amount protected from market declines) by 5% or more a year until the 10th contract anniversary or the first withdrawal, whichever comes first."[66]

55. A “step-up” can generally be defined as a potential periodic increase of a benefit base to equal the then current contract value only if that contract value is more than the last benefit base amount as of some measuring date (e.g., daily or annually). In other words, if, as a result of positive market performance as of the relevant measuring date the contract value is greater than the last calculated benefit base, then the benefit base will be reset to equal that new contract value. *See infra* note 104 (describing the term “benefit base”); *infra* Appendix (showing how this term can vary from contract feature-to-contract feature).

56. *See, e.g.*, METLIFE INVESTORS USA INSURANCE COMPANY, SUPPLEMENT DATED FEBRUARY 27, 2006 TO THE PROSPECTUS DATED MAY 1, 2005 2 (2006), *available at* http://www.sec.gov/Archives/edgar/data/356475/000119312506033852/d497.txt.

57. *See, e.g.*, FIRST METLIFE INVESTORS INSURANCE COMPANY, CONTRACT PROSPECTUS PIONEER PRISM XC VARIABLE ANNUITY 40 (2009), *available at* http://us.pioneerinvestments.com/misc/pdfs/va/prism/prismcontractprospectus_xcny.pdf.

58. *See, e.g.*, RIVERSOURCE LIFE INSURANCE COMPANY, PROSPECTUS FOR RIVERSOURCE VARIABLE ACCOUNT (2012), *available at* ftp://ftp.sec.gov/edgar/data/1000191/0000950123-12-003216.txt.

59. A “roll-up” can generally be defined as a periodic increase of a phantom benefit base based on a stated rate of interest.

60. *See, e.g.*, *How Can My Retirement Income Keep Pace with Inflation*, AXA EQUITABLE (June 2011), http://www.axa-equitable.com/inflation/inflation.html.

61. *See, e.g.*, *Nationwide Financial Increases Amount of Guaranteed Income Offered Through The Nationwide Lifetime Income Rider*, NATIONWIDE (Oct. 30, 2008), http://www.nationwide.com/newsroom/press-release-nw-financial-releases-2008.jsp.

62. *See, e.g.*, *Polaris: The Total Retirement Package*, SUNAMERICA.COM, https://www.sunamerica.com/web/Webpages/Admin/TridionData.do?Page_ID=364957 (last visited Apr. 15, 2012).

63. A “deferral bonus” can generally be defined as a periodic increase of a phantom benefit base based on a stated rate of interest payable on predetermined dates so long as the contract owner has not taken a partial surrender.

64. *See, e.g.*, HARTFORD LIFE INSURANCE COMPANY, HARTFORD’S PERSONAL RETIREMENT MANAGER SELECT III 57 (2011), *available at*: http://edgar.brand.edgar-online.com/EFX_dll/EDGARpro.dll?FetchFilingHTML1?ID =8084460&SessionID=7R61FjMCVRssG77.

65. *See, e.g.*, INSTITUTIONAL RETIREMENT INCOME COUNCIL, KEY TERMS GLOSSARY 3 (2010), *available at* http://iricouncil.org/docs/Key%20Terms%20Glossary%20High%20Res.pdf.

66. *See, e.g.*, Kerry Pechter, *The Most Wanted List (of Variable Annuities)* BANK INVESTMENT CONSULTANT (Sept. 1, 2010), http://www.bankinvestmentconsultant.com/bic_issues/2010_9/the-most-wanted-list-of-variable-annuities-2668455-1.html?zkPrintable=true.

Using different terms to describe the same thing or using the same terms to describe different things can blunt the effectiveness of attempts to alert consumers about certain risks. The following list describes several risks currently under regulatory scrutiny and how inconsistent descriptors could obscure the significance of these risks:

a. Interchangeably calling guaranteed minimum withdrawal benefit (GMWB) payouts "withdrawals," "partial surrenders," "scheduled benefit amounts," or "income," could lead consumers to ignore warnings about the impact that taking withdrawals greater than scheduled benefit amounts ("excess withdrawals") may have in triggering proportionate reductions in their guaranteed death and withdrawal benefits because they may not understand that guaranteed minimum withdrawal benefit payouts withdrawals, partial surrenders, scheduled benefit amounts or income (even though some or all of such sums may represent a return of premiums) all meant to refer to the same thing.[67]
b. Touting forced asset allocation models, mandatory controlled volatility funds, or involuntary asset transfer programs (whether discretionary or formulaic) as a *benefit* to protect against market declines may not adequately alert consumers that they may be forfeiting participation in market rallies based on how these investment restrictions limit investments in equities and that product issuers also benefit from lower volatility in terms of their long-term guarantee obligations and reduced hedging expenses.[68]

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67. N.Y. Ins. Dep't, Guaranteed Minimum Withdrawal Benefits and Excess Withdrawals Under Annuity Contracts, Circular Letter No. 5 (Feb. 7, 2011), *available at* http://www.dfs.ny.gov/insurance/circltr/2011/cl2011_05.pdf. New York insurers must fully disclose the consequences of withdrawing more than their scheduled guaranteed benefit amount (sometimes colloquially referred to as breaking the speed limit) and give owners 30 days to reverse the transaction. The New York Insurance Department notes that the following sample disclosure is acceptable:

> Withdrawals in excess of the guaranteed withdrawal amount, called "excess withdrawals", will result in a permanent reduction in future guaranteed withdrawal amounts. If you would like to make an excess withdrawal and are uncertain how an excess withdrawal will reduce your future guaranteed withdrawal amounts, then you may contact us prior to requesting the withdrawal to obtain a personalized, transaction-specific calculation showing the effect of the excess withdrawal.

Id.

68. Eileen P. Rominger, Dir., Div. of Inv. Mgmt., U.S. Sec. & Exchange Comm'n, Keynote Address at the Insured Retirement Institute 2011 Government, Legal & Regulatory Conference (Jun. 28, 2011), *available at* http://www.sec.gov/news/speech/2011/

c. Describing various types of payments received by product issuers from underlying funds as well as payments made by product issuers to distributors in addition to commissions as "revenue sharing" may confuse consumers about what exactly is being paid by whom to whom and otherwise diminish the relevance of the potential conflicts of interest that belie these arrangements.[69]

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spch062811epr.htm. Where applicable, registrants are warned to disclose the trade-offs in market participation inherent in certain risk mitigation arrangements associated with living benefit riders, and specifically that:

(a) investment restrictions forcing use of asset allocation models may benefit insurance companies in mitigating their guarantee exposure and otherwise limit upside investment potential;

(b) insurance companies may unilaterally change account allocations under so-called "stop-loss" features, as well as the parameters of any permissible changes and market participation limitations;

(c) a potential conflict of interest may result from the fact that the amount of an insurance company's liability under a living benefit rider is directly related to the performance of funds that may be managed by an affiliate and that the management of such a fund could even be influenced by the risk exposure faced by the adviser's affiliate, the insurance company; and

(d) insurance companies "head off" any potential for overreaching in their dealings with a fund or conflicts of interest pursuant to Section 17(d) under the Investment Company Act of 1940, as amended, by not attempting to influence underlying fund holdings in a manner so as to mitigate its tail risk exposures to the detriment of contract owners.

See generally Jeffrey S. Puretz & Alison Ryan, *Asset Allocation Programs: Regulatory Issues Surrounding Use with Variable Insurance Products*, 2005 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 89 (overview of asset allocation program regulatory considerations).

69. *See* FIN. INDUS. REGULATORY AUTH., REGULATORY NOTICE 10-54 (2010), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p122361.pdf (request for comment for a plain English disclosure to retail customers of, among other things, revenue sharing payments as a potential conflict of interest in recommending certain products over others); FINRA Rule 2830(l)(4) (2011) (special cash compensation arrangements disclosed in fund prospectuses or statements of additional information); FIN. INDUS. REGULATORY AUTH., REGULATORY NOTICE 09-34 (2009), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p119013.pdf (disclosure of special cash compensation and revenue sharing arrangements); Shaunda Patterson-Strachan, *Recent Developments in Annuity Enforcement Actions and Litigation,* 2007 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 667, 701-07; Jeffrey S. Puretz et al., *Revenue Sharing: Regulatory Developments and Litigation*, 2007 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 349, 351; Stephen M. Saxon, *Revenue Sharing: Regulatory Developments and Litigation*, 2007 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 409, 411; Robert B. Shapiro, *State Regulatory Developments, Compensation Disclosure, Insurable Interest and Product Filings*, 2005 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 339, 341–68. *See generally* Hartford Inv. Fin. Servs. et al., Exchange Act Release No. 54720, 89 SEC Docket 643 (Nov. 8, 2006) (finding a violation of Section 34(b) under the Investment Company Act of 1940 for improper disclosure of revenue sharing and directed brokerage practices); BISYS Fund Servs., Inc., Exchange Act Release No. 54513, 88

B. *Can/Should Variable Annuities be Widget-zed?*

Unlike other investment vehicles such as mutual funds, the plethora of variations in variable annuity features, and in particular, optional guaranteed minimum lifetime withdrawal benefit (GMLWB) riders, confound attempts to draw meaningful direct comparisons from one product to another.[70]

The wide degree of variation using the same colloquial term to describe GMLWBs might be attributable to the speed of product evolution. However, the existence of such wide variations (especially without industry standards to say when any such variation(s), whether in isolation or when combined with other modifications, warrant a new classification), tend to fuel confusion and confound effective comparisons.

During 2007-08, FINRA unsuccessfully tried to address this problem as part of its Variable Annuity Data Repository Task Force pilot program.[71] The pilot program's goals included developing consistent terminology to create a centralized data repository that sales support areas could use to conduct direct comparisons of product features.[72] From the beginning, however, misgivings existed about building such a database due to the absence of a common vocabulary, the inherently complex structure of some variable annuities and the velocity of change in the types of features availa-

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SEC Docket 2961 (Sep. 26, 2006) (finding that fund willfully aided and abetted and caused advisers' violation of Section 34(b) under the Investment Company Act of 1940 because marketing arrangements were not disclosed in fund prospectuses or statements of additional information).

70. For a sampling of GMLWB variable annuity products, see *infra* Appendix.

71. *See infra* notes 72-74 and accompanying text.

72. The working group focusing on common definitional standards followed the following guidelines as established by the Task Force:

> An industry group of carriers and broker-dealers should work with FINRA to develop common definitional standards for describing the features and benefits provided by variable annuities, with an initial focus on living benefit riders. These definitions could be used in a number of contexts across the industry beyond FINRA's data repository project. By establishing common industry terminology, the working group would in no way intend to limit or constrain the manner by which carriers structure and market their products. Rather, the goal would be to facilitate consistent understanding of product features and attributes that are common in the industry, and enable those features to be captured as data elements.

Memorandum from Jonathan Davis, Vice President, FINRA Strategic Planning to Variable Annuity Data Repository Task Force (Nov. 5, 2007); Draft Report of the FINRA/ Industry Variable Annuity Data Repository Task Force 4-5 (Nov. 6, 2007) (source on file with author).

ble.[73] Some task force members were also concerned about providing public access to this data repository tool because a presumably uneducated consumer unaided by a sales agent might make buying decisions based on raw information.[74]

Despite this failure, the idea of using a more common lexicon is not farfetched. For instance, the closing statement provided when you buy a home or refinance a mortgage proves that ways could be found to adopt regulations requiring consistent terminology to describe fees within consumer-facing disclosures.[75]

Any attempted transition to consistently-used industry-wide terms will not be easy or likely be universally embraced. However, that does not mean that such efforts should be avoided. As discussed in the following section, some degree of confusion over using different nomenclature might be reduced through virtual disclosure layering wherein readers might be able to correlate divergent terminology with more detailed discussions otherwise available within statutory prospectuses and associated examples. More importantly, once freed from the inflexible constraints of using black and white block print disclosures, issuers could finally be liberated to explore more effective ways to more educate, enthrall, and excite consumers through use of multi-media forms of communication better adapted to their financial literacy and their unique capacity to comprehend working knowledge.

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73. *See* Draft Report of the FINRA/Industry Variable Annuity Data Repository Task Force 4-5 (Nov. 6, 2007).

74. *See id.* at 7-8.

75. The Board of Governors of the Federal Reserve System sought to implement the 1968 Truth-in-Lending Act, title I of the Consumer Credit Protection Act, as amended (15 U.S.C. § 1601) through Regulation Z, 12 C.F.R. § 226, which is designed to promote the informed use of consumer credit by requiring consistent disclosures about its terms and costs. 12 C.F.R § 226.1(b) (2011). To fulfill its objective, Regulation Z includes defined terms that are then used in relevant consumer-facing disclosures. *See* 12 C.F.R. §§ 226.2(a), 226.5(a)(3) (2011). *See generally* REVISIONS TO MODEL REGULATION 245-1, AS ADOPTED BY THE LIFE INSURANCE AND ANNUITIES (A) COMMITTEE § 4(I) (Aug. 3, 2011) (draft dated Jul. 20, 2011) (source on file with author) (definition of market value adjustment).

III. THE GREAT BEYOND: TECHNOLOGY MEETS LAYERED DISCLOSURE

A. *Interactive Text and Video Interspersed Prospectuses*

Imagine a web-based app on your, or your sales agent's, personal handheld device that presents text, interactive data[76] as well as succinct, interspersed videos like those popularized by Harry Potter's *Daily Prophet.*[77] Then imagine that an interactive elec-

76. For instance, imagine an optional "illust-pectus" combining summary prospectus (being deemed to be part of a statutory prospectus) disclosures with the types of interactive expense information currently found in personalized illustrations. An illust-pectus could customize the exact costs of ownership based on that particular consumer's contemplated selections of share class, riders, and sub-accounts and display such data in tabular or graphic formats on demand. A web-deliverable illust-pectus might also alleviate bundling challenges by allowing users (or their brokers) to download an illust-pectus showing only those classes, riders and sub-accounts that are then available to that specific prospect based on their response to three simple questions: (i) who is your broker-dealer, (ii) where do you live, and (iii) how old are you? The growingly popular distribution of iPads and comparable hand held devices to wholesalers and distributors could also accelerate use of Internet-based layered disclosures and mollify concerns about consumer web access. *See generally* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 919, 124 Stat. 1376, 1837 (2010) (point-of-sale documents provided to retail investors must be in a summary format and contain clear and concise information about investment objectives, strategies, costs and risks; and any compensation or other financial incentive received by the producer in connection with the purchase); Ann B. Furman, *Variable Products Distribution Issues: Suitability, Advertising, and Electronic Communications*, 2010 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 130, 189-97 (survey of FINRA regulatory oversight over electronic communications); Amy C. Sochard, *Distribution and Advertising Developments*, 2010 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 221 (survey of FINRA regulatory oversight over social media web sites); WILSON-BILIK ET AL., *supra* note 2, AT 118-28 (REPRINTING Correspondence to Andrew J. Donohue, Dir., SEC Div. of Inv. Mgmt. from June 4, 2010, that advocates for layered variable annuity disclosures based on their ability to (A) provide simplified, meaningful disclosure at the point of sale; (B) provide targeted and relevant information on an annual basis (in lieu of the current evergreen process of sending statutory prospectuses); (C) make product summary prospectuses generally consistent with sub-account summary prospectuses; (D) encourage insurers to develop web-based, consumer-oriented disclosure platforms; and (E) reduce printing costs and thereby be more environmentally conscious); COUGHLIN, *supra* note 29, at 6 ("More than simply online transactions and investment calculators, a new emphasis in financial services will be on data visualization and simplification of longevity costs and options, as well as 24/7 consumer engagement."); Michael Ellison, *How to Use Tablets to Connect with Investors*, IGNITES.COM (June 21, 2011), http://www.ignites.com/c/211052/26662/tablets_connect_with_investors?referrer_module=EmailMorningNews&module_order=7&code=%5Bmerge%20members_.member_id_secure%5D ("there is an untapped opportunity for the industry to tailor custom-made iPad applications that will connect with individual investors").

77. J.K. Rowling's Harry Potter fictional stories (and associated films) frequently depicted a newspaper with interactive story insets resembling the type of video boxes found within many news websites. *See Daily Prophet – Harry Potter Wiki*, WIKIA.COM, http://harrypotter.wikia.com/wiki/Daily_Prophet (last visited Apr. 15, 2012). Alterna-

tronic assistant (e.g., a talking paper clip) helps you and your sales agent (whether meeting face-to-face or corresponding through say, video conferencing) to navigate from audio-visual information to key definitions which are then hyperlinked to more detailed disclosures and examples located within an electronic statutory prospectus.[78] It would also take a mere "click" to generate printed versions of these screen shots as effective disclosure take-aways.[79]

Computer-assisted data presentation is oriented in a scrolling, top-down way to help viewers logically absorb data.[80] Informative headings and hyperlinks also help viewers move from layer-to-layer

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tively, consumer experience and engagement could also be fostered by publishing or broadcasting QR codes for consumers to scan using their mobile phones to hyperlink to an insurer's web page providing this information. For a description of guidance on the application of FINRA rules governing communications with the public through social media sites from personal devices, see FIN. INDUS. REGULATORY AUTH., REGULATORY NOTICE 11-39 7 (2011), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p124186.pdf. *See also* FIN. INDUS. REGULATORY AUTH., REGULATORY NOTICE 10-06 (2010), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120779.pdf.

78. The SEC has embraced the concept of Internet-based delivery of disclosure documents but not for investment companies. W. Thomas Conner, *Disclosure Reform for Variable Products: The Promise of New Technologies*, 2006 A.L.I.-A.B.A. CONF. ON LIFE INS. COMPANY PRODUCTS 3, 57. *See generally* Technical Release 2011-03 (Dep't of Labor, Sept. 20, 2011), *available at* http://www.dol.gov/ebsa/pdf/tr11-03.pdf (interim guidance on the electronic disclosure of fee and expense information by participant-directed individual account retirement plans under ERISA Reg. § 2550.404a-5); IRI SURVEY, *supra* note 32, at 1 (94% of consumers would prefer to receive a shorter, printed summary prospectus instead of a full prospectus if details were available online or upon request).

> [O]nline delivery is also under consideration to further facilitate the ease with which this information may be obtained. Boomers are both comfortable and proficient with the use of the Internet, as confirmed by several studies. For example, research from AARP shows that 80% of Boomers are online, and two-thirds have used online technology for at least six years. Ensuring that those in the VA target market have access to the products available to them–in terms of both content and delivery–is imperative as they explore retirement income solutions.

Id. at 11. AARP objections to electronic delivery of mutual fund summary prospectuses indicate that the Greatest and Silent generations are less comfortable relying solely on web-based delivery than Baby Boomers and subsequent generations. *See, e.g.*, Sara Hansard, *SEC Study: Prospectuses Go Largely Unread*, INVESTMENT NEWS (Aug. 11, 2008), *available at* http://www.investmentnews.com/article/20080811/REG/499018976 (AARP studies show that older investors still prefer to receive investment related information by regular mail); AARP/FPA GUIDE, *supra* note 20, at 28. These concerns would seem to be transitional as over time fewer and fewer elderly persons may purchase new products based on the imposition of maximum age limits.

79. *See* AARP/FPA GUIDE, *supra* note 20, at 28.

80. Redish & Selzer, *supra* note 9, at 49-50. A 1984 study of more than 50 life insurance policies found that uninformative headings confused readers. *Id.* at 50 (citing

of information based on their level of interest and literacy.[81] Hyperlinks to other industry or regulator sponsored websites providing generic product guidance could further enrich this experience.[82]

Technology can help the variable annuity industry move from flat, paper-based prospectuses into multi-dimensional, dynamic, and individually differentiated learning opportunities much like

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J.C. REDISH, BEYOND READABILITY: HOW TO WRITE AND DESIGN UNDERSTANDABLE LIFE INSURANCE POLICIES (Am. Council of Life Ins., 1984)).

> Computer science, psychology, and media arts designers are now using creative ways to highlight important data about everything from auto repair to personal health. Data visualization is an evolving field that is introducing tools that include mindmaps, hotspots, even the variable size tagging that is now common on the Internet. Mindmaps, for example, show in a single image the connections between information, priorities, activities, people, etc. Hotspots focus users' attention with clouds of color on key information, saving them the aggravation of navigating through ambiguous content to find what might be most important. Tagging changes the size of a word to indicate its frequency of use as well as its "importance."

COUGHLIN, *supra* note 29, at 6; *see* COUGHLIN & PROULX, *supra* note 32 (examples of tagging words related to retirement and financial planning).

81. *See* NAVA Speech, *supra* note 4.

> The Division . . . also want[s] to tame the mass of available data and make it usable, whether for an annuity investor or one of the many intermediaries who digest the information and repackage it for investors. It is here that interactive data . . . could help investors quickly pull up and compare the surrender charges for five different variable annuities at a glance. Or it might allow an investor to track changes in the portfolio holdings of an underlying fund to better assess how closely the stated objectives and strategies of the fund are followed. The possibilities are endless and full of great promise.

Id.

82. For examples of regulatory/industry sponsored websites providing self-guided educational opportunities see: U.S. Securities and Exchange Commission, INVESTOR.GOV, http://www.investor.gov (last visited Apr. 15, 2012); Financial Literacy and Education Commission, MYMONEY, http://www.mymoney.gov (last visited Apr. 15, 2012); CONSUMER FINANCIAL PROTECTION BUREAU, http://www.consumerfinance.gov (last visited Apr. 15, 2012); *Retirement Investment Tools*, INSURED RETIREMENT INSTITUTE, http://www.irionline.org/consumers (last visited Apr. 15, 2012); and National Endowment for Financial Education, MY RETIREMENT PAYCHECK, http://www.myretirementpaycheck.org (last visited Apr. 15, 2012). For other websites for professionals working with older clients, see AARP/FPA GUIDE, *supra* note 20, at 33-35. The OIEA publishes Investor Alerts and Bulletins on the SEC's website, www.SEC.gov, as well as on www.Investor.gov. The Commission also disseminates alerts through a variety of other channels, including a designated RSS feed, www.Gov.delivery, press releases, and a Twitter account, @SEC_Investor_Ed. Financial Literacy: Empowering Americans to Make Informed Financial Decisions: Hearing Before the Subcomm. on Oversight of Gov't Mgmt., the Fed. Workforce, & D.C. of the S. Comm. on Homeland Sec. & Governmental Affairs (Apr. 12, 2011) (statement of Lori J. Schock, Dir., Office of Investor Educ. and Advocacy, U.S. Sec. & Exchange Comm'n) *available at* http://www.sec.gov/news/testimony/2011/ts041211ljs.htm.

those that many of us already experience when visiting news websites or using e-book readers. However, doing so requires collaboration by and among academia, gerontologists, information systems, legal, marketing, and sales agent constituencies.

B. *Form N-4.2*

Trade groups such as the Committee of Annuity Insurers and the Insured Retirement Institute have been collaborating with the Commission staff for some time to explore ways to improve Form N-4 (variable annuity registration statement).[83] After all, informed financial decisions about variable annuities are currently linked to a prospectus, and amendments to Form N-4 provide the nexus from which proposals for a summary prospectus[84] and an annual update document naturally emanate.[85]

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83. *See, e.g.*, WILSON-BILIK ET AL., *supra* note 2, at 17-24; *see also* The Committee of Annuity Insurers, LAYERED VARIABLE ANNUITY DISCLOSURE (Meeting of Committee of Annuity Insurers and SEC Staff, Division of Investment Management Sept. 16, 2010) (source on file with author). Goals of the Committee of Annuity Insurers (CAI) include: (i) encourage investors to actually read disclosures; (ii) level the playing field with mutual funds using summary prospectuses; and (iii) collaborate with the Commission and state insurance regulators in the use of appropriate consumer disclosures (i.e., summary prospectus and annual update document). *Id* at 8-9; CARL B. WILKERSON, ACLI DISCLOSURE INITIATIVE FOR FIXED, INDEX AND VARIABLE ANNUITIES: CONSTRUCTIVE CHANGE ON THE HORIZON, *in* Letter from Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation, Am. Council of Life Ins., to Florence B. Harmon, Acting Secretary, U.S. Sec. & Exchange Comm'n, 28-33 (Aug. 20, 2008), *available at* www.sec.gov/comments/sr-finra-2008-019/finra2008019-14.pdf (explaining ACLI's work with state and federal regulators to improve disclosure).

84. *See* WILSON-BILIK ET AL., *supra* note 2, at 17-23. *See generally* IRI SURVEY, *supra* note 32 (validation of interest in summary prospectuses and an overview of IRI's proof of concept summary prospectus version).

85. *See* WILSON-BILIK ET AL., *supra* note 2, AT 23-24. The annual update document is intended to reduce the burdens and costs of annually providing variable product registration statements. *See* Item 32(a) undertaking to Form N-4. As currently proposed, the annual updating document would update important prospectus information and could generally bear resemblance to the types of non-material updates currently provided to owners whose contracts comply with the conditions set forth in the so-called "Great West" line of no-action letters. The "Great-West" line of no-action letters permit separate accounts registered as unit investment trusts to cease filing annual post-effective amendments to registration statements and annually delivering new prospectuses to existing contract owners, provided that the issuing insurance company has stopped selling new contracts and other conditions set forth in the no-action letters are met. *See, e.g.*, Great-West Life & Annuity Ins. Co., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 1188 (Oct. 23, 1990). There is a concern, however, that development of amendments to Form N-4 to eliminate the annual "evergreen" process through use of an annual update document may encourage the Commission staff to rescind the Great-West line of no-action letters because such relief would no longer be considered to be necessary.

One observation is that Form N-4 was not necessarily intended to accommodate the vast number, variety, and overall complexity of features now offered through a variable annuity prospectus. As Table 2 reveals, this has exacerbated prospectus length and readability difficulty.

TABLE 2: INDIVIDUAL VARIABLE ANNUITY READABILITY COMPARISONS[86]

	High	Median	Low
Page Count	347	92	46
Words	255,270	58,114	34,184
Definitions	33	30	19
Share Classes	5	1	1
Sub-Accounts	100	59	11
Optional Benefit Riders			
- Active	22	9	7
- Archive	21	3	0
Passive Sentences (%)	30	23	19
Flesch Reading Ease Score	39.6	33.9	28.2
Flesch-Kincaid Grade Level	15.9	14.3	13.2

86. Tabular data is based on the author's calculations using the prospectuses for the eight top-selling variable annuities as of the second quarter of 2011 as determined by Morningstar Annuity Research Center. Formerly VARDS Online, the Morningstar Annuity Research Center provides insurance companies and asset management firms with data and applications for conducting competitive analysis and product development and supporting sales initiatives. *See Morningstar Annuity Research Center*, MORNINGSTAR.COM, http://corporate.morningstar.com/US/asp/subject.aspx?xmlfile=578.xml (last visited Apr. 15, 2012). Readability data presented excludes tables of contents, tables, graphs, charts, examples and appendices within prospectuses as well as statements of additional information and sub-account prospectuses, whether in summary or statutory form (when bound together, a top selling variable annuity "book" was almost two inches thick). Share class (the number of different share classes combined within the same prospectus) counts disregard products with sales charge schedules that vary based on different fee structures. Sub-account (the mutual-fund like offerings available to investors of one or more share classes) counts exclude general account, fixed account (and variations). Optional rider counts disregard differences based on whether available on a singular or joint ownership and state variations. Optional benefit riders were categorized in terms of whether available to new investors (Active) or limited to only past investors (Archive). Results indicate that prospectuses sampled were written at a college student's reading level. *See supra* note 8 (providing a description of the Flesch Reading Ease Score and the Flesch-Kincaid Grade level). By way of illustration, the Flesch Readability Score for the text of this Article is 28.5 and the associated grade level is 14.9 (college sophomore) based on the Flesch-Kincaid Reading Level formula. *See also* IRI SURVEY, *supra* note 32, at 3-4 (survey of the 15 top-selling variable annuities of the first quarter of 2011: (i) "53% exceeded 150 pages in length and 13% topped 200 pages"; and (ii) average prospectus length was 166 pages ranging from approximately 60 pages to nearly 350 pages).

Complexity is among the biggest challenges for the development of a summary prospectus and annual update document. For instance, consensus has yet to emerge about how to describe multiple generations of optional contract benefits ("riders") in a summary prospectus or annual update document without confusing consumers about which riders or rider versions they can elect as well as which investment restrictions will apply to them.[87] While this confusion may be reduced if product issuers introduce new riders through filing new initial registration statements, recent informal industry surveys indicate that product issuers may prefer to either add new riders within the same prospectus and/or relocate inactive riders to a prospectus appendix. In some instances; however, product issuers intermingle new rider features within an otherwise unavailable rider (in other words, instead of calling the newest generation of rider "version I, II or III", the rider keeps the same name but includes a statement to the effect that the newest features are only available for those electing the rider before or after a specified date).[88]

Absent some way to connect the relevant summary prospectus and annual update document with a corresponding statutory prospectus,[89] future paper-based prospectuses may eventually not be allowed to include multiple generations or available and unavaila-

87. Another issue facing the Commission staff and industry groups is whether open, soft or hard closed sub-accounts (i.e., sub-accounts accepting additional contributions or limiting any such contributions to either existing or no contract owners) should all be included in the same prospectus because consumers may not understand which ones they can invest in (because sub-account closure may depend on factors like when your contract was bought, share class, contract version and even the distribution channel through which you bought your contract).

88. The Committee of Annuity Insurers (CAI) and the Insured Retirement Institute (IRI) both informally polled their members during the summer of 2011 in response to concerns about overburdening registration statements, as raised during a joint meeting with the Commission staff on June 16, 2011.

89. One way to do this could be to assign a different CUSIP number to each relevant configuration of products (whether proprietary or nationwide versions), open riders (or rider versions), statutory companies, share classes and/or open sub-accounts. A CUSIP is a commonly used unique identifier assigned by the CUSIP Service Bureau. *See generally Product CUSIP Recommended Industry Standard*, NAVA DATA CONFORMITY WORKING GROUP (Oct. 2005) (source on file with author) (making recommendations about assigning one or more CUSIP numbers based on permutations of the foregoing factors). Each insurance company already has a unique consumer information source code number that consumers can use to search for an insurer, file complaints regarding insurance companies, and view a variety of information about selected companies. *See Consumer Information Source,* NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, https://eapps.naic.org/cis/help.do#about_cis (last visited Apr. 15, 2012).

ble riders. Anecdotal evidence already exists that the Commission staff is starting to urge certain product issuers to file initial registration statements rather than add new riders to an existing registration statement. Presumably, this will lead certain product issuers to transition away from combination prospectuses (sometimes called "kitchen sink" prospectuses). These actions may also have the effect of aligning prospectuses with future summary prospectuses and annual update documents.

Constituents should quickly coalesce around a solution to these issues for two very practical reasons. First, the client-facing materials actually used to sell variable annuities are more likely to have been reviewed and approved by FINRA using a "fair and balanced" standard[90] than current Commission rules and forms. Second, the size of the variable annuity market,[91] coupled with increasingly onerous pre-sale prerequisites[92] may drive sales agents and consumers to other financial products that are perceived as being less complicated[93] or have less negative press.[94]

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90. Given the likelihood that variable products are sold to the public based in whole or in part on sales literature, FINRA could be viewed as the pre-eminent regulator. *See* FINRA Rule 2210(d)(1)(A) (2009).

> All member communications with the public shall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service. No member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communications to be misleading.

Id.

The National Association of Insurance Commissioners (NAIC) is also exerting regulatory influence over the solicitation of variable annuities through proposed amendments to Annuity Disclosure Model Regulation 245-1 by making delivery of a Buyer's Guide and disclosure document mandatory after January 1, 2014 "unless, or until such time as, the SEC has adopted a summary prospectus rule or FINRA has approved for use a simplified disclosure form applicable to variable annuities or other registered products." *See supra* note 38.

91. *See, e.g.*, Darla Mercado, *Challenges are Ahead for Variable Annuity Sales*, INVESTMENT NEWS (June 30, 2011), *available at* http://www.investmentnews.com/article/20110630/FREE/110639994 (stating that while gross sales of variable annuities appear to be rising modestly, much of that growth seems to be coming from product exchanges, rather than inflows of new money).

92. *See, e.g.*, Larry Niland, *How the NAIC Model Regulation is Changing the Ways Annuities are Sold and Supervised*, LIMRA REGULATORY REVIEW (Oct. 2010), *available at* http://www.limra.com/pdfs/compliance/NAIC.pdf; *see supra* note 30.

93. *See* Press Release, AARP Fin. Inc., When it Comes to Financial Jargon, Americans are Befuddled (Apr. 17, 2008), *available at* http://www.plainlanguage.gov/news/index.cfm?topic=ysnAll&offset=16 (more than half of adults surveyed made a bad investment decision because they did not read or understand financial literature); Marie Z. Rice, CONSUMER KNOWLEDGE AND PREFERENCES OF FINANCIAL PRODUCTS 14 (LIMRA 2009), *available at* http://media.hbwinc.com/pdf/Consumer%20Knowledge%

Conclusion

Plain English disclosures will surely help improve suitability and drive more informed decision-making. A concerted effort to figure out how to effectively convey the working knowledge that consumers need and want to make their decisions is more important now than ever. Whether as a result of a Commission literacy study or continued collaboration between the industry and its regulators, we must come up with a better understanding about how we can more effectively tell our story to our intended audience and then support this story with clearer, consistent communication vehicles.

When Mick Jagger asked, "what's puzzling you," he was singing about the nature of Satan's game.[95] We must ask a similar question about what is so puzzling about deferred variable annuities that so many consumers are still so confused? Maybe the devil is in the details of how these products work and our obsession with describing these intricacies. Let's face it, writing prospectuses can be like trying to narrate how a Rube Goldberg device[96] works. Sympathy for relying on a paper-driven, design-based prospectus disclosure paradigm should end. Success in pursuing plain English and providing working knowledge[97] should come from simplicity[98] through synthesizing rather than merely truncating[99] disclosures.

20of%20Insurance.pdf (consumer education about annuities lags behind other financial products); IRI SURVEY, *supra* note 32, at 4-6 (Seventy percent of respondents reported that they "seldom or never read their prospectus." Virtually all of those who claim to read prospectuses focus their attention on the product summary and fees sections. Only 58% of prospectus reading respondents look at their contract benefits sections.).

94. *See, e.g.*, Interview by Eric Schurenberg with Suze Orman, CNN (June 19, 2008), *available at* http://money.cnn.com/2008/06/19/pf/Suze_Orman.moneymag/index.htm ("I hate [variable annuities] with a passion—a passion!").

95. THE ROLLING STONES, *supra* note 1.

96. A "Rube Goldberg device" is commonly defined as a contraption that accomplishes by complex means what seemingly could be done simply. *See About Rube Goldberg*, RUBE-GOLDBERG.COM, http://www.rube-goldberg.com/ (last visited Apr. 15, 2012).

97. *See* Coughlin & D'Ambrosio, *supra* note 14, at 88 ("What boomers are looking for is working knowledge: knowledge to understand what their advisor is recommending and enough knowledge to engender confidence that the advisor is an informed and trusted advocate for their future.").

98. *See* COUGHLIN, *supra* note 29, at 5 ("Complexity is a barrier to consumer engagement. Moreover, the more complex a product or service, the less likely it is to be trusted by the consumer.").

99. *See* SEC Updated Staff Legal Bulletin No. 7, 1999 WL 34984247 (June 7, 1999), *available at* http://www.sec.gov/interps/legal/cfslb7a.htm. Consumers and brokers do not appear to necessarily reward product issuers merely for simplifying prospectuses. For instance, in February 2011, John Hancock Insurance Company

We must embrace technology as a way to solve this puzzle. Other industries have figured out how to empower consumers with the working knowledge needed to make informed decisions. We must now do the same.[100]

The pursuit of using plain English to improve informed decision-making has been a long one.[101] We still have a long way to go to solve the puzzle of how to best provide all the working knowledge that all relevant parties need to have in order make an informed decision whether or not to buy or recommend a variable annuity. But wouldn't it be wonderful if future consumer transactions could follow the following script?[102]

One day before too long, a customer will walk into a bank or a broker's office and ask for a way to turn their nest egg into a lifetime long income stream. She'll be given a presentation from the sales agent's personal handheld device describing in plain English what she will get, how much it will cost her and what trade-offs she will be asked to make. The presentation will include colored graphs, short tables and even an interactive pop-up box where a speaker will describe, in non-technical terms, how selected features solve some of her financial longevity concerns. She'll take out her glasses and then re-review the whole presentation from A to Z and even play around with some variable data points to see how it might change her outcomes—whether for better or worse. She will place her cursor over terms she doesn't understand and will be hyper-

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announced the cessation of sales of its "simplified" AnnuityNote variable annuity. The simplified structure of this product was based on an embedded lifetime guaranteed minimum withdrawal benefit (rather than one elected separately). Darla Mercado, *John Hancock will Draw the Curtains on AnnuityNote Simplified VA*, INVESTMENT NEWS (Mar. 29, 2011), *available at* http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20110329/FREE/110329927.

100. The Commission could help lead this initiative by hiring and leveraging information technology experts to develop regulations and the FAQs needed to implement these initiatives.

101. The following quote from Dr. Flesch in 1979 offered a description of an informed decision:

> One day before too long, a customer will walk into a bank and ask for a loan. He'll be given a new, Plain English loan note to sign. He'll sit down, take out his glasses and read the whole note from A to Z. At several places he'll ask questions and get explanations. He'll read about the bank reaching into his checking account, selling his car without telling him, and charging 20 percent of the unpaid loan for a letter on their lawyer's stationery. When he's through, he'll take off his glasses and put them back in his pocket. Then he'll say, "I won't sign this," and walk out.

FLESCH, *supra* note 3, at 123.

102. The text that follows is the author's application of Dr. Flesch's description of an informed decision in the context of this Article. *See supra* note 101.

linked to an electronic statutory prospectus for more information and even be able to click again and link to hypothetical examples applying the concepts she was concerned about. At several points she'll ask questions and get clear and concise explanations from her well trained sales agent. She'll understand how, among other things, the insurer will charge a fee if she surrendered her annuity at different points in time and that if she took more than her scheduled withdrawal that her benefits, including her death benefit, may decrease by more than the extra sums she withdrew. Perhaps at this juncture she will also realize that this type of financial product requires a long-term investment horizon. When she's through, she'll take off her glasses and put them back in her pocket. Then she'll say, "I now understand what is being asked of me and what can happen if I don't follow the rules," and then she will turn to her sales agent, smile and say "where do I sign?"

APPENDIX: ILLUSTRATIVE RANDOM SAMPLING OF GUARANTEED MINIMUM LIFETIME WITHDRAWAL BENEFIT (GMLWB) VARIABLE ANNUITY PRODUCTS

The following table illustrates many of the types of typical variations of key features such as rider fees (and any limitations on fee increases) annual lifetime withdrawal amounts (expressed as a percentage of account value), the potential basis for increases in withdrawal amounts based on positive market performance (called "step-ups"); as well as the effects of taking more than scheduled withdrawals.[103]

ISSUER:	A	B	C	D	E	F	G	H	I
RIDER FEE BASIS	Benefit Base A[104]	Benefit Base B	Benefit Base C	Benefit Base D	Benefit Base E	Benefit Base F	Greater of Account Value or Benefit Base G	Benefit Base H	Benefit Base I
POTENTIAL RIDER FEE INCREASE FREQUENCY	Any contract anniversary after the 1st year	Each quarterly anniversary- cannot increase more than 0.50% in any 12 month period	Upon step-up only or after the 2nd contract anniversary	After 2d contract anniversary- cannot change for another 2 years	Upon step-up on a contract anniversary, after 10 yrs	Upon step-up on a contract anniversary	Upon step-up only	Up or down 0.25% per year	Every rider anniversary
LIFETIME WITHDRAWAL PERCENTAGE SINGLE LIFE ONLY	4% Ages 59.5-64 5% Ages 65+	4.0% Ages 60-64 4.5% Ages 65-79 5.5% Ages 80+	4% Ages 35-64 5% Ages 65-74 6% Ages 75-80 7% Ages 81+	4% Ages 59.5-64 5% Ages 65+	4% Ages 55-59½ 5% Ages 59½+	3% Ages 45-59½ 4% Ages 59½-64 5.25% Ages 65-80 6.25% Ages 81+	3% Ages 45-54 4% Ages 55-59½ 5% Ages 59½-84 6% Ages 85+	*Inc Opt 1* 6% Ages 59½+ *Inc Opt 2* 6% <64 7% 65+	4.5% Ages 59-64 5.5% Ages 65-74 6.5% Ages 75+
OTHER FEATURES:									
STEP-UPS	Annual	Quarterly	Choice of Quarterly or Annually	Monthly	Annually	Annually	Daily	Annually	Monthiversary
IMPACT OF EXCESS WITHDRAWALS	Pro-Rata reduction of Benefit Base and Death Benefit	Same as A	Pro-Rata reduction of Benefit Base only if standard Death Benefit applied	Same as A	Same as A	Pro-Rata reduction of Benefit Base and Death Benefit if over rider limits; otherwise dollar-for-dollar	Same as A	Dollar-for-dollar reduction of Benefit Base and Death Benefit	Greater of dollar amount surrendered or proportional amount surrendered

103. This Appendix was created by the author using data created by the competition unit of The Hartford Financial Services Group, Inc. Such data is on file with the author.

104. A "Benefit Base" (or words of similar import) refers to phantom account values that may be influenced, in accordance with various formulas, upon certain events such as, but not limited to, subsequent investments and/or withdrawals, deferral bonuses and other rider idiosyncratic features. For instance, upon contract issuance, account value and a benefit base might both equal the initial premium payment. However, the benefit base may thereafter differ significantly from account value and in some instances, could continue to exist even where there is no remaining account value. In other instances, more than one benefit base may apply when calculating different values within the same rider (for example, one benefit base may be used to calculate step ups and another used for deferral bonuses). While the benefit base will influence many benefit values; contract owners may not actually extract any benefit base.