



Insured Retirement Institute

Variable Annuity Summary Prospectus High in Demand by Consumers

An Examination of Consumer Preferences, Industry Perspectives, and IRI Initiatives

June 2011

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Overview

The need for a variable annuity (VA) summary prospectus is well-documented. The present long-form prospectus—which would remain available for those requesting further detail—often exceeds 160 pages in length and contains a high level of so-called legalese. For a number of reasons, including length and consumer preferences, the prospectus is seldom read by those for whom it is intended. According to research from the Insured Retirement Institute (IRI), less than one-quarter of prospective clients read the prospectus provided to them and, of those, less than 60% read the sections on contract benefits. More than 90% of respondents have indicated that they would read a summary prospectus if available.

One of the key initiatives of IRI is to spearhead the development of a variable annuity summary prospectus (“VA Summary Prospectus”). In December 2008, IRI submitted a Draft Summary Prospectus Rulemaking Petition to the U.S. Securities and Exchange Commission (SEC), an idea that generated very positive feedback. Since then, IRI has met with the SEC on several occasions to help advance its consideration of a summary prospectus for variable annuity products, including a meeting in mid-June 2011. As of this writing, the implementation of the VA Summary Prospectus proposal is progressing.

In this report, we analyze the need for a VA summary prospectus based on feedback from consumers, insurers, and asset managers. We then provide an update on IRI’s initiatives pertaining to the development of a VA summary prospectus, and delve into the key points that such a document would contain.

Key Findings and Analysis

- **Consumer Preferences.** An exclusive survey from the Insured Retirement Institute, conducted in 2011, found that 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. This is up from 86% in a similar survey conducted one year ago.
- If provided with a short summary prospectus written in clear, everyday language, 59% would be more likely to discuss the product with their advisors.
- **Consumer Behavior at Point of Sale.** very few variable annuity owners read their product prospectuses-- which as stated typically range from 100 to 300 pages in length -- at the time they are making the decision to purchase an annuity. More than three-quarters (78%) seldom or never read their prospectuses at all, while 5% report that they always read the current prospectus and just 17% read it most of the time.[Respondents did not provide specific reasons for their answers.]
- **Consumer Behavior After Purchase.** The vast majority (87%) of annuity contract owners rarely or never refer to their prospectuses for questions about their annuities after purchase. Only a handful (13%) have referred to their prospectuses after purchasing a variable annuity (always or most of the time).

- **Information Most Important to Consumer.** Of those who read prospectuses before purchasing an investment or variable annuity, most look at the fees, expenses, and risks to a higher degree than death benefits and other contract benefits.
 - The most often-read parts of a VA prospectus are the summary/highlights section (98%) and the information of fees and expenses (97%). Deductions from accounts in the forms of sales loads and commissions are read by 88% of respondents.
 - The investment component is also of interest to VA owners. Risks and investment choices were cited by nearly 90% as sections of the prospectus they read. (Although it is unclear whether the respondents actually obtained the investment information from the prospectus or from other materials provided by their financial advisors.)
 - Only 58% of VA owners look at the descriptions of contract benefits, although 69% will read the section focused on death benefits.
- **Industry Perspectives.** Nearly 70% of insurance industry executives believe that the ideal length of a variable annuity summary prospectus is less than ten pages. However, IRI recognizes that a summary prospectus may sometimes be longer to incorporate riders and other information that companies offer.

Methodology

Proprietary data in this report is derived from IRI surveys of investors, insurers, and variable insurance asset managers during first quarter 2011. The investor survey, conducted for IRI by Cogent Research, gauged the perspectives of 709 retirees and pre-retirees with at least \$100,000 in investable assets, including workplace plans but excluding the value of any real estate. The second conducted for IRI by Cerulli Associates, examined attitudes of three dozen insurers and asset managers regarding the future of the VA industry. IRI provided analysis and commentary for the results of both surveys in June 2011.

Background

In December 2008, the Insured Retirement Institute (IRI) submitted a proposal to the SEC for a Variable Annuity Summary Prospectus and elimination of the annual update. The proposed changes, similar to those of the mutual fund industry, would:

- provide variable annuity investors with key information presented clearly and concisely, while enabling them to receive the same amount and type of information that is currently available either online or, upon request, in writing,
- give prominence to key information that variable annuity investors can use in making an informed investment decision, and
- require the use of plain English format, which should enhance the ability of variable annuity investors to compare different variable annuities available in the marketplace.

Summary prospectuses have been widely adopted in the mutual fund industry, further indicating the demand and need for a similar disclosure document for variable annuities. As of May 2011, 62%

of mutual funds had adopted standalone summary prospectuses, up from 41% one year earlier, according to Broadridge Financial Solutions. The summary prospectus amendments for the mutual fund industry were approved by the SEC in 2009, acting on a proposal made in November 2007, and required the addition of a short, standardized, plain-English summary of key information to the front of the mutual fund prospectus.

The IRI proposal was met with a positive reaction by the SEC. In November 2009, then-SEC Director of Investment Management Andrew J. “Buddy” Donohue recognized the leadership of IRI in its efforts to help simplify prospectus language for consumers. In his remarks to the American Law Institute-American Bar Association Conference on Life Insurance Company Products, Director Donohue said he believes the IRI proposal “is a positive step toward the creation of a variable annuity short form disclosure document,” and that he is “confident that this is doable and (he) looks forward to working with the industry toward that goal.”

One month later, in December 2009, SEC Chairman Mary Schapiro confirmed that her staff was developing the much-anticipated VA summary prospectus. She underscored its importance by stating that “at the end of the day, our investor in that Main Street office just wants to know the facts, so he is not taken advantage of by hidden fees or questionable motivations. And he needs this information when it is most meaningful—at the time he is making his investment decision.”

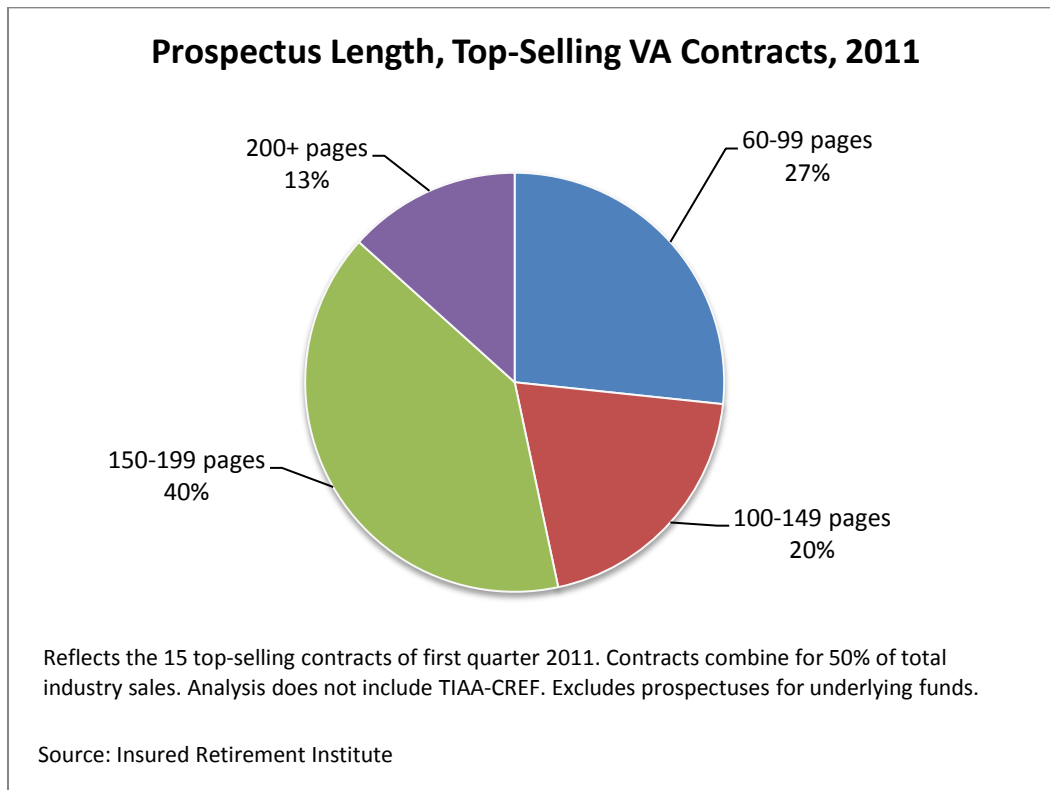
The IRI Summary Prospectus Working Group, a subcommittee of the IRI Federal Regulatory Affairs Committee, has since been working with the SEC to answer questions, prepare sample summaries, and other issues pertaining to this need. Among the Working Group’s key projects was the creation of a new proof-of-concept variable annuity summary prospectus, presented to the SEC in June 2011.

The State of the Variable Annuity Prospectus

A prospectus is required to be delivered to contract owners by law, yet most go unread by the owners of the variable annuities for whom they are written. Even among those investors who state they frequently read the prospectus, several key areas are not reviewed, on average. One of the reasons for this situation is the length of the full prospectus.

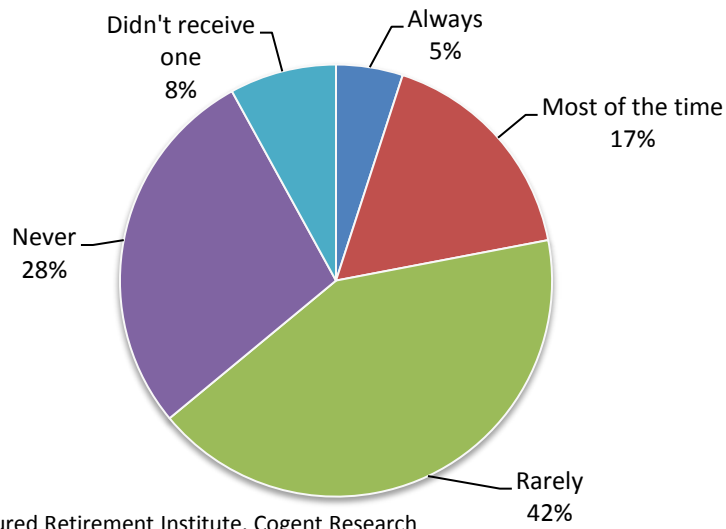
Of the prospectuses associated with the 15 top-selling VAs of first quarter 2011, 53% exceeded 150 pages in length and 13% topped 200 pages. The average length of the product prospectus in this sample was 166 pages, and ranged from approximately 60 pages (for a contract with few riders) to nearly 350 pages. (The 15 top-selling VA contracts accounted for one-half of total industry sales in first quarter 2011; TIAA-CREF is excluded from this analysis.)

These figures represent the annuity product prospectus only—that is, the prospectus focuses on the insurance features of the contract, with only basic information on the underlying investment choices. The underlying investment fund prospectuses, which discuss the funds in which the annuity contract owner can invest, can add another 200-300 pages to the overall disclosure materials, depending upon the number of underlying funds offered with the contract. Either alone or with the underlying investment fund prospectuses, the variable annuity contract prospectus tends to be daunting.



Only 22% of VA owners who responded to our survey reported that they always or almost always read the prospectuses provided with their contract. Seven out of 10 respondents (70%) seldom or never read them at all, a cautious figure given the increasing complexities of the VA product.

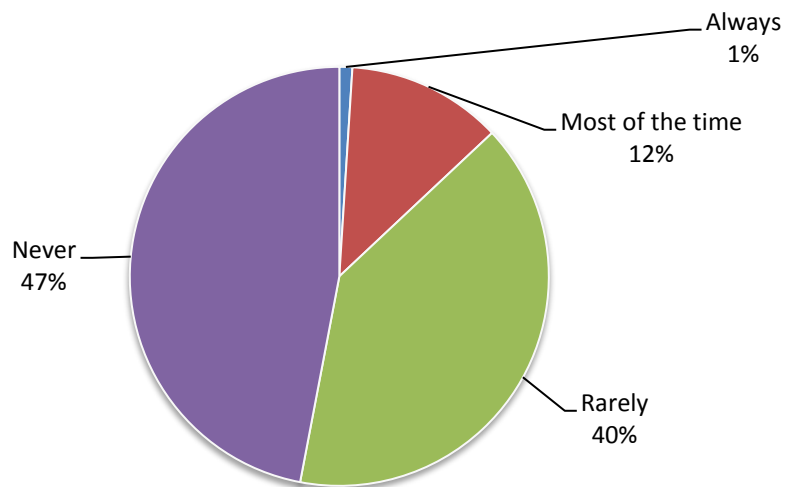
Percent of Consumers Who Read the Prospectuses Provided with their Variable Annuities, 2011



Sources: Insured Retirement Institute, Cogent Research

Additionally, very few VA owners use the prospectus as a reference tool after purchase. Based on IRI's experience, among the reasons VA owners might consider referring to the prospectus would be to understand benefit triggers, review the basic features of the investment options, and evaluate the tax or fee implications of any transactions they make.

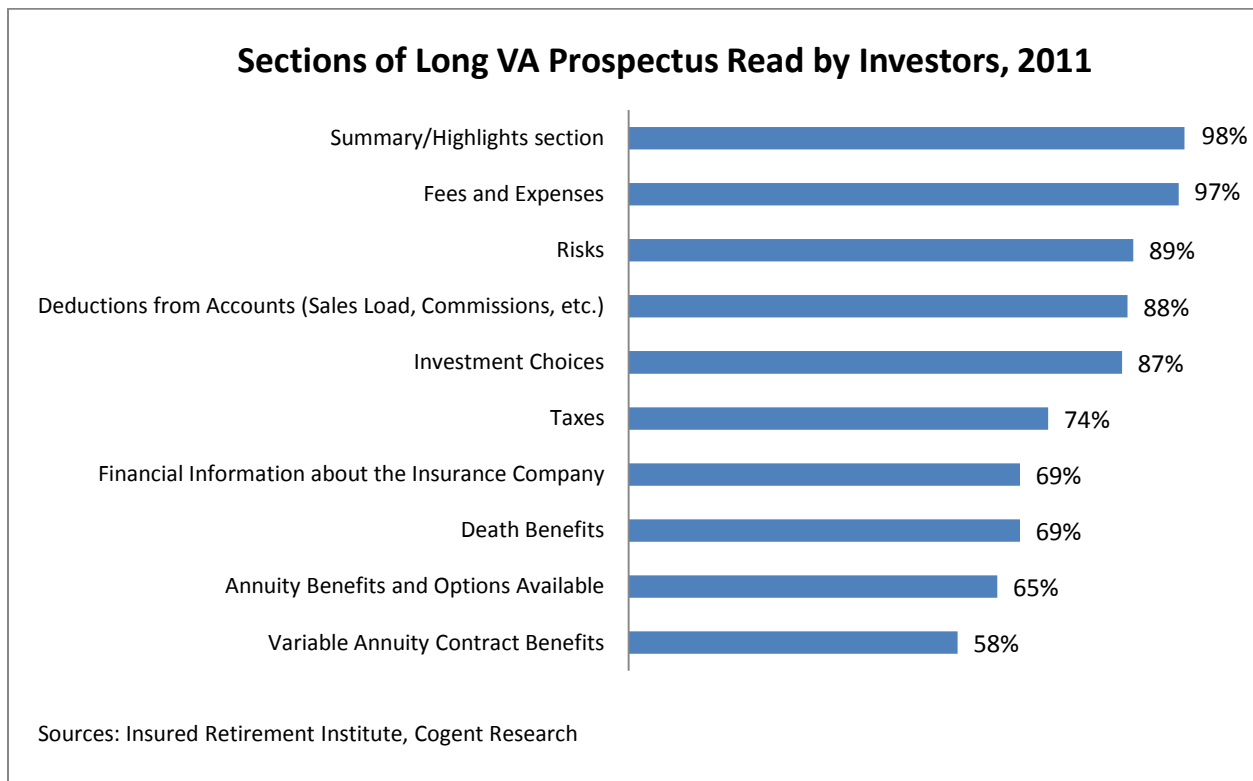
Percent of Consumers Who Refer to their Variable Annuity Prospectuses After Purchase, 2011



Sources: Insured Retirement Institute, Cogent Research

Of those who report that they regularly read the VA prospectus prior to purchase, the most frequently reviewed sections are those that contain the product summary and highlights (98% of respondents) and fees and expenses (97%). Risks, sales load, and investment choices are consulted by more than 85% of investors each. While it is clear that investment information is important to consumers, it is unclear whether the respondents actually obtained the investment information from the prospectus or from other materials provided by their financial advisors.

Interestingly, the sections on the features and benefits of VAs are read with far less frequency. Only 58% of respondents indicated that they review the general description of the VA contract and its benefits, while 69% read about annuity death benefits. This is unfortunate given that living benefits are among the key selling points and differentiators of today's VAs. Yet, it is also understandable given the technical and legal language that is used in the long prospectus. Lengthy appendices showing numerous mathematical examples can also add to the intricacy, indicating an even greater need for a clearer, more concise explanation to accompany the detail provided in the full prospectus.

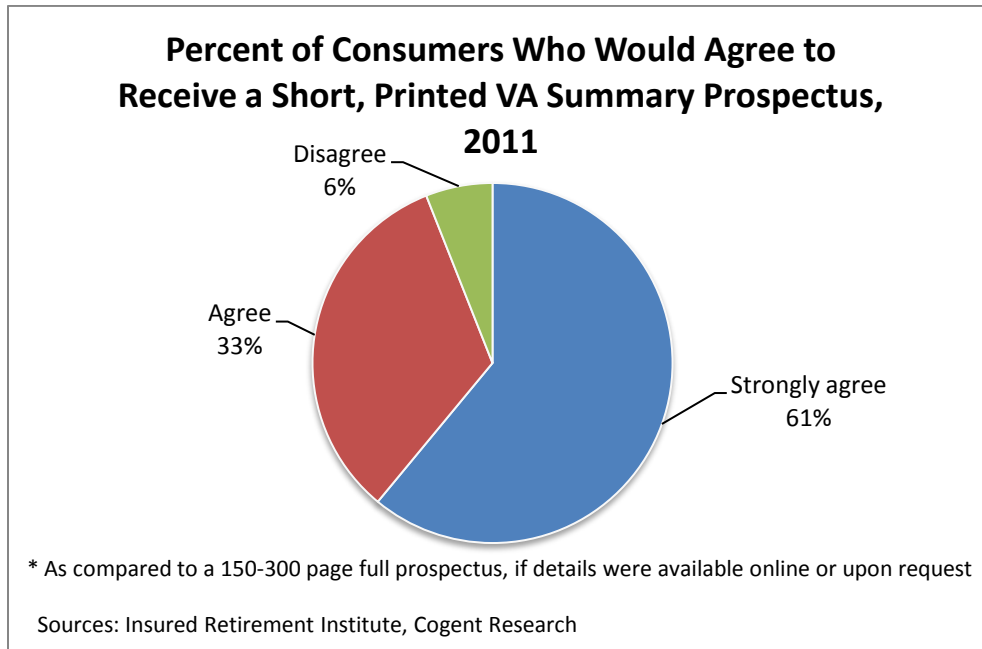


Summary Prospectus in Demand

Both consumers and insurance industry executives have expressed a strong desire for a summary prospectus for variable annuities.

Consumer Perspective

An exclusive survey from the Insured Retirement Institute, conducted in 2011 by Cogent Research, found a strong consumer preference for a VA summary prospectus. Nearly all (94%) of investors agreed that they would prefer to receive a shorter, printed summary prospectus if the full prospectus were available online or upon request, up from 86% in a similar survey conducted one year ago. Approximately two-thirds (61%) of respondents to the 2011 survey cited a strong preference.

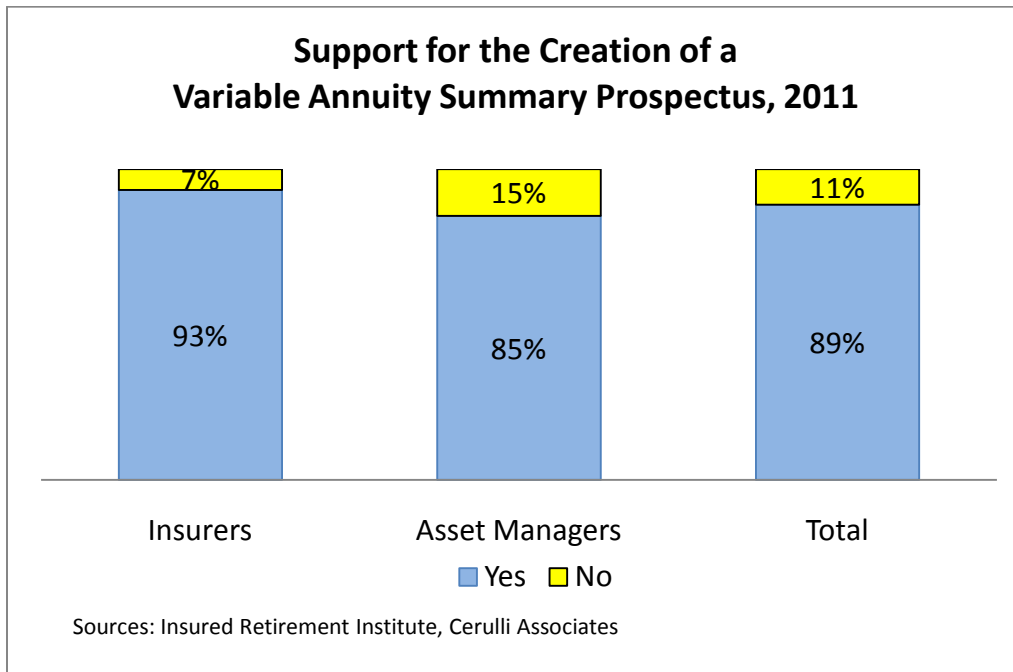


The same survey found that a summary prospectus would also enhance investors' discussions with their financial advisors, possibly boosting investor interest in annuities in response. Nearly two-thirds (59%) of survey respondents indicated that they would be more likely to discuss VAs with their advisors if they were provided with a short summary prospectus written in clear, plain English—a significant implication for the industry.

Insurer and Asset Manager Perspectives

Product manufacturers are also strongly advocating for the use of a VA summary prospectus. In a 2011 survey conducted for IRI by Cerulli Associates, 89% of industry executives expressed support for the development of a VA summary prospectus. Not surprisingly, insurers back the VA summary prospectus concept to a higher degree than the asset managers who oversee the underlying funds, yet both groups still indicate substantial support (93% and 85%, respectively).

There were various reasons given for the support of a VA summary prospectus, some of which are listed verbatim, below. The key reasons pertain to investor and financial advisor education, increased likelihood of the prospectus serving its consumer purpose, and the potential of both of these factors to increase acceptance by financial advisors and resulting in sales to consumers. A couple of respondents also mentioned that there was high demand on the part of their clients.



Selected Survey Responses Regarding the Support of a VA Summary Prospectus

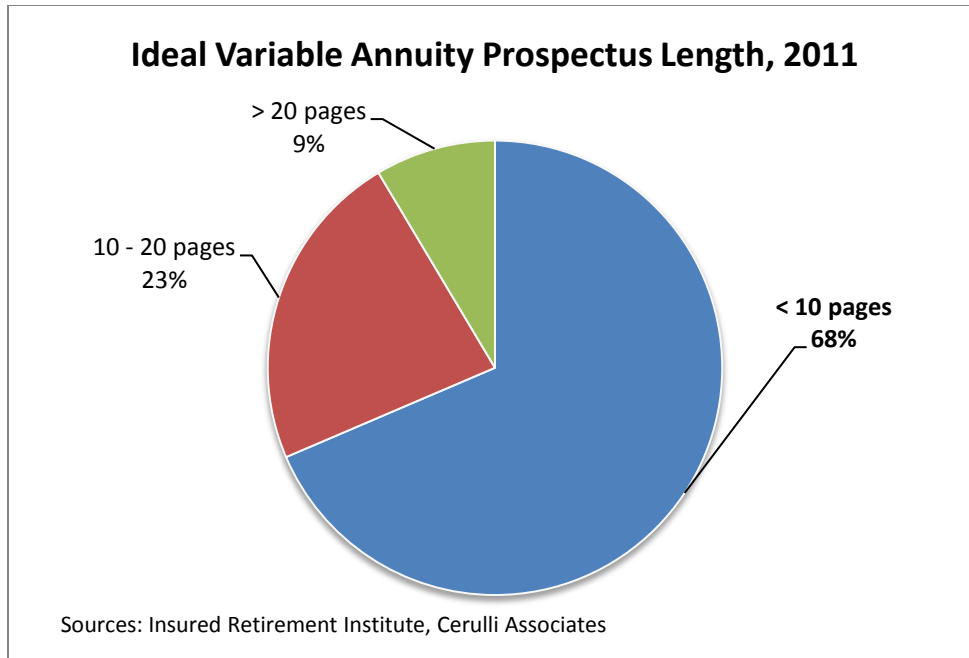
Reason(s) for Supporting VA Summary Prospectus	Firm Type
(1) <u>Greater product understanding</u>	
• “To educate advisors on a topic they fear only because they are not knowledgeable about it.”	VA asset manager/subadvisor
• “Help both advisors and clients better understand the proposed products”	Insurance company
• “To make key expenses, features, and consequences of products more transparent and easier to understand.”	Insurance company
(2) <u>Increased likelihood of being read</u>	
• “To streamline the language and make the prospectus more user-friendly for the consumer.”	VA asset manager/subadvisor
• “Aligns with standard mutual fund practice,” “Similar to mutual funds”	Insurance company VA asset manager/subadvisor
• “Better for the customer, but not to replace the full prospectus, only as a supplement”	Insurance company
(3) <u>Will lead to industry growth</u>	
• “Simplifying the prospectus for investors is critical to increasing acceptance of these products.”	VA asset manager/subadvisor
• “Makes product more accessible to clients and advisors”	Insurance company
• “Potentially helps with attracting new advisors and clients to annuity products”	Insurance company

Sources: Insured Retirement Institute, Cerulli Associates

Anatomy of a Summary Prospectus

The IRI Summary Prospectus Working Group has partnered with a consumer financial literacy consulting firm, Lightbulb Press, to prepare a sample variable annuity summary prospectus. Keeping in mind that formal guidance from the SEC is still in progress, we provide a basic outline of the components.

The sample summary prospectus is 13 pages long, which is closely aligned with the range of feedback IRI has received from insurance industry executives over the past couple of years. The most recent data on ideal summary prospectus length is presented below. While the length of a summary prospectus will vary depending on what a product offers, nearly 70% of respondents believe that the ideal length of a variable annuity summary prospectus is less than ten pages, and another 23% believe the ideal length is between 10 and 20 pages. However, IRI recognizes that a summary prospectus may sometimes be longer to incorporate riders and other information that companies offer.



IRI's proof-of-concept sample summary prospectus for VAs is comprised of ten sections running from one-half to two pages long. Our proposal includes the following sections:

- *Understanding Your Annuity Contract*: Describes contract basics, including asset accumulation and income options (including living benefits) in general terms.
- *Investment Choices*: Provides general information on the investment alternatives, including the number of funds, investment restrictions, and rules on transfers. The reader is directed to the full prospectus for detailed information on the funds and management of the funds.
- *Receiving Income*: Describes the key implications of withdrawals (with and without the principal protection features), and the options for receiving lifetime income payments (via minimum withdrawal benefits or annuitization).
- *Death Benefits*: Briefly describes the standard and guaranteed minimum death benefits available with the contract.
- *Annuity Contract Series*: Explains the differences between the variations of contract types, such as B-shares and L-shares, if available.
- *Cost of Ownership*: At roughly one-and-a-half pages, clearly outlines the charges associated with the contract, how and when they are applied, and the average annual cost estimate of owning the annuity. Most of the information is presented in tables for ease of reading.

- *Risk to Consider:* Focuses on general risks (such as investment risk) and those associated with guaranteed benefits.
- *Taxation:* Provides implications of annuity taxation (including tax deferral and penalties), as well as a prominent statement about annuities purchased on a tax-qualified basis.
- *Buying Your Annuity Contract:* Explains the steps to purchase the annuity contract, alerts the investor to check on any age limits and broker-specific features, and prominently displays the free look provision.
- *Distribution of the Contracts:* Briefly addresses advisor compensation.

It is important to note that, with the exception of the cost data, the information in the summary prospectus is qualitative, enabling prospective and current clients to learn about the product without having mathematical formulas deterring their understanding. The material, per SEC feedback, is largely in plain English versus technical legalese.

Additionally, online 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.

Conclusion

A prospectus for any product is of no benefit if it is not read and understood by prospective and current investors. As research has shown, there is a critical need for a more consumer-friendly document in the variable annuity industry to best serve the investing public. Annuities are designed to be held long-term, and have many sophisticated features that can be difficult to comprehend by both investors and advisors. IRI contends that the development and distribution of a summary prospectus for variable annuities will lead to greater understanding of the product and increased consideration and adoption as part of an investor's overall retirement plan. With the first wave of the 79 million Baby Boomers turning 65 this year, the demand for guaranteed retirement income is at an all time high. Of note, IRI research shows that nine out of 10 Boomers who own annuities have a higher confidence in the financial stability of their retirement when compared to those who do not. By reducing the length of the information and presenting it in a more consumer friendly format, investors will have a better opportunity to become more informed about an insured retirement strategy

IRI continues to advocate for the development and adoption of a rule permitting the use of VA summary prospectuses and is working directly with the SEC and other stakeholders to make this a reality. Yet, the same reasons that underlie the need for the document also present challenges. As Director Donahue stated in his December 2009 presentation, "It is interesting that the very complexity of these products which makes clear, concise disclosure so important also makes the goal that much more difficult to accomplish. But I am confident that it is doable and I look forward to working with the industry toward that goal." With the assistance of firms that do business in the VA industry—almost all of whom already support this initiative—we anticipate that a rule will be adopted and that summary prospectuses will gain wide adoption in the coming years. With the target market for retirement products growing every day, the need is greater now than ever.