ADVANTAGE COMPENDIUM

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Helping Seniors Make Wise Decisions About Annuities

That mental prowess declines as we become aged is not something newly realized, and many theories have been advanced over the years to try to explain why it happens. Two thousand years ago Cicero said senility was due to laziness and argued that mental stimulation would keep one sharp. A couple of centuries later the physician Galen said the reason for mental decline was that people grew cooler as they aged resulting in an accumulation of excess phlegm that caused brain function to slow (Schäfer, 2005). The snot head theory of aging was generally accepted until the mid 1700s when Antonio Fracassini of Verona theorized that aging caused a hardening of the vessels to the brain and this caused the decline.

The decision making ability declines with age *(Isabella et al, 2008)*

There continues to be a great deal of research into how old age affects the decision-making powers. It is interesting work, but this story is not about asking why or even if the decisions of senior citizen are negatively impacted by aging. Instead, my goal is to offer a prescriptive approach using the findings of academic research in this area to illuminate things that can be done that may or should help seniors arrive at better decisions regarding the purchase of an annuity. My hope is this story will assist interested parties in the annuity industry in doing a better job in producing products, sales materials, disclosures, and agent training that puts seniors in the position to make the best possible decision when it comes to buying an annuity.

I have outlined the problems in senior decision-making that research has uncovered and suggested ways that these problems may be minimized and possibly avoided. Since current academic research is still mainly working to identify precisely why decision-making ability declines with age, and is not yet offering many specific solutions, I have attempted to provide annuity contextual answers to the generally recognized cognitive problems.

It should be noted my proposed solutions assume seniors are not afflicted by dementia, Alzheimer's, or anything else beyond normal aging that would hurt the decision-making ability. Dementia not only affects the person's actual ability to make an informed decision but their ability to determine whether additional help is needed. Indeed, as dementia worsens the individual become even less aware that they have a problem (Van Wielingen et al, 2004). Coupled with this is the problem that if the dementia is mild the senior may still be able to process and respond to some financial decisions without seeming impaired. My solutions assume the senior is not legally impaired.

No Evidence That An Active Brain Remains Young

It is widely assumed that keeping mentally active will prevent or at least slow mental decline, but there is a lack of research supporting this contention. A 2006 study concluded that, "there is currently little scientific evidence that [engaging] in mentally stimulating activities alters the rate of mental aging" and that the "mental-exercise hypothesis is more of an optimistic hope than an empirical reality" (Salthouse). The study does not prove keeping mentally active does not work, it says that it cannot find direct results that say it does work. The author also says that keeping mentally active will not hurt you, should contribute to quality of life, and that future research may be more supportive.

Who Is A Senior Citizen?

Although the U.S. Senate Committee on Aging describes senior citizens as anyone age 60 or older (http://aging.senate.gov/issues/elderfraud/investment_fraud.cfm) most of the state regulatory laws and proposals seem to define a senior as a citizen age 65 and beyond. The various studies on aging and decision-making I have read used "old age" subject groups from as low as age 50 to as high as age 102.

Giambra's study found that memory decline became significant after age 65, and the age 65 to 70 period is when "cognitive decrements begin to appear" (1995). After age 85 more rapid declines in working memory occur (Zelinski, Burnright). However, based on my research any attempt to define a "senior citizen" by coming up with a stated age is entirely arbitrary because people age differently. I use the word "senior" in this article to describe one that is older than middle-aged, and I will leave it to the lawmakers and scientists to decide the magic age at which a citizen become old.

Problems In Decision-Making

"Perceptual speed, memory, and fluency showed similar amounts of decline, whereas knowledge showed preserved stability until about age 90" (Singer et al, 2003)

Declines In Working Memory

There have been numerous studies that conclude our working memory gets worse as old age progresses (Verhaeghen, 2003). Making decisions requires the use of working memory.

During the decision-making process our minds are fed streams of data consisting of words, numbers and pictures, that we then need to temporarily store, while simultaneously being able to determine to what degree different parts of the data are useful to our decision, doing comparisons and rankings between the different types of data and also accessing stored knowledge to determine whether the data is consistent with what we know, coordinating it all to put it in a form that we can process, and then sifting and sorting through our past knowledge again to see if the new decision is similar or contradicts a past decision reached, so that finally a new decision can be made (Heinz-Martin et al, 2002). It is an extraordinary process, and research finds that the people that can juggle the most pieces – the ones with the largest working memories – are the smartest people (Kyllonen & Christal, 1990).

Working Memory Declines – Seniors can hold less new data in their heads at one time and the speed of processing the data slows. This means

Seniors get overwhelmed by too many choices (and don't multitask well), and

Seniors use mental shortcuts that often do not result in good decisions. They mistake quantity for quality, they ignore the true risk of a situation, and they tend to choose what they recognize instead of what is best.

Two related factors affecting senior decision-making are the slowing of reaction time in processing, comparing and coordinating all of these pieces, and a decrease in the total data we are able to hold in our heads. Seniors process decisions more slowly than young adults and decision accuracy also declines (Bopp & Verhaeghen, 2007).

A comparison explaining the differences in decision-making between young and old could be made by looking at a recent computer with a Pentium chip and an earlier one with an 8086 processor. Both can solve problems, but the early processor can only take in only so much data at a time and then it processes the data more slowly than the computer with the Pentium chip. If the old processor received too much data it often went into a data loop freeze and did not generate an optimal solution. It appears normal aging eventually downgrades our mental hardware, but still allows us to compute.

This analogy can be taken further in that the 8086 processor can still provide good answers if the data is presented more simply and more time is given for computation, and these same steps should be taken to improve seniors' capability.

Seniors Suffer From Too Many Choices

A January study on decision-making concluded, "We find that the probability of a person selecting the optimal option declines as the number of options increases, with the decline more pronounced for older subjects" (Besedes, 2009). Many studies have concluded that too many choices result in worse decisions or no decision regardless of age (Iyengar & Lepper, 2000; Thompson et al, 2005) and thus the more choices you offer to old consumers the worse they do in making a good decision.

What this means is while everyone can suffer from the negative effects of too much information seniors are more likely to make decision errors when they have too many choices and too much information is given (Peters et al, 2007).

Seniors Don't Do Multitasking Well

Although studies show that multitasking hurts decision-making accuracy for both young and old the inaccuracy of seniors whilst multitasking is greater (Verhaeghen et al, 2003). There is much evidence showing that seniors do not multitask well (Kray & Lindenberger, 2000). The implication is all adults, but especially seniors, should focus solely on the decision at hand and not attempt to do additional things at the same time.

Seniors Look At Quantity Not Value

A current paper states, "Older subjects tend to discard information on the relative importance of attributes, selecting options with the largest number of attributes" (Besedes, 2009). This indicates that seniors tend to choose the product with the greatest number of benefits instead of the product with the greatest value, even if the benefits are not important to them. As an example, a senior that was strongly interested in having an annuity that waived surrender charges upon death might be more likely to choose an annuity that waived surrender charges for critical illness, nursing care needs and unemployment – and did not waive charges for death – over an annuity that only waived charges for death because three benefits are more than one benefit. Seniors tend to ignore information on the importance of the benefits and make selection based on quantity of benefits.

Seniors Ignore The Odds Even When Disclosed

In a similar vein, in decisions where the odds are presented younger consumers tend to look at the odds and choose payoffs based on the best odds; by contrast, seniors treat all choices as having equal probability even when the odds are presented (Besedes, 2009). This could be the reason why seniors congregate at the slot machines instead of enjoying the better odds at the blackjack and craps tables, and why showing the highest, lowest and median hypothetical index annuity return deludes seniors into thinking they have a 1 in 3 chance of earning 12% a year forever even if the actual probability is less than 1%.

Seniors Use More Heuristics

Seniors rely more on heuristics (mental rules of thumb or shortcuts) as mental load increases and working memory declines (Mata et al, 2007). Rules of thumb are often good because we rely on a favorable past decision to guide the current one, but they may also produce poor decisions.

The *compromise heuristic* leads to taking a middle option offered even if it is not optimal (Drolet & Simonson, 2007). The *recognition heuristic* tells us if one of two objects is recognized and the other is not, then the recognized one is usually preferred (Goldstein & Gigerenzer, 2002) but only to a point. As an example, if decision is about which will pay the highest return: a Fidelity annuity, a MetLife annuity or an XYZ annuity, the person may well choose the Fidelity or MetLife annuity because they recognize these names and infer that they must provide a higher yield than XYZ.

The recognition heuristic can backfire if the recognition is negative (Goldstein & Gigerenzer, 2002). If one had a bad experience with Fidelity and MetLife they would be inclined to try their luck with the unknown choice. However, if the decision-maker was an annuity industry analyst the recognition heuristic would not apply because all annuities would be equally recognized.

Consequences

Due to declines in working memory capacity and processing speed seniors tend to use less information in making decisions, find it more difficult to understand some information, and tend to forget previous decisions resulting in inconsistencies (Mata et al, 2007). In addition, seniors select decision-making strategies that are less mentally demanding than young adults do. However, these less intensive strategies often result in good decisions because seniors have more knowledge than young adults and they can often use this knowledge to offset capacity and processing declines, but it is not that seniors choose to apply their knowledge; it is because mental decline forces them to search for other ways to make the decision so they must rely on what they have left (Mata et al, 2007).

The "however" in all this is often there is enough information and brain power to make a good decision. A 2006 study agreed that seniors do not dig as deep as young adults when getting data for the decision, but found the magnitude of errors was the same for both groups (Musielak et al). The authors said while young adults do better on cognitive tests they do not perform better than seniors when confronted with real life problems.

Being Too Positive

The *socioemotional selectivity theory* states that as people age their motivation changes from learning new things to maintaining a positive emotional state; seniors work hard to keep themselves in a positive frame of mind (Cartensen et al, 2000). A possible problem exists if the senior works so hard to remain positive that they create false memories. Piguet led a study that found both young and old remembered negative and neutral words when they were tested on them, but that seniors were much more likely than the young to create false memories for the positive words they had not heard (2008). Although some studies have not found that seniors manipulate their memories to maintain a positive mental state (Fernandes & Ross, 2008) several other studies say seniors spend more time trying to feel emotionally good and tend to block out negative emotions, and if negative information is received, seniors disproportionately forget it (Kennedy & Mather, 2007).

Although the stereotype of seniors is often the complaining curmudgeon, seniors are more likely to be in a good mood more often than young adults, and seniors work hard to keep themselves in a positive frame of mind (Cartensen et al, 2000). They are more affected by appeals to emotion than logic and react positively when asked to recount life experiences. And although all people are subject to *vividness bias* – whereby we react more to the brightest color, biggest number, loudest noise – seniors are more susceptible to this bias (Kennedy & Mather, 2007). All of this may mean, for example, that a senior does not comprehend the possible impact of surrender charges because they are viewed as a bummer on their positivity, and since they do not intend to surrender the policy they do not anticipate feeling the emotion of regret.

Improving Decision-Making

Give Seniors Enough Time

A 2005 study found that when seniors are given more time to study and remember new data that they perform as well as young adults (Spaniol & Bayen). The study says if seniors are not pressured and not rushed they tend to make decisions as well as anyone else. In addition, if given the deliberation time needed, seniors do not tend to be more risk-averse or conservative than young adults (Denburg, Tranel & Bechara, 2005).

Seniors may also have trouble learning new data, so it may take repeated exposure to get new data taught (O'Connor & Kaplan, 2003). This requires ongoing questioning to determine if the new data is being processed.

Note: To improve their decisions seniors should be given all the time they need without feeling pressured or rushed.

Meet With Seniors In The Morning

When do seniors make best decisions? In the morning (Yoon, 1997). Yoon's study says, "older people may have greater processing resources available in the morning, such that presenting information in the morning, as opposed to afternoon or evening, may serve to reduce age-related processing differences".

If the decision is something that a senior cannot or should not decide using a mental rule of thumb, then it is best to make the presentation in the morning. This also may mean annuity applications and disclosure forms should show the time of day signed as well as the date, to track whether there is a relationship between future complaints and time of day of the sale.

Note: If at all possible, meet in the morning if the senior is being asked to make a complicated decision or one that is in an area outside of the senior's past knowledge.

Training Seniors

A 2003 study took college educated young and senior adults through six financial planning problems (Hershey, Jacobs-Lawson & Walsh). A group of both young and senior adults received six hours training on retirement planning concepts; another group of young and old received no training. Although the untrained young and senior (average age 69) adults did worse than either trained group the untrained seniors did much worse. On the other hand, the trained young and senior (average age 73) adults performed at much high levels – at times the seniors outperformed the youngsters.

Seniors were taught procedures to help them make good financial decisions and it worked! However, without training they did not choose well, hinting that a lifetime of knowledge may not be helpful if it is not related knowledge. This indicates that all adults, but especially seniors, should probably be legally required to pass a day-long course on financial and retirement planning before they are permitted to touch their own money. At the very least, it would be helpful if holistic retirement planning education is made available to seniors by carriers and agents.

Note: An untrained senior needs to rely on help (advisor, agent) because their own decisions may not be good unless they are experienced in the area, so the agent or advisor needs to determine how savvy the senior is to determine how much help is needed. Ideally the agent or carrier would provide training and education to help the senior determine whether an annuity is needed and which annuity mix is right for their situation.

Connect Emotionally With The Senior

There is a great degree of agreement that emotions affect decisions (Mata, 2007). In the case of seniors it has been found they respond better to, and remember more of, information when it is emotionally charged (Hanoch, Wood & Rice, 2007). Indeed, Hanoch writes that an environment that is emotionally void and filled only with cold facts could pose cognitive difficulties to seniors. The message here is that when emotions are tied in with goals seniors remember the message.

The other element mentioned is seniors focus on positive information over negative or neutral data. This positive focus could mean that as soon as a senior connects a decision with a positive emotion that they quit processing any new information. It also indicates how information should be presented to enhance decision-making.

If the emotional tie-in is presented first the senior may stop looking for new information as soon as they find a data anchor to connect the emotion to, and this results in overlooking other important information (Hanoch, Wood & Rice, 2007). This suggests that the factual information should first be presented and then the emotional link to the senior's goal is revealed.

Note: This is a balancing act. The senior needs to know the facts so they can make a good decision, but they will not be motivated to remember and process the facts unless they feel an emotional connection. However, if the emotional link is built up too quickly the senior may make a premature decision that is not optimal.

Give Enough Choices, But Not Too Many

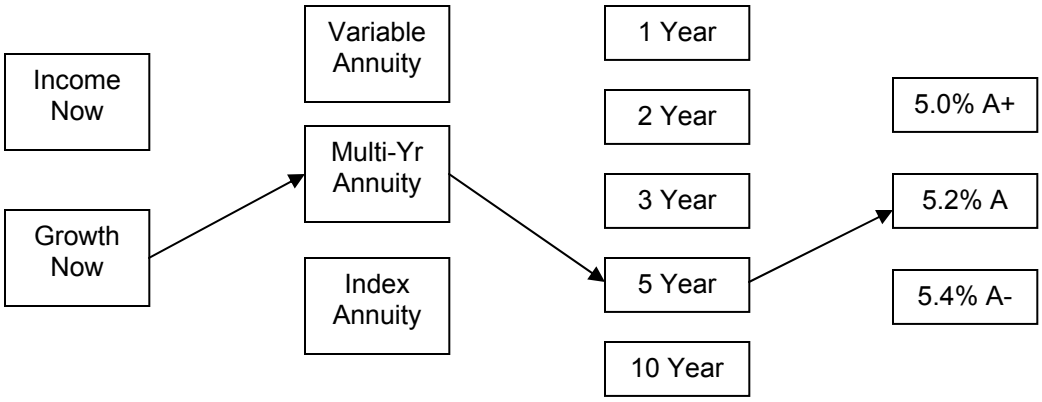
In November 2005 Medicare made available what became a menu of 55 prescription drug plans. Of the 43 million eligible Medicare customers roughly 10 million – less than a quarter – actively decided to select one plan (Reed et al, 2008).What about the other three-quarters of eligible retirees? I believe they were crushed by choice overload wherein they were so afraid of making the wrong decision that they refused to make any decision. This is coupled with the working memory problem that says as we age we hold less data in our head. Too many choices worked to prevent good decision-making.

When seniors were asked how many options they wanted to choose from the average senior wanted 4 choices when it came to picking a hospital or drug plan, 5 choices for a doctor or jar of jam, and 6 choices for an apartment or car (Reed, Mikels & Simon, 2008). In general, adults under age 50 wanted 50% more choices than seniors.

This does not mean the senior should be denied the availability of selecting from amongst the 96 variable annuity sub-accounts, or the six different crediting methods on the five different indices with the three different premium bonus levels, it means either the carrier or agent needs to act as sorter to make the decision manageable.

Data Sorting

In the annuity world the process could begin by determining whether the annuity will be used to generate an income now or in the near future. If the answer is now, the presentation could then focus on comparing immediate annuities and annuities with lifetime payout/withdrawal benefits. If the answer is the annuity will be used for growth, the presentation could focus on the risk/reward aspects of variable, index and fixed rate annuities. If the answer is the senior wants no market risk to principal and a yield guaranteed for the surrender charge period, the presentation would show the yields on multi-year annuities with varying terms. If a five-year term was selected, the focus could then be on choosing from the three highest yielding annuities from carriers rated by A.M. Best as "A+, A, or A-".



By sorting the data the senior did not need to pick the one perfect annuity out of the thousands available. The greatest number of choices encountered at any one time is five and each step involved one small aspect of the overall decision process to keep working memory from being overwhelmed.

The sorting process can also be done by using a variation of the recognition heuristic. The carrier creates sales materials showing other seniors with various needs and goals and the annuity mix used in each situation to provide a solution. The idea is the senior recognizes themselves in one of the vignettes and copies the solution.

Mata says that, "older adults are adaptive and may still be able to perform successfully by relying on simpler strategies in the appropriate environment. In other words, simplicity can pay" (2007). The idea is not to deny choices to the senior, but to create a strategy that simplifies the processing of the choices.

Note: Give the senior choices but present a series of bite-sized choices rather than entire buffet.

Help Seniors Process Information

The correct amount of data disclosure depends on the need for what is and is not disclosed. The variable annuity world is hamstrung by SEC disclosure requirements, which means seniors will need to rely on representations made by their advisor/agent to make a decision – even the new simplified Summary Prospectus experiment to attempt to reduce the confusion caused by a normal prospectus has resulted in so much unimportant minutiae displayed that investors still cannot figure out actual mutual fund loads and returns (Beshears et al, 2009). In the fixed annuity world the senior needs to be able to determine whether 1) an annuity is the right decision, and if so, 2) which annuity product is the right one for them. Unfortunately, disclosure is not uniform across products or states.

If seniors are able to process information they make better decisions. Indeed, a 2008 study found that seniors "can make advantageous decisions when complete information about the decision situation is available" (Zamrian et al). The difficulty is in conveying the information in a manner that the senior can work with if working memory skills have declined. There are ways to help seniors make better decisions and cope with a worsening working memory.

Symbols

In a 1993 study Cole proposed using symbols to make decisions easier. I only found one study that directly tested this (Peters et al, 2007), but seniors made better decisions when they could use symbols to evaluate and compare choices. The appeal of the 4 stars, AAA rating, 5 Diamonds type of symbols is they simplify decision-making. Instead of getting information on every restaurant in town one can simply look at restaurants with a minimum Zagat rating of 27 and assume that all will be acceptable. It would make decisions much easier if one annuity had a rating of 4 Jacks and another was rated 3 Jacks.

When considering annuities one can rate the carrier. There are already different symbols used to represent financial strength, by using surveys you could also develop ratings showing how good the customer service is, and you could even grade the annuity renewal histories if the carriers cooperated. Unfortunately, I cannot figure out how to create meaningful symbols to help in evaluating annuity products.

Should an annuity with a 6 year surrender period have a higher rating than one with a 10 year period? Perhaps not, if that extra four years enabled the carrier to offer higher yields and the annuityowner would not need the cash for at least 10 years. Does a minimum guarantee of 2% on 100% of premium justify more stars than one of 2% on 90%? Not if it is an index annuity with a goal of maximizing money available for index participation – the 100% guarantee might get you a 7% interest cap while the 90% might get you 8%. Speaking of caps, it would be impossible to assign ratings based on first year rates, cap, spreads or bonuses because most annuities can change at least one interest rate factor in future years making a mockery of any attempt to denote the best index annuity crediting.

Multi-year annuities and immediate annuities could be graded based on their yield/income factors in specific time periods, and one could probably factor in the financial strength, but these annuities essentially have their own rating system; the disclosed yield. Symbols would help seniors in processing annuity information, but beyond the financial ratings already in use I cannot come up with a broad ratings based system that could accurately rank annuities.

Standardized Disclosure

If you look at the label on a can of soup or almost any other packaged food the first line will tell you the serving size, below that the calories are listed, and below that the total grams of fat, cholesterol and carbohydrates are disclosed. This displaying of data is required by the Nutritional Labeling and Education Act of 1990 (http://aces.nmsu.edu/pubs/_e/E-136.pdf). The act also defines what the standardized terms mean and if particular claims are made these claims must meet federal regulatory requirements (as an aside, the act exempts beverages with no nutritional significance from this law, so why do bottled water makers choose to print the label?)

The labeling act allows consumers to compare the calories and healthiness of various foods and standardizes some definitions, so that, for instance, a packaged meal labeled "very low sodium" must have a salt content no greater than 35 milligrams per 100 grams (http://www.fda.gov/Food/LabelingNutrition/LabelClaims/ucm064911.htm).

It does not provide all of the information needed for a decision. For example, if the label says a soup serving has 7 grams of fat one would not know whether this is high or low without comparing it to other soups. In addition, the label does not tell whether the food tastes excellent, fair or poor; one needs to determine this for oneself. The final problem is the consumer needs a frame of reference for the information. Is 7 grams of fat good or bad – the answer would depend on the consumer's other food choices and their individual situation. Standardized disclosure only helps consumers that want to understand their choices so they can make the best decision, and this is why it would be helpful in the annuity world.

Standardized Definitions

The National Association of Insurance Commissioners (NAIC) publishes an annuity buyer's guide, but the few definitions given are usually incomplete. For example, the guide says the minimum guaranteed interest rate is the lowest rate your annuity will earn, but as previously discussed the guaranteed rate could be 2% and it might be paid on 100% or 90% of value. The guide says the death benefit is often the contract value. This value is described in one section as the premium plus interest less applicable charges, so does this mean death benefits are usually paid net of surrender charges? Not most of the ones with which I am familiar.

Since products evolve it would be difficult to create a comprehensive glossary that remains up-to-date, and it really does not matter what a carrier calls their lifetime withdrawal benefit as long as the senior understands what they are getting. The terms that need standardized definitions are in the area that I receive the most questions from seniors about – when can I get my money. Some possible definitions are as follows:

Accumulated Value – this is the amount of money that is used to compute your income if you elect to annuitize your annuity, or you will receive if you cash in your annuity and there are no surrender penalties.

Cash Value – this is the amount of money you will receive if you cash in your annuity. If there are no surrender penalties the cash value is the same as the accumulated value.

Death Benefit – this is the amount of money your beneficiary will receive if you die.

Minimum Guaranteed Value – this is the minimum amount of cash you will receive if you cash in your annuity.

Surrender Penalties – these are charges for excess withdrawals above and beyond the free withdrawal limit.

These definitions would help a senior to make apple-to-apple comparisons. The cash value is the amount of cash one receives if you cash the annuity in. The annuitybuyer would not need to determine whether one annuity's contract value is the same as another annuity's surrender value or a third annuity's accumulated value. The minimum guaranteed value avoids the issue of different premium baselines used by calculating the minimum cash received based on the stated rate or minimum floating rate.

Definitions could be used in other areas. Index annuity methodologies often use different terms to describe the same thing. A crediting method that sums the monthly gains – up to a cap, and subtracts monthly losses – without a cap, to determine interest credited is most often called a "monthly cap" but a few carriers began calling it the "monthly point-to-point" method. The problem is a point-to-point method is generally understood to lock-in the gain or loss at the "point" but a monthly point-to-point does not lock gains or losses in each month, so calling it a monthly point-to-point is misleading at best. I am also disturbed by the number of consumers that seem to believe that a guaranteed lifetime withdrawal benefit income growth rate of 7% or 8% is really guaranteeing them a 7% or 8% cash-on-cash yield for life. It would help the decision-making process if each term meant the same thing.

However, if you create a long list of annuity formula definitions you return to the possible problem of overwhelming the working memory. Seniors can compare bank money market accounts by looking at the APY (annual percentage yield); it would be helpful if seniors could get a handle on different annuities by looking at the MGV (minimum guaranteed value) or the LPA (lifetime payout amount).

Standardized Forms

The nutritional information on a cereal box or soup can has the same format. This reduces mental load because one does not need to search for and transcribe the data on different foods allowing the focus to be placed elsewhere. Although there is commonality between annuity disclosure forms it would be helpful if some basic information was presented using the same format and language. One format is:

Safety:
You understand annuity guarantees are backed by the claims paying ability of the annuity carrier and are not FDIC insured. The A.M. Best Financial Strength Rating of the annuity carrier is _____.

Liquidity:
You will be able to withdraw 100% of your premium, any premium bonus, and interest earned without any surrender penalties or charges after _____ years.

You will be able to withdraw up to _____% of your premium, any premium bonus, and interest earned each year without any surrender penalties or charges after _____ year(s).

You will be able to withdraw 100% of your premium, any premium bonus, and interest earned without any surrender penalties or charges if you are confined to a nursing home, long term care facility or hospital for more than _____ days.

If you die your beneficiaries will receive 100% of your premium, any premium bonus, and interest earned without any surrender penalties or charges after _____ years.

Bonuses:
The annuity credits a premium bonus of ____%. You understand that a premium bonus will result in your annuity having lower future interest rates or index participation than if you had purchased the same annuity without a premium bonus.

The annuity credits a premium bonus of ____%. The premium bonus is 100% vested after ____ years.

Minimum Guaranteed Values:
Your annuity premium is $_____If you cash in the annuity you will receive, after any surrender penalties and charges, a minimum of:

$_____ After 1 Year

$_____ After 5 Years

$_____ After 10 years

Surrender Penalty:

Yr 1	2	3	4	5

Yr 6	7	8	9	10

Lifetime Withdrawal Benefits:
You understand that any bonus or guaranteed growth rate associated with increasing the lifetime benefit payout does not increase the cash value of the annuity.

You understand that if you do not choose to receive a lifetime payout you receive zero benefit from any bonus or guaranteed growth rate.

You understand that if you are receiving a lifetime payout and die before your annuity cash value is exhausted that you receive zero benefit from any bonus or guaranteed growth rate.

If I choose to begin lifetime withdrawals my minimum annual payout will be $_____ after 5 years and $_____ after 10 years.

XYZ Annuity Benefit Summary and Disclosure

1. You understand annuity guarantees are backed by the claims paying ability of the annuity carrier and are not FDIC insured. The A.M. Best Financial Strength Rating of the annuity carrier is **"A" (Excellent).**

2. You will be able to withdraw 100% of your premium, any premium bonus, and interest earned without any surrender penalties or charges after **10 years.**

3. You will be able to withdraw up to 10% of your premium, any premium bonus, and interest earned each year without any surrender penalties or charges after **1 year**(s).

4. You will be able to withdraw 100% of your premium, any premium bonus, and interest earned without any surrender penalties or charges if you are confined to a nursing home, long term care facility or hospital for more than **60 days**.

5. If you die your beneficiaries will receive 100% of your premium, any premium bonus, and interest earned without any surrender penalties or charges after **10 years**.

6. The annuity credits a premium **bonus of 10%**. You understand that a premium bonus will result in your annuity having lower future interest rates or index participation than if you had purchased the same annuity without a premium bonus.

7. The annuity credits a premium bonus of 10%. The premium bonus is 100% **vested immediately**.

8. Your annuity premium is $100,000. If you cash in the annuity you will receive, after any surrender penalties and charges, a minimum of:

$ 91,308 After 1 Year

$101,222 After 5 Years

$107,333 After 10 years

9. Surrender Penalty:

Yr 1	2	3	4	5	6	7	8	9	10
10%	10%	10%	9%	8%	7%	6%	5%	4%	3%

10. Lifetime Withdrawal Benefits:
You understand that any bonus or guaranteed growth rate associated with increasing the lifetime benefit payout does not increase the cash value of the annuity.

You understand that if you do not choose to receive a lifetime payout you receive zero benefit from any bonus or guaranteed growth rate.

You understand that if you receive a lifetime payout and die before your annuity cash value is exhausted that you receive zero benefit from any bonus or guaranteed growth rate.

If I choose to begin lifetime withdrawals my minimum annual payout will be $8,415 after 5 years and $13,980 after 10 years.

The standardized form answers the "when can I get my money" question by clearly stating when and under what circumstances the senior has access. It allows seniors to create mental short-cuts to reduce working memory demands. For example, if the senior wants to ensure that all money is available without strings in 10 years or less they know this is spelled out in the second disclosure. If a senior's requirement is that 100% of cash must be available upon death of the annuity owner the answer in the fifth disclosure would allow the senior to quickly dismiss this annuity and move on to another.

There are other areas that lend themselves to standardized disclosure. One area that would help lessen confusion in the lifetime withdrawal benefit area would be to only permit carriers to show the guaranteed payout amount at different ages/ contract years rather than talking about and showing income withdrawal benefit account growth, which is not a real cash number but is often perceived as such.

Processing Information
The point of standardization is to help seniors make better decisions by lessening demands on working memory. If it is known that "cash value" means the same thing regardless of the annuity then the mind does not need to process how each annuity calculates their value, but can simply compare the final cash values of each. Presenting the information in a standardized format allows seniors to create mental shortcuts that allow them to accept or reject products based on an earlier decision. Again, if a no strings attached death benefit is important the senior may used a standardized format to quickly dismiss all annuities without this feature and move on to the other parts of the decision. A benefit of standardization is it allows senior to quickly reject annuities that do not meet their goals.

The carrier or agent does not need to wait for NAIC to create standardized definitions or forms to help standardize the disclosure of information. The carrier should ensure that the same descriptions are used in all their products, so that a 5% premium bonus on one annuity has the same impact as a 5% premium bonus on another.

If the carrier creates hypothetical illustrations the same timeframes and general assumptions should be used. The agent should try to be consistent in the references and definitions used during the annuity presentation. The senior needs a frame of reference to process the annuity information and the agent often provides that frame.

State Assisted Decision-Making

State laws and agencies often attempt to help seniors make wise decision. They mainly do this by placing the responsibility for a wise decision on the purveyor of the products or services sold, and not generally by educating or assisting the senior to make wise decisions on their own.

Asymmetric Paternalism
We give government the power to protect citizens that are deemed incapable of making good decisions. In the 19th century these protected groups were "idiots, minors or married women." In the 21st century government still protects those legally regarded as minors, but the classification of an idiot waxes and wanes based on prevailing politics. For example, people that do not mind being around cigarette smoke are generally viewed by their local government as idiots and helped with their decision by laws providing for the segregation of smokers. A term used to describe this use of governmental power to override individual decisions is asymmetric paternalism.

Asymmetric paternalism is demonstrated by government establishment of default choices, state mandated disclosures, decision framing, cooling off periods and limits on customer choice (Camerer et al, 2003). Over the last few years several state governments have passed or considered legislation saying that when one reaches age 65 and wants to buy an annuity that they are incapable of making a good decision.

Default Choice – In 2009 Texas proposed a bill (SB961) mandating that an annuity purchased during a consumer's working life would have to be paid out as early as when the consumer turned age 70, making the default choice either receiving an income that may not be needed, or being taxed on many years of tax-deferred interest in a single year when the income may not be wanted.

Framing – New York State passed a law saying index annuities must disclose what the reinvested dividends on the associated index would have been, but refused to require index funds to show that they would have performed worse than the typical index annuity half of the time.

Disclosure – The same states that will not disclose that winning their lottery is less likely than pulling out the correct ping pong ball from an Olympic sized pool of ping pong balls, are requiring annuity carriers to expand disclosure language without determining if the additional language is helpful.

Cooling Off Periods – Several states are attempting to increase the current free-look period in which a consumer may return an annuity and get their money back, even though "Cooling-off periods appear more intrusive...and should thus be implemented with much greater reticence and only after careful analysis" (Camerer et al, 2003). However, if a consumer changes their mind after buying a certificate of deposit or mutual fund they are fully exposed to any possible loss.

Limits On Choice – In the annuity world the most visible sign was the 10/10 surrender period phenomena wherein some states determined that their residents should not be allowed to consider annuities with a surrender period longer than 10 years – in Florida a 5 year maximum period was briefly considered. I have not seen any empirical research concluding that longer surrender charges impose a greater economic harm on consumers.

I believe a primary reason for this asymmetric paternalism is a societal prejudice against old people. We tend to treat seniors as relapsed children and try to protect them because this let us both marginalize them and rationalize the guilt we feel in doing so. Another reason for these protectionist measures is because there is strong evidence that at least some annuity sales to seniors have been improper (Marrion, 2009) and the states are attempting to correct a problem that they do not see carriers addressing. However, it will prove more effective if regulators and carriers work together to develop annuity material, presentations, and disclosures designed to help seniors make better decisions.

When Is There Elder Financial Abuse?
According to 164 deputy district attorneys, senior law enforcement detectives, adult protective service workers, and public guardians and victims:

- There must be an emotionally or mentally vulnerable senior with assets
- Either the financial transactions or the senior are kept secret or controlled
- No independent determination was made that the senior was able to act in their own best interest
- The benefit received was not proportionate to the assets transferred
- The transactions are not in writing, are poorly disclosed and represent a conflict of interest

If all of these are in place then there is elder abuse (Kemp, 2005).

Who Should Pay For An Improper Annuity Sale?
If a senior is taken advantage of by an agent who pays for the damage? Parker at the University of Tulsa (2007) says it is simple, "The law must hold institutions such as life insurance companies accountable where their agents engage in financial elder abuse of an insured."

What if the carrier was not and could not reasonably be aware of the abuse. Parker says it does not matter because "If ultimate accountability were placed on the employing company to exercise care in the training, supervision, and monitoring of its agents, then major advances in curtailing the problem would certainly occur".

Conclusions

There are things that can be done to help seniors make better decisions about buying an annuity. The easiest way to help the decision process is to take it slow. Do not rush through the presentation, probe for understanding, and if possible, schedule the appointment for the morning.

Seniors need to be aware of choices, but pre-sort the choices into manageable sizes. In my last paper on aging I said disclose all relevant facts but only relevant facts. The senior does not need to know everything; they need to know everything meaningful for their decision. When the information is disclosed it should be done in stages so that working memory can process and digest the data, make a series of small decision, which can then be used to make the final decision.

Seniors process information better if they have an emotional attachment, and they respond more strongly to a positive message. This means one should not simple recite facts, but show how the facts relate to their emotional needs because this leads to greater concentration in making the decision. However, seniors can also use finding a positive emotion as a stopping point and not give the decision their full consideration. This may result in the senior tuning out on the negative aspects of the annuity because they found one or two positive emotional points to attach to.

When I read senior complaints about the annuity purchased they often claim they were unaware of the surrender penalties when they bought, even though the senior signed disclosures at time of purchase stating these penalties. Based on the research it is possible that any discussion of surrender penalties was ignored because a positive emotion created a mental shortcut to the decision. What this may mean is carriers and agents need to spend more time covering surrender penalties with seniors, and perhaps increasing the prominence of the surrender penalties, and any other negative facts, on sales materials and disclosures.

Although standardized definitions and disclosure forms would aid in senior decisions it would probably take regulatory action for this to happen. This does not mean carriers and agents cannot standardize their own approach by creating disclosures and product benefit descriptions that are similar in appearance and meaning, or when presenting different annuities to the senior using similar terms and comparisons.

Someday we may find out exactly why decision-making powers decline with age, and if we can identify the problem we may be able to find a solution to prevent age-related decline. Until then, there are many things that can be done to assist seniors in making wise decisions.

Helping Senior Make Wise Decisions

- **Give them all the time they need (preferably in the morning)**
- **Make choices bite-sized**
- **Educate them**
- **Make an emotional connection (but beware of satisficing)**
- **Try to standardize the information so that decision powers are used to determine the best choice and not wasted on trivia**
- **Work together to develop annuity sales material, consumer presentations, and disclosures designed to maximize the decision-making powers of the senior**

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Advantage Compendium Ltd. (www.advantagecompendium.com) is led by Jack Marrion, providing research and consulting services to insurance companies and financial firms in a variety of annuity areas. He has conducted a broad scope of research ranging from the behavioral economic reasons why consumers buy or don't buy financial products to producer and marketing company future industry impact models, as well as providing coaching specifically for annuity carriers and distributors.

His insights on the annuity and retirement income world have appeared in hundreds of publications including Best's Review, *Business Week, Kiplinger, Smart Money, The New York Times*, and *The Wall Street Journal*. In 2006 the National Association of Insurance Commissioners asked him to address their annual meeting and teach regulators the realities of index annuities. He is a frequent speaker at industry functions and a columnist for *Senior Market Advisor*, as well as a regular contributor to *National Underwriter*. Best's Review said he was likely to affect the course of the industry.

Prior to forming Advantage Compendium, Jack Marrion was president and owner of a NASD broker/dealer with offices in nine states, and formerly vice president of a life insurance company and previously vice president of an NYSE investment banking firm. He has an MBA from the University of Missouri and his doctoral studies in the area of cognitive bias in decision-making form a new paradigm in the marketing and development of retirement income products. Neither Jack Marrion nor Advantage Compendium sell or endorse any financial product.

Fall Issue Focus: Although the purchase of income annuities or annuitization of deferred annuities are often the most logical decision in retirement planning the reality is life contingent immediate annuity sales and annuitization rates have barely budged from a decade ago. In the next issue we examine the behavioral economic problems that are stopping sales, offer suggestions on how to overcome the problems, and present several innovative product concepts for annuity income planning.