Go to www.aaii.com for two more Briefly Noted articles this month.

Briefly Noted

Proposed Rules for Brokers Working With Senior Investors

The Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) analyzed how the investment industry interacts with "senior investors," investors the regulators define as aged 65 years old or older. The analysis involved 44 examinations of broker-dealers.

The SEC and FINRA used the information to create a list of steps that broker-dealers should consider incorporating into their procedures. The recommendations are not mandated, but rather are described as designed to "facilitate a thoughtful analysis" of policies and procedures related to senior investors.

Among the recommendations are:

- **Training:** Require mandatory continuing education. Course should cover the various stages of mental capacity (full or diminished) and solutions to assisting investors with diminished mental capacity. Supervisory staff should also be trained to assist when elder financial abuse is suspected.
- **Senior Designations:** All senior financial/investment designations should have a verified curriculum, a continuing education element and accreditation from a recognized independent institution (44% of designations currently allowed by broker-dealers are not independently accredited.)
- **Marketing and Communications:** Require written supervisory approval for any unscripted seminars or other related forms of public appearances. Evaluation forms should be distributed to attendees, with responses reviewed by a supervisor.
- **Account Documentation:** Ask senior investors to provide more detailed financial information, such as short- and intermediate-term expenses. Establish automated supervisory alerts to ensure profiles reflect changes in a client's personal and financial circumstances.
- **Suitability:** Adopt policies and procedures addressing senior investor-specific suitability risks. (Note that this is less stringent than the fiduciary rule would mandate.) Digitally store all conversations between broker representatives and senior investors about investment recommendations.
- **Disclosures:** Provide a detailed description of all registered representative compensation for each product sold on their website. Also distribute a single, comprehensive disclosure form that uses simple definitions and lists all fees and expenses.
- **Customer Complaints:** Code complaints as "senior related" in internal systems in order to respond better to and better analyze complaints from senior investors.
- **Supervision:** Establish policies for working with investors suffering from diminished capacity and for addressing occurrences of suspected financial abuse. Maintain product suitability guidelines for variable annuities, equity-indexed annuities, REITs, options and other alternative products.

Source: "National Senior Initiative: A Coordinated Series of Examinations," Securities and Exchange Commission and the Financial Industry Regulatory Authority.

Financial Disruptions Alter Retirement Plans for Many

Those who have seen their long-term financial plans adversely affected by an event are not alone. A survey conducted for TD Ameritrade found that two-thirds of American adults have experienced such a disruption.

The most common disruption (43% of respondents) has been the loss of a job or being forced to take a lower-paying job. Notably, poor investment or business performance was also among the most common reasons given (28%).

Whatever the reason, the disruption had a significant negative affect. Prior to the disruption, more than $500 was being saved per month. After the disruption, almost 80% of respondents said they reduced their savings and or expenditures and 49% said their ability to save or invest money was reduced. The net effect was a nearly 60% drop in the amount saved. Given the average disruption length of nearly five years, TD Ameritrade calculates the total drop in savings as being in excess of $16,000 per person. This decline in wealth caused 49% of survey respondents to say they may either need to delay retirement or forgo it completely. About 43% expect to have less money available than they previously expected.

Nearly half of all respondents said they wish they had saved a greater proportion of their income prior to the disruption. Many (36%) said they wish they had started saving or investing earlier.

If this data describes you, there are steps that can be taken. The first is to work longer. This will increase the amount that can be saved, reduce the number of years savings will be required to last in retirement and boost the monthly Social Security benefit. Some studies suggest that postponing retirement may even be better for a person's health.

The second is to save more. The annual limits on contributions to 401(k) plans and individual retirement accounts (IRA) are increased once a person reaches age 50. Additional money can also be set aside in a Roth IRA (subject to certain restrictions) and or a taxable account.

Source: "Financial Disruptions Delay Targeted Retirement Age to 68 Years Old or Later," TD Ameritrade, March 31, 2015.

Investors Have Difficulty Valuing Annuities

Investors and economists do not share the same opinions about annuities. Economists like annuities because they transfer the risk of outliving one's savings to a third party (meaning an insurer). Individual investors, however, commonly do not view these products in the same manner.

In an attempt to understand the reasons why, the Center for Retirement Research at Boston College (CRR) looked to see if there is a cognitive bias against annuities. Specifically, CRR researchers sought to determine if investors dislike annuities because they find them hard to value.

The researchers asked 2,210 individuals to value hypothetical changes in their monthly Social Security benefit. Study participants were asked how much they would pay to raise their monthly benefit by $100 and how much they would demand in exchange for a $100 decrease. In both instances, the initial offer was $20,000 and was adjusted based on the amount a respondent was willing to transact at. In theory, the transaction amount for receiving a $100 per month boost or accepting $100 per month reduction should be the same; the results proved otherwise.

The median price the study's participants were willing to pay for an additional $100 monthly benefit was $3,000. On the other hand, participants demanded a median compensation of $13,750 in exchange for a $100 reduction. To put these numbers in perspective, the lifetime value of a $100 monthly Social Security benefit is $16,855. The researchers say this experiment shows the difficulty investors have in valuing annuities. By not comprehending the value of a future stream of income, investors lack the ability to determine if an annuity is a good choice or not.

The researchers further found that altering how the question was asked changed how participants valued the change in benefits. Specifically, offering an initial lump sum of $30,000, instead of $20,000, increased the median amount participants demanded for a $100 per month benefit cut. The researchers say this behavior is further evidence that many investors have difficulty assessing the actual value of an annuity.

Source: "Are Cognitive Constraints a Barrier to Annuitization?" Jeffery Brown, Arie Kapteyn, Erzo Luttmer and Olivia Mitchell, Center for Retirement Research at Boston College, March 2015, Number 15-6.

Fundraising Requirements Loosened for Smaller Companies

The Securities and Exchange Commission (SEC) adopted final rules allowing small companies to publicly raise money. The proposed rule change had been expected since the passage of the Jumpstart Our Business Startups (JOBS) act. This is a step toward allowing companies to sell equity via crowdfunding.

There are two aspects to the rule change, which differ by the size of a company's offerings. Tier 1 consists of securities offerings of up to $20 million in a 12-month period. Tier 2 consists of securities offerings of up to $50 million. Participation by security-holders (e.g., shareholders) who are affiliates of the issuing companies is capped at $6 million for Tier 1 companies and $15 million for Tier 2 companies. Participation by selling security-holders is further capped at 30% of the issuer's initial and subsequent offerings for the first 12 months following the initial offerings.

Tier 2 companies must also provide audited financial statements; file annual, semiannual and current event reports; and limit purchases by non-accredited investors (individuals who don't meet high income or wealth requirements) to no more than 10% of the investor's annual income or net wealth. Tier 2 issuers will be exempt from the SEC's registration requirements if they meet certain conditions including a public float (shares available for trading on public exchanges) of less than $75 million or, in the absence of a public float, annual revenues of less than $50 million.

To be eligible, a company must be organized in and have its principal place of business in the United States or Canada and not already be an SEC-reporting company. Excluded for these type of offerings are companies without a specific business plan; those that have indicated their intention to merge with an unidentified company; those seeking to sell asset-backed securities (e.g., mortgage-backed securities) or fractional undivided interests in oil, gas or other mineral rights; those that have not filed reports required by the rules within the past two years; or those that are disqualified under the "bad actor" rules.

Keep in mind that the amount of information provided by either Tier 1 or Tier 2 companies may be very limited. Investors should treat such companies as highly risky and not allocate any funds to them that are needed for long-term or other financial goals.

Source: "SEC Adopts Rules to Facilitate Smaller Companies' Access to Capital," Securities and Exchange Commission, March 25, 2015.