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## SEC Action on Variable Annuity Summary Prospectus Uncertain

By Gary O. Cohen

The SEC and its Staff have repeatedly, if intermittently, announced the SEC's intention to authorize a summary prospectus and layered disclosure scheme for variable annuities, as the SEC has done for mutual funds.

Probably the most prominent announcement was by SEC Chairman Mary L. Schapiro who referred to the start of the project five years ago when she stated that the Staff "is developing a simplified 'summary prospectus' for variable annuities."<sup>1</sup>

Norm Champ, Director of the SEC's Division of Investment Management, cheered the industry when he announced, more than a year and a half ago, that the variable annuity summary prospectus was a "regulatory priority."<sup>2</sup> Thereafter, the SEC twice reported<sup>3</sup> to Congress an anticipated date of action, but missed both dates. The SEC then announced<sup>4</sup> the date of action to be March 2015. However, an SEC Staff official has publicly stated<sup>5</sup> that the March date could slip.

This means that more than seven years have passed since the SEC proposed<sup>6</sup> to authorize the summary prospectus and layered disclosure scheme for *mutual funds* and almost six years since the SEC's adoption.<sup>7</sup>

The SEC's long delay over the seven-year period is due to a combination of factors, most likely including:

- Commissioner and Chairman turnover, along with Commissioners' general unfamiliarity with variable insurance products, and
  - Congressional pressure to complete mandates of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010<sup>8</sup> (Dodd-Frank Act) and the Jumpstart Our Business Startups Act of 2012 (JOBS Act).<sup>9</sup>
- Other factors that may or may not have contributed tangentially to the long delay are:
- the SEC Staff's lingering hesitancy to take on new initiatives in the wake of the SEC's debilitating chagrin of missing the Bernard Madoff ponzi scheme,<sup>10</sup> and;
  - disclosure-creep that the SEC Staff has encountered with the mutual fund summary prospectus, along with the fact that variable annuities, particularly their optional riders, do not lend themselves to summary descriptions as readily as mutual fund shares.

### I. Weight of History

#### A. Problems of Fit

The stalled variable annuity summary prospectus is symptomatic of the difficulty that the SEC has experienced in seeking to fit variable annuities and, later, variable life insurance<sup>11</sup> (together "variable insurance products") under the federal securities laws.

Ironically, the SEC fought vigorously, for more than a decade, to extend its jurisdiction over variable annuities and life insurance company separate accounts that fund variable annuities.

Beginning in the middle 1950s, a number of life insurance companies undertook to offer and sell variable annuities without what the SEC deemed to be required registration with the SEC under the federal securities laws. The SEC brought two lawsuits<sup>12</sup> against these life insurance companies for not registering security interests under variable annuities pursuant to the Securities Act of 1933 (Securities Act). The SEC was the defendant in a third lawsuit<sup>13</sup> brought by another life insurance company for not exempting the company's separate account funding variable annuities from registering as an investment company pursuant to the Investment Company Act of 1940 (1940 Act). The two Securities Act cases went to the Supreme Court and the 1940 Act case went to the Second Circuit, with the SEC winning all three cases.

However, once the SEC won jurisdiction, it ran into problems fitting variable annuities under the federal securities laws.

The SEC's difficult experience with variable annuities under the 1940 Act has been summed up by statements of SEC Chairmen and other Commissioners. Chairman Ray Garrett, Jr., declared that "the '40 Act registration has been something of a nightmare."<sup>14</sup> Chairman Arthur Levitt testified before Congress that fitting the products under the 1940 Act "has been difficult, resulting in the regulatory equivalent of fitting a square peg into a round hole."<sup>15</sup> Commissioner Philip A. Loomis observed that "the job of fitting the variable annuity into the Investment Company Act was a very difficult one" and "it is quite clear that this effort was not always successful."<sup>16</sup> The SEC has recognized that "[b]ecause variable insurance contracts have both insurance and investment features, neither they nor the separate accounts that fund them fit comfortably under investment company regulation."<sup>17</sup>

The SEC also experienced difficulties fitting variable annuities under the Securities Act. The SEC

candidly acknowledged, as recently as 1990, that fundamental questions remain unanswered, such as what "security should be registered," what entity should be deemed "issuer" of the security, and when should a "sale" of the security be deemed to occur.<sup>18</sup> Some SEC Commissioners have bemoaned their inability to achieve a simplified variable annuity prospectus. Commissioner Loomis conceded that "[t]he [variable annuity] prospectus undoubtedly was, and probably is, unduly complex."<sup>19</sup> Commissioner Cynthia A. Glassman once quoted certain disclosure in a variable annuity prospectus and exclaimed: "Actually, I have no idea what this says."<sup>20</sup>

In view of the difficulties of fitting variable annuities under the federal securities laws, the SEC fell into a regrettable pattern of refining regulation of mutual funds, but then waiting years to extend the same refinements to variable insurance products. This regulatory pattern is evidenced by the fact that neither the SEC nor the Staff has even mentioned, much less addressed, a summary prospectus for *variable life insurance*.

## B. First Staff Consideration

The SEC Staff first raised the concept of a variable annuity summary prospectus in 1976 — more than 38 years ago. The Staff's focus then was the so-called "evergreen" prospectus sent annually to existing owners to disclose, with appropriate updates, the continuing offer of security interests under their variable annuities.

At least one Staff member believed that once an investor owned a variable annuity, the investor did not need to receive a prospectus each year describing his or her insurance rights and obligations, but could get by with only a "limited or *summary* prospectus [that] would relate solely to the investment features of the variable annuity."<sup>21</sup>

Needless to say, the SEC did not pursue the concept of a variable annuity summary prospectus at that time. Over the years, the industry made various attempts to get the SEC to authorize and implement simplified variable annuity disclosure, including,

among other things, a variable annuity summary prospectus for offerings and an abbreviated annual updating prospectus.

Early on, the American Council of Life Insurers<sup>22</sup> took an active role in these efforts. In more recent years, the Insured Retirement Institute<sup>23</sup> (IRI) and Committee of Annuity Insurers<sup>24</sup> (CAI) have taken the lead.

### C. Financial Literacy Report

Some observers believe that the SEC missed a golden opportunity to think through the variable annuity summary prospectus in the 2012 financial literacy study and report<sup>25</sup> that Congress mandated by the Dodd-Frank Act.

The Dodd-Frank Act directed the SEC to “identify... the existing level of financial literacy among retail investors, including subgroups of investors identified by the Commission,” and “the most useful and understandable relevant information that retail investors need to make informed financial decisions before engaging a financial intermediary or purchasing an investment product<sup>26</sup> or service that is typically sold to retail investors.”<sup>27</sup>

The SEC conducted the mandated study and submitted a report<sup>28</sup> to Congress, entitled “Study Regarding Financial Literacy Among Investors” (Report). The Report referred to variable annuities and variable annuity owners and to a summary variable annuity prospectus, as well as to mutual funds, mutual fund shareholders and the summary mutual fund prospectus. The SEC’s outside consultant formed focus groups that included variable annuity owners and mutual fund shareholders.<sup>29</sup>

However, the Report expressed its findings in terms of retail investors generally and not in terms of variable annuity owners or mutual fund shareholders specifically. Also, the Report did not address funds underlying separate accounts separately from retail funds.

The Report summarized, in a separate section,<sup>30</sup> public comments received advocating “a layered disclosure system for variable products,” including

“a summary disclosure document,” and “an integrated system of summary documents delivered in paper and/or electronic format that are linked to more comprehensive web-based documents.”<sup>31</sup> The section noted that the American Council of Life Insurers “provided sample summary disclosure documents for fixed, index, and variable annuity products.”<sup>32</sup>

But the Report did not express any view, or make any specific recommendation, regarding the comments or sample disclosure documents, except to report its general finding that “[w]ith respect to investment product disclosures, investors favor summary documents containing key information about the investment product.”<sup>33</sup> The Report stopped short of advising Congress of the SEC’s view of the Report’s analysis, findings or conclusions and what, if anything, the SEC was doing, or planning to do, with regard to the findings.

## II. Recent Developments

### A. Priority Announcement

The SEC Staff, in March 2013, announced that the variable annuity summary prospectus was a “regulatory priority.”

The announcement came in a speech of Norm Champ, Director of the SEC’s Division of Investment Management, read by his Deputy Director, David Grim in Director Champ’s absence. The speech referred to the “streamlined ‘summary prospectus’” for mutual funds and stated, without qualification, that “[t]he Division is beginning work on a rule that would create a similar summary prospectus for variable annuities.”<sup>34</sup> The speech did not acknowledge former SEC Chairman Schapiro’s announcement,<sup>35</sup> more than three years earlier, that the Staff had started “developing” such a prospectus.

Director Champ specified that the variable annuity summary prospectus was the fourth of eight “regulatory priorities.”<sup>36</sup> The “short-term regulatory priorities” included potential money market fund

reform, identity theft red flags rules, and portfolio valuation guidance. The variable annuity summary prospectus was at the top of five “longer-term regulatory initiatives,” which included an ETF rule, enhancements to fund disclosures about operations and portfolio holdings, review of the rules that apply to private fund advisers, and a derivative concept release.

Industry reaction was wary, but fairly confident. The industry was wary, because nothing appeared to have come from SEC Chairman Schapiro’s 2009 announcement, noted above. But the industry was also fairly confident, because Director Champ claimed that the Division Staff had developed its regulatory priorities “in close consultation with the Chairman and the Commissioners.”<sup>37</sup> Industry confidence endured as Director Champ and others repeatedly assured<sup>38</sup> the industry that the Staff was actively working on the project.

## B. SEC Reports to Congress

Neither the SEC nor the Staff has announced a specific timetable for the variable annuity summary prospectus project. However, in early 2013, the SEC reported<sup>39</sup> to Congress that its Staff expected, in effect, to submit its recommendation to the Commissioners by October 1, 2013, for the SEC to publish a proposal sometime after that date, and for the Staff to analyze public comments on the proposal before October 1, 2014.

Contrary to its representation to Congress, the SEC did not meet the 2013 date. Instead, the SEC, reported<sup>40</sup> to Congress, earlier this year, that its Staff expected, in effect, to submit its recommendation to the Commissioners by October 1, 2014.

However, the SEC did not meet the 2014 date either. Instead, the SEC announced<sup>41</sup> that it had submitted a Notice of Proposed Rulemaking to the Office of Management and Budget, advising, in effect, that the SEC did not expect to take the matter up until March 2015. The Notice specified that the “priority” was “nonsignificant” and that there was no “legal deadline.”

The SEC Staff has stated publicly that the SEC may miss the March 2015 date. The Associate Director and Deputy for Disclosure Policy of the SEC Division of Investment Management, warned at an industry conference in July that, “while this proposal remains a ‘staff priority,’ the timing could slip past March 2015.”<sup>42</sup>

## C. Industry Push-Back

In response to the SEC announcement of further delay until March 2015, industry groups submitted comments objecting to the delay and requesting earlier action.

The IRI submitted a letter urging the SEC to publish its proposal in 2014. The IRI argued that:

[i]f a Variable Annuity Summary Prospectus Rule is not finalized during 2014, as a practical matter, variable annuity summary prospectuses will not be available to investors and financial advisors until at least early to mid-2016, more than seven years after IRI submitted its variable annuity summary prospectus proposal to the SEC and more than six years after Chairman Mary Schapiro voiced support for the development of the rule.<sup>43</sup>

The IRI sent a copy of its letter to each Commissioner. The IRI stated, at the time, that it intended to schedule a meeting with each Commissioner to urge acceleration of the March 2015 date.

The CAI also submitted a letter to the SEC stating that “the members of the Committee are very concerned with what appears to be a further five or six month delay in a very important and longstanding rulemaking project for the Commission, the Committee and investors.”<sup>44</sup>

The CAI acknowledged that “the Commission and its staff have competing priorities,” but argued that “there is no substantive reason why the benefits of streamlined and layered disclosure should not be available to variable annuity investors.”<sup>45</sup>

### III. Reasons for Delay

#### A. Commissioner Turnover

Director Champ, in his announcement that the variable annuity summary prospectus was a regulatory priority, stated that the Division Staff developed its regulatory priorities “in close consultation with the Chairman and the Commissioners.”<sup>46</sup> However, since that consultation, three of the five Commissioners have been replaced, including the Chairman.<sup>47</sup> So, a question arose whether the new Commissioners would pursue the former Commissioners’ priorities.

Observers looking for a positive answer took comfort in Director Champ’s statement that the regulatory priorities are “important work” and present issues that “must be tackled.”<sup>48</sup> However, SEC watchers know that it is the SEC Chairman, and not the other Commissioners, who has the final word on setting the SEC’s regulatory agenda.

#### B. Congressional Pressure

The chief reason the SEC is currently delaying action on the variable annuity summary prospectus is probably Congressional pressure for the SEC to give top priority to adopting all of the rules mandated by the Dodd-Frank Act and the JOBS Act.

Various members of Congress have written to the SEC urging faster action on adopting rules mandated by the statutes. For example, Senator Carl Levin (D. Mich.) characterized the SEC as the slowest of the regulators to adopt rules mandated by the Dodd-Frank Act and stated that the “SEC needs to stop procrastinating and get the job done.”<sup>49</sup>

In September, the House Committee on Appropriations passed the SEC’s budget for fiscal year 2015 as part of the Financial Services and General Government Appropriations Bill. In doing so, the Committee issued a report<sup>50</sup> that took what appears to be contradictory statements in the context of the variable annuity summary prospectus.

On the one hand, the Report directs the SEC to work to simplify disclosure. The Report refers to

disclosure in the context of corporate elections and proposals, but is broad enough to apply to the variable annuity summary prospectus, as follows:

The [disclosure] system must be overhauled as the Commission has recently acknowledged, to eliminate obsolete disclosures and make disclosures more relevant to investors. The Committee received the Commission’s report for fiscal year 2014 and understands that this is an important issue for the Commission. The Committee directs the Commission to submit an updated report on SEC’s efforts to modernize disclosure requirements within 90 days of enactment of this Act.<sup>51</sup>

On the other hand, the Report directs the SEC to adopt rules required by Congress before adopting “discretionary” rules, as follows:

The Committee believes the SEC should undertake all statutory rulemakings of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the Jumpstart Our Business Act (JOBS Act) *before undertaking any discretionary rulemakings*.<sup>52</sup>

The Report does not explain what it means by the term “discretionary rules.” If the term includes rules authorizing a variable annuity summary prospectus, then the SEC might not be able to move ahead with the summary prospectus without risking the ire of the Committee that, along with its Senate counterpart, controls the SEC’s budget.

#### C. Staff Risk Aversion

The US Government Accountability Office (GAO), in the wake of the Bernard Madoff matter, submitted a report<sup>53</sup> to Congress pointing out the need for improved personnel management at the SEC.

The GAO reported low Staff morale, a culture of risk aversion, and an unwillingness to innovate. More than half of the supervisory and nonsupervisory Staff agreed that “fear of public scandals may have contributed to the culture of risk aversion.” Some senior officers told the GAO that “recent enforcement failures and related, sustained criticism from members of Congress, the SEC’s former Inspector General, and the public has [sic] contributed to their unwillingness to take risks and innovate.”<sup>54</sup> Some observers believe that these circumstances have been a factor contributing to the SEC’s long delay in taking up the challenge of creating a variable annuity summary prospectus.

#### D. Mutual Fund Summary Prospectus

The SEC has had almost five years of experience with the mutual fund summary prospectus, which the SEC authorized for use after January 1, 2010.<sup>55</sup>

By all accounts, the experience has been positive and in the best interests of mutual fund offerees and shareholders. For example, the SEC’s Division of Investment Management “has observed that funds often provide clear and concise disclosure in response to the specific Summary [prospectus] Section requirements of Form N-1A.”<sup>56</sup>

However, the SEC Staff recently declared that it is seeing “what it believes are unnecessarily long Summary Sections,”<sup>57</sup> that is, summary prospectuses. Among other things, the Staff observed “long, complex and detailed descriptions of principal investment strategies and risks that are dense, are not user-friendly, and do not appear to be summaries of the information . . . in the prospectus,”<sup>58</sup> “the use of technical terms that are not explained in plain English,”<sup>59</sup> “information . . . that is not required or permitted,”<sup>60</sup> and lack of specification of “which of the [investment] strategies and risks are principal and which are not principal.”<sup>61</sup>

The reaction of the SEC Staff to these disclosure problems in summary prospectuses has been relatively mild. The Staff did not threaten any action

against funds or any roll-back of the authorization of the summary prospectus. The Staff merely offered “guidance” by reminding funds of the summary prospectus requirements and stated that the “staff encourages funds to revisit their disclosure in light of the guidance.”<sup>62</sup>

It follows that the problems that the SEC Staff has found with mutual fund summary prospectuses do not appear to be sufficiently significant to threaten the SEC’s authorization of variable annuity summary prospectuses.

### IV. Favorable Prospects

#### A. Division Director

Some observers believe that Director Champ is an unusually well-qualified, hands-on manager who is interested in process as well as substance and well-suited to oversee the development of a variable annuity summary prospectus both at the Division and Commission levels.

Director Champ is well-versed in the SEC,<sup>63</sup> having served on the Staff prior to being named Director on July 5, 2012.<sup>64</sup> He had been serving as Deputy Director of the SEC’s Office of Compliance Inspections and Examinations (OCIE). In that position, he sat on the Executive and Operating Committees, served as the acting head of the broker-dealer, investment adviser/investment company and credit rating agency exam programs, and as acting chief counsel.

Director Champ joined the SEC Staff in January 2010 as the Associate Regional Director for Investment Adviser/Investment Company Examinations in the SEC’s New York Regional Office. He received the Chairman’s Award for Law and Policy for his role in OCIE’s implementation of the Dodd-Frank Act and the Chairman’s Award for Labor-Management Relations for his role in the reorganization of OCIE.

In contrast, the two previous Division Directors, Eileen Rominger and Andrew “Buddy” Donohue, had not previously served on the SEC Staff.

## B. Absence of Objectors

The insurance industry expects no objection to the SEC's authorization of a variable annuity summary prospectus.

In the past, the Investment Company Institute (ICI) has objected<sup>65</sup> to SEC exemptive relief that the ICI believed could give variable insurance products a competitive advantage over mutual funds shares.

However, mutual fund investment advisers who are not affiliated with life insurance companies have received from life insurance companies, for investment management, increasing amounts of money accumulated under variable insurance products.<sup>66</sup> These investment advisers manage the money either by having it invested in mutual funds sponsored by the advisers or by serving as sub-investment advisers to mutual funds sponsored by life insurance companies.

A variable annuity summary prospectus could help increase the amounts of money flowing to investment advisers who are not affiliated with life insurance companies.

## V. Conclusion

Since the SEC proposed the mutual fund summary prospectus and layered disclosure regime more than seven years ago, momentum has built for a similar disclosure approach for variable annuities.

The SEC and its Staff are clearly on record as favoring the approach. In fact, the SEC has set hard dates for considering and implementing the concept. However, higher priorities — most importantly, rule-making mandates imposed by Congress — have caused the SEC to miss its target dates and stall the project.

The SEC's intention remains reasonably firm, but the timing is anything but certain.

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participated, and continue to participate, in certain matters addressed in this article. He thanks his colleagues Robert B. Shapiro and Edward J. Zaharewicz for reviewing and commenting on the article. The views expressed are those of Mr. Cohen and do not necessarily reflect the views of his colleagues, the firm or the firm's clients.

## NOTES

<sup>1</sup> Chairman Schapiro said:

Our staff already has announced that it is developing a simplified “summary prospectus” for variable annuities, which are widely regarded as one of the most difficult-to-understand products on the market. It is precisely in this type of product where simplicity of disclosure is essential.

Mary L. Schapiro, Chairman, SEC, “The Consumer in the Financial Services Revolution,” Consumer Federation of America 21st Annual Financial Services Conference (Dec. 3, 2009) available at <http://www.sec.gov/news/speech/2009/spch120309mls.htm> [hereinafter Chairman Schapiro Announcement].

<sup>2</sup> Norm Champ, Director, SEC Division of Investment Management, Remarks to the Investment Management Institute 2013 (Mar. 7, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1365171515032#.VCcv9fldVwQ> [hereinafter Director Champ Announcement]. Director Champ, a few months earlier, had indicated more generally that the Staff was moving in this direction. Remarks to the ALI CLE 2012 Conference on Life Insurance Company Products (Nov. 1, 2012) (“we are committed to making improvements in the important area of helping variable annuity investors to make informed investment decisions”), available at <http://www.sec.gov/News/Speech/Detail/Speech/1365171491624#VCa7qfldVwQ>.

<sup>3</sup> See *infra* ns.39 and 40 and accompanying text.

<sup>4</sup> *Regulatory Flexibility Agenda*, Securities Act Release No. 9563, Securities Exchange Act Release No.

71771, Investment Advisers Act Release No. 3803, Investment Company Act Release No. 30989 (March 21, 2014), available at <http://www.sec.gov/rules/other/2014/33-9563.pdf>; and (May 23, 2014) (addressing the rulemaking as “RIN: 3235-AK60” at 6-7), available at <http://www.thecorporatecounsel.net/nonMember/docs/SEC-2014-0850-0001.pdf> [hereinafter Regulatory Flexibility Agenda]. See Office of Information and Regulatory Affairs, Office of Management and Budget, Executive Office of the President, View Rule, RIN: 3235-AK60, available at <http://www.reginfo.gov/public/doleAgendaViewRule?pubId=201404&RIN=3235-AK60>.

<sup>5</sup> Susan Nash, Associate Director and Deputy for Disclosure Policy, SEC Division of Investment Management, oral remarks at the 2014 Insured Retirement Institute Government, Legal & Regulatory Conference (July 1, 2014). Shortly before press deadline, the SEC announced that it had “approved the publication of an agenda of its rulemaking actions pursuant to the Regulatory Flexibility Act,” but stated that the agenda was not “scheduled for publication in its entirety [until an unspecified date] in fall 2014.” *Regulatory Flexibility Agenda*, Securities Act Release No. 9663, Securities Exchange Act Release No. 73341, Investment Advisers Act Release No. 3945, Investment Company Act Release No. 31283 at 1 (Oct. 10, 2014) (stating in boldface in note 1: “The items listed in the Regulatory Flexibility Agenda for Fall 2014 reflect only the priorities of the Chair of the U.S. Securities and Exchange Commission, and do not necessarily reflect the view and priorities of any individual Commissioner”), available at <http://www.sec.gov/rules/other/2014/33-9663.pdf>.

<sup>6</sup> *Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies*, Securities Act Release No. 8861, Investment Company Act Release No. 28064 (Nov. 21, 2007), available at <http://www.sec.gov/rules/proposed/2007/33-8861.pdf>.

<sup>7</sup> *Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies*, Securities Act Release No.

8998, Investment Company Act Release No. 28584 (Jan. 13, 2009), available at <http://www.sec.gov/rules/final/2009/33-8998.pdf> [hereinafter SEC Rel. 33-8998]. See generally Gary O. Cohen, “Implications of Fund Summary Prospectus for Life Insurance Companies,” *The Investment Lawyer*, Vol.15, No.3, at 1 (March 2008).

<sup>8</sup> Pub L. 111-203, 124 Stat. 1376 (July 21, 2010) [hereinafter Dodd-Frank Act]. President Barack Obama signed the Act into law on July 21, 2010.

<sup>9</sup> Pub L. 112-106, 126 Stat. 306 (Apr. 5, 2012). President Barack Obama signed the JOBS Act into law on April 5, 2012.

<sup>10</sup> See Press Release, SEC, “SEC Charges Bernard L. Madoff for Multi-Billion Dollar Ponzi Scheme” (Dec. 11, 2008), available at <http://www.sec.gov/news/press/2008/2008-293.htm>.

<sup>11</sup> In the 1970s, the SEC held rule-making proceedings leading to its regulation of security interests under variable life insurance under the Securities Act of 1933 and the separate accounts that fund them under the Investment Company Act of 1940. See *Separate Accounts of Life Insurance Companies Funding Certain Variable Life Insurance Contracts*, Investment Company Act Release No. 9482 (Oct. 18, 1976) (adopting exemptive rules).

<sup>12</sup> SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959); SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967).

<sup>13</sup> Prudential Ins. Co. v SEC, 326 F.2d 383 (1964).

<sup>14</sup> Ray Garrett, Jr., Chairman, SEC, Address Before the San Diego Mortgage Bankers Association (July 2, 1974), quoted by Evan Kemp, Jr., SEC Staff Member, “Proceedings of Conference on Variable Annuities and Variable Life Insurance” (June 24-25, 1976) (printed in *The Business Lawyer*, Special Issue, Vol.32, at 759-760 (Mar. 1977)) [hereinafter Business Lawyer Special Issue].

<sup>15</sup> Testimony of Arthur Levitt, Chairman, SEC, concerning S. 1815, the “Securities Investment Promotion Act of 1996,” before the Committee on Banking, Housing, and Urban Affairs, United States Senate (June 5, 1996) (Appendix: SEC Analysis and Recommendations on S. 1815 at 8).

- <sup>16</sup> Philip A. Loomis, Commissioner, SEC, Remarks at Proceedings of Conference on Variable Annuities and Variable Life Insurance (June 24-25, 1976), Business Lawyer Special Issue, *supra* n.14, at 693 [hereinafter Commissioner Loomis Remarks].
- <sup>17</sup> *Request for Comments on Reform of the Regulation of Investment Companies*, Investment Company Act Release No. 17534 (June 15, 1990).
- <sup>18</sup> *Id.*
- <sup>19</sup> Commissioner Loomis Remarks, *supra* n.16, at 692-693.
- <sup>20</sup> Cynthia A. Glassman, Commissioner, SEC, Remarks at the Plain Language Association International's Fifth International Conference (Nov. 4, 2005), available at <http://www.sec.gov/news/speech/spch110405cag.htm>.
- <sup>21</sup> The SEC Staff member stated:

A complete section 10(a)(3) prospectus describing the variable annuity contract should precede or accompany each presentation or offer of the variable annuity to an investor. Once the first payment under a variable annuity contract is accepted by the insurance company and the insurance rights and obligations of the investor and insurance company are fixed, a more limited or *summary prospectus* or other material which the Commission specifies as constituting a prospectus would be given annually to investors. This limited or *summary prospectus* would relate solely to the investment features of the variable annuity. The receipt of each purchase payment would be deemed a sale of a security within the meaning of section 5 of the 1933 Act.

Once the insurance obligations have been fixed, it could be argued that a requirement that an investor annually receive a prospectus describing both the insurance and investment components of the variable annuity would serve no useful purpose and in fact might confuse or mislead investors. Once the insurance obligations become fixed, the investment

aspects of the variable annuity become the important component of the variable annuity from the standpoint of the investor. Basically, an investment decision, not an insurance decision, is made by the investor when each payment after the first is made to the insurance company.

- Evan J. Kemp, Jr., "Theory of Federal Securities Regulation and Theory of State Insurance Regulation," Panel on Variable Contract Registration and Disclosure Requirements, Conference on Variable Annuities and Variable Life Insurance (June 24-25, 1976), Business Lawyer Special Issue, *supra* n.14, at 755, 757 (emphasis added).
- <sup>22</sup> See Carl B. Wilkerson, Vice President and Chief Counsel - Securities and Litigation, American Council of Life Insurers, ACLI Disclosure Initiative for Fixed, Index and Variable Annuities: Constructive Change on the Horizon, ALI-ABA Course of Study Materials, Conference on Life Insurance Company Products 217 (Nov. 8-9, 2007) (referring to joint efforts with the National Association for Variable Annuities, the predecessor organization of the Insured Retirement Institute). See *infra* n.32 and accompanying text.
- <sup>23</sup> The 2012 ALI-CLE Conference on Life Insurance Company Products included a presentation by the IRI's Senior Vice President and General Counsel. The IRI documents included a so-called Proof of Concept Sample Variable Annuity Summary Prospectus (14 pages long), variable annuity summary prospectus research done in 2012, a proposed Rule 499 under the Securities Act authorizing a variable annuity "Summary Offering Prospectus," and a proposed amendment to the Form N-4 Registration Statement for variable annuities and variable annuity separate accounts. J. Lee Covington, II, Annuity Disclosure Reform: Implications of the SEC's Financial Literacy Report, the Point-of-Sale Summary Prospectus and Abbreviated Annual Update, and the Annuity Buyer's Guide, ALICLE Conference on Life Insurance Company Products, Course of Study Materials

321 (Oct. 31-Nov. 2, 2012). See *infra* ns.43-45 and accompanying text.

<sup>24</sup> The 2010 ALI-ABA Conference on Life Insurance Company Products included a presentation by life insurance company representatives and law firm counsel summarizing industry efforts and related documents. Mary Jane Wilson-Bilik, Sutherland Asbill and Brennan LLP, Dodie Kent, AXA Equitable Life Ins. Co., and C. Christopher Sprague, Prudential Ins. Co. of Am., The Challenge of Annuity Disclosure Reform: Summaries, Profiles, and Buyers' [sic] Guide, ALI-ABA Conference on Life Insurance Products, Course of Study Materials 1 (Oct. 28-29, 2010). See *infra* n.44 and accompanying text.

<sup>25</sup> SEC, Study Regarding Financial Literacy Among Investors (Aug. 2012) available at <http://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf> [hereinafter SEC Financial Literacy Report].

<sup>26</sup> The statutory language referred broadly to an "investment product" and this arguably included variable annuities as well as variable life insurance. The Dodd-Frank Act included other language that was sufficiently broad to cover unit investment trust separate accounts that fund variable insurance products. For example, the Dodd-Frank Act mandated the SEC to identify the existing level of financial literacy among retail investors, "including subgroups of investors identified by the Commission." So, the SEC could identify life insurance company product owners as a subgroup of investors. The Dodd-Frank Act also mandated the SEC to identify methods to improve the timing, content and format of disclosure "to investors with respect to . . . investment products." So, the SEC could view "investment products" as including variable insurance products.

<sup>27</sup> Dodd-Frank Act, *supra* n.8, at Section 917.

<sup>28</sup> SEC Financial Literacy Report, *supra* n.25.

<sup>29</sup> *Id.* at 59.

<sup>30</sup> *Id.* at 25-27.

<sup>31</sup> Regarding a layered disclosure system and summary variable annuity prospectus, the Report stated as follows:

c. Summary Disclosure Documents/Layered Disclosure – Annuity Products

Several commenters, generally representing the insurance industry, specifically advocated for **establishing a layered disclosure system** for annuity products. One commenter recommended that the Commission consider reforming the current disclosure framework for annuity products into a "simplified and unified system of relevant disclosure" with "a goal being to increase the likelihood that investors will read and learn from at least some of the material." This commenter supported using "an integrated system of summary documents delivered in paper and/or electronic format that are linked to more comprehensive web-based documents." This commenter indicated that summary disclosures would communicate the "most important information in a format that annuity investors would be more likely to read and understand, while the layered disclosure platform would give investors continuous and instantaneous access to a broader wealth of information.

According to another commenter, a prospectus for annuity products ranges from 100 to 300 pages of complex legal language that investors find difficult to understand. This commenter believes annuity products should have a summary disclosure document similar to a mutual fund summary prospectus. This commenter suggested that the "ideal **summary prospectus**" for an annuity product would be 10 pages or less; written in plain Language [sic]; and cover contract basics, investment choices, death benefits, costs, risks, adviser compensation, and taxation. Additionally, the commenter recommended developing a one-page document for retail investors that covers an annuity product's fees, historical performance, and investment strategy. Another commenter provided sample summary disclosure documents for fixed index, and variable annuity products.

*Id.* at 25-27 (emphasis added and footnotes deleted).

<sup>32</sup> *Id.* at 27.

<sup>33</sup> *Id.* at iv.

<sup>34</sup> Director Champ's complete statement was:

A few years ago, the Commission adopted a streamlined "summary prospectus" for mutual fund investors. That document contains key information about fund investment objectives and strategies, risks, and fees and provides the ability to "click through" or request more detail for those who want it. This initiative was a revolution in communicating to investors the core information they most want while simultaneously making more detailed information readily accessible to investors, intermediaries, the financial press, and others who are interested.

The Division is beginning work on a rule that would create a similar *summary prospectus* for variable annuities, a type of hybrid insurance and investment product. The insurance benefits offered by these products, and the limitations on those benefits, are often complex; their costs can be difficult to understand; and they frequently offer a wide array of investment options. These and other factors often result in disclosure that is long and difficult to understand. Our goal is to facilitate the communication of concise, user-friendly information to investors considering variable annuities and enhance the transparency of the benefits, risks, and costs of these products.

Director Champ Announcement, *supra* n.2 (emphasis added).

<sup>35</sup> Chairman Schapiro Announcement, *supra* n.1.

<sup>36</sup> Director Champ explained the development of the "regulatory priorities" as follows:

The Division of Investment Management had completed the drafting of rules that the Dodd-Frank Act mandated for that area. Accordingly, the Division had turned its attention to

"discretionary" or "non-mandatory rulemaking initiatives." It did so with a realization that the SEC finds itself in an "era of limited budgets," which means that the SEC Staff has been following an approach of "allocating its resources wisely" and "focusing our energy and trying to become smarter, more strategic and more targeted." To this end, Director Champ asked the Division Staff to "take a fresh look at policy initiatives" and stated that the Division Staff "went through a very thoughtful and deliberate approach to analyze potential regulatory initiatives."

Director Champ Announcement, *supra* n. 2.

<sup>37</sup> Director Champ Announcement, *supra* n.2.

<sup>38</sup> See, e.g., Remarks to the 2013 Insured Retirement Institute Government, Legal & Regulatory Conference (June 18, 2013) ("Another area of staff focus is a new rule that would create a summary prospectus for variable annuities"), available at <http://www.sec.gov/News/Speech/DetailSpeech/1365171606081#.VCbruPldVwQ>; Remarks to the ALI CLE 2013 Conference on Life Insurance Company Products (Nov. 14, 2013) ("We continue to work hard to fashion a framework for disclosure"), available at <https://www.google.com/webhp?sourceid=chrome-instant&ion=1&espv=2&ie=UTF-8#q=Remarks%20to%20the%20ALI%20CLE%202013%20Conference%20on%20Life%20Insurance%20Company%20P>; and Remarks to the 2014 Mutual Funds and Investment Management Conference (March 17, 2014) ("Reforming variable annuity disclosure is also a current policy initiative of the Division"), available at <http://www.sec.gov/News/Speech/DetailSpeech/1370540410057>.

Moreover, other Staff members referred to the variable annuity summary prospectus project. See, e.g., David W. Grim, Deputy Director, SEC Division of Investment Management, Remarks before [sic] the 5th Annual DCIIA Public Policy Forum (Apr. 3, 2014) ("Focusing on potential reforms to variable annuity disclosure is also a current matter on which

Division staff is working”), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370541453144#.VCcCYfldVwQ>.

However, in his remarks to an IRI conference in July, 2014, Director Champ did not address the variable annuity summary prospectus per se. Remarks to the 2014 Insured Retirement Institute Government, Legal & Regulatory Conference (July 1, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370542269804#.VCbsnPldVwQ>.

<sup>39</sup> The SEC’s fiscal year begins on October 1. The SEC reported to Congress:

Variable Annuity Summary Prospectus: In FY 2013, IM expects to recommend that the Commission propose rules designed to provide variable annuity investors with more user-friendly disclosure and to improve the delivery of information about variable annuities through increased use of the internet [sic] and other electronic means of delivery. In FY 2014, IM expects to analyze comments submitted on the proposed rules and consider whether to recommend that the Commission adopt rules to improve disclosure to variable annuity investors.

SEC, FY 2014 Congressional Budget Justification, FY 2014 Annual Performance Plan, FY 2012 Annual Performance Report, 95 (2013), available at <http://www.sec.gov/about/reports/secfy14congbudgjust.pdf> [hereinafter SEC Report to Congress].

<sup>40</sup> The SEC reported to Congress:

Variable Annuity Summary Prospectus. In FY 2014, IM expects to recommend that the Commission propose rules designed to provide variable annuity investors with more user-friendly disclosure and to improve the delivery of information about variable annuities through increased use of the Internet and other electronic means of delivery. In FY 2015, IM expects to analyze comments submitted on the proposed rules and consider whether

to recommend that the Commission adopt rules to improve disclosure to variable annuity investors.

SEC, FY 2015 Congressional Budget Justification, FY 2015 Annual Performance Plan, FY 2013 Annual Performance Report 77 (March 7, 2014) available at <http://www.sec.gov/about/reports/secfy15congbudgjust.pdf>.

<sup>41</sup> Regulatory Flexibility Agenda, *supra* n.4.

<sup>42</sup> See *supra* n.5 and accompanying text.

<sup>43</sup> Letter of J. Lee Covington II, Senior Vice President and General Counsel, IRI, to Kevin O’Neill, Deputy Secretary, SEC (July 14, 2014) (footnote deleted), available at <http://www.sec.gov/comments/s7-04-14/s70414-2.pdf>.

<sup>44</sup> Letter of Stephen E. Roth, Sutherland Asbill & Brennan LLP, to Ms. Elizabeth M. Murphy, Secretary, SEC (July 9, 2014), available at <http://www.sec.gov/comments/s7-04-14/s70414-1.pdf>.

<sup>45</sup> *Id.*

<sup>46</sup> Director Champ Announcement, *supra* n.2.

<sup>47</sup> Mary Jo White, on April 10, 2013, replaced Elisse B. Walter who was Acting Chairman following the resignation of Chairman Mary L. Schapiro. Kara Stein, on August 9, 2013, replaced Ms. Walter as Commissioner, and Michael Piwowar, on August 15, 2013, replaced Troy A. Paredes as Commissioner.

<sup>48</sup> Director Champ Announcement, *supra* n.2.

<sup>49</sup> Peter Schroeder, “Levin urges SEC to move quicker on Dodd-Frank rules,” *The Hill* (June 12, 2014), available at <http://thehill.com/policy/finance/209215-levin-urges-sec-to-move-quicker-on-dodd-frank-rules>.

<sup>50</sup> HR Rep. No. 113-508, at 74 (2014).

<sup>51</sup> *Id.* at 72.

<sup>52</sup> *Id.* at 74 (emphasis added).

<sup>53</sup> U.S. Gov’t Accountability Office, GAO-13-621, Securities and Exchange Commission: Improving Personnel Management Is Critical for Agency’s Effectiveness 16 (July 2013) (emphasis added). Section 962 of the Dodd-Frank Act, *supra* n.8, mandates the GAO to report on the SEC’s personnel management.

<sup>54</sup> *Id.*

<sup>55</sup> SEC Rel. No. 33-8998, *supra* n.7.

<sup>56</sup> SEC Division of Investment Management, IM Guidance Update, Guidance Regarding Mutual Fund Enhanced Disclosure, No. 201-408, at 1 (June 2014), available at <http://www.sec.gov/investment/im-guidance-2014-08.pdf>.

<sup>57</sup> *Id.* at 2.

<sup>58</sup> *Id.* at 3.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* at 4.

<sup>61</sup> *Id.* at 2-4.

<sup>62</sup> *Id.* at 5.

<sup>63</sup> Together with his SEC experience, Director Champ has practical experience in the business and legal worlds. Prior to joining the SEC Staff, he was general counsel for ten years, as well as a member of the executive committee and a partner, at the investment management firm Chilton Investment Company, a multi-national adviser to private funds and managed accounts.

Before that, he was a lawyer at the firm of Davis Polk & Wardwell and spent two years as a law clerk for the Honorable Charles S. Haight, Jr. of the U.S. District Court for the Southern District of New York. Director Champ received his bachelor's degree from Princeton University, *summa cum laude*, in 1985. He received his master's degree in 1986 from King's College University of London, where he was a Fulbright Scholar. He earned his juris doctor degree from Harvard Law School, *cum laude*, in 1989.

<sup>64</sup> Press Release, SEC, SEC Names Norm Champ as Director of Division of Investment Management

(July 5, 2012), available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171483040>. The information set out in the text and *supra* n.63 is drawn from the SEC press release.

<sup>65</sup> For example, the ICI intervened as a party in the proceeding that the SEC ordered regarding a rule-making petition filed by the life insurance industry for exemptions from the federal securities laws for variable life insurance. Investment Company Institute, Petition To Intervene as a Party, *In Re* Petition of the American Life Convention and the Life Insurance Association of America for the Issuance of Certain Exemptions from the Federal Securities Laws, File No. 4-149 (Mar. 24, 1972).

<sup>66</sup> ICI data show that "variable annuity mutual funds" increased in number from 331 in 1990 to 1,728 in 2013 and increased in assets from \$28,749,000 in 1990 to \$1,653,633,000 in 2013. However, the ICI does not appear to break the data down among mutual funds sponsored (i) by life insurance companies and advised exclusively by investment advisers affiliated with those companies, (ii) by life insurance companies and sub-advised by investment advisers not affiliated with those companies, and (iii) by investment advisers not affiliated with life insurance companies. See Investment Company Institute, 2014 Investment Company Fact Book, A Review of Trends and Activities in the U.S., Table 55, Variable Annuity Mutual Funds: Total Net Assets, Net New Cash Flow, and Number of Funds, 214 (2014), available at [www.icifactbook.org](http://www.icifactbook.org).

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