

SEC Proposes Summary Prospectus Option and Modernized Disclosure for Variable Insurance Products

October 31, 2018

On October 30, the SEC voted to propose modernized disclosures for variable annuities and variable life insurance policies (“variable insurance products” or “contracts”), including the use of an optional summary prospectus.

Perhaps the most striking aspect of the proposal is the “*access equals delivery*” approach to prospectus delivery for the mutual funds that serve as the underlying investments of these products (“underlying funds”).

The following is an overview of the proposal, which is [available here](#).

Purpose of the Proposal

The purpose of the proposal is “to help investors make informed investment decisions” regarding variable insurance products by providing them “with key information relating to the contract’s terms, benefits, and risks in a concise and more reader-friendly presentation, with access to more detailed information available online and electronically or in paper format on request.”

According to SEC Chairman Jay Clayton, “[p]roviding key summary information about variable annuities and variable life insurance contracts to investors is particularly important in light of the long-term nature of these contracts and their potential complexity.”

Scope of the Proposal

The proposal would apply to variable insurance products registered on:

- Form N-3 (for variable annuities issued through management separate accounts),
- Form N-4 (for variable annuities issued through unit investment trust separate accounts), and
- Form N-6 (for variable life insurance policies issued through unit investment trust separate accounts).

The proposal also would affect the delivery of statutory and summary prospectuses of underlying funds whose shares are offered to separate accounts funding variable insurance products.

Key Aspects of the Proposal

The proposal would permit:

- the use of an ***initial*** summary prospectus for variable insurance products currently offered to new investors,
- the use of an ***updating*** summary prospectus for existing investors, and
- ***online delivery*** of underlying fund prospectuses and other documents.

In addition, the proposal would ***grandfather*** the industry’s longstanding practice of relying on the so-called “Great-West” line of no-action letters, which conditionally permits the delivery of alternative disclosures in lieu of updating the registration statements and delivering current prospectuses for certain variable insurance products.

Discussion of Initial and Updating Summary Prospectuses

The proposal includes new Rule 498A, which would permit the optional delivery of initial and updating summary prospectuses for variable insurance products. The initial summary prospectus would consist of key disclosures, which must appear in the specified order, including:

- a contract overview (including basic information about the contract and benefits),
- a key information table (providing a summary of fees and expenses, risks, restrictions, taxes and conflicts of interest),
- a description of the standard death benefit,
- a summary of other benefits available under the contract,
- a description of the procedures for purchasing the contract,

- information regarding the possibility of contract lapse (for VLI policies),
- information about contract surrenders or withdrawals,
- a full fee table, and
- an appendix (in tabular format) with summary information about the underlying funds.

The initial summary prospectus also would include a cover page that identifies the depositor, registrant, and contract, and includes certain legends. The legends include disclosure regarding how to obtain the statutory prospectus, free look rights, and the availability of additional general information about variable contracts prepared by the SEC at [Investor.gov](https://www.investor.gov).

Notably, the initial summary prospectus may only describe a *single* currently offered contract, but may describe *more than one class* of a currently offered contract. This condition appears to be designed to prohibit a summary prospectus from describing multiple contracts, or currently offered and no-longer-offered features and options of a single contract. This condition may cause significant work for issuers to create separate summary prospectuses for contracts that are currently described in a single statutory prospectus, and may require systems changes to ensure the correct summary prospectus is delivered to each contract owner.

A sample initial summary prospectus is [available here](#).

The updating summary prospectus would consist of three key disclosures, including:

- a concise description of any contract-related changes that occurred within the prior year that have affected the availability of underlying funds or the statutory prospectus disclosure relating to the fee table, the standard death benefit, and the other benefits available under the contract,
- the Key Information Table (the same as provided in the initial summary prospectus), and
- an appendix providing summary information about the underlying funds.

The updating summary prospectus, as proposed, would include previously provided information including definitions.

A sample updating summary prospectus is [available here](#).

The use of summary prospectuses would be subject to the following additional conditions:

- the summary prospectus must be sent or given to an investor not later than the time of the “carrying or delivery” of the contract security,
- the summary prospectus must not be bound with any other materials except underlying fund summary and statutory prospectuses, subject to certain conditions,
- the summary prospectus must meet the applicable content requirements, and
- the initial summary prospectus, updating summary prospectus, contract statutory prospectus, and contract statement of additional information (SAI) must be publicly accessible, free of charge, on a website in the manner specified in the proposed rule.

Discussion of Access Equals Delivery for Underlying Fund Prospectuses

The proposal would permit online delivery of underlying fund prospectuses, including underlying fund prospectus amendments. The access equals delivery approach would be conditioned on the following:

- an initial summary prospectus is used for each currently offered contract,
- a summary prospectus is used for the underlying fund (only if the underlying fund is registered on Form N-1A), and
- the underlying fund’s current summary prospectus, statutory prospectus, SAI, and most recent shareholder reports are posted online in accordance with specified conditions.

The specified conditions include that (a) the contract summary prospectus must disclose a website address where investors can access underlying fund summary and statutory prospectuses, (b) the underlying fund documents must be publicly accessible, free of charge, on a website in the manner specified in the proposed rule, and (c) investors must be able to receive paper or electronic copies of the documents upon request.

In addition, under the proposal, any communication related to an underlying fund, other than a prospectus permitted or required under section 10 of the Securities Act, would not be deemed a prospectus if the above conditions are satisfied. Moreover, under the proposal, if an underlying fund prospectus is amended between annual updates, the updated prospectus must be posted online, but need not be delivered to investors.

Discussion of Impact on Great-West Line of No-Action Letters

The proposal notes that from 1977 to 1995, the SEC staff issued a series of no-action letters (sometimes referred to as the “Great-West” line of no-action letters) stating that the staff would not recommend enforcement action to the SEC if issuers of variable insurance products did not update the registration statements for these products and did not deliver updated prospectuses to existing investors. These no-action letters were conditioned on the provision of certain other information to investors, such as:

- current underlying fund prospectuses and periodic reports, as well as proxy materials, related voting instruction forms, and other shareholder materials;
- transaction confirmations (e.g., for purchase payments, surrenders, and other transactions);
- updated audited financial statements of the separate account registrants and, in the case of variable life insurance policies, updated audited financial statements of the issuing insurer (for variable annuity contracts, an offer to make financial statements of the issuing insurer available upon request); and
- a statement at least once a year of the value and the number of units of the variable insurance product owned by the investor.

The no-action letters also were generally conditioned on representations that the separate accounts would file annual reports on Form N-SAR (which subsequently was replaced by Form N-CEN), that there were no material changes to the variable insurance product, that the product would no longer be offered to the public, and that the registrant did not contemplate such an offering in the future. The no-action letters generally were limited to the circumstance where there were 5,000 or fewer investors in a contract.

The proposal noted that as of the end of 2017, *more than half* of the Securities Act registrations for variable insurance products may be the subject of alternative disclosures permitted by the no-action letters.

Under the proposal, the SEC would continue to permit insurers to rely on the Great-West line of no-action letters with respect to variable insurance products existing as of the effective date of any final summary prospectus rules. The proposal refers to these existing products as “Alternative Disclosure Contracts” and notes that this position is limited to the “current universe of Alternative Disclosure Contracts.” The proposal also describes the legal effect of its position as follows:

The Commission’s position on Alternative Disclosure Contracts would be an agency statement of general applicability with future effect designed to implement, interpret, or prescribe law or policy. This position would be consistent with the Staff Letters up to the effective date of any final rule and effectively would moot those letters. The

Commission's longstanding position is that all staff statements are nonbinding and create no enforceable legal rights or obligations of the Commission or other parties.

The proposal notes that if a material change were made to an Alternative Disclosure Contract, the registration statement for that contract must be updated and the position would no longer apply.

Notably, the proposal does not extend access equals delivery for underlying fund prospectuses to issuers relying on the Great-West line of no-action letters. As a result, issuers continuing to rely on the Great-West line of no-action letters would need to deliver paper copies of separate account/issuer financial statements as well as underlying fund prospectuses. This position may tend to encourage issuers to migrate Great-West contracts to the summary prospectus disclosure regime in order to avoid the expense of having to deliver paper copies of such materials. Alternatively, issuers relying on the Great-West line of no-action letters may be incentivized to ask the SEC to extend access equals delivery for underlying fund prospectuses to Great-West contracts.

In anticipation of the foregoing, the proposal contains two alternative approaches for contracts that are no longer offered with fewer than 5,000 investors and no material changes since the last update ("discontinued contracts"). Both approaches would modify, as well as codify by rule, the disclosure framework of the Great-West line of no-action letters. Under the first approach (Approach 1), the SEC would adopt final rules codifying the disclosure approach in the Great-West line of no-action letters, except that: (a) investors would receive an annual notice that includes information comparable to that included in an updating summary prospectus, and the notice would be posted on the insurer's website; (b) the financial statements required by the no-action letters would be posted to the insurer's website and delivered to an investor upon request; (c) registrants would be permitted to rely on proposed Rule 498A to satisfy the prospectus delivery requirements for underlying funds; and (d) investors would continue to receive periodic reports and proxy materials of underlying funds.

Under the second approach (Approach 2), the SEC would adopt final rules that would permit registration statements to be updated by ***forward incorporation by reference***. Approach 2 is similar to Approach 1 except that a registrant would be required to maintain a current registration statement, to make a contract statutory prospectus and SAI available online, and to deliver such prospectus and SAI to an investor upon request. However, Approach 2 would only require a registrant to update the registration statement when there are material changes to the offering. In the meantime, a registrant would file separate account and depositor financials with the SEC and incorporate them by reference into the registration statement (even if they are filed after the effective date of the registration statement) and post them to the insurer's website.

The proposal notes that both Approach 1 and Approach 2 could be implemented to apply either to all discontinued contracts (including Alternative Disclosure Contracts), or only to discontinued

contracts going forward with Alternative Disclosure Contracts continuing to operate under the Great-West line of no-action letters.

Discussion of Disclosure Modernization

The proposal also would update the disclosures required by the registration forms for variable insurance products. The proposal notes that the changes to the variable annuity registration forms (N-3 and N-4, which the SEC adopted in 1985) would draw from and be more consistent with N-6, the registration form for variable life insurance that the SEC adopted in 2002.

The changes are comprehensive and would affect various aspects of every item of the current forms governing prospectus disclosure. In addition to the new summary prospectus disclosure requirements, the changes would include new disclosure requirements made in response to the “evolution” of these products, such as “the prevalence of optional benefits” offered thereunder.

Discussion of Other Changes

Among other things, the proposal would require variable insurance product registrants to submit Interactive Data Files containing data about their products using the Inline XBRL format. The purpose of this requirement is to allow investors, investment professionals, and others to analyze and compare available information about variable insurance products. As is the case for mutual funds and ETFs, the proposal would automatically suspend the ability of a registrant to file post-effective amendments under Rule 485(b) if the registrant failed to file the required Interactive Data File, though registrants could request temporary and continuing hardship exemptions.

The proposal also would make certain technical and conforming changes to the regulatory framework for variable insurance products, including, among other things, changes to the rules governing variable life insurance, namely Rules 6e-2 and 6e-3(T) (“VLI Rules”). Specifically, the proposal would amend the VLI Rules to eliminate the rate regulatory provisions and the definitions of sales charges in light of changes to the Investment Company Act of 1940 enacted by the National Securities Market Improvement Act of 1996 or “NSMIA.” The proposal requests comment on the continued utility of the exemptions provided by the VLI Rules and whether changes to other aspects of the VLI Rules would be appropriate.

Comment Period Deadline

The public comment period ends on February 15, 2019. To facilitate comments on the variable annuity summary prospectus, the proposal includes a “Feedback Flier” appendix [available here](#).

Transition Period

The proposal provides for an 18-month transition period to give registrants sufficient time to update their prospectuses and registration statements. Accordingly, under the proposal, all initial registration statements, and all annual updating post-effective amendments, filed 18 months or more after the effective date would need to comply with the proposed amendments. However, the proposal would permit registrants to rely on proposed Rule 498A to satisfy its statutory prospectus delivery obligations as early as the effective date of the Rule, provided the registrants also comply with the amendments to the applicable registration form. Registrants also would be required to submit specified disclosures in Inline XBRL within the same 18-month period.

Initial General Observations

To the credit of the SEC and its staff, the proposal represents another step in a long series of efforts to modernize the means by which important disclosures are conveyed to increasingly technologically savvy investors.

The Insured Retirement Institute (fka the National Association for Variable Annuities or NAVA) first proposed rulemaking to permit the use of a summary prospectus for variable annuities in December 2008. The authors of this client alert were involved in the preparation of that submission. Since that time, the Insured Retirement Institute and others have worked closely with the SEC staff on developing the summary prospectus initiative, including developing a sample variable annuity summary prospectus.

Over this development period, however, the technology used to disseminate information and the devices available to receive information have grown dramatically. Accordingly, a fair comment would be to apply the access equals delivery approach to the delivery of summary prospectuses themselves.

For more information regarding the SEC's summary prospectus proposal, please contact: [Richard T. Choi](#), [Chip Lunde](#), [Ann Young Black](#), [Ann Began Furman](#), [Stephen W. Kraus](#), [Gary O. Cohen](#), [Thomas C. Lauerman](#), [Josephine Cicchetti](#), or [Edmund J. Zaharewicz](#).

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