

# Variable Product Disclosure Reform: Decision Points for Insurers

July 09, 2020

Implementing all the reforms adopted by the SEC in connection with its variable insurance product summary prospectus rule (Rule 498A) is potentially a major undertaking, depending on the number and nature of an insurer's variable product filings.

Although some of the reforms are optional, the following steps generally are mandatory and must be completed by May 1, 2021:

1. If the insurer has relied on the SEC staff letters (the "Staff Letters") under which registration statements for certain discontinued VLI or VA contracts have not been annually updated, the insurer must determine whether all those contracts will be eligible to rely on the "Alternative Disclosure" procedure that the SEC has prescribed to replace the Staff Letters.
2. As to all discontinued contracts that will rely on the Alternative Disclosure procedure, the insurer must file its 2020 annual audited financial statements, and those of each relevant separate account, with the SEC via EDGAR
3. If a contract that has been relying on the Staff Letters will not be relying on the Alternative Disclosure procedure, the insurer must bring the related registration statement current and resume prospectus delivery to the owners of those contracts.

It also generally is mandatory that, by May 1, 2022, all active registration statements on Forms N-4 and N-6 be brought into compliance with major revisions to those forms that the SEC adopted as part of the reforms. This includes, but is not limited to, any active registration statements that formerly relied on the Staff Letters but that were not brought into compliance with the Form N-4 and N-6 revisions at the time they were brought current.

Although these deadlines are mandatory, insurers have more flexibility about whether or when to implement other aspects of the SEC's reforms.

Considerations relevant to some of the key questions in this regard are summarized below.

### ***Which Discontinued Contracts Can Rely on the New Alternative Disclosure Procedure?***

In the "adopting release" for its reforms, the SEC set forth a new "Alternative Disclosure" procedure that incorporates somewhat different terms and conditions than the Staff Letters. The SEC made the Alternative Disclosure procedure available beginning July 1, 2020, and the SEC staff also has announced the withdrawal of the Staff Letters effective on that date.

The Staff Letters were limited to circumstances in which sales of the contract had been discontinued and, in almost all cases, fewer than 5,000 of the contracts remained outstanding.

- *Owners versus Contracts* — Under the new Alternative Disclosure procedure, the 5,000 limit will be based on the number of current contract owners, whereas the Staff Letters focused on the number of outstanding contracts. Also, this limit will apply without any exceptions, whereas several of the Staff Letters involved larger numbers.
- *Entire Registration Statement* — For purposes of this limit under the Staff Letters, some insurers counted certain, somewhat different, contracts separately from other contracts covered by the same registration statement. However, under the new Alternative Disclosure procedure, owners of all contracts covered by a registration statement will have to be counted.

### ***Should All Eligible Discontinued Contracts Rely on the Alternative Disclosure Procedure?***

Insurers have the option of whether to rely on the Alternative Disclosure procedure for any or all of the contracts that are eligible to do so. The adopting release allows an insurer to choose one of two variations within the Alternative Disclosure procedure, one of which the release calls "modernized" and requires delivery of annual "Notice Documents" containing the same information that is required in an updating summary prospectus (USP), discussed below.

#### *Pros:*

- Reliance on the Alternative Disclosure procedure for a contract avoids the cost of bringing current the related registration statement (generally by May 1, 2021). This cost may vary widely and will depend largely on the number of years since the registration statement was updated and how similar the contracts it covers are to any contracts for which the insurer still maintains a current registration statement.

- Reliance on the Alternative Disclosure procedure also will enable the insurer to avoid future annual costs of updating the registration statement and printing and delivering contract prospectuses.
- Under the Alternative Disclosure procedure, an insurer has the option of using annual “Notice Documents,” which has the additional advantages summarized under the next question below.
- A decision now to rely on the Alternative Disclosure procedure may preserve more future optionality for the insurer. Although the insurer could later decide to stop relying on the Alternative Disclosure procedure, the SEC staff may take the position that, once a registration statement is brought current, the Alternative Disclosure procedure will not thereafter be available as to that registration statement.

*Cons:*

- For contracts relying on the Alternative Disclosure procedure that do not use Notice Documents, the compliance requirements will be somewhat more burdensome than under the Staff Letters, principally because of the new requirement to file annually the relevant insurer and separate account financial statements.
- Even if Notice Documents are used, Notice Documents themselves entail costs as summarized under the next question below.
- Once a registration statement is brought current and into compliance with the form amendments, USPs and e-delivery of underlying fund prospectuses can be used for annual updating purposes, subject to certain conditions. As discussed under other questions below, the use of such USPs and e-delivery could substantially reduce annual prospectus delivery costs, as well as provide a convenient means of delivering various types of information that insurers send owners of discontinued contracts from time to time.
- Although an insurer may be able to spread some of the costs associated with reactivating a registration statement by deferring compliance with the Form N-4 or N-6 amendments until the 2022 update season, this will also delay the ability to use USPs or rely on e-delivery for fund prospectuses in connection with that registration.
- There may be some compliance and cost advantages to using a single updating methodology that can be used for all variable product registration statements, rather than having a different methodology for some contracts as permitted under the Alternative Disclosure procedure.

***Should “Notice Documents” Be Used for Discontinued Contracts Relying on the Alternative Disclosure Procedure?***

Insurers relying on the Alternative Disclosure procedure have the option of choosing, now or in the future, the “modernized” variation, in which case the insurer provides annual Notice Documents to contract owners.

*Pros:*

- When annual Notice Documents are used, insurers (i) will be relieved of otherwise applicable costs of annually duplicating and delivering certain audited financial statements to contract owners and (ii) may rely on e-delivery of prospectuses for funds that make summary prospectuses available, which would further reduce duplication and delivery costs. Some additional considerations as to e-delivery of fund prospectuses are discussed under the separate question about that subject further below.
- Notice Documents would provide owners with more relevant information than they would otherwise receive under the Alternative Disclosure procedure and could be a convenient vehicle for insurers to transmit various types of information that they find it necessary or advisable to convey to such owners from time to time.

*Cons:*

- Notice Documents are required to contain extensive disclosures relating to the contracts, as well as a separate summary of changes that have occurred, all of which must be updated each year. The resources required to prepare these disclosures may be especially significant for the first Notice Document prepared for a contract whose prospectus has not been updated for many years.
- Insurers also will incur costs in complying with all the SEC’s other requirements applicable to Notice Documents, including filing the Notice Documents with the SEC via EDGAR (separately from the financial statement filings mentioned above) and duplicating and delivering them to contract owners. However, these and other costs of implementing the use of Notice Documents can be deferred by delaying their use until 2022 or later.

***Should Compliance With the Form N-4/N-6 Amendments Be Accelerated?***

Although registration statements that are being updated are generally not required to be brought into compliance with the form amendments until May 1, 2022, earlier compliance is permitted.

*Pros:*

- Rule 498A makes compliance with the form amendments a precondition to the use of initial summary prospectuses (ISPs), USPs, and e-delivery of fund prospectuses. Accordingly, early compliance with the form amendments (for example, by May 1, 2021) could enable earlier benefits from these sources. These benefits, as well as related costs, are addressed in the questions that follow below.

*Cons:*

- Considerable resources may be required to bring registration statements into compliance with the amended requirements of Forms N-4 and N-6, and deferring such compliance for some or all of its registration statements may enable an insurer to manage its resources more effectively.
- For some registration statements — e.g., where the volume of required prospectus delivery is small — the potential cost of a year’s delay in using ISPs, USPs, and fund prospectus e-delivery may be modest.

***As to Contracts That Are Still Being Sold, Should “ISPs” Be Prepared or Deferred?***

Preparation and use of ISPs is not mandatory, and doing so can be deferred or omitted entirely for any contract.

*Pros:*

- Because ISPs are much briefer than full statutory prospectuses, the use of ISPs can substantially reduce the costs of duplicating and delivering contract prospectuses.
- ISPs are generally more “customer-friendly.”
- Use of ISPs can, in turn, enable the use of USPs and e-delivery of fund prospectuses, as Rule 498A conditions those procedures on using ISPs for certain contracts. The potential benefits of USPs and fund prospectus e-delivery (as well as some costs) are summarized under the questions that follow below.

*Cons:*

- There will be incremental costs in drafting an ISP. However, these will generally be relatively modest for a given contract, because most of the substantive disclosures in an ISP are required to be included in the related statutory prospectus, regardless of whether ISPs are used.
- Further resources will be required to comply with certain additional requirements (including electronic formatting and website posting requirements) applicable to ISPs.

- Insurers can spread the burden of implementing the reforms over a longer period of time by deferring ISP usage for some or all eligible contracts, and such deferral will not prejudice an insurer's ability to commence ISP usage at any future time.

### ***As to Registration Statements That Are Being Updated, Should USPs Be Prepared or Deferred?***

Preparation and use of USPs is not mandatory, and doing so can be deferred or omitted entirely for any contract.

#### *Pros:*

- Because USPs are much briefer than full statutory prospectuses, the use of USPs substantially reduces the cost of duplicating and delivering contract prospectuses.
- USPs are customer-friendly, particularly because they are required to contain a separate summary of specified types of changes that have occurred since the date of the most recent statutory summary prospectus. This should enable most recipients of USPs to focus efficiently on information that is most likely to interest them.

#### *Cons:*

- A USP may be used only if an ISP is being used for any contracts that are currently being offered for new sales pursuant to the prospectus to which the ISP relates.
- There is some incremental cost to drafting a USP. However, this cost will generally be modest for any one contract because most of the content will already be included in the related statutory prospectus. Although the summary of changes that a USP is required to include is not required to be in the statutory prospectus, the incremental cost of drafting it may also be modest, except in some cases in which a number of years have passed since the statutory prospectus for the contract has been updated.
- Further resources will be required to comply with certain additional requirements (including electronic formatting and website posting requirements) applicable to USPs.
- Insurers can spread the burden of implementing the reforms over a longer period of time by deferring USP usage for some or all eligible contracts, and such deferral does not prejudice an insurer's ability to commence USP usage at any future time.

### ***Must or Should the E-Delivery Procedure Be Deferred for Some Underlying "Fund" Prospectuses?***

Rule 498A permits, but does not require, insurers to deliver fund prospectuses by making them available on a website, subject to certain conditions.

*Pros:*

- The e-delivery procedure for fund prospectuses will result in major reductions in the duplicating and delivery costs for fund prospectuses.
- It will avoid bombarding customers with masses of paper that is only marginally relevant to them.
- It may reduce the possibility of inadvertent failures to deliver a required fund prospectus.

*Cons:*

- The new e-delivery procedure is available only as to funds that make fund summary prospectuses available and not all funds historically have done so.
- E-delivery of fund prospectuses is available only in connection with contracts covered by a registration statement under which an ISP is used for each contract then being offered under that registration statement. As noted under an earlier question, this can be an important benefit to using ISPs.
- Although an insurer can use the new fund prospectus e-delivery procedure for some of its registration statements, contracts, or related funds and not for others, the complications of that approach may generate administrative costs for the insurer.
- Insurers can spread the burden of implementing the reforms over a longer period of time by deferring e-delivery of fund prospectuses for some or all eligible contracts, and such deferral does not prejudice an insurer's ability to commence such e-delivery at any future time.

***What Are Some Potential Timesaving Steps?***

- Start early. Many decisions will need to be made.
- Develop a consistent approach for making the statutory prospectus changes.
- Where ISPs, USPs, or Notice Documents will be used, develop templates that can be used for similar products.
- Consider allocating the responsibility for ISP or USP templates to the same persons who are responsible for the basic approach in the statutory prospectuses (or at least for the relevant portions thereof).

- For discontinued contracts whose prospectuses have not been recently updated, consider allocating responsibility to persons who are most familiar with those products and their history, if such persons are available.

## Authored By



Thomas C. Lauerman

## Related Practices

[Life, Annuity, and Retirement Solutions](#)  
[Financial Services Regulatory](#)

## Related Industries

[Life, Annuity, and Retirement Solutions](#)  
[Securities & Investment Companies](#)  
[Life, Annuity, and Retirement Solutions](#)

©2024 Carlton Fields, P.A. Carlton Fields practices law in California through Carlton Fields, LLP. Carlton Fields publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information and educational purposes only, and should not be relied on as if it were advice about a particular fact situation. The distribution of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship with Carlton Fields. This publication may not be quoted or referred to in any other publication or proceeding without the prior written consent of the firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our Contact Us form via the link below. The views set forth herein are the personal views of the author and do not necessarily reflect those of the firm. This site may contain hypertext links to information created and maintained by other entities. Carlton Fields does not control or guarantee the accuracy or completeness of this outside information, nor is the inclusion of a link to be intended as an endorsement of those outside sites.