The Investment Lawyer

Covering Legal and Regulatory Issues of Asset Management

VOL. 31, NO. 4 • APRIL 2024

REGULATORY MONITOR

Life Insurance and Annuity Developments

By Ann B. Furman

Registered Index-Linked Annuities— Regulators Play Catch-Up

ales of registered index-linked annuities (RILAs)¹ exceeded sales of variable annuities (VAs) for the first time in fourth quarter 2023.² This is remarkable considering RILAs are a relatively new insurance product first introduced in 2010,³ whereas VAs have been around for quite some time, first introduced over 70 years ago.⁴

Insurance and securities regulators that establish the regulatory framework for RILAs—including the National Association of Insurance Commissioners (NAIC) at the state level and the US Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) at the federal level—are in catch-up mode to align product regulation with the popularity of the product.

This column discusses pending and expected regulatory changes relating to RILAs⁵ at the state and federal levels. It also discusses ways in which regulators have likened (and not likened) RILAs to VAs in setting the regulatory regime.

State Insurance Regulation of RILAs

Life insurance companies issuing a new VA may file their VA for approval with the Interstate Insurance Product Regulatory Commission (Compact), a relatively streamlined approval process based on VA product standards, and with any

non-Compact states. On the other hand, life insurance companies issuing a new RILA must file their RILA for approval in each jurisdiction where sales will be made, a much slower, resource-intensive process. The Compact is working to develop core product standards for RILAs to facilitate filing RILA with the Compact.⁶ RILA Compact standards are expected this year.

The NAIC Standard Nonforfeiture Law for Individual Deferred Annuities (Model 805)⁷ sets forth nonforfeiture requirements for certain types of fixed annuities.⁸ VAs are excluded from the Model 805 standard nonforfeiture requirements. Life insurance companies currently file RILAs as VAs under state law to receive consistent nonforfeiture treatment. To address standard nonforfeiture requirements in the context of RILAs, the NAIC recently adopted Actuarial Guideline 54 (AG 54),⁹ applicable to RILAs issued on or after July 1, 2024.

The Model 805 nonforfeiture requirement does not apply to VAs because for VAs, the nonforfeiture amount is equal to accumulation up to that time, at rates of interest equal to the net investment return, less specified deductions. The net investment return is based upon the investment experience of investment assets of a separate account of the issuing life insurance company. The daily market values of the VA separate account assets are the basis of all the variable benefits under

the annuity, including surrender values. On the other hand, RILA benefits are not funded by unitized separate accounts, meaning that RILA values are not determined by the market prices of the investment assets. AG 54 sets forth the conditions under which a RILA is consistent with the definition of a VA and exempt from Model 805. AG 54 also specifies nonforfeiture requirements for RILAs that are consistent with VAs. Life insurance companies have begun modifying their existing RILAs to comply with AG 54.

SEC Regulation of RILAs

The SEC Staff has given considerable attention to the registration of RILAs under the Securities Act of 1933 (1933 Act), including the accounting standards applicable to financial statements required to be filed in RILA registration statements. Most VAs are registered on Form N-4, a form designed for registration of the separate account under the Investment Company Act of 1940 (1940 Act) and registration of the annuity contract and/or units of interest in the separate account under the 1933 Act. Further, unless a life insurance company is required to prepare financial statements in accordance with United States generally accepted accounting principles (GAAP)—because it is a public reporting company or for some other reason—a life insurance company is, subject to certain conditions, permitted to prepare and file financial statements in accordance with Statutory Accounting Principles (SAP)¹¹ in variable insurance product registration statements on Forms N-3, N-4, and N-6.

Because the SEC has not designed a registration form specifically for RILAs, life insurance companies register RILAs on either Form S-1 or S-3, the latter being available to a life insurance company that is a public reporting company or seasoned issuer. But those S-forms are not well-suited to registering securities in the form of insurance products where the purchaser does not acquire a conventional debt or equity security issued by the life insurance company. For example, many of the S-form disclosure and

reporting requirements are not relevant to a RILA purchaser.¹² Accordingly, the life insurance industry lobbied the SEC and Congress to create a registration form tailored to RILAs. In the end, it took an act of Congress to require the SEC to develop a registration form for RILAs.¹³

Specifically, Congress required the SEC to develop a new registration form for RILAs by June 30, 2024, or permit life insurance companies to register RILAs on Form N-4, the registration form for VAs. In response, the SEC issued a release on September 29, 2023 (RILA Form Proposing Release), 14 that proposes amendments to Form N-4 to make that form available and suitable for registration of RILAs under the 1933 Act. The SEC has scheduled the proposed RILA amendments for adoption on or before June 30, 2024.

There will be several benefits to registering RILAs on Form N-4. Life insurance companies will be able to avoid preparing and filing GAAP financial statements to the same extent as if they were registering a VA. This will avoid any possible need to seek relief (as some insurers have done) under Rule 3-13 of Regulation S-X¹⁵ to permit filing SAP financial statements in RILA registration statements. Also, RILA issuers will be able to enjoy the summary prospectus framework currently in place for VAs, pay registration fees in arrears on a net basis, and utilize a single Form N-4 registration statement to cover both RILA and VA options that are offered under the same annuity contract.

Even though the RILA Form Proposing Release treats RILAs as VAs for registration statement purposes and financial statement purposes, the SEC declined to treat RILAs as VAs for advertising purposes. An open issue is whether the final RILA rule package will allow RILAs to rely on Rule 482 under the 1933 Act for advertising purposes. Rule 482 applies to investment company advertisements and allows an ad to include performance information under standardized formulas as well as nonstandardized performance that is accompanied by standardized performance. A Rule 482 ad is an "omitting

prospectus," and the rule does not require that the communication be accompanied or preceded by a statutory prospectus.

Rule 482 permits VA issuers to deliver sales material directing the recipient to contact a specified number to receive a prospectus. This is particularly important for ads in the form of billboards, TV commercials, electronic communications, and social media. Rule 433 under the 1933 Act addresses conditions for using a free writing prospectus (FWP) and permits seasoned issuers and well-known seasoned issuers to use an FWP without preceding or accompanying it by a prospectus.¹⁶ On the other hand, FWPs used by nonseasoned issuers must be preceded or accompanied by a statutory prospectus, placing nonseasoned (nonpublic reporting company) RILA issuers at a disadvantage to seasoned (public reporting company) RILA issuers that are entitled to rely on prospectus delivery requirements under Rule 433(b) (1) for FWPs.17

The RILA Form Proposing Release notes that the SEC considered amending Rule 482 to include RILAs but declined based on a lack of standards for showing RILA performance. Commenters on the proposed rule have encouraged the SEC to amend Rule 482 to cover RILAs to level the playing field between VA and RILA advertisements.¹⁸

FINRA Regulation of RILA Sales Material

FINRA Rule 2210(c) requires filing with FINRA retail communications of registered investment companies. This requirement includes VA communications but not non-investment company RILA communications. As such, RILA retail communications are excluded from FINRA filing requirements unless another FINRA Rule 2210(c) filing category applies.

Rule 2210(c) does not include an explicit category for RILAs. The closest filing category requires filing of "[r]etail communications concerning any security that is registered under the 1933 Act and that is derived from or based on a single security,

basket of securities, an index, a commodity, a debt issuance or a foreign currency."19 While on its face, this category would appear to sweep in RILAs that are registered under the 1933 Act and based on an index, FINRA guidance addressing this category notes that the purpose of this filing requirement is to cover securities with "derivative-like features" or "registered structured products," such as "exchange-traded notes that are not registered under the [1940] Act but are registered under the 1933 Act, registered reverse convertibles, registered structured notes, registered principal protection notes, and any other registered security that includes embedded derivative-like features."20 By contrast, RILAs do not include derivative-like features and can be distinguished. That is, unlike the instruments listed in FINRA's FAQ guidance, RILAs also allow a contract owner to set the maximum loss he or she is willing to tolerate. That said, FINRA reviews RILA advertisements that are filed voluntarily under standards designed for VAs and investment companies.

Conclusion

Although the regulatory framework for RILAs is in a state of change, it appears that several major regulatory issues will be resolved by Summer 2024. By that time, the Compact product standards for RILAs should be complete or close to complete, the SEC registration form for RILAs should be adopted and ready for use, and FINRA will have had an opportunity to update its guidance to clarify whether RILA communications are required to be filed for approval.

Ms. Furman is a shareholder at Carlton Fields, P.A., in Washington, DC, and co-chairs the firm's Financial Services Regulatory Practice Group. She thanks her colleagues, Ann Y. Black, Gary O. Cohen, and Thomas C. Lauerman, for reviewing and contributing to this column. The views expressed are those of Ms. Furman and do

4 THE INVESTMENT LAWYER

not necessarily reflect the views of her firm, its lawyers, or its clients.

NOTES

- A RILA is an annuity that is registered with the SEC, issued by a life insurance company, not issued by an investment company, and the returns of which "(i) are based on the performance of a specified benchmark index or rate (or a registered exchange traded fund that seeks to track the performance of a specified benchmark index or rate); and (ii) may be subject to a market value adjustment if amounts are withdrawn before the end of the period during which that market value adjustment applies." Registration for Index-Linked Annuities Act, S.3198, 117th Congress, incorporated into H.R. 2617, Consolidated Appropriations Act, 2023, and signed by President Biden on December 29, 2022 (hereinafter RILA Act).
- Source: Life Insurance Marketing and Research Association (LIMRA) Preliminary U.S. Annuity Fourth Quarter 2023 Sales Estimates, available at https://www.limra.com/siteassets/newsroom/fact-tank/ sales-data/2023/q4/4q-annuity-sales.pdf. According to LIMRA, Q4 2023 sales of RILAs and VAs were \$13 billion and \$12.3 billion, respectively. Id.
- Society of Actuaries Research Institute, Registered Index-Linked Annuities at 4 (August 2022), available at https://www.soa.org/4a375c/globalassets/assets/files/resources/research-report/2022/registered-index-linked-annuities.pdf.
- The College Retirement Equity Fund created the first VA in 1952. See J.M. Poterba, "The History of Annuities in the United States," Working Paper 6001 at 24, National Bureau of Economic Research (April 1997), available at https://www.nber.org/system/files/working_papers/w6001/w6001.pdf.
- RILAs also are known as structured annuities, buffered annuities, and index-linked variable annuities. In addition, a few life insurance companies issue registered index-linked life insurance, a life insurance policy that operates like a RILA.

- NAIC Standards for Individual Deferred Index-Linked Variable Annuity Contracts (Commonly Marketed as Registered-Index Linked Annuities) (Product Standards Committee Recommended Draft dated January 31, 2024), available at https:// www.insurancecompact.org/sites/default/files/2024-01/240131-standards-for-individual-deferredindex-linked-variable-annuity-contracts.pdf.
- NAIC Model 805 does not define "variable annuity." However, the NAIC Variable Annuity Model Regulation (NAIC Model 250) defines a VA as "a contract that provides for annuity benefits that vary according to the investment experience of a separate account." NAIC Model 250 § 2B.
- Nonforfeiture is an insurance concept designed to provide a contract owner with a certain value if the contract owner surrenders the contract. NAIC Model 805 defines the minimum nonforfeiture amount as "the minimum value required under [Model 805]. It reflects net considerations, the nonforfeiture rate, and other items as specified in [Model 805]." See infra n.9 at § 3F.
- NAIC, Actuarial Guideline LIV, Nonforfeiture Requirements for Index-Linked Variable Annuity Products, adopted March 25, 2023, available at https://content.naic.org/sites/default/files/committeespending-action-actuarial-guideline-liv-230224.pdf. AG 54 provides conditions under which RILAs, called index-linked variable annuities in AG 54, may qualify as VAs exempt from NAIC Model 805.
- ¹⁰ *Id*.
- "Statutory Accounting Principles are designed to (1) ensure consistent reporting among insurers and (2) assist state insurance departments in the regulation of insurance companies. The ultimate objective for regulators is to ensure an insurer is solvent as this is critical to ensure that policyholders, contract holders, and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute to provide an adequate margin of safety. The cornerstone of solvency measurement is financial

- reporting." NAIC Statutory Accounting Principles (SAP), available at https://content.naic.org/cipr-topics/statutory-accounting-principles.
- Life insurance company issuers of RILAs may be able to rely on Rule 12h-7 under the Exchange Act, which serves to relieve the life insurance company from periodic reporting requirements applicable to pubic companies.
- RILA Act, *supra* n.1. Before proposing the RILA registration form, the SEC conducted RILA investor testing, as mandated by the RILA Act. *See* Office of the Investor Advocate, Investor Testing Report on Registered Index-Linked Annuities (September 2023), available at https://www.sec.gov/files/rila-report-092023.pdf.
- SEC Proposed Rule, Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities, Securities Act Release No. 11250; Exchange Act Release No. 98624; Investment Company Act Release No. 35028 (September 29, 2023). The comment period ended on November 28, 2023. The SEC received 14 sets of comments.
- Rule 3-13 provides that "[t]he Commission may, upon the informal written request of the registrant, and where consistent with the protection of investors, permit the omission of one or more of the financial statements herein required or the filing in substitution therefor of appropriate statements of comparable character." [17 C.F.R. § 210.3-210.13]
- ¹⁶ Rule 433(b)(1), 17 CFR § 230.433(b)(1).

- Rule 433 splits types of issuers for purposes of FWP prospectus delivery requirements. An FWP used by a seasoned issuer or well-known seasoned issuer is not required to be preceded or accompanied by a statutory prospectus. On the other hand, an FWP used by a non-reporting and unseasoned issuer must be accompanied or preceded by a prospectus. Securities Act Rule 433(b)(1) & (b)(2)(i).
- See, e.g., Insured Retirement Institute (letter from J. Berkowicz and E. Micale dated November 28, 2023) ("The SEC declined to extend Rule 482 to RILAs. We urge the SEC to reconsider this posture and revise the Proposal to bring RILAs under Rule 482, or alternatively, under Rule 433."); Group 1001 (letter from R. Cloud and M. Bloom dated November 28, 2023) ("we believe that Rule 482 ... should be modified to apply to RILAs."); Committee of Annuity Insurers (letter from Eversheds Sutherland dated November 28, 2023) ("the SEC should amend Rule 482 to permit RILA advertising under that rule."); and American Council of Life Insurers (letter from J. McAdam dated November 28, 2023) ("By not extending Rule 482 to RILAs, the SEC perpetuates an inconsistency between variable annuities and RILAs as it relates to advertising requirements. In particular, the failure to amend Rule 482.").
- ¹⁹ FINRA Rule 2210(c)(3)(D).
- ²⁰ FINRA, Frequently Asked Questions about Advertising Regulation, FAQ C.1.2., available at https://www.finra.org/rules-guidance/guidance/faqs/advertising-regulation#c1.

Copyright © 2024 CCH Incorporated. All Rights Reserved.

Reprinted from *The Investment Lawyer*, April 2024, Volume 31, Number 4, pages 20–24, with permission from Wolters Kluwer, New York, NY, 1-800-638-8437, www.WoltersKluwerLR.com

