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## REGULATORY MONITOR

### SEC UPDATE

*By Harry Eisenstein*

#### **RILA Rulemaking: Things Left Out in the Cold and Things Left Unsaid**

The Securities and Exchange Commission's (SEC) recent rulemaking providing to registered index linked annuities (RILAs) and market value adjustment annuities (MVAs) the same registration framework used by variable annuities<sup>1</sup> was a comprehensive and well thought out effort, making adjustments in filing, fee payment, disclosure, and other registration related requirements to accommodate these products within that framework. The adopting release for the rulemaking (Adopting Release) did, however, explicitly leave certain matters untouched and, in addition, left unaddressed certain matters that have raised questions for issuers of insured investment products.

#### **Products Left Untouched**

The rulemaking followed a congressional mandate enacted at the end of 2022 for the SEC to establish a new registration framework for RILAs within 18 months.<sup>2</sup> Given such a short deadline, it was not surprising that the SEC decided not to extend the variable product registration framework to other non-variable products, such as contingent deferred annuities and index linked insurance products, but the decision is regrettable nonetheless. Aside from forcing issuers of these other non-variable products

to continue using the burdensome Form S-1/S-3 registration framework, it seems likely that extending that framework would not have been exceedingly difficult. The required disclosures for variable annuities and variable life products have been harmonized since the 2020 rulemaking adopting a summary prospectus option for these products, which would have facilitated the work in amending the form for variable life products, Form N-6, to accommodate indexed life products. Also, contingent deferred annuities work very much like a guaranteed minimum withdrawal benefit, which is a very well understood feature in variable products, and arguably would not have presented any unusual wrinkles that would have had to be worked through. It is to be hoped that the SEC will resolve to close the loop on these remaining non-variable products in the near future.

Separate from not extending the variable product registration framework to these other non-variable products, the Adopting Release did not address current SEC Staff policy with respect to allowing under Reg S-X §3-13<sup>3</sup> the use of financial statements prepared under state statutory accounting principles (SAP) in registration statement filings on Form S-1 for indexed life products. Currently, SEC Staff has not been willing to allow the use of SAP financial statements in registration statement filings

for indexed life products. This is unjustifiable, since the logic behind SEC Staff letters issued allowing the use of SAP financial statements in other non-variable products is agnostic as to the type of insurance product being registered and would apply equally to indexed life products.

In addition, issuers of RILAs and/or MVAs who would otherwise qualify under Form N-4 to use SAP financial statements in registration statement filings for those products<sup>4</sup> cannot do so if they also have an outstanding registered offering of indexed life products, since registration statement filings for indexed life products must use GAAP financial statements. This result is inconsistent with the legislation mandating the adoption of a new registration framework for RILAs, and it is hoped SEC Staff will change its approach so that the policy on the use of SAP financial statements is applied equitably across all non-variable insurance products.

### **Prohibition on Marketing Communications Preceding Prospectus Delivery Left in Place**

Notwithstanding the general intent expressed in the Adopting Release to “provide parity” between variable and non-variable annuities,<sup>5</sup> the SEC determined not to extend to RILAs and MVAs one of the communications rules, that is, Rule 482 under the Securities Act of 1933 (Securities Act), to which variable annuities are subject. Among other things, this rule allows issuers of variable annuities to disseminate advertisements and other sales materials and literature regarding these products without being subject to a prior or concurrent statutory or summary prospectus delivery requirement. This prohibition, with one exception being carved out for seasoned issuers,<sup>6</sup> has the practical result that issuers of RILAs and MVAs cannot engage in broad-based advertisements for these products.<sup>7</sup>

While declining to extend Rule 482 to RILAs and MVAs,<sup>8</sup> the SEC invited further engagement on the matter.<sup>9</sup> The contours of successful approaches to amend Rule 482 to eliminate this regulatory bias

against non-variable annuities in marketing communications are unknown at this time, but it is expected that the insured investment products industry will engage intensively both with the SEC and with the Financial Industry Regulatory Authority to address this bias in a manner that satisfies the SEC’s investor protection concerns.

### **Disclosure and Filing Matters Not Addressed in the Adopting Release**

To be sure, the SEC did not intend to address all possible disclosure issues that might arise in connection with the rulemaking. Nonetheless, certain issues already have been encountered by registrants or have been recognized as requiring further clarification from SEC Staff. Fortunately, some, although not all, of these issues have been clarified informally by SEC Staff members. Among others, these include the following:

- *Intermediary Specific Variations*—The item requiring from both variable and non-variable issuers a general description of the contract outside of its investment options (Item 8 of Form N-4) has an instruction requiring the disclosure of “all material ... intermediary-specific variations (for example, variations resulting from different brokerage channels) to the offering.”<sup>10</sup> In the past, variable annuity registrants have addressed this requirement by noting, in the case of investment options, that not all are available and explaining how investors could find out what options are available and, in the case of benefits, noting which benefits might not be available. The Adopting Release did not specifically address the instruction to Item 8(a) and, while the instruction has not changed, SEC Staff appears to have taken the position that the instruction requires a description of the sets of contract features that are made available by different distributors (for example, if an intermediary offers a version of a contract that excludes a material

benefit described in the contract, that version would have to be disclosed in the prospectus). These variations could include variations in the underlying investment options as well as variations in the contract features.

This interpretation could present a considerable burden on life insurance companies, who may not be aware of decisions taken by each and every intermediary as to what features and investment options to offer and could present an additional issue in obtaining information in the case of proprietary products. The burden imposed by this interpretation hardly seems justifiable by the incremental benefit to the investor. Hopefully, SEC Staff will engage with the industry on an arrangement that takes the serious logistical burdens imposed on issuers into account.

- *Disclosure of Minimum Downside Limits*—Form N-4 requires in several parts of the prospectus the disclosure of “any minimum limits on Index losses that always will be available under the Contract or, alternatively, [a prominent statement] that the Insurance Company does not guarantee ... the Contract will always offer Index-Linked Options that limit Index losses.”<sup>11</sup> This language isn’t very clear as to whether a commitment by an issuer to provide a downside limit of one type (for example, a floor) for the life of a contract is sufficient to avoid having to state it does not guarantee the contract will always offer indexed investment options that limit index losses, where that Contract also offers indexed investment options with a downside limit of another type (for example, a buffer).

On this point, SEC Staff has indicated that issuers should provide an indexed investment option that has a specified minimum downside limit for each type of downside limit being offered or state there may not be any other indexed investment options with a minimum downside limit. One other issue, relating to the alternative requirement to state that the issuer

does not “guarantee” there will be indexed investment options with a minimum downside limit remains unclear. Specifically, it is not clear from this language whether the commitment to provide an indexed investment option with a minimum downside limit must be specified in the contract, or whether a commitment in the prospectus is sufficient.

- *Using Rate Sheet Supplements*—Prior to the RILA rulemaking, SEC Staff had issued guidance allowing variable product issuers to file changes in numerical terms applicable to certain benefits offered with these products via a prospectus supplement as opposed to filing a reviewable post-effective amendment pursuant to Securities Act Rule 485(a).<sup>12</sup> The Adopting Release noted that the issue of allowing RILA issuers to do the same was “beyond the scope of [the] rulemaking.”<sup>13</sup> Fortunately, SEC Staff members have informally advised that RILA registrants can use this “rate sheet” supplement process to the same extent as variable product issuers.
- *Describing Fixed Indexed Options in the Appendix*—The Adopting Release does not explicitly address the treatment of fixed indexed options other than to require certain disclosures for all fixed options, including fixed options. Form N-4 requires a separate table in the prospectus Appendix for fixed options, with columns for information that are aimed at traditional fixed products (that is, term and minimum guaranteed interest rate).<sup>14</sup> The Form does note that registrants “may add, modify or exclude table headings only as necessary to describe the material features of a [f]ixed [o]ption,”<sup>15</sup> and SEC Staff members have informally advised that registrants whose offerings registering on Form N-4 include fixed indexed options should take the headings of the table for indexed options as a starting point. Nonetheless, it is to be hoped that SEC Staff experience with potentially disparate treatments of fixed indexed options will result in more uniform guidance going forward.

- *Describing Costs for a Combination Contract in the Ongoing Fees and Expenses Section of the Key Information Table*—The Lowest and Highest Cost Annual Cost Table requires calculating and including the cost of periodic charges imposed on benefits.<sup>16</sup> Contracts may impose an adjustment to reflect changes in interim value when account value is removed, referred to in Form N-4 as a “Contract Adjustment,” and this adjustment could be made for deductions to pay for those charges. The instructions did not clarify whether the costs noted in the table should reflect Contract Adjustments made upon these deductions, which would require certain assumptions regarding interim value. Fortunately, SEC Staff members informally clarified that the cost figures in the table need not reflect these Contract Adjustments.

Separately, the Minimum and Maximum Annual Fee Table in this section requires an entry for base contract fee as a percent of total average net assets attributable to the contract.<sup>17</sup> SEC Staff members have informally advised that base contract fees in this case may be but are not required to be stated separately for the variable and non-variable options. Where an issuer chooses to state one figure for a base contract fee, it is unclear how the figure should be calculated for the table (that is, as a percent of all assets or a percent of assets allocated to the variable options). It is expected that this issue would be resolved, if necessary, during the upcoming review process of registration statements for RILAs and MVAs using Form N-4.

This abbreviated list describes only some of the issues that were not resolved in the RILA rulemaking (others include matters such as the procedures to be followed in requesting template relief to facilitate the review of multiple RILA and/or MVA filings and in obtaining file numbers and CIKs in EDGAR where the issuer has other registered offerings). While SEC Staff members already have informally

provided some guidance on certain issues, it is to be expected that more guidance will be forthcoming as this first wave of filings made to comply with the amended rules and forms are reviewed. In addition, it is to be hoped that the SEC Staff will continue to engage with the industry on still outstanding issues, such as those identified above, to find resolutions that both accommodate legitimate industry concerns and protect investor protection interests.

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#### NOTES

- <sup>1</sup> *Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities*, Securities Act Release No. 11294 (July 1, 2024) [89 Fed. Reg. 59978 (July 24, 2024)] available at <https://www.sec.gov/files/rules/final/2024/33-11294.pdf>.
- <sup>2</sup> Division AA, Title I of the Consolidated Appropriations Act, 2023, Pub. L. 117-328; 136 Stat. 4459 (Dec. 29, 2022).
- <sup>3</sup> Under this rule, SEC Staff can provide permission for the use of financial statements not prepared in accordance with generally accepted accounting principles (GAAP). SEC Staff has provided this permission for the use of SAP financial statements in registration statement filings for RILAs, MVAs, and contingent deferred annuities where the issuer is not otherwise required to prepare GAAP financial statements. *See, e.g., American General Life Insurance Company, The Variable Annuity Life Insurance Company and The United States Life Insurance Company in the City of New York* (May 28, 2024) (noting that the requesters, issuers of RILAs and MVAs, would not be required to prepare audited GAAP financial statements other than in connection with issuing those RILAs and MVAs).

- <sup>4</sup> See Form N-4, Item 26(b) (allowing the use by a RILA and MVA issuer of SAP financial statements in registration statements for those products on Form N-4 if the issuer would not have to prepare GAAP financial statements except for use in a registration statement filed on Forms N-3, N-4 or N-6),
- <sup>5</sup> Adopting Release, *supra* n.1 at 226.
- <sup>6</sup> Certain RILA and MVA Issuers were “seasoned” issuers and used Form S-3 to register offerings of these products. As such, these issuers were able to take advantage of a provision in a Securities Act rule, Securities Act rule 433(b)(1)(i), relating to “free writing prospectuses” allowing them to engage in marketing communications without a prior or concurrent prospectus delivery requirement. To preserve the status quo, the SEC amended Rule 433(b)(1)(i), which now allows RILA and MVA issuers who “would otherwise be eligible to use Form S-3” to continue to use free writing prospectuses without that delivery requirement.
- <sup>7</sup> With regard to online communications, the SEC has for some time allowed securities issuers to disseminate marketing communications online where the materials have an active hyperlink to the prospectus, on the basis that the active hyperlink essentially constituted the concurrent delivery of the prospectus. See *Use of Electronic Media*, Securities Act Release No. 7856, Exchange Act Release No. 42728, Investment Company Act Release No. 24426 (April 20, 2000) [65 Fed. Reg. 25843 (May 4, 2000)], available at <https://www.govinfo.gov/content/pkg/FR-2000-05-04/pdf/00-11079.pdf>.
- <sup>8</sup> For a discussion of concerns raised by the SEC in not extending Rule 482 and of possible approaches to address these concerns, see T. Conner, H. Eisenstein, A. Furman, and W. Kotapish, “Rules for RILA and MVA Marketing Communications—Still Being Held Back, But There Remains a Crack in the Door,” 31 *The Inv. Lawyer* 9, 2024 WLNR 15977012 (Sept. 1, 2024).
- <sup>9</sup> Adopting Release, *supra* n.1, at 244.
- <sup>10</sup> Form N-4, Instruction to Item 8(a).
- <sup>11</sup> Form N-4, Item 1(a)(6) (Front Cover Page), 2(b)(2)(iii) (Overview), Item 3 Instruction 3(a) (Key Information Table), Item 5(a) (Principal Risks of Investing in the Contract), and Item 6(d)(2)(i)(B) (Description of Insurance Company, Registered Separate Account, and Investment Options).
- <sup>12</sup> *Use of rate sheet supplements in connection with variable insurance products*, Accounting and Disclosure Information 2018-05, SEC Division of Investment Management (last updated June 12, 2008), available at <https://www.sec.gov/about/divisions-offices/division-investment-management/fund-disclosure-glancel-accounting-disclosure>.
- <sup>13</sup> Adopting Release, *supra* n.1, at n. 627.
- <sup>14</sup> Form N-4, Item 17(c).
- <sup>15</sup> Form N-4, Item 17(c), Instruction 1(c).
- <sup>16</sup> Form N-4, Item 2, Instruction 2(c)(ii).
- <sup>17</sup> Form N-4, Item 2, Instruction 2(c)(i)(D).

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