

The Investment Lawyer

Covering Legal and Regulatory Issues of Asset Management

VOL. 28, NO. 5 • MAY 2021

REGULATORY MONITOR

SEC UPDATE

By Gary O. Cohen

SEC Addresses Variable Insurance, But Not Always with Precision

The Securities and Exchange Commission (SEC), to its credit, is slowly but surely moving variable insurance contracts¹ and related entities into the SEC's regulatory mainstream. However, some of the language that the SEC is using to do so is less than precise in light of the Securities Act of 1933 (1933 Act), the Investment Company Act of 1940 (1940 Act), and SEC rules and pronouncements.

The imprecise language is not widespread, involves technicalities, and does not appear to have legal consequences. Indeed, the imprecise language may be more in the nature of an inadvertent "slip of the tongue" or even lack of careful proofreading.

Yet the SEC is viewed as a premier independent agency with higher than common standards. It administers the federal securities laws pursuant to statutory, rule, and form definitions that carefully circumscribe its regulatory authority. And the SEC is a highly vocal advocate for enhancement of readability through clear writing.²

Moreover, the SEC appears to be changing its regulatory approach for variable insurance products and entities. It is beginning to propose and adopt rules for life insurance companies (insurance companies) and their unit investment trust separate accounts (separate accounts) at the same time that it

does so for open-end management investment companies (mutual funds). Traditionally, the SEC has followed a vexing pattern of addressing regulatory matters first for mutual funds and, only years later, for insurance companies.³

Part of the problem results from the uncomfortable fit of variable insurance products and entities under the federal securities laws.⁴ The SEC has never been able to make an airtight match of variable insurance contracts and entities with statutory concepts under the federal securities laws. The SEC Staff has forthrightly acknowledged that fundamental regulatory questions have not been definitively answered, as follows:

What "security" should be registered? In the case of variable annuities, should it be the contract, or only the accumulation and annuity units representing payments allocated to the separate account? Similarly, what should be deemed to be the "security" registered by the issuer of variable life insurance contracts? Who should be considered the "issuer" of variable insurance contracts: the insurance company sponsoring the separate account, or the separate account itself? When should a sale be deemed to occur for a variable insurance contract that requires the remittance of periodic payments over its life?⁵

The SEC recently adopted⁶ new Rule 12d1-4 providing conditional exemptions from the restrictions in Section 12(d) of the 1940 Act for certain fund of funds arrangements, including those of separate accounts. This column looks at some of the terminology that the SEC used in its release adopting Rule 12d1-4 (SEC Adopting Release) in light of the 1933 Act, 1940 Act, and SEC rules and registration statement forms.

Insurance Company Does Not “Issue” a Separate Account

The SEC Adopting Release refers to “the insurance company *issuing* the separate account.”⁷ The statement is imprecise. An insurance company does not *issue* a separate account. The term “issuer” is defined in the 1933 Act and the 1940 Act in the context of issuing a “security,”⁸ not an entity.

The 1933 Act, 1940 Act, and SEC’s rules define a separate account as “an account established and maintained by an insurance company.”⁹ Definitions in SEC registration statement Forms N-4 and N-6 refer to “the sponsoring insurance company that establishes and maintains the [separate account] Registrant.”¹⁰

It follows that an insurance company, rather than “issue” a separate account, *establishes* and *maintains* a separate account.

Contract Does Not “Invest” in a Fund

The SEC Adopting Release refers to “fees and charges associated with each variable insurance contract that *invests* in the acquiring fund.”¹¹ The statement is imprecise. A variable insurance contract does not “invest” in an acquiring fund. Conversely, an acquiring fund does not become a portfolio company of a “variable insurance contract.”

SEC registration statement Forms N-4 and N-6 define “Portfolio Company” to mean “any company in which the [separate account] Registrant invests. . . .”¹² Rule 12d1-4(b)(2)(iii) refers to a “separate account . . . that invests in an acquiring fund.”

It follows that a separate account, not a “variable insurance contract,” invests in portfolio companies, which include an “acquiring fund.”

Conclusion

The SEC seems to be moving variable insurance contracts and related entities into the SEC’s regulatory mainstream. In doing so, it would behoove all concerned for the SEC to use technically precise language, consistent with statutory, rule and form definitions.

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NOTES

- 1 Variable insurance contracts include variable annuity contracts and variable life insurance policies.
- 2 See Rule 421(d) under the 1933 Act and Rule 30e-3(d) under the 1940 Act, requiring use of “plain English,” including “[d]efinite, concrete . . . words.”
- 3 For a detailed discussion of the SEC’s regulatory pattern, see Gary O. Cohen, “SEC Acts on Variable Insurance Matters Stretching Back for Decades,” *The Investment Lawyer*, Vol. 27, No. 7 at 28 (July 2020). For example, the SEC adopted

a summary prospectus for mutual funds in 2009 and took more than 11 years to adopt the same for separate accounts. See *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) (authorizing the use of a summary prospectus by mutual funds), available at <https://www.sec.gov/rules/final/2009/33-8998.pdf>, and *Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts*, Securities Act Release No. 10765, Exchange Act Release No. 88358, Investment Company Act Release No. 33814 (Mar. 11, 2020) (authorizing the use of a summary prospectus by separate accounts), available at [sec.gov/rules/final/2020/33-10765.pdf](https://www.sec.gov/rules/final/2020/33-10765.pdf).

⁴ The SEC has stated 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.” *Request for Comments on Reform of the Regulation of Investment Companies* 52, Securities Act Release No. 33-6868, Securities Exchange Act Release No. 28124, Investment Company Act Release No. 17534, Investment Advisers Act Release No. 1234, International Series Release No. 128 at 52 (June 15, 1990), available at http://3197d6d14b5f19f2f440-5e13d29c4c016cf-96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1990/1990_0615_SECInvestmentT.pdf.

⁵ *Id.* at 53.

⁶ *Fund of Funds Arrangements*, Securities Act Release No. 10871, Investment Company Act Release No. 34045 (Oct. 7, 2020) [hereinafter SEC Adopting Release], available at <https://www.sec.gov/rules/final/2020/33-10871.pdf>.

⁷ *Id.* at 94. The SEC’s complete statement is:

With respect to a separate account funding variable insurance contracts that invests in an acquiring fund, the final rule will require an acquiring fund to obtain a certification from the *insurance*

company issuing the separate account that it has determined that the fees and expenses borne by the separate account, acquiring fund, and acquired fund, in the aggregate, are consistent with the standard set forth in section 26(f)(2)(A) of the Act. (Emphasis added.)

⁸ Section 2(a)(4) of the 1933 Act and Section 2(a)(22) of the 1940 Act define “issuer,” in pertinent part, to mean “every person who issues or proposes to issue any security”

⁹ Section 2(a)(14) of the 1933 Act, Section 2(a)(37) of the 1940 Act, and Rule 0-1(e)(1) under the 1940 Act define “separate account,” in pertinent part, to mean “an account established and maintained by an insurance company pursuant to the laws of any state or territory of the United States”

¹⁰ Form N-4 and Form N-6, General Instructions, A. Definitions, definition of “Depositor” at iv. and v., respectively. SEC Form N-4 registration statement for variable annuity contracts and unit investment trust separate accounts, effective July 1, 2020 [hereinafter Form N-4], available at <https://www.sec.gov/rules/final/2020/33-10765-form-n-4.pdf>, and SEC Form N-6 registration statement for variable life insurance contracts and unit investment trust separate accounts, effective July 1, 2020 [hereinafter Form N-6], available at <https://www.sec.gov/rules/final/2020/33-10765-form-n-6.pdf>.

¹¹ SEC Adopting Release, *supra* n.6, at 97. The SEC’s complete statement is:

Under the orders, the insurance company must certify to the acquiring fund that the aggregate of all fees and charges associated with each *variable insurance contract that invests in the acquiring fund* are reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company. (Emphasis added.)

¹² Forms N-4 and N-6, *supra* n.10, General Instructions, A. Definitions, definition of “Portfolio Company” at iv. and v., respectively.

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