

Sprouting: Modernized Variable Product Disclosures: SEC Approves Summary Prospectuses

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As spring begins, and after many years of fertilizing and watering by industry representatives, the SEC has adopted comprehensive reforms to its disclosure requirements for variable annuities (VAs) and variable life insurance (VLI).

The centerpiece is new Rule 498A under the Securities Act, which authorizes the use of summary prospectuses for both VAs and VLI. These, like the similar summary prospectuses that mutual funds have used for more than 10 years, will be much shorter and consumer-friendly than the full statutory prospectuses that otherwise would be required to be delivered.

Rule 498A prescribes the content — and much of the format — of the summary prospectuses, and registrants will have only limited flexibility to include information that is not specifically prescribed. As discussed below, the requirements differ somewhat for “initial summary prospectuses” that can be used in connection with initial sales of variable contracts and “updating summary prospectuses” that can be used to satisfy ongoing prospectus delivery requirements over the life of an outstanding contract.

Initial Summary Prospectuses for Variable Products

The required content of the initial summary prospectuses includes:

- A “Key Information Table” setting forth limited information about fees and expenses, risks, certain restrictions under the contract, tax treatment, and conflicts of interest.
- A narrative overview of the contract’s purpose, benefits, and other features and characteristics.
- A table setting forth the same “fee table” information for the contract as appears in the statutory prospectus.
- An Appendix with a table setting forth information about each underlying fund portfolio and fixed account investment option available under the contract. For each underlying portfolio, for example, this would include (i) the portfolio’s investment objective, adviser (or, as relevant, subadviser), expense ratio, and performance information; and (ii) disclosure of any investment restrictions resulting from a “hard” or “soft” close of a portfolio or based on what features or benefits a contract owner has selected.

A separate initial summary prospectus will be required for each VA and VLI contract, although contracts that vary principally as to their distribution fees and expenses can be considered “classes” of the same contract for this purpose. Each initial summary prospectus must be filed as an exhibit to a contract’s initial registration statement (and/or any material amendments thereto) under the Securities Act.

If a summary prospectus is provided to customers together with other materials, the rule requires the summary prospectus to have greater prominence and cannot be bound together with any materials other than statutory or summary prospectuses for underlying portfolios that are available to the customer.

Updating Summary Prospectuses for Variable Products

A registrant may use an updating summary prospectus for an outstanding contract if an initial summary prospectus is being used for all new sales of contracts covered by the same statutory prospectus. Unlike the initial summary prospectus, however, the updating summary prospectus is not limited to a single contract, but may include any or all outstanding contracts covered by the statutory prospectus.

With respect to the contracts it covers, an updating summary prospectus must include:

- A concise description of several specified types of changes, if any, that have occurred since the most recent summary or statutory prospectus provided to the customer.

- A current Key Information Table and a current underlying portfolio/investment option Appendix, in each case comparable to that described above for initial summary prospectuses.

The conditions for use of an updating summary prospectus are generally similar to those for initial summary prospectuses, except that an updating summary prospectus need not be filed as an exhibit to the registration statement. Rather, updating summary prospectuses will be filed pursuant to Securities Act Rule 497.

Electronic Underlying Portfolio Summary Prospectuses

If initial summary prospectuses are used for each contract that is still being offered pursuant to a registration statement, Rule 498A permits the related underlying portfolio summary prospectuses to be made available electronically. This has the potential for great cost-savings because currently applicable preconditions for electronic delivery make hard copy delivery of underlying portfolio statutory or summary prospectuses necessary in many cases.

Under Rule 498A, if specified conditions are satisfied, underlying portfolio summary prospectuses will be considered delivered if the variable product initial or updating summary prospectus refers the investor to a website where the underlying portfolio prospectuses are available. In this regard, it is not required that all underlying portfolios available under a contract use this new method of satisfying their prospectus delivery obligations. Thus, the new method could be used for some underlying portfolios while continuing to deliver hard copy statutory or summary underlying portfolio prospectuses for other portfolios available under the same contract.

Amendments to Variable Contract Registration Forms

The SEC also adopted significant amendments to the registration forms for VAs (Forms N-3 and N-4) and VLI (Form N-6). Under these amendments, essentially all the substantive disclosures required in variable product initial and updating summary prospectuses also will be disclosed in the statutory variable product prospectuses for the related Forms N-3, N-4, or N-6.

Other highlights of the amendments to these forms include:

- Providing for the body of the fee table to include a line item that reflects any underlying portfolio fee waivers and expense caps, rather than permitting such information only in a footnote to the table.
- No longer requiring unit value tables — which have grown exceedingly voluminous over the years — in VA prospectuses or statements of additional information (or anywhere else).
- Withdrawing the “Guidelines” to the preparation of Forms N-3 and N-4.

These and the many other form amendments adopted by the Commission will require very substantial rewriting and reorganizing of the affected registration statements.

Compliance with the new requirements is not mandatory for initial or amendment filings on Forms N-3, N-4, and N-6 that are made before January 1, 2022. Nevertheless, earlier compliance is advantageous because the new initial and updating summary prospectuses for variable contracts and the new electronic delivery procedure of underlying portfolio prospectuses will be available only if the applicable Forms N-3, N-4, and N-6 have been brought into compliance with the new requirements.

Electronic Access and Formatting Requirements

The amendments to these forms, as well as the preconditions for using summary prospectuses in the manner discussed above, also require documents to be available online and impose electronic formatting requirements. For example:

- Variable product summary prospectuses (whether initial or updating), statutory prospectuses, and SAIs must be easily and publicly available at a website in easily readable and retainable form.
- Persons accessing these documents must be able to move directly and electronically between documents and portions of documents in specified ways that, for example: (i) link material in a summary prospectus with portions of the statutory prospectus or SAI that provide further explanation; (ii) link defined terms in summary prospectuses to the definitions of those terms; and (iii) link tables of contents in statutory prospectuses and SAIs with the discussions of the items referenced in those tables.
- If the new procedure is relied upon for electronic delivery of underlying portfolio summary prospectuses, those summary prospectuses, together with the related underlying portfolio statutory prospectuses, SAIs, and most recent annual and semiannual reports to shareholders, also must be among the documents available at the above-mentioned website.

Inline XBRL format will be required to be used for the submission of specified disclosures in variable product statutory prospectuses contained in certain filings made on or after January 1, 2023. Accordingly, registrants have an additional year to comply with the XBRL requirement, as compared to the other form amendments.

Compliance with these new electronic access and formatting requirements may require significant investments of time and resources for some registrants, depending on what practices or capabilities they already have in place.

Discontinued Variable Contracts

Many VA and VLI issuers rely on a line of SEC staff no-action letters (the “Staff Letters”) that provide an alternative to

updating their variable product registration statements and delivering current prospectuses every year for certain of these products. The Staff Letters are limited to circumstances in which sales of the VA or VLI contract have been discontinued and, in most cases, fewer than 5,000 of the contracts are outstanding. In these cases, and subject to certain conditions, the Staff Letters have permitted insurers generally to satisfy their updating obligations by providing contract owners each year (i) the audited financial statements of the separate account that supports the contract (plus, in the case of VLI, financial statements of the insurer); and (ii) the underlying portfolio documents that contract owners otherwise would usually receive (e.g., underlying portfolio statutory or summary prospectuses (and supplements thereto), proxy statements, and annual and semiannual shareholder reports).

In its release adopting the reforms, the Commission announced an “Alternative Disclosure” procedure that will be available for certain VA or VLI contracts that, by July 1, 2020, have ceased to be offered for new sales. Although there were some inconsistencies among the Staff Letters, the terms and conditions of this new Alternative Disclosure procedure are generally the same as the terms and conditions as those letters. The new procedure does make some changes, however, including:

- Subject to certain conditions, the new Alternative Disclosure procedure offers insurers the option of providing investors with an annual “Notice Document” instead of (i) the underlying portfolio statutory or summary prospectus; and (ii) any separate account or insurance company financial statements. Insurers, however, would have to continue to deliver those items if they decide to follow the new Alternative Disclosure procedure, but not use Notice Documents.
 - Any such Notice Document and the related financial statements will be filed with the SEC as new EDGAR submission types that the SEC will create.
 - The Notice Document would be required to (i) include the information that an updating summary prospectus would contain; and (ii) identify a website that makes publicly available the underlying portfolio’s summary and statutory prospectuses, SAI, and most recent shareholder reports, and the separate account’s and insurer’s financial statements.
- The new Alternative Disclosure option is strictly limited to registration statements with no more than 5,000 current investors, whereas several of the Staff Letters covered more than 5,000 outstanding contracts.
- As to VA contracts relying on the new Alternative Disclosure procedure, the insurer’s financial statements must be made available, whereas only a few of the Staff Letters required this for VA contracts.

Although the SEC staff is withdrawing the Staff Letters, the new Alternative Disclosure procedures will be available commencing July 1, 2020, for contracts that satisfy the new procedures’ eligibility requirements.

Issuers of discontinued contracts who have relied on Staff Letters and who choose not to rely on, or do not qualify for, the new Alternative Disclosure procedures may be required to update the registration statements for those contracts, which could be costly.

The Commission did not grant any relief whatsoever for contracts whose sales continue beyond July 1, 2020, although the Commission is open to further consideration of that subject. Accordingly, the registration statements for such contracts may need to continue to be updated unless and until additional investments are no longer being accepted into any separate account option.