BETTER MARKETS

February 14, 2019

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts (Release Nos. 33–10569; 34–84508; IC– 33286; File No. S7–23–18)

Dear Mr. Fields:

Better Markets[1] appreciates the opportunity to comment on the above-captioned proposal ("Proposal" or "Rule Proposal" or "Release") released for comment by the Securities and Exchange Commission ("SEC" or "Commission"). We appreciate the Commission and the staff's effort for putting this exceptionally long and detailed Proposal together. The Proposal, among other changes, would permit, but not require, insurance companies to satisfy their statutory obligations of delivering prospectuses (and other documents related to underlying portfolio companies) of variable contracts to investors at the time of a sale with a new summary prospectus.

Under the current regulatory regime, sale of a variable contract is accompanied by a compendium of disclosure documents and other filings that is often hundreds of pages long, includes documents and information that are difficult to read and understand for the average investor, and is costly to produce and deliver. The Proposal would leave almost all these statutory disclosure documents intact (in other words, they would still need to be created and maintained) but would now give a choice to insurance companies to satisfy the delivery obligations of these prospectuses by offering the new summary disclosure (designed to the specifications outlined in the Proposal) and making the rest of the documents available online through the so-called "layered disclosure" method.

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

As we understand, insurance companies and financial professionals have, for decades, requested from the SEC[2] the option to satisfy their statutory prospectus and other document delivery requirements through a summary and layered disclosures. Given the convoluted alternatives considered and "grandfather" clauses present in the Proposal, the lack of serious analysis of the exceedingly complex and expensive nature of these variable contracts, and the fact that the new summary disclosure itself is optional, suggests that maximally accommodating the industry was the primary motive or goal here.

Our comments assess the Proposal solely from the perspective of **investors**, who, in the case of variable contracts, are **exclusively retail and often older and of modest investable means**. For example, as set forth in the release, the average age of investors at first purchase of a variable contract is 51. It is shocking and, we believe, telling that **sixty percent of annuity investor households have incomes (note, NOT investable assets) under $75,000 and 35% are below $50,000**.[3]

From the investors' perspective, the key questions are: is the summary disclosure a meaningful improvement over the status quo? Or, will it become yet another handout that will be long, confusing, and easily overwhelmed by the strong incentives of the broker who is eager to sell a variable contract that will generate thousands of dollars in commissions and residual income for herself while the investor is left with a financial product that is potentially unsuitable (or worse, dangerous for his financial well-being).

To be clear, we agree with and share the Commission's concerns that the current volume, format, and content of statutory disclosures found in the variable contracts make it "difficult for investors to find and understand key information that they may want to make an informed investment decision."[4] We also note that variable contracts are perhaps the most complex and expensive financial products marketed and sold to retail investors. Thus, the danger for the investor to make an ill-informed or ill-advised decision in selecting a variable product that can be devastating for his or her financial well-being is significant. Given this challenge and opportunity, the Commission should strive to offer a simple, clear, and proven solution for the benefit of the investor. Unfortunately, that is not this Proposal.

We can join the Commission in speculating that investors would more likely read a shorter version of a document than the longer version of the said document. We could also join the Commission in speculating that investors would use and marginally benefit from layered disclosure, especially if the information and presentation offered online is user-friendly and has interactive features (and assuming the investors have access to and ability to use such technology). But neither of these speculations are grounds for good policymaking.

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2 *See* "SEC Proposes Summary Prospectus Rule for Variable Annuity and Variable Life Insurance Contracts." K&L Gates. November 29, 2018. Accessed on February 10, 2019. Available at http://www.klgates.com/sec-proposes-summary-prospectus-rule-for-variable-annuity-and-variable-life-insurance-contracts-11-29-2018/.

3 Release at 61805.

4 Release at 61805.

The Commission needs observable, robust, and unbiased data and provable conclusions that its actions will cure a known harm. And the public needs to be provided with an ample opportunity to analyze and comment on such data to assess whether the proposed solutions would in fact accomplish what they purport to accomplish. Without the addition of such grounds, the Commission lacks a valid basis – and would be ill-serving its mission – by finalizing this Proposal as released.

In sum, there is no basis, and the Release itself reveals none, that the new summary disclosure will in fact be read by reasonable investors, and when read, it will be understood, and when understood, the broker (who owes no fiduciary duty towards them) will not downplay the risks and dilute the effectiveness of the disclosure. We therefore urge the Commission to approve new disclosures only after it provides the public with appropriate, sufficient and, indeed, compelling data that those new disclosures would serve the investors being pitched these complex and costly financial products.

SUMMARY

- The Proposal does not show how or why an average retail investor would want to or be able to read, comprehend, be less-confused, ask questions and make informed investment decisions after he or she is provided the new summary disclosure (as proposed). Therefore, before any new disclosure rules are finalized, the SEC must do at least the following: (1) the SEC must distill the most investor-friendly suggestions solicited through this comment process and then create as many versions of the summary disclosures as practicable, including graphical and computer and smartphone-friendly versions; (2) the SEC should then conduct a robust and irreproachable investor testing of these draft summary disclosures and optimal means of achieving layered disclosures; (3) the SEC should then provide the results, data, and methodologies as part of a re-Proposal for public comment. Once the Commission settles on a new summary disclosure, it should make it mandatory and universal and not exempt any issuer or variable contract from these requirements. Only following this sequence of data gathering to inform policymaking would the Commission have an appropriate basis to make a proposal. Only then would the SEC give confidence to the public and investing public (and the industry) that a new summary disclosure can and would improve investor's decisions, and not simply add to the already lengthy and useless disclosures investment professionals are required to produce which do not clarify or get read.

- The Commission is to be commended for continuing the policy of making disclosure information both machine and human-readable. We support the new amendments to various registration and filing forms, including, eventually, any new data-driven summary disclosures, to now be in the Inline XBRL format. We believe the provision of this information through the modern format of Inline XBRL would enable third-party data analysts and investment professionals to offer value-added services to retail investors, which would in turn inform and empower them to make better investment decisions.

Brief Description of the Proposal

The Proposals, among other changes, would permit insurance companies that issue variable contracts – an SEC-regulated investment product – to satisfy their statutory requirements of delivering disclosure documents to new investors by providing a new, dozen-plus pages long disclosure and by making the rest of disclosures documents available online. The Proposal also creates a new "Updating Summary Disclosure" that would be provided to existing investors of variable contracts. If the issuer elects to provide a summary disclosure, it must, then, design the document[5] in such a way so that it includes the following sections: cover page and table of content; purpose of the contract; phases of the contract; premiums; key information, which would include: fees and expenses, surrender charges, transaction charges, on-going fees and charges, risks, restrictions, taxes, conflicts of interest, and general instructions, etc.[6] The summary disclosure would also include an appendix that would list portfolio companies and investment options available under the contract, and it would contain a permanent URL linking to a website maintained by the insurance company that would house all the remaining statutory prospectuses both regarding the contract and the underlying portfolio companies. As discussed more below, the Proposal would exempt a majority of existing variable contracts from the new summary disclosure specifications.

The Proposal also includes many changes to registration forms Form N-3, N-4, and N-6 used by insurance companies to register the variable contracts (which are securities, and therefore regulated under the federal securities laws) with the SEC. And, importantly, the Proposal requires registrants to use Inline XBRL format when filing much of the information in the above-mentioned Forms and disclosure documents.

COMMENTS

The Proposed Summary Disclosure is Unclear, Too Long, Framed Too Much in Legalese, and Untested. Only After Extensive Investor-Testing Data-Gathering Should the Commission Re-Propose and Finalize Any New Summary Disclosures.

As a threshold matter, the Commission unjustifiably and unfortunately remains too reliant on a disclosure regime. A disclosure regime by itself is little more than a modified version of "buyer beware." Disclosures can easily be designed, for example, to obscure the real significance of an investment professional's conflicts of interest, the complexity of the fee structures, and penalties for early withdrawals. Additionally, consent can easily be extracted from clients who feel pressured and confused, or worse, falsely comforted. In fact, studies show that regulation by disclosure alone can actually undermine investor protection goals by emboldening investment professionals to ignore the client's best interest once they have "checked the disclosure box," and by rendering investors even more vulnerable to conflicted advice once they receive disclosures. Investor and consumer literature is replete with studies, surveys, and other analyses showing that average retail investors often lack the basic knowledge necessary to understand complicated financial

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5 The new summary disclosure (to be delivered to new investors) and updating summary disclosure (to be delivered to existing investors) contain very similar information and sections. Therefore, the comments we offer in this letter should extend over both new and updating summary disclosure, as applicable.

6 *See* Release pp. 62739-49 for detailed descriptions of these various elements.

and investment matters, and that financial professionals enjoy informational asymmetry vis-à-vis the investor.[7] These problems are exacerbated when investors are marketed complex products like variable contracts.

The Commission's suggestions and assumptions throughout the Release that the Proposal is sufficient to cure the extensively documented and proven harm arising from the fact that investors do not read disclosure documents are simply not supported by adequate or appropriate data and analysis. As important, there is no evidence that investment professionals will not now use the veneer of additional, supposedly more user-friendly disclosure to peddle even less suitable variable contracts that would maximize their fees and commissions while risking the financial health and future of the American investor.

<u>The Suggested Language in the Release is No Better Than the Status-Quo, which has been Shown to Not be Effective.</u> The suggested language for the summary disclosure, as proposed in the Release, is long, full of legal jargon, lacks sufficiently salient information, and whatever meager theoretical effectiveness it may have can easily be dismissed by the investment professional, given his or her strong incentives to make the sale and the fact that he or she owes no fiduciary duty towards the investors. The design elements and the suggested language – to say nothing of the actual need for an additional disclosure document – is completely untested from the perspective of the user: the Mr. and Mrs. 401(k).

In the hundreds of pages of the Proposal, the Commission fails to demonstrate that the average retail investor would actually read the proposed summary disclosure, understand its legalese, and ultimately use the information to make more informed decisions with respect to his or her investment choices and financial well-being. In two startling passages buried deep in the Proposal, the Release itself admits this:

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7 For example, there is a growing consensus among experts that mere disclosure is not an effective cure for the ills posed by conflicts of interest and that a fiduciary duty is a more effective solution. *See* Angela Hung et al., Effective Disclosures in Financial Decision-making (2015), *available at* https://www.rand.org/pubs/research_reports/RR1270.html; George Loewenstein et al., *The Limits of Transparency: Pitfalls and Potential of Disclosing Conflicts of Interest*, 101 American Economic Review: Papers and Proceedings 423 (2011); Robert Prentice, *Moral Equalibrium: Stock Brokers and the Limits of Disclosure*, 2011 Wis. L. Rev. 1059 (2011) (concluding that disclosures do not give sufficient information to investors and may even cause brokers to give more biased advice); Omri Ben-Shahar & Carl Schneider, *The Failure of Mandated Disclosure*, 159 U. Pa. L. Rev. 647 (2011) (finding that disclosure as a regulatory tool has a history of being ineffective); Daylian Cain et al., *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*, 34 J. of Legal Studies 1 (2005). Similar findings were presented at a recent meeting of the SEC's Investor Advisory Committee's on December 7, 2017, where four panelists discussed the limitations and sometimes the counterproductive effects of disclosures as a remedy to conflicts of interests. *See* Meeting of the Securities and Exchange Commission Investor Advisory Committee (Dec. 7, 2017), https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac120717-agenda.htm; Sunita Sah et al., *The Burden of Disclosure: Increased Compliance with Distrusted Advice*, 104 J. of Personality and Social Psychology 289 (2013) (describing 6 experiments revealing that disclosure can increase pressure to comply with advice if the advisees feel obliged to satisfy their advisors' personal interests).

> "We do not have data on the extent to which the use of summary prospectuses enhances readership compared to a scenario in which variable contract investors were only to receive a statutory prospectus and not a summary prospectus."[8]

And again, citing a 2008 investor survey the SEC commissioned regarding *mutual fund* summary disclosures, the Release states that some investors prefer short disclosures but that this survey still

> "do[es] not provide [the Commission] with information with respect to the extent to which variable contract investors would actually be more likely to read a variable contract summary prospectus relative to a statutory prospectus."[9]

These two admissions alone should have stopped the Commission from releasing the Proposal. This is an outright acknowledgment that the Commission does not have a basis for the Proposal.

Thus, the Commission must otherwise prove that any new disclosures would effectively improve investors' understanding of variable contracts and ultimately lead to better investment decisions. However, the Proposal fails to show that the new disclosures would actually be read, understood, and found useful and informative by average retail investors for the purposes of making financial decisions. As proposed, summary disclosures' language is not sufficiently clear, as it is couched in "legalese." The proposed items within summary disclosures are not appropriately salient, and nothing in the Proposal shows why the suggested length or the selection of the topics to be covered is adequate or sufficient, much less optimal. While the Proposal does discuss some generic benefits of shorter disclosures requirements,[10] and refers to some complaints SEC's Office of Investor Education and Advocacy has received from investors regarding their lack of understanding of many features of variable contacts,[11] it ultimately fails to demonstrate that this particular summary disclosure would be meaningfully more investor-friendly and useful to investors than status quo.

Most importantly, the Proposal lacks the necessary empirical data and investor-testing that would establish the new summary disclosures as beneficial, or that the specific version suggested in Release is an improvement. A fundamental premise of the Commission's proposed regulatory approach is that a summary disclosure document can be developed and that will enable investors to make more informed choices among the available financial products and investment professional services. Until testing and data verify that this is correct – including with regard to the least financially sophisticated investors most in need of enhanced protections who, as stated above are the majority of

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8 Release at 61804.

9 *See* footnote 642 on pp.61804-5 of the Release.

10 Release at 61807 discusses the problem of "information overload," and how that might lead to inefficient investment decisions.

11 Release at 61807.

purchasers of these products – the Proposal lacks a basis and the public cannot evaluate it.[12]

Before proceeding further, the Commission must empirically verify and validate the reasonableness of the assumptions that underlie the Proposal. One way to do that would be to distill the most investor-friendly suggestions in response to the Proposal into as many versions of summary disclosures as practicable, including versions in computer, web-friendly, graphical, and info-graphical formats, and then conduct robust and irreproachable investor testing of the resulting options. The Commission should at a minimum test:

- whether the design, language, emphasis, length, and other elements of the summary disclosure are effective;
- whether investors, given their investment goals and appetite for risk, understand the benefits of variable contracts;
- whether they understand the impact of high fees and surrender charges on the performance of their contract;
- whether they understand the implications of conflicts of interest that may prompt an investment professional from recommending an investor to purchase a variable contract, or exchange an existing contract with a new one, and the fact that the investment professional may not have an ongoing duty of care.

After this investor testing is complete, the SEC should set forth its findings, data, methodology, and other relevant analysis as part of a re-proposal for public comment. Unless the Commission follows these steps, it should not promulgate new summary disclosure requirements.

<u>Once the Commission Settles on an Effective New Summary Disclosure, it Must Make It Universal.</u> While the Proposal permits the creation of new, shorter disclosures that issuers can elect to provide to investors who purchase variable contracts, it also exempts over 54% of existing contracts from these new disclosures.[13] This will bifurcate the investor class between those who are left with hundreds of pages unreadable and ineffective prospectuses,

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12 *See* a letter from public interest organizations to SEC Chairman Jay Clayton (May 21, 2018) regarding a similar effort of creating new summary disclosure document, the Form CRS. The letter calls for robust investor testing before any new disclosures are finalized. It is available at https://consumerfed.org/testimonial/public-interest-groups-call-on-sec-to-delay-comment-deadline-for-best-interest-regulatory-proposal/.

13 *See* Release at 61770. The Release discusses the so-called Alternative Disclosure Contracts ("Great-West" and the likes contracts) that have been sold under a series of staff No-Action Letters starting 1977 (the last staff No-Action Letter was issued in 1995). Of the 1,576 existing variable contracts that hold current registration with the SEC (as of the publication of the Release), 855 operate under No-Action Letter, and therefore would be exempt from the new summary disclosure specifications. In other words, even if the issuers of these contracts decide to offer a summary disclosure, they will not be obligated to do so according to the summary disclosure specifications outlined in the Release. The Commission estimates that 521 of the 855 contracts operating under the No-Action Letters are variable annuities held by approximately 2,690,000 individual investors. The Commission lacks reliable data regarding the number of investors in variable life contracts. *See* footnote 662 at Release 61806.

and those who would have the supposed benefit of shorter, clearer disclosures. If the Commission's assumptions about the usefulness of the new summary disclosures are correct, and the Commission and the staff themselves believe in the effectiveness of these new summary disclosures, then why not extend those benefits to all investors of variable contracts?

In the Release, the Commission tries to explain its reasoning for offering this major grandfathering clause: issuers that have relied on SEC's No-Action letters[14] since the 1970s will essentially be unjustifiably burdened with these new summary disclosure specifications, and therefore they are exempted.[15] This reasoning is inappropriate. The Commission's mission is to "protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation."[16] If the Proposal is beneficial for the investors of new issuances of variable contracts, the same benefits ought to be extended to the millions of retail investors who are holding existing variable contracts. Such action by the Commission would also bestow an unjustifiable advantage to insurance companies with large existing bases of investors in variable contracts, and, erect a competitive regulatory disadvantage against new issuers of variable contracts.

Commission Should Require Inline XBRL Format from All Filers. We fully support requiring filers to use Inline XBRL format. Analysts, newly forming "fintech" service providers, and others can digest this machine-readable format and offer value-added services to investors empowering them to make more informed investment decisions, including the ability to compare benefits and costs of variable contracts, and the services offered by investment professionals.

CONCLUSION

The Commission has an opportunity to offer bold and effective solutions that would help retail investors make informed investment decisions relating to two of the most complex and potentially harmful investment products: variable life insurance and variable annuities contracts. Instead of offering untested and ineffective new disclosures, the Commission must first thoroughly test, and only then propose for comment new summary disclosures.

Sincerely,

Dennis M Kelleher

14 *See* note 13 *supra* for background regarding the so-called Alternative Disclosure Contracts operating under these staff No-Action letters.

15 Release at 61771-2, and 61821-2.

16 *See* SEC's "About" webpage. Available at https://www.sec.gov/about.shtml.

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