American Council of Life Insurers

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February 15, 2019

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

By Electronic Delivery

Re: ACLI Comment on 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; RIN 3235-AK60

Dear Mr. Fields:

On October 30, 2018, the SEC invited comment on an initiative addressing Updated Disclosure Requirements and a Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts. The proposal reflects a very constructive approach to streamlined, functional disclosure that is beneficial to consumers, life insurers, and salespersons alike. We appreciate the opportunity to share the views of the life insurance industry on this significant initiative.

The American Council of Life Insurers ("ACLI") is a national trade association representing 280 life insurers that hold over 95 percent of the industry's total assets. Our members serve 75 million American families that rely on life insurers' products for financial and retirement security. Our members offer life insurance, annuities, retirement plans, long-term care, disability income insurance, and reinsurance.

For many years, ACLI has actively participated in multiple regulatory initiatives addressing variable contract disclosure under the Federal securities laws. We have consistently supported layered disclosure as a better means to enable informed decision-making by consumers. The SEC's disclosure initiative reflects ACLI's long-advocated approach to summary disclosure: streamlined, simplified plain-English information through a layered process with access to more detailed information through supplemental web-based or paper distribution on request.[1] We are, therefore, very interested in, and supportive of, the SEC's proposed summary disclosure initiative.

[1] ACLI recommended positions on layered disclosure and electronic delivery in submissions to the SEC over many years, including:

- ACLI submission on the SEC's Best Interest Initiative (August 3, 2018) [beginning at page 31];

I. Overview of the Proposed Summary Disclosure Initiative

The SEC invited comment on proposed rule and form amendments that are intended to help investors make informed purchase decisions regarding variable annuity and variable life insurance contracts. The proposal would modernize disclosures by using a layered disclosure approach designed to provide investors with key information relating to the contract's terms, benefits, and risks in a concise and more reader-friendly presentation, with access to more detailed information available online and electronically or in paper format on request. The proposed new rule would permit registrants to satisfy their prospectus delivery obligations under the Securities Act of 1933 for a variable annuity or variable life insurance contract by sending or giving a summary prospectus to investors and making the statutory prospectus available online.

The proposed rule also would consider registrants to have met their prospectus delivery obligations for any portfolio companies associated with a variable annuity or variable life insurance contract if the portfolio company prospectuses are posted online. In addition, the SEC proposed amendments to the registration forms for variable annuity and variable life insurance contracts to update and enhance the disclosures to investors in these contracts, and to implement the proposed summary prospectus framework.

- ACLI's response to the SEC Chairman's *Request for Information about Standards of Conduct for Broker-Dealers and Investment Advisers* (Oct. 3, 2017) [beginning at page 6].
- ACLI's July 5, 2013 Submission in response to the SEC's Request *for Data and Information on Brokers, Dealers and Investment Advisers* [beginning at page 15];
- ACLI's August 30, 2010 Submission in response to the SEC's request for information on its Study *on the Responsibilities of Brokers, Dealers, and Investment* Advisers in fulfillment of Section 913 of the Dodd-Frank Act [beginning at page 10]; and,
- ACLI's December 13, 2007 Submission in response to the *RAND* Study *on Broker-Dealer and Investment Advisory Issues* [beginning at page 6]. ACLI's RAND Submission appears in Appendix A of our Comments on the SEC *Study on the Responsibilities of Brokers, Dealers, and Investment Advisers* beginning at page 14.

Another example of ACLI's advocacy for streamlined plain-English disclosure appears in the recommendations of our CEO Task-Force on Annuities on disclosure for fixed, index and variable annuities that we submitted to the SEC for consideration in 2007. With this ACLI model, consumers could make apples-to-apples comparisons using a two-page document about core features. As part of this initiative, ACLI also developed instructional guidelines for life insurers on how to prepare this streamlined, transparent disclosure. ACLI's membership approved the final project for advancement with regulators. This seminar outline summarized ACLI's VA Disclosure Initiative*. See* Wilkerson, *ACLI Disclosure Initiative for Fixed, Index and Variable Annuities: Constructive Change on the Horizon* [American Law Institute-American Bar Association Presentation] (2007) https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/SeminarOutline.ashx?la=en .

ACLI Rulemaking Petition on Inaugural Simplified Prospectus Form N-6 for Variable Life Insurance

ACLI filed a rulemaking petition with the SEC that led to the adoption of Form N-6. [https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/RulemakingPetition.ashx?la=en] This seminar outline explains the administrative history, purpose, intent and design of VLI Registration Form N-6. Form N-6 and these materials provide background for review of the SEC's summary VLI prospectus initiative. See Wilkerson, *The Administrative History of Variable Life Insurance Registration Form N-6: The Proposal's Purpose, Design, and Intent* [American Law Institute-American Bar Association Presentation] (2002) [https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/SeminarOutline3.ashx?la=en].

A layered disclosure framework is a core feature of the initiative. The proposal would permit issuers to give investors a summary prospectus for variable contracts, while making the full prospectus and related materials available online. On this point, SEC Division of Investment Management Director Dalia Blass aptly observed that "[i]nvestors in variable annuities and other variable insurance products often have to navigate a complex set of disclosures about the variable contract and underlying investment options when deciding whether to invest."[2] She also explained that the proposed "rules [are] designed to provide investors with more user-friendly, layered disclosure about variable insurance products."[3]

This approach parallels the layered disclosure that mutual funds have enjoyed since 2009.[4] The variable contract initiative is, however, tailored to variable contracts. Instead of a single summary prospectus, the proposal introduces two: an initial summary prospectus for new investors and an updating summary prospectus for existing investors. The initial summary prospectus would explain a contract's features, costs and risks, while the updating summary prospectus would provide information on changes that occur in the years following the initial summary prospectus. In both versions, the use of tables and high-level summaries are designed to make them more reader-friendly and easier to navigate.

This proposed framework also would permit layered disclosure about the underlying mutual funds supporting variable contracts. Certain key information about these funds would appear in the summary prospectus. The funds' full prospectuses will be available online. This change should meaningfully improve the experience of investors. Instead of being confronted with disclosure the size of a telephone book and divining what is relevant, the SEC's proposal allows investors to navigate the information in a manner responsive to their needs and financial sophistication.

As the SEC has explained, the summary prospectus would not be a self-contained disclosure vehicle, but instead one element in a layered disclosure framework.[5] Consumers will use the summary prospectus as a starting point. For more granular detail, information can be efficiently extracted from different additional disclosure layers. Consumers will obtain the layered disclosure in the format of their choice, paper or electronic, at no charge.

The SEC and its staff have developed a significant, clearly written initiative that reflects skillful and commendable hard work in the public interest. The proposal is an example of good government regulation at its best.

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[2] *See*, SEC Division of Investment Management Director Dalia Blass, *Testimony on Oversight of the SEC's Division of Investment Management* (Sept. 26, 2018) Before the United States House of Representatives Committee on Financial Services, Subcommittee on Capital Markets, Securities, and Investment https://www.sec.gov/news/testimony/testimony-2018-09-26-blass.

[3] *Id.*

[4] Many investors are already familiar with mutual fund summary prospectuses. The SEC notes in the Release that approximately 95% of mutual funds and ETFs currently offer a summary prospectus. This estimate is based on EDGAR data for the number of mutual funds and ETFs that filed a summary prospectus in 2017 (10,686) and the Investment Company Institute's estimated number of mutual funds and ETFs as of 12/31/2017 (11,253). *See* Investment Company Institute, 2018 Investment Company Fact Book, at 52, *available at* https://www.ici.org/pdf/2018_factbook.pdf.

[5] *See* Keynote Address: ALI CLE 2018 Conference on Life Insurance Company Products [Speech of Division of Investment Management Director Dalia Blass] (Nov. 8, 2018) at https://www.sec.gov/news/speech/speech-blass-110818#_ftn6

II. Summary of ACLI's Position

- ACLI strongly supports the SEC's summary disclosure initiative and its layered delivery of information about variable annuities and variable life insurance;

- Life insurers' products help American families achieve financial and retirement security. The summary disclosure initiative greatly advances these important national priorities.

- The summary disclosure proposal is a very constructive development beneficial to consumers, life insurers, and the environment.

- Because of the high correlation between summary disclosure, financial literacy and retirement and financial security, the proposal's layered disclosure approach can help ameliorate financial literacy challenges in a functional manner and enhance American families' retirement and financial security;

- As a general principle, the variable contract summary disclosure proposal should endeavor to implement equivalent approaches paralleling the mutual fund summary disclosure rules, for consistency and competitive balance.

- With broader exposure to variable contracts through user-friendly summary disclosure, the proposal dovetails with the SEC's capital formation priorities by enlarging the marketplace and broadening the scope of life insurers' investments;

- The proposal should continue the SEC's well-reasoned positions on disclosure for variable contracts that are no longer actively marketed or in the future may change to a status of no longer actively marketed;

- The summary disclosure initiative commendably creates a more balanced regulatory and disclosure environment for financial products competing in the same markets;

- Careful awareness and coordination about the cumulative disclosure under proposed Regulation Best Interest, Form CRS, the summary disclosure initiative, and required disclosure under state insurance laws will help prevent information overload that thwarts the noble objectives of the proposal;

- We support the SEC's desire to "future proof"[6] the rule, keep it from becoming rapidly outdated, and to get it right because "it will be on the books for a long time."[7]

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[6] *See* SEC Division of Investment Management Director Dalia Blass speech *Keynote Address: ALI CLE 2018 Conference on Life Insurance Company Products* (Nov. 8, 2018) at https://www.sec.gov/news/speech/speech-blass-110818#_ftn6 (last visited on January 16, 2019) ["This rule – if it gets adopted – could be on the books for a long time. I don't want a rule that is going to be out of date the minute it is adopted – we want to future-proof it."].

[7] *Id.*

III. Life Insurers' Interest in the Summary Disclosure Initiative

Life insurers create and market products that fulfill consumers' retirement, estate, tax, and financial planning needs. With the decline of defined benefit pensions and the uncertain status of federal safety net programs, Americans bear increasing personal responsibility for their own financial well-being. Life insurers have responded to these consumer needs with a wide range of products, including variable annuities and variable life insurance, that fulfill the federal securities laws and address America's financial and retirement security challenges.[8]

The summary disclosure initiative involves layered, summary information for variable annuities and variable life insurance. ACLI has actively participated in the federal securities rulemaking process for over five decades, and has provided substantive submissions on multiple disclosure reform initiatives, including among others:

- ACLI Comment[9] on Simplified Mutual Fund Disclosure on Form N-1A;
- ACLI Comment[10] on Simplified Variable Annuity Disclosure on Forms N-3 and N-4;
- ACLI Rulemaking Petition[11] for Simplified VLI Disclosure on Form N-6;
- ACLI Comment[12] on Proposed VLI Simplified Disclosure Form N-6;
- ACLI Comment[13] on the Off-the-Page Prospectus Initiative;
- ACLI Comment[14] on the Variable Annuity Fee Table;
- ACLI Comment[15] on Variable Life Insurance Depiction of Underlying Fund Performance;
- ACLI Comment[16] on the Mutual Fund Summary Disclosure Initiative;

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[8] This includes regulation under the Securities Exchange Act of 1934, the Securities Act of 1933, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. Life insurers must also satisfy a comprehensive set of state insurance laws and regulations in every U.S. jurisdiction.

[9] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/033083_File_No_S7957_Prop_Form_N1A_Prosp_Sim_Prop.ashx?la=en

[10] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC SITE/CW/061584_File_No_S71007_Prop_Forms_N3_4.ashx?la=en

[11] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/RulemakingPetition.ashx?la=en The background on this initiative is discussed in Wilkerson, *the Administrative History of Variable Life Insurance Registration Form N-6: the Proposal's Purpose, Design and Intent* (2002) [ALI-ABA Presentation] at https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/101601_ALI_ABA_Form_N6_Admin_History.ashx?la=en

[12] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC SITE/CW/122199_Supplemental_Submission_on_Proposed_Reg_Form_N6.ashx?la=en

[13] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/062293_Off_the_Page_Prospectus_Proposal.ashx?la=en

[14] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/062802_Proposed_Amendments_Variable_Annuity_Fee_Tables.ashx?la=en

[15] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/062993_Variable_Life_Insurance_Sales_Materials.ashx?la=en

[16] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/033083_File_No_S7957_Prop_Form_N1A_Prosp_Sim_Prop.ashx?la=en

- ACLI Comment[17] on the Depiction of Fees and Charges in Form N-6;
- ACLI Comment[18] on Proposed Amendments to Form N-1A;
- ACLI Proposal[19] on Simplified Annuity Disclosure;
- ACLI Submission[20] on VLI Sales Materials;
- ACLI Transcript[21] of Its Focus Group Evaluation of Fees and Charges in Form N-6; and,
- ACLI Comment[22] on Disclosure Topics in the Investment Company Act Study.

As institutional investors, life insurers contribute significantly to the U.S. economy and capital formation.[23] In sum, the summary disclosure initiative will buttress capital formation by enabling consumers to understand the role of variable life insurance and variable annuities in financial and retirement security.[24] This broader exposure will enable increased capital formation and investment in the economy. Some further refinements, discussed below, are necessary to achieve this and the other important objectives in the initiative.

IV. Consumers' Interest in the Summary Disclosure Initiative

The summary disclosure initiative will provide consumers with an uncluttered, readable means to understand variable annuities and variable life insurance through layered disclosure and a plain-English synopsis. While we would not presume to speak for consumers, the Consumer Federation of America[25] (CFA) has expressed unequivocal support for layered disclosure and a summary prospectus, and recommended the SEC extend layered summary disclosure into a wider range of retail contexts. In 2012, the CFA stated that:

> Our approach to disclosure issues is guided by three simple principles. Disclosure policy should be designed to ensure that investors get the information they need, in a form they can use, at a

[17] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/062802_Proposed_Amendments_Variable_Annuity_Fee_Tables.ashx?la=en
[18] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/041583_File_No_S7957_Proposed_Form_N1A.ashx?la=en
[19] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/AnnuityDisclosureTemplates.ashx?la=en . This ACLI proposal is discussed in Wilkerson, *ACLI Disclosure Initiative for Fixed, Index and Variable Annuities: Constructive Change on the Horizon*, (2007) [ALI-ABA Presentation] at https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/2007_Constructive_Change_on_The_Horizon.ashx?la=en
[20] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/062993_Variable_Life_Insurance_Sales_Materials.ashx?la=en
[21] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/081301_Focus_Group_Transcript_N6.ashx?la=en
[22] https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/011590_Supplemental_Submission_File_No_S71190_Study.ashx?la=en
[23] These important contributions are further explained below in Section V of this submission.
[24] Footnote 28 *infra* highlights the nexus between variable products and capital formation, in the SEC's eyes.
[25] According to its website, the CFA "is an association of non-profit consumer organizations that was established in 1968 to advance the consumer interest through research, advocacy, and education. Today, nearly 300 of these groups participate in the federation and govern it through their representatives on the organization's Board of Directors."

> time when it is useful to them in making their investment decision.[26] Over the years, however, we have come to accept that summary disclosures, though imperfect, may in fact be better at conveying information than the more complete disclosures we have traditionally preferred. While our views had been evolving for some time, research we conducted in 2005-2006 on mutual fund purchase practices was decisive in convincing us to drop our opposition to summary disclosure documents.
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> Two factors were particularly influential in changing our views: one was the further evidence provided by our survey that a majority of investors do not view the prospectus as an important source of information; the other was the high quality of the "fund snapshots" produced by many fund companies for display on their websites.
>
> Particularly appealing was the way some fund companies took advantage of the flexibility provided by the Internet to both highlight key data and draw the investor in to more complete and detailed discussions of important topics. In short, there are a variety of at least theoretical benefits to summary disclosure. Summary documents have the potential to be effective in allowing investors to make quick comparisons among a number of options before narrowing down their selection for more careful review.
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> In addition, some investors who might be turned off by a lengthier document may be drawn in by the summary and encouraged to explore further in certain key areas. On the other hand, some investors who never look beyond the summary might still be said to benefit if, absent a summary, they wouldn't have looked at any disclosure document. In such cases, while we might consider that the investor is making an inadequately informed investment decision, they would still arguably be better informed than they would otherwise have been without exposure to the summary document.
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> We would encourage the Commission to consider how wider use of summary disclosure documents could be incorporated into a layered approach to disclosures in a variety of retail contexts. In developing such documents, the Commission will need to suppress its natural inclination to think like lawyers, and focus instead on how to most effectively convey the truly essential information in a concise and compelling fashion.

In its 2012 analysis, the CFA further stated that:

- When it comes to direct-to-investor disclosure, less is often more;
- Summary disclosures should focus on the issues most important to an informed decision; and,
- Disclosures should be designed to promote sound decision-making.

ACLI agrees with the CFA's supportive perspective on layered summary disclosure stated above and its positive impact on consumer decision making.

[26] Submission of Consumer Federation of America on the SEC's Study on Financial Literacy https://www.sec.gov/comments/4-645/4645-44.pdf

V. The Role of Life Insurers in U.S. Capital Formation and the Economy

The SEC's summary disclosure initiative fulfills the agency's tripartite mission—to protect investors, to maintain fair, orderly and efficient markets, and to facilitate capital formation.[27] The SEC website emphasizes that "the SEC's regulation of the securities markets facilitates capital formation, which helps entrepreneurs start businesses and companies grow. Last year nearly $4.27 trillion was raised in public and private securities offerings, promoting economic growth and job creation."[28]

Life insurers are significant institutional investors that have a major role in U.S. capital formation and the U.S. economy. Life insurers' assets supporting fixed insurance products ($4.25 trillion) and variable insurance products ($2.52 trillion) reflect a substantial percentage of the U.S. equities and bond market. Life insurers' assets are invested in corporate bonds (33%), stocks (31%), government bonds (8%), commercial mortgages (6%), and other assets (22%). Life insurers are the largest institutional investor in U.S. corporate bond financing. Approximately 48% of life insurers' $7.2 trillion total assets in 2016 were held in long-term bonds, and over 38% of long-term bonds purchased by life insurers have maturities exceeding 20 years (at the time of purchase).[29] Life insurers, therefore, are significant participants in the U.S. equities market and are one of the principal sources of U.S. long-term corporate financing. In these roles, life insurers have an important impact on the U.S. economy.[30]

Efficient and effective disclosure standards will broaden consumers' functional access to variable annuities and variable life insurance as financial and retirement solutions. In turn, premiums on variable contracts are invested in capital formation and the economy. These are important considerations in finalizing the summary disclosure initiative. Indeed, SEC Division of Investment Management Director, Dalia Blass, recently stated that "[t]he asset management industry is critical to the U.S. economy and for the retirement and financial needs of millions of American investors, particularly our Main Street investors."[31]

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[27] *See* SEC Chairman Clayton's Testimony on Oversight of the U.S. Securities and Exchange Commission (June 21, 2018) [https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission] before the House Financial Services Committee.

[28] This statement appears on the SEC website highlighting job creation due to capital formation; [http://www.secvip.org/#] (last visited December 27, 2018).

[29] These calculations are based on data from the 2017 NAIC Annual Statement Data and ACLI calculations based on the U.S. Federal Reserve Board, Flow of Funds Accounts of the U.S.

[30] We greatly appreciate the Chairman Clayton's recognition of life insurers' contributions to U.S. capital formation and the economy. *See* SEC Chairman Clayton's Testimony on Oversight of the U.S. Securities and Exchange Commission (June 21, 2018) [https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission] before the House Financial Services Committee. The Chairman's testimony noted that:

> At least 51% of U.S. households are invested directly or indirectly in our capital markets with 44% of all households owning at least one U.S. mutual fund. It is also important to note that like mutual funds, many U.S. households also participate indirectly in our capital markets through variable annuities and variable life insurance contracts funded by an array of underlying mutual funds: 29,172,000 individual variable annuity contracts and 4,959,000 individual variable life insurance contracts were in force in the U.S. as of 2016. Many Americans indirectly participate in the U.S. stock market through these SEC regulated contracts. (Emphasis added).

[31] *See*, Dalia Blass, *Testimony on Oversight of the SEC's Division of Investment Management* (Sept. 26, 2018) Before the United States House of Representatives Committee on Financial Services, Subcommittee on Capital Markets, Securities, and Investment https://www.sec.gov/news/testimony/testimony-2018-09-26-blass .

Well-designed regulatory initiatives can have a significant positive impact on life insurers' capital formation. The summary disclosure initiative will constructively enhance the economic and retirement security of markets distinctively served by life insurers. In his December 13, 2018, remarks to the SEC Investor Advisory Committee, SEC Chairman Clayton aptly observed that

> Disclosure is at the heart of our country's and the SEC's approach to both capital formation and secondary liquidity. As stewards of this powerful, far reaching, dynamic and ever evolving system, a key responsibility of the SEC is to ensure that the mix of information companies provide to investors facilitates well-informed decision making. The concepts of materiality, comparability, flexibility, efficiency and responsibility (i.e., liability) are the linchpins of our approach. This group knows these concepts well, knows that they are interrelated, and knows that, when we consider changes to our approach to disclosure, these concepts should be front of mind.[32]

We fully agree.

VI. America's Financial and Retirement Security Challenges

Government studies reveal that many individuals and families are not adequately prepared for financial and retirement security.[33] Insurance products can play a significant role in American's management of retirement and financial risks.[34] Functional, accessible disclosure will ensure that consumers have better exposure to insurance products in building a firm financial foundation throughout life and in retirement.

In reflections on the 2018 rulemaking agenda, SEC Chair Clayton emphasized that:

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[32] *See* Remarks to SEC Investor Advisory Committee (Dec. 13, 2018) at https://www.sec.gov/news/speech/clayton-remarks-investor-advisory-committee-meeting-121318 (last visited December 27, 2018).

[33] *See, e.g.,* GAO Report to Congress, *The Nation's Retirement System-A Comprehensive Re-evaluation Is Needed to Better Promote Future Retirement Security* (Oct 2017) [Fundamental changes have occurred over the past 40 years to the nation's current retirement system, made up of three main pillars: Social Security, employer-sponsored pensions or retirement savings plans, and individual savings. These changes have made it increasingly difficult for individuals to plan for and effectively manage retirement]; Speech, SEC Commissioner Kara Stein*, The New American Dream: Retirement Security* (Oct 16, 2018) ["Today, we as a nation face a fast-approaching crisis—an aging population without sufficient resources to fund a secure retirement. This crisis is a collective problem that, unless solved, will cause many individual tragedies…. The retirement tsunami is approaching. Now is the time to do something about it. Let's move to higher ground."] https://www.sec.gov/news/speech/speech-stein-101618; Oakley and Kenneally, *Retirement Security 2015: Roadmap for Policy Makers Americans' Views of the Retirement Crisis,* (Mar. 2015) ["Some 86 percent agree that the nation faces a retirement crisis, and 57 percent strongly agree there is a crisis. Surprisingly, the sentiment is highest among those with annual income above $75,000] https://www.nirsonline.org/reports/retirement-security-2015-roadmap-for-policy-makers-americans-views-of-the-retirement-crisis/ .

[34] The Department of Labor observed that thirty-one percent of IRAs include investments in annuities. *See, e.g.*, DOL's Fiduciary Investment Advice, Regulatory Impact Analysis at 54 (Apr. 14, 2015) https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/1210-AB32-2/ria.pdf .

> Main Street investors, now more than ever before, are responsible for saving for retirement. With the shift away from traditional defined benefit pension plans, American workers are increasingly relying primarily on defined contribution plans, such as 401(k) plans and IRAs, to save for retirement. We owe it to these investors to make sure they have access to a broad mix of investment opportunities to save for retirement and to achieve other financial goals. Accordingly, we are looking at initiatives to facilitate access to capital for issuers and to make sure Main Street investors have the best possible mix of investment opportunities.[35]

We agree. An annuity is the only form of longevity protection in today's market. It allows investors to convert retirement savings into a stream of monthly guaranteed income for life—a process known as "annuitization." With the shift away from defined-benefit plans, without an annuity, a retiree now bears the risk of outliving his or her retirement savings. That risk is becoming only more significant as Americans live longer. An annuity enables the retirement saver to transfer that longevity risk—the risk they will live longer than expected—to the insurer.[36] Similarly, life insurance provides financial protection for families and estates following an insured's death.

Importantly, despite the value of annuities and life insurance to American's overall wellbeing, these products are not universally understood. Effective readable disclosure will enable consumers to obtain essential information for educated purchase decisions. Additionally, life insurance salespersons help customers obtain core information through "needs analysis" programs, mandatory disclosures, comparative illustrations, and the elements of state and Federal suitability obligations, among other things. This long-standing advisory and information-sharing process helps Americans conduct informed purchase decisions and enhances financial and retirement security.

Americans deserve access to retirement and life insurance products and related financial guidance from financial professionals. Through the summary disclosure initiative, consumers will be better able to obtain and understand information to meet their financial and retirement security needs.

[35] *See* Chair Clayton's remarks in *SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks* (Dec. 6, 2018) at https://www.sec.gov/news/speech/speech-clayton-120618 (last visited December 27, 2018).

[36] The 2017 Treasury *Report on Asset Management and Insurance* explained that "[b]ecause annuities are the only financial services product that can provide a guaranteed lifetime income stream, and because longevity risk (the risk of outliving one's assets) has become a key retirement concern, annuities are an important contributor to the Core Principle of empowering Americans to save for retirement." Treasury report *A Financial system that Creates Economic Opportunities-Asset Management and Insurance* (Oct. 2017) https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-That-Creates-Economic-Opportunities-Asset_Management-Insurance.pdf (last viewed Aug. 2, 2018) at 70. The peace of mind that annuities provide against longevity risk improves retirees' overall well-being and mental health. A study commissioned by the DOL "found that beneficiaries of lifelong-guaranteed income—such as from a privately-purchased annuity…were more satisfied in retirement and suffered from fewer depression symptoms than those without such income." Michael J. Brien & Constantjn W.A. Panis, *Annuities in the Context of Defined Contribution Plans: A Study for the U.S. Department of Labor, Employee Benefits Security Administration* (Nov. 2011). The "boost in well-being became stronger" the longer the person was retired—a finding "consistent with the notion that retirees who rely on finite savings and [defined-contribution] plan assets grow increasingly worried about funding retirement expenses as they grow older and deplete their assets, whereas recipients of lifelong-guaranteed income, other than from Social Security, are less concerned with outliving their resources." *Id.*

Additionally, the initiative's simplified disclosure will help Americans' achieve improved financial literacy.

VII. The High Correlation Between Simplified Disclosure, Financial Literacy and Retirement and Financial Security

The SEC identified American's financial literacy deficits as contributing factors to consumers' confusion about financial products, advice, and the roles of financial professionals. In its Section 917 Report under the Dodd-Frank Act (DFA), the SEC noted that "studies reviewed by the Library of Congress indicate that U.S. retail investors lack basic financial literacy. The studies demonstrate that investors have a weak grasp of elementary financial concepts." The SEC's report entitled the *Study Regarding Financial Literacy Among Investors*[37] also suggested layered disclosure as a solution to financial literacy challenges and defined it as an "approach to disclosure in which key information is sent or given to the investor and more detailed information is provided online and, upon request, is sent in paper or by e-mail."

ACLI has consistently supported layered disclosure in numerous submissions to the SEC, [38] and emphasized the nexus between functional disclosure, financial literacy, retirement security, and capital formation. The SEC acknowledged an ACLI comment letter[39] that supported layered disclosure in the SEC's 2012 financial literacy report, and specifically highlighted ACLI's comprehensive summary disclosure initiative for variable, fixed and index annuities that emphasized layered disclosure for functional consumer understanding.[40] Layered disclosure prevents the

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[37] *Study Regarding Financial Literacy Among Investors* (Aug. 2012) https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf . (last visited December 27, 2018).

[38] ACLI submitted input on four SEC actions concerning layered disclosure, including:

- ACLI's response to the SEC Chairman's Request for Information about Standards of Conduct for Broker-Dealers and Investment Advisers (Oct. 3, 2017) found at https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2640466-161282.pdf.
- ACLI's July 5, 2013 Submission in response to the SEC's Request *for Data and Information on Brokers, Dealers and Investment Advisers*;
- ACLI's August 30, 2010 Submission in response to the SEC's request for information on its Study *on the Responsibilities of Brokers, Dealers, and Investment* Advisers in fulfillment of Section 913 of the Dodd-Frank Act; and,
- ACLI's December 13, 2007 Submission in response to the *RAND* Study *on Broker-Dealer and Investment Advisory Issues*.

ACLI also advocated layered disclosure in its:

- 2012 submission on the SEC's Financial Literacy Study; and,
- 2010 summary disclosure initiative for fixed, index and variable annuities at https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/AnnuityDisclosureTemplates.ashx?la=en (discussed further in footnote1).

[39] ACLI submission on Dodd-Frank Act Study on Financial Literacy (Mar. 23, 2012 at https://www.sec.gov/comments/4-645/4645-38.pdf (last visited December 27, 2018).

[40] The SEC acknowledged ACLI's comprehensive summary disclosure initiative for annuities at footnote 112 of the financial literacy study https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf . ACLI's comprehensive summary disclosure initiative for annuities (explained further in footnote 1) appears in Appendix A of ACLI's comment letter on financial literacy at https://www.sec.gov/comments/4-645/4645-38.pdf

inundation of consumers with lengthy disclosure that dilutes the value of important information and thwarts informed purchase decisions.[41] We appreciate the SEC's acknowledgement in the proposal about ACLI's notation that state and federal requirements already mandate the circulation of multiple informational documents to consumers and purchasers.[42]

Relatedly, academic observers have noted the connection between information overload, financial literacy and annuities.[43] Others have correlated financial and retirement security challenges with low

. (last visited December 27, 2018). ACLI developed disclosure templates for fixed, indexed and variable annuities that provide essential information in a streamlined, plain-English format. The templates were designed to help consumers make informed purchase decisions through uniform, comparable disclosure. ACLI worked with FINRA staff so that the variable annuity template could be used as one means of fulfilling the disclosure requirements under Rule 2330, the suitability and supervision rule for variable annuities. FINRA found the template to be worthwhile and recommended that ACLI staff share it with disclosure experts in the SEC's Division of Investment Management for input. The SEC generously offered three rounds of constructive input on the variable annuity disclosure template. ACLI incorporated all the SEC's suggestions, with one exception concerning cost projections for riders accompanying the variable annuity. Cost projections for riders are dependent upon the unique factors of an individual purchaser and did not lend easily to depiction in a standardized expense table. The disclosure template advised users to briefly explain all available riders with a cross reference to additional prospectus disclosure, but did not contemplate cost disclosure for all combinations of riders. For unexplained reasons, FINRA never acted upon ACLI's submission notwithstanding the SEC's valuable input and support.

[41] The SEC's three coextensive Regulation Best Interest initiatives are also designed in response to financial literacy issues, in part. ACLI commented on Reg. BI, Form CRS, and the Investment Adviser Interpretations, respectively at https://www.sec.gov/comments/s7-07-18/s70718-4173937-172339.pdf , https://www.sec.gov/comments/s7-08-18/s70818-4173943-172344.pdf , and https://www.sec.gov/comments/s7-09-18/s70918-4208142-172847.pdf. Disclosure requirements under Reg. BI and Form CRS should empower broker-dealers and investment advisers to refer retail customers seeking more detailed disclosure to the entity's website where they can access such information (or allow them to receive a "hard copy" by request).We urge that the SEC's consideration of disclosure requirements should include a thorough analysis of the disclosures that retail customers will receive understate insurance law, Form CRS and Reg. BI. Loading more disclosure on top of the above-noted disclosure information is more likely to result in "information overload" than an enhanced understanding of the product or transaction by retail customers.

[42] *See* summary proposal release at footnote 22 and 65, and accompanying text in the release. ACLI made these points in its comment on the SEC Chairman's Request for Information on Standards of Conduct for Investment Advisers and Broker-Dealers https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2640466-161282.pdf . Under the SEC's plain-English rule, issuers must use plain-English principles in the organization, language, and design of the front and back cover pages, the summary, and the risk factors section in filings with the SEC's Division of Corporation Finance under the 1933 Act. When drafting the language for selected parts of the prospectus, issuers must comply with a series of specified plain-English principles. See "Plain-English Disclosure," the updated SEC Staff Bulletin No 7 at http://www.sec.gov/interps/legal/cfslb7a.htm . *See also* the SEC's "Plain-English Handbook" at http://www.sec.gov/news/extra/handbook.htm .

[43] Researchers observed that financial literacy and information overload influence the decision to purchase an annuity and how they relate to subsequent confidence and satisfaction. The researchers explained:

> Using a dataset from a large-scale experiment, we find that as financial literacy increases, information overload decreases. In addition, people who experience higher levels of information overload are less confident in their choice and are less satisfied with their decision. We recommend that educators and retirement plan architects consider simplifying the decision environment in addition to improving financial literacy with the goal of increasing investor confidence and satisfaction.

Agnew and Szykman, *Annuities, Financial Literacy, and Information Overload*, Oxford Scholarship Online (2011) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1707659 . This study focused on new findings that relate to the annuity decision and to financial literacy and information overload. The study sheds light on financial literacy.[44] The summary disclosure initiative fulfills functional layered disclosure and can help ameliorate financial literacy challenges while coextensively boosting financial and retirement security. Additionally, the initiative compliments the intent of the SEC's *Investor Experience Initiative*, which specifically referenced variable contract separate accounts and associated underlying funds.[45]

The SEC directly addressed the connection between financial literacy and functional disclosure in its 2012 Financial Literacy Study under Section 917 of the DFA. The DFA directed the SEC to "identify … the existing level of financial literacy among retail investors, including subgroups of investors identified by the Commission," and "the most useful and understandable relevant information that retail investors need to make informed financial decisions before engaging a financial intermediary or purchasing an investment product[46] or service that is typically sold to retail investors."[47] Significantly, the SEC's report, entitled the *Study Regarding Financial Literacy Among Investors*[48] referred to variable annuities and variable annuity owners and a summary variable annuity prospectus.

Other more direct means to improve American's financial literacy should be prioritized by the SEC and other financial regulators through comprehensive educational outreach, such as investor.gov.[49] Approaches such as this efficiently address the underlying causes of financial illiteracy. Coordinated, plain-English, user-friendly financial and retirement education by state and federal regulators dovetails well with other practical solution to American's financial literacy challenges.[50] Additional,

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how literacy and overload relate to each other, and reveals how these factors may influence financial choices. *Id*. At 7.

44 *See* Crossan, *How to Improve Financial Literacy: Some Successful Strategies*, Oxford University Press (July 2011) http://pensionresearchcouncil.wharton.upenn.edu/wp-content/uploads/2015/09/0-19-969681-9-13.pdf

45 On June 5, 2018, the SEC announced that it would be exploring "modernization of the design, delivery and content of fund disclosures" in order "to improve the investor experience and help investors make more informed investment decisions." The SEC issued a broad request for comment on the disclosure requirements for retail investment funds, including **insurance-dedicated mutual funds** and **insurance company separate accounts.** Regarding mutual funds **underlying variable insurance product separate accounts**, the SEC said that "[b]ecause of the unique nature of these types of funds, they are subject to different disclosure requirements. We are seeking input on how to appropriately tailor disclosure requirements to these types of funds." (Emphasis added). The SEC also requested comments on how to improve performance advertisements for mutual funds and variable insurance products. Finally, the SEC said that its primary motivations for its investor experience initiative are to keep up with technological innovations, the broadening markets for investment company products [including variable contracts], and the increasing complexities of products. (emphasis added) *See* https://www.sec.gov/rules/other/2018/33-10503.pdf (Last visited December 27, 2018). All of these objectives dovetail with the proposed variable product summary disclosure initiative.

46 The statutory language referred broadly to an "investment product" and this certainly included variable annuities as well as variable life insurance because the SEC addressed variable contracts in its financial literacy study. The DFA also included other language that was sufficiently broad to cover unit investment trust separate accounts that fund variable insurance products.

47 Pub L. 111-203, 124 Stat. 1376 (July 21, 2010) at Section 917. President Barack Obama signed the Act into law on July 21, 2010. Pub L. 111-203, 124 Stat. 1376 (July 21, 2010).

48 SEC *Study Regarding Financial Literacy Among Investors* (Aug. 2012) https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf

33 https://www.investor.gov/

50 ACLI developed comprehensive guidelines and instructions for life insurers on how to prepare disclosure documents for fixed, index, and variable annuities. *See*, Wilkerson, *ACLI Disclosure Initiative for Fixed, Index, and Variable Annuities: Constructive Change on the Horizon*, ALI-ABA Conference on Life Insurance Company Products (2007). The materials provided plain-English, streamlined, user-friendly point-of-sale disclosure. ACLI shared the guidelines with the SEC and FINRA, and incorporated all the constructive suggestions the SEC's Division of Investment Management staff offered in an informal process. Similarly, the NAIC's Deferred Annuity

concerted endeavors to improve Americans' financial literacy will help ameliorate financial and retirement security challenges in the United States.

VIII. Preserving Regulatory and Competitive Balance Going Forward

Mutual funds and variable contracts operate within the same marketplace for financial and retirement solutions. Life insurers strongly support the SEC's endeavors to implement simplified, summary disclosure for variable annuities and variable life insurance. The proposal will be good for consumers, salespersons, life insurers and the environment. The industry, however, observes that disclosure simplification initiatives and regulatory reform for mutual funds has historically occurred years before parallel actions for variable products.[51] This led to competitive regulatory and marketplace imbalances.

With this initiative, variable products will be on a more level playing field enjoyed by mutual funds since 2009. Significantly, in an October 11, 2018 speech, SEC Commissioner Jackson emphasized the need for competitive balance in SEC rulemaking, where he stated:

> First, although the economic analysis that accompanies our rulemakings technically includes, as the law requires, an assessment of the effects of the proposal on competition, that work doesn't sufficiently engage with the *lack* of competition in the markets we regulate. (Emphasis in original) The absence of meaningful competition in certain markets ought to inform our policy choices….
>
> Second, we should more formally bring competition economics into our work at the SEC. That's why I've called for the creation of an Office of Competition Economics within our Division of Economic Risk and Analysis. As we all know, DERA's expertise in trading, finance and investment is incredibly important, and has served the Commission well in the past. But without the input of experts who specialize in the complex dynamics of competition economics,

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Buyers' Guide provides excellent streamlined, plain-English disclosure allowing apples to apples comparison of fixed, index and variable annuities, https://www.naic.org/documents/prod_serv_consumer_anb_la.pdf (Last visited July 31, 2018). ACLI's Guidelines and the NAIC Buyers' Guides provide a rich source of disclosure about essential information to an annuity purchase decision that may be useful as the SEC advances the summary disclosure initiative.

[51] Some selected examples of delays between variable contracts and mutual funds in simplified disclosure and regulatory reform include, among others:

- Simplified variable annuity disclosure Forms N-3 and N-4 were adopted 6 years after simplified mutual disclosure Form N-1A;
- Simplified variable life insurance Form N-6 was adopted 11 years after ACLI's rulemaking petition, and many years after simplified mutual disclosure Form N-1A;
- The SEC's variable contract summary disclosure initiative was proposed 9 years after the mutual fund summary disclosure initiative was adopted;
- Variable contracts were excluded from the SEC proposal giving mutual funds authority to use off-the-page prospectuses in 1993;
- The variable contract summary disclosure initiative was proposed 11 years after ACLI's annuity disclosure simplification project and 7 years after the IRI summary disclosure project; and,
- Rule 486 for variable contracts was adopted 2 years after Rule 485 for mutual funds.

> I worry we will struggle to fully understand the concentrated industries we oversee. Combining expertise in competition economics with the cutting-edge research of our financial economists will help the Commission better pursue our competition mandate. But I hope I've convinced you today that as a matter of history, law, and economics, our mandate also includes ensuring robust competition in our capital markets. And the forgotten fourth pillar of the SEC's mission reinforces the other three: more competitive markets are more likely to be efficient, promote capital formation, and most of all, protect investors.
>
> I took office at the SEC at a time of unprecedented economic inequality and ever more concentrated financial markets in the United States. In a world in which control of America's financial future is increasingly concentrated, ensuring that the SEC pursues the vigorous competition that investors deserve has never been more important. [52]

Commissioner Jackson's observations poignantly underscore the importance of ensuring level playing fields among marketplace competitors. Parallel regulatory reform timetables in the competing market for mutual funds and variable contracts should always be implemented going forward in SEC initiatives. Procrastinated treatment for variable contracts is unwarranted. Likewise, we strongly concur with parallel SEC recognition about the importance of competition in rulemaking. Former SEC Chairman Levitt emphasized the importance of reviewing the impact of rulemaking on competition when he stated:

> In response to the National Securities Markets Improvement Act of 1996 (NSMIA), the Commission has rededicated itself to considering how rules affect competition, efficiency, and capital formation as part of its public interest determination. Accordingly, the Commission intends to focus increased attention on these issues when it considers rulemaking initiatives. In addition, the Commission measures the benefits of proposed rules against possible anti-competitive effects, as required by the Exchange Act.[6]

Going forward, it is essential as a matter of competitive balance and regulatory fairness for regulatory modernization and disclosure simplification to occur on equal timeframes for both mutual funds and variable contracts.[53] Moreover, consumers should be able to access modernized disclosure for all

[52] https://www.sec.gov/news/speech/speech-jackson-101118

[53] ACLI has consistently advocated that variable contracts should have equivalent regulatory relief on a similar time frame with mutual funds. For example, ACLI strongly objected to the exclusion of variable contracts from the SEC's proposed off-the-page prospectus proposal for mutual funds. In that letter, ACLI noted:

> Although the life insurance industry supports the policy and objectives of the off-the-page initiative, we strongly object to the exclusion of insurance company separate accounts from relying upon Rule 482(g). This limitation is unnecessary and contradicts some of the very objectives the proposal seeks to fulfill, such as competitive balance and equal marketing access. *See* ACLI Submission (June 22, 1993) at 2 https://www.acli.com/-/media/ACLI/Public/Files/PDFs-PUBLIC-SITE/CW/062293_Off_the_Page_Prospectus_Proposal.ashx?la=en .

The letter also stated:

> In a long and troubling history of regulatory enhancements and accommodations, variable contract separate accounts have experienced long delays in equivalent regulatory treatment for thinly substantiated reasons. For example, simplified registrations Forms N-3 and N-4 for variable annuity separate accounts were developed several years after the simplified mutual fund registration Form N-1A, which ironically served as the principle template for the variable annuity simplified registration form. Likewise, separate accounts unnecessarily waited several years to obtain equivalent regulatory treatment in Rule 486 under the 1940 Act. We submit that it is unnecessary once again to exclude

competitive and comparable financial products, so they can make relative and informed purchase decisions on retirement and financial solutions.

IX. Coordination of Summary Disclosure Initiative with Reg. BI and Form CRS

Currently pending on the SEC's rulemaking agenda is the proposed Best Interest initiative. The disclosure obligation under Reg. BI provides an important means for consumers to understand the material facts relating to the scope and terms of their relationship with their broker or investment adviser, and all material conflicts of interest associated with the recommendation. It will be important to calculate the totality of disclosure consumers obtain under different regulations to ensure that they do not thwart sensible summary disclosure through collective information overload. The SEC's approach in Reg BI properly advances informed consumer decision making, and equitably allows broker-dealers to create disclosure tailored to their specific business model, product line, and operation. This framework wisely avoids a "one-size-fits-all" approach to regulation recently noted by SEC Chairman Clayton.[54]

As we noted in our August comment letters on Reg BI and Form CRS[55], the disclosure standards in Form CRS do not mesh well with the disclosure proposed in Reg. BI. Further, the creation of two new disclosure events may frustrate the worthwhile goals of consumer understanding by enlarging the already significant number of disclosures a consumer would face.[56] The volume of disclosure currently delivered can, unfortunately, dilute the value of meaningful disclosure essential to understanding and informed decision making. More numerous disclosure documents also thwart the SEC's commendable emphasis on streamlined, simplified, user-friendly, plain-English information. In our comments on Reg. BI, we recommended that a single disclosure fulfilling Reg. BI and Form CRS would reduce disclosure burdens and increase the likelihood consumers will read the required information. We encouraged the SEC to clarify that broker-dealers can appropriately elect to merge required disclosure under Reg. BI and Form CRS in a single document.[57]

The summary disclosure initiative's approach to communicating useful information without dilution through over-disclosure could be also followed in Reg. BI and Form CRS to allow elective access to

variable contract separate accounts from new, sensible regulatory enhancements simply because they are different from mutual funds. *Id*. at 7.

ACLI filed its summary disclosure templates with the SEC in 2007, and IRI filed its Summary Prospectus Proposal in 2011. *See*, Cohen, *SEC Action on Variable Annuity Summary Prospectus Uncertain*, 21 Investment Lawyer 12 (Dec. 2014) for an analysis of delays encountered.

[54] Chairman Clayton observed that "a key to restoring vibrancy in our public markets is recognition that a one size regulatory structure does not fit all." *See Remarks to the Annual Government-Business Forum on Small Business Capital Formation* (Nov. 30, 2017); [https://www.sec.gov/news/public-statement/annual-government-business-forum-small-business-capital-formation] (last visited on July 3, 2018).

[55] ACLI submission on the SEC's Best Interest Initiative (Aug. 3, 2018) at https://www.sec.gov/comments/s7-07-18/s70718-4173937-172339.pdf and ACLI submission on Form CRS (Aug. 3, 2019) at https://www.sec.gov/comments/s7-09-18/s70918-4208142-172847.pdf.

[56] For the variable life and variable annuities under the SEC's jurisdiction this can be especially profound. Consumers will already receive a prospectus, a contract under state insurance law, sales literature, confirmation statements, periodic reporting documents and other related disclosures.

[57] Our submission noted that disclosure standards and objectives should be consistent and parallel in Form CRS and Reg. BI to avoid confusion and to promote clear understanding. We noted that a more flexible approach to required disclosure is preferable and would serve consumers better.

more detailed disclosure through imbedded links to broker-dealer or product manufacturer websites, where consumers can find more comprehensive information. The SEC has referenced and supported this constructive approach in Reg. BI and other initiatives.

X. Reduced Environmental Footprint

The summary disclosure initiative is a constructive development for life insurers and consumers by allowing streamlined, simplified, plain-English disclosure essential to an informed purchase decision. The commendable use of layered disclosure and supplemental information through embedded links will reduce the length and volume of printed variable contract prospectus materials. This aspect will significantly reduce the environmental footprint of printing, postage, storage and transportation of lengthy prospectus materials under current practices. At the same time, however, consumers will still have access to the same total content through web-based links. These sensible practices enhance informed decision making, which enables retirement and financial security while reducing the environmental impact of disclosure practices.

XI. ACLI Responses to Specific Questions in the Summary Disclosure Initiative

The 689-page release posed approximately 698 individual questions that could be roughly grouped into about 300 categories. ACLI reviewed the questions carefully with its members to identify those questions on which we could offer constructive input. The questions of primary interest to us and our respective answers to them appear below in the order presented in the proposal. We greatly appreciate the care and attention the SEC staff devoted to developing questions eliciting input.

Initial Summary Prospectus

Scope of Disclosure to Be Included in Initial Summary Prospectus

- *Should the initial summary prospectus be limited to describing a single contract that the registrant currently offers for sale? Would this reduce the initial summary prospectus' complexity and minimize confusion to investors? Should we allow an initial summary prospectus to describe multiple contracts if the registrant currently offers multiple contracts through the related registration statement? Should we restrict the number of contract classes that may be included in an initial summary prospectus?* (Page 33-34).

A single summary prospectus should be permitted for multiple contracts that have substantially similar features. This approach would greatly reduce the complexity and volume of similar initial summary prospectuses, and would reduce consumer confusion, especially in different group annuity markets with similar contracts. For these and other reasons, the SEC should not restrict the number of contract classes that are permitted to be included an initial summary prospectus and should not require the initial summary prospectus to be limited to a single contract. These approaches properly balance costs and benefits, and comport with the initiative's objectives of streamlined, simplified, user-friendly disclosure.

It can be challenging, from a timing perspective, to obtain portfolio company expense and performance data for reference in variable contract materials because their prospectus updates generally occur contemporaneously with product prospectus updates. To the extent that all such date can be determined by the time that funds file their annual reports, would be extremely helpful if the SEC could encourage underlying funds to share the required expense and performance information in summary form with variable contract issuers at the time the funds prepare the annual reports.

- *Should we impose word or page limits on the proposed section? If so, what should the word or page limits be (e.g., no more than one page).* (Page 47).

ACLI recommends that the initiative not prescribe word or page limits and give life insurers flexibility to elect the length that is appropriate to the circumstances and unique factors of the specific contract. Based on preliminary discussions, our members anticipate that the initial summary prospectus will range between 5 and 10 pages in length without the index or table of contents.

- *Are there additional disclosure topics that should be required to be included in the proposed "Overview" section? Instead, should we provide flexibility to registrants in preparing this section as to topics, etc.?* (Page 47).

ACLI finds the list of overview topics to be reasonable but emphasizes that flexibility is essential to allowing life insurers to develop appropriate disclosure based on their products, markets and customers.

Cover Page and Table of Contents

- *Should we include any additional information or eliminate any of the information that we have proposed to include in these parts of the initial summary prospectus? Will the proposed legends adequately inform investors of the various means for obtaining additional information about a variable contract?* (Pages 40-41).

The initiative requires a legend describing a "free look" period. We recommend that the requirement for this legend should be amended to add "if applicable." Some types of group annuity contracts, such as those used to fund Section 403(b) retirement plans, are not required to have free look provision under state law. It would be inappropriate and misleading to require this disclosure if the free look period is not applicable. The simple solution of adding to the legend requirement a qualification "if applicable" makes this requirement more reasonable and fitting.

Key Information Table

- *Should we require the proposed Key Information Table to be included in the initial summary prospectus?* (Page 65).

Locating the Key Information Table in the initial summary prospectus is consistent with the approach currently taken in Form N-3, Form N-4 and the mutual fund summary prospectus standards.

- *Should we require cross-references to the location (section or sub-section, or heading or sub-heading) in the statutory prospectus where the information provided in response to each line-item of the Key Information Table is discussed in greater detail?* (Page 66).

There need not be required cross-references to the location in the statutory prospectus where the information provided in response to each line-item of the Key Information Table. The statutory prospectus has a table of contents. The required inclusion of cross references is unnecessary as a matter of clear summary disclosure and redundant of the table of contents in the statutory prospectus. This requirement should be removed because it conflicts with the worthwhile goals of simplified, uncluttered summary disclosure and maintaining a level regulatory playing field with mutual funds. We note that the mutual fund summary prospectus initiative has been very successful, and there is no reason to deviate from that model for competing variable insurance products.

- *Is $100,000 an appropriate figure to use as the basis for the cost example in the proposed table? (Page 65).*

The initiative would require an example of the maximum surrender charge an investor could pay (in dollars) under the contract assuming a $100,000 investment. We recommend instead that the assumed $100,000 average for variable contracts overstates the impact of surrender charges for contracts that are below that average. A better comparative substitute would be to lower the assumed figure for average contract size to $10,000 and follow the approach in the mutual fund summary disclosure practices. This would implement consistent disclosure standards and a level regulatory playing field.

- *Would the two-column presentation be effective for investors reading an electronic version of the initial summary prospectus?*

We would prefer that the SEC leave companies with discretion to use a one or two column format based on specific formatting and design preferences. The priority should emphasize readability and clarity of presentation, rather than stipulating the number of appropriate columns.

- *Is the level of detail of the disclosure that we propose in each line-item of the Key Information Table appropriate, and does it strike the right balance between providing enough information to alert an investor to the most salient facts (including fees, expenses, and risks) of the variable annuity contract, but not too much, or too detailed information?* (Page 67).

The SEC staff achieved the correct level of detail here and struck the correct balance between appropriate levels of information without overwhelming consumers with too much detail. This properly achieves the SEC's commendable objectives in layered disclosure.

- *Would the disclosure that a registrant would provide in response to the proposed "Fees and Expenses" line-items convey the appropriate amount of information to investors and concisely alert investors to the most important fees and expenses associated with the variable annuity contract? In some instances, an investment professional may charge fees for providing additional services that are directly deducted from the value of the investor's contract and which may be treated as a withdrawal from the contract, reduce the contract's benefits, and be subject to surrender charges. What disclosures, if any, would be appropriate to be included in the Key Information Table or elsewhere, such as in the fee table?* (Page 67-68).

Investment professional fees are not traditionally part of the contract and are separately charged, and disclosed, but the investment professional. If these types of fees are not part of the contract, no disclosure should be mandated. Some newer versions of contracts that use the investment advisory channel may have professional fees deducted as part of the contract. Disclosure about the presence of these features would be reasonable under those circumstances.

- *Would the Minimum and Maximum Annual Fee and Lowest and Highest Cost tables convey information in a way that investors are likely to easily understand? Is $100,000 an appropriate figure to use as the basis for the cost example in the proposed table? Should we require that registrants use a different figure instead?* (Page 68).

We understand that the $100,000 figure is based on an industry average. The release explains that "we propose to use $100,000 as the basis for the surrender charge example because the value of the average variable annuity contract has recently exceeded $100,000." While we understand the explanation, we believe that annuities are purchased with a wide range of values, and this high level, perhaps skewed by large annuity purchases, does not provide a meaningful benchmark for consumers. This is an instance where it would make rational comparative sense to parallel the benchmark of $10,000 used in the mutual fund summary proposal regime. The minimum and maximum annual fee and lowest and highest cost table may generate more misunderstanding than summary knowledge if the required assumption is overstated. Additionally, because of the many optional benefits offered in some products, we also recommend an alternative that would allow the summary to instead refer to the table in the back of the summary and explain that charges are dependent on which options customers choose. The minimum and maximum could be misleading, particularly in a summary presentation. We do, however, support the proposed depiction of fees and costs in the base contract and optional benefits with an assumption of $10,000 of contract value.

- *Should we require additional information to accompany the tables? For example, should the legend accompanying the tables inform investors that it is possible that the total fees associated with the contract may exceed the accumulated gains from the investment options selected by the investor?* (Page 68).

There should not be a legend accompanying the tables to inform investors that it is possible that the total fees associated with the contract may exceed the accumulated gains from the investment options selected by the contract owner. This concept deviates from the approach afforded to mutual funds in their summary disclosure and should not be included in the variable product summary disclosure as a matter of regulatory and competitive balance. The drift of this question suggests an unfair, unnecessary bias against variable contracts, which in many cases offer minimum guaranteed benefits not available from mutual funds or other investment products. This concept should be jettisoned.

- *Should we require registrants creating an electronic version of the initial summary prospectus to provide an interactive calculator for investors to determine how fees and expenses would affect their specific investments?* (Page 68).

There should not be a requirement to provide an interactive calculator for consumers to evaluate fees and charges. The information that a calculator would provide is typically within the province and explanatory expertise of salespersons. An interactive calculation done in a vacuum without the added explanation of a salesperson could lead to confusion and could conflict with the worthwhile role of simplified disclosure. Additionally, the maintenance and programming burdens of an interactive calculator in view of the different options possible under contracts would be great. Again, there should be regulatory consistency with the mutual fund summary disclosure standards. As such, interactive calculator requirements should be bypassed. Optional use of an interactive calculator, however, would be acceptable.

- *Should variable life insurance contracts also be required to show the lowest and highest possible combination of charges in the Form N-6 Key Information Table? Cost of insurance is often an important component of expenses for variable life insurance contracts (unlike variable annuities) and can vary significantly from one insured person to another depending on various demographic characteristics (e.g., age, gender, health, smoking status). If the lowest and highest possible combinations of charges are shown, how should variations in cost of insurance be reflected?*

This category of information should not be depicted in the key information table. Instead, this more appropriately should refer consumers to the more detailed discussion later in the summary disclosure and in the statutory prospectus. It would clutter and potentially confuse if it were included in the Form N-6 key information table.

- *Would the disclosure that a registrant would provide in response to the proposed "Risks" line-items adequately convey an overview of the risks of investing in a variable contract?* (Page 69-70).

The proposal would require depiction of a risk of loss. This could be unnecessarily confusing because variable contracts are not intended as short-term investments and should be held for the long term. Loss is not realized unless there is a withdrawal or redemption. Account values will fluctuate. It would be more appropriate to refer instead to the fact that the contract may be subject to market fluctuations or risks.

- *Are the proposed disclosure items in that table useful and appropriate for consideration by investors in connection with the initial purchase of a variable contract, or should we revise, supplement, or replace those items? For the associated fee of each optional benefit, should the summary table permit a range of fees?* (Page 75).

Rather than a range of fees for optional benefits, the current fee should be disclosed in the interest of clear communication.

General Requests for Comment on the Initial Summary Prospectus

- *Should we impose any page or word limits on the initial summary prospectus (e.g., 10 pages or 2,500 words)? (Pages 89-90).*

While life insurers understand the need for brevity in the summary prospectus, there should not be a preordained page or word limit because each company's products are different and vary in complexity. Given the range of design and other features among variable products, registrants should be given flexibility to prepare the summary disclosure in a length best fitting their circumstances. Of course, it would be important in the adoption release to emphasize again that the summary prospectus is expected to be just that—summary and not excessive. We simply are noting a concern, therefore, with the inflexibility that a set page or word limit could impose. The absence of page and word limits would give worthwhile adaptability to future developments that could "future proof" a rule that is expected to remain for a long time.

- *Would investors be more likely to read an initial summary prospectus if we required the use of certain design elements—such as larger font sizes or greater use of white space, colors, or visuals—or provided additional guidance on such design elements?* (Page 90).

While we appreciate the benefits of good presentation in disclosure materials, the initiative should not require the use of specified design elements such as font sizes, white space, color or visuals, and should not provide guidance on those features other than to underscore the importance of readability, accessibility and user-friendliness in the initiative. The initiative should provide reasonable flexibility to employ design elements in a manner best fitting the individual situation.

- *Should registrants creating electronic versions of the initial summary prospectus be required to include active hyperlinks for website addresses referenced in the electronic version, as would be required under our proposal?* (Page 90).

It could be administratively burdensome to have active hyperlinks for website addresses referenced because this would necessitate continuous maintenance to determine whether the websites have changed locations of information.

Updating Summary Prospectus

- *Is it appropriate to permit the updating summary prospectus to include multiple contracts under the statutory prospectus to which the updating summary prospectus relates?* (Pages 94-95).

Optional authority to permit the updating summary prospectus to include multiple contracts under the statutory prospectus to which the summary prospectus relates would be quite appropriate and consistent with layered disclosure goals. The final action, however, should not make this practice mandatory because it may not lend itself well to all companies and their products. A flexible optional approach makes better sense. In a related context, the SEC staff recently stated:

> In addition to the increased use of analytical tools in our regulatory oversight, the Division continues to make efforts to improve the efficiency and effectiveness of our internal processes. This pertains to some of the core work of the Division, including the review of disclosures of over 12,000 investment companies by our Disclosure Review and Accounting Office. Funds make many filings and their complexity varies. To better focus our resources, the staff generally takes a risk-based approach to reviewing disclosure filings, devoting particular focus to (1) filings by novel and complex funds; (2) new disclosures; and (3) disclosures that most directly influence investment decisions, such as disclosures on investment strategies, risks, fees, and performance.
>
> In addition, the Division is working to improve the transparency of our fund disclosure review process. We recently launched a new webpage that is designed, in part, to provide more clarity and practical guidance on the preparation of fund disclosures. For example, the webpage has accounting and disclosure information for practitioners that covers various practical topics like how to request selective review of a disclosure filing or request relief to avoid making multiple filings when a fund complex makes substantially identical disclosure

> changes to multiple funds. The website allows us to share with the public accounting and disclosure topics that are frequently raised with the staff. The goal of this effort is to help funds and practitioners navigate our disclosure review process. (emphasis added).[58]

The staff statement above reflects good practical judgment and applies in a parallel fashion to the question of permitting an updating summary prospectus available to include multiple contracts.

Scope of Disclosure to Be Included in Updating Summary Prospectus

We support the SEC's commendable application of layered disclosure concepts in the updating summary prospectus. The amount of detail required about changes to underlying fund expenses may be contrary to the worthwhile goals of layered disclosure and may, therefore, be burdensome. Instead, disclosure should note that underlying fund expenses can be expected to change and that contract owners should consult the appendix discussing them in greater detail. This follows the approach in the SEC's example concerning liquidation and renaming developments.

As a policy matter, a company should be permitted to use an updating summary prospectus, irrespective of whether the company used an initial summary prospectus for existing contract owners. Otherwise, the limitation conflicts with the layered disclosure concept if companies were denied the ability to provide updates even where they had delivered a full statutory prospectus and not used an initial summary prospectus.

The release states that an updating summary prospectus that describes multiple contracts could contain a separate Key Information Table for each of the contracts or use a different presentation approach that consistently discloses the required information for each contract in the required order. We support the SEC's commendable flexibility allowing an approach that makes the most sense for each company.

The release asks whether it is appropriate or necessary for the table that appears in the updating summary prospectus to include a line-item on investment professional compensation. We note that the updating document is essentially disclosure about the product rather than professional compensation. The scope of investment professional compensation will be considered in proposed Regulation BI and proposed Form CRS. Once a contract has already been purchased, this information is not sufficiently relevant to be required in the table. Finalization of Regulation BI and Form CRS may resolve questions about appropriate disclosure about investment professional compensation.

- *The proposed rule would not permit the summary prospectus to be bound together with any materials other than prospectuses for the portfolio companies that are available under the contract. This approach is modeled on rule 498(c). Do registrants currently rely on rule 498(c) to bind the variable contract's statutory prospectus with the prospectuses or summary prospectuses for the underlying portfolio companies? Since reliance on the proposed rule*

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58 See, Dalia Blass, Testimony *on Oversight of the SEC's Division of Investment Management* (Sept. 26, 2018) Before the United States House of Representatives Committee on Financial Services, Subcommittee on Capital Markets, Securities, and Investment https://www.sec.gov/news/testimony/testimony-2018-09-26-blass

would be optional, should we continue to permit binding to be consistent with rule 498(c)? (Page 117).

The SEC should continue to permit binding of related materials together in a rational fashion that does not present confusing disclosure in connection with delivery of statutory or summary prospectuses.

- *Under proposed rule 498A, use of the summary prospectus would be voluntary. Should we make use of the summary prospectus regime mandatory for all variable contract registrants?* (Pages 117-118).

We recommend that the use of the summary prospectus be voluntary not mandatory. The SEC has demonstrated commendable flexibility in the initiative to allow companies to tailor practice that fit their situations best.

- *Would registrants be more likely to adopt the regime if the portions of the statutory prospectus that are also summary prospectus disclosures were segregated and placed at the beginning of the statutory prospectus?* (Pages 117-118).

We recommend that registrants be given flexibility to present disclosure where it makes most logical sense, and not to require placement at the beginning of the statutory prospectus.

Online Accessibility of Contract Statutory Prospectus and Other Documents Relating to the Contract

- *Does the proposed rule appropriately provide a safe harbor to address the possibility of inadvertent technological problems*? (Page 133).

The proposed rule sensibly contains a safe harbor addressing inadvertent technological problems that can, and do, occur. The proposed safe harbor provides that the conditions regarding the availability of the required online contract documents will be deemed to be met, even if the required online contract documents are temporarily unavailable, provided that the person has reasonable procedures in place to ensure that those materials are available in the required manner. A person relying on the proposed rule to satisfy prospectus delivery obligations would be required to take prompt action to ensure that those materials become available in the manner required as soon as practicable following the earlier of the time when the person knows, or reasonably should have known, that the documents were not available in the manner required. This approach constructively accommodates technological glitches that may occur with even the best software and technology.

Concerning inadvertent technological problems, the release also inquires whether persons relying on the proposed rule who have technological issues that temporarily prevent them from complying with the online posting requirements of the rule should be required to disclose on the website that the information was not available for a time and to explain the reasons for the failure to comply. We do not support a requirement in the proposed rule to post alerts on the insurer's website due to technological issues because consumers will already be aware of this on attempting to reach the website. A posting requirement would not further enhance consumers' awareness and would be redundant and unnecessarily burdensome for registrants.

- *Are those aspects of the proposed rule that mirror the approaches taken in the rule governing the use of mutual fund summary prospectuses, e.g., required online documents, formatting requirements, linking, ability to retain online documents, safe harbors for temporary noncompliance) appropriate in the context of variable contract disclosure?* (Pages 133 – 34).

The parallel approaches proposed in the rule properly mirror the sensible, constructive approaches adopted in the mutual fund summary disclosure initiative. Those approaches have worked well in the mutual fund context and can be expected to work equally well in the context of variable contracts.

- *How else could we modify the proposed summary prospectus regime to take greater advantage of modern technology to modernize current disclosure practices for variable contracts? For example, should insurers consider employing technology to require a retail investor to scroll through the entirety of the summary prospectus before entering the next stage in the sales process, accessing a different part of the insurer's website to obtain more information, or checking a box to submit the application to purchase a variable contract? Are there other ways that technology could be used to encourage investors to read the summary prospectus? (*Page 134).

The proposed summary prospectus initiative currently exploits modern technology in a rational manner for variable contracts. Using technology, however, to force investors to scroll through the entirety of the summary prospectus before entering the next stage in the sales process is inappropriate and overbearing. Moreover, this approach goes beyond the statutory requirement to deliver disclosure and would create an unprecedented and unnecessary requirement to force consumers to read disclosure in its entirety. No other aspect of the federal securities laws requires the forced reading of appropriately delivered disclosure by consumers. There is no reason to institute such a practice in this instance for variable contracts.

- *Does the proposal sufficiently encourage electronic design and delivery? Are there other ways we can modify the requirements to make clear that paper – based delivery is not the only permissible or desired delivery format?* (Page 134).

The summary prospectus initiative appropriately encourages electronic design and delivery. We see no need to modify the requirements to make clear that paper-based delivery is not the only permissible or desired delivery format.

- *Are there other requirements that we should consider for insurers that are offering variable contracts to retail investors? Should we require that certain disclosures be presented in a manner reasonably calculated to draw retail investor attention to it? Are there other ways to ensure the retail investors receive the information they need to clearly understand the features, costs and risks of the variable contract they are considering?* (Page 134).

ACLI believes the proposal adequately addresses the SEC's intentions in the proposal and does not suggest that other requirements should be considered in the offering of variable contracts to retail investors. The initiative's layered disclosure, by its very nature, already provides that certain key disclosures be presented in a manner reasonably calculated to draw retail investor attention. Within that framework, registrants should have the flexibility to tailor their disclosure in a manner appropriately conveying information to consumers in a streamlined, simplified, plain – English format. The proposal contains enough guidance ensuring that retail investors receive the information needed to clearly understand the features, costs and risks of the variable contract, and no further revisions are necessary.

Other Requirements for Summary Prospectus and Other Contract Documents

- *Should persons relying on the proposed rule be required to send the required online contract documents to any person requesting such documents within three business days after receiving such a request? Would a different period be appropriate? Should compliance with this requirement be a condition to reliance on the proposed rule? If not, why not?* (Page 138).

The requirement to send online contract documents within three business days after request is appropriate and parallels the practices under the mutual fund summary disclosure initiative. This three-day delivery requirement would, of course, be qualified by the proposal's safe harbor for technological challenges, and It would be worthwhile to make this clarification in the adoption of the final rule concerning this three-day delivery requirement.

- *Does the proposed rule effectively promote investors' ability to request paper copies of the required online contract documents? Should we require registrants to make available to investors a way to opt into the automatic annual delivery of future statutory prospectuses in a paper format without having to specifically request the documents each year? Should we allow registrants to give investors the option of automatic delivery of future statutory prospectuses in paper?* (Page 139).

The proposed rule quite effectively promotes investors' ability to request paper copies of the required online contract documents. The SEC should not mandate opt in or opt out practices concerning future delivery of paper prospectuses, which would impose unnecessary tracking responsibilities and costs that would greatly overshadow the marginal benefit to consumers. Further, few variable contract purchasers are likely to request a paper copy after the initial purchase. This reflects life insurers' experiences under current paper delivery obligations. In sum, the clearly publicized ability to obtain a paper copy without charge through a toll-free 800 number provides a functional and practical mechanism for consumers to obtain a paper copy. No further requirements are needed.

- *Should the rule require that the summary prospectus be given greater prominence than any materials that accompany the summary prospectus? Does this requirement pose any challenges to registrants? How might a summary prospectus be given greater prominence than any materials that accompany the summary prospectus when being delivered or made available electronically?* (Page 139).

The variable contract summary prospectus initiative should track the approach followed in the mutual fund summary disclosure initiative. Imposing prominence requirements is unnecessary. We support the proposal's narrative that the summary prospectus should be the first among several documents listed electronically or delivered in a bundle. This approach has worked well in the mutual fund industry and can be expected to work equally well for variable contract disclosure. Consistent with current practices approved by the SEC, it would make sense to reconfirm the flexibility to position the summary prospectus on top of several documents listed electronically or delivered in a bundle.

- *Should compliance with any or all of the proposed requirements discussed in this section be a condition of reliance on the rule? Should the failure to comply with these requirements be a violation of Commission rules that does not result in an inability to rely on the rule or a violation of section 5 (b)(2)?* (Page 139).

We agree that failure to comply with any of the requirements discussed in this section should not result in an inability to rely on the rule or be construed as a violation of section 5 (b)(2), but instead simply be a violation of Commission rules. This approach would sensibly follow the practices implemented in the mutual fund summary disclosure initiative.

- *The proposed rule would require any website address or cross reference that is included in an electronic version of the summary prospectus (i.e., electronic versions sent to investors or available online) to be an active hyperlink. To what extent, if any, would this requirement present challenges or add costs or burdens with respect to the use of summary prospectuses, given that active links are not required (or permitted) in EDGAR filings?* (Pages 139-40).

The proposal currently requires active links from the summary prospectus table of contents to the statutory prospectus. This standard for additional embedded links is burdensome, unnecessary, and potentially confusing, and goes beyond the practices currently required in the mutual fund summary disclosure initiative. We recommend that this proposed requirement for additional embedded links be removed, and parallel the practices currently required in mutual fund summary disclosure. This proposed requirement would create unnecessary confusion for registrants in light of the explicit requirements regarding links under EDGAR standards. In sum, the active links from the summary prospectus's table of contents to the full statutory prospectus are sufficient. No further requirements for embedded links should be included in the final rule.

Filing Requirements for the Summary Prospectus

- *Should we require filing of the preliminary form of any contract summary prospectus? If not, what alternatives should we consider to facilitate staff review of the summary prospectus disclosures, and would investors be adequately protected if staff did not have the opportunity to review a summary prospectus pre-use? Should we only require the initial summary prospectus (or updating summary prospectus) to be filed prior to first use?* (Page 150-151).

While we support allowing the SEC an opportunity to review the preliminary form of any summary prospectus, it would be unduly burdensome and inefficient (for both SEC staff and for issuers) to require registrants to file a preliminary summary prospectus for each contract during an issuers' implementation of summary prospectuses. In some cases, it may be preferable to allow issuers to file a "form of" or "template" summary prospectus under rule 485 (a) that could be filed for other contracts that are "substantially similar" or which the Registrant will assert is meaningfully representative of similar contracts, like the relief currently provided under rule 485 (b) (1) (vii). This will reduce the volume of reviews required by the SEC staff, while allowing for more efficient use of summary prospectuses for issuers. There are many cases where SEC staff review of a "template" or similar representative would provide adequate protection for investors. Our suggestion here would economize on the time and resources of SEC staff and issuers alike, while equally serving the purposes of the summary disclosure initiative.

On these points, SEC Division of Investment Management Director, Dalia Blass, recently acknowledged the efficiencies of single review of multiple similar filings when she stated:

> In addition to the increased use of analytical tools in our regulatory oversight, the Division continues to make efforts to improve the efficiency and effectiveness of our internal processes. This pertains to some of the core work of the Division, including the review of disclosures of over 12,000 investment companies by our Disclosure Review and Accounting Office. Funds make many filings and their complexity varies.[59]
>
> The Division is working to improve the transparency of our fund disclosure review process. We recently launched a new webpage that is designed, in part, to provide more clarity and practical guidance on the preparation of fund disclosures. For example, the webpage has accounting and disclosure information for practitioners that covers various *practical topics* like how to request selective review of a disclosure filing or request relief to avoid making multiple filings when a fund complex makes substantially identical disclosure changes to multiple funds.[60]

We agree with these efficient disclosure review endeavors and recommend that similar practices be applied to the SEC staff variable contract review of summary disclosure.

- *Should we require post-use filing of the summary prospectus? Should only the initial summary prospectus (or updating summary prospectus) be filed after use?* (Page 151).

The focus of these questions is not clear to us. We note that the release indicates that the initial and updating summary prospectuses must be filed as exhibits. Perhaps the focus of this question concerns staff review of these documents. In that event we note that the mutual fund summary disclosure initiative does not require review.

- *If the updating summary prospectus includes a description of a contract change that is not similarly described in the related statutory prospectus would this adversely affect investor protection (for example if certain information were not deemed to be part of the registration statement for purposes of Section 11 of the Securities Act?* (Page 151).

It would not be confusing to have descriptions of contract changes that are not similarly described in the related statutory prospectus nor would it adversely affect investor protection. Indeed, this is essentially the same practice that currently exists, and it has not been identified as a source of

[59] *See*, Dalia Blass, *Testimony on Oversight of the SEC's Division of Investment Management* (Sept. 26, 2018) Before the United States House of Representatives Committee on Financial Services, Subcommittee on Capital Markets, Securities, and Investment https://www.sec.gov/news/testimony/testimony-2018-09-26-blass.
[60] *Id.* Emphasis added.

confusion or an adverse impact on investor protection. Under current practices, a synopsis of contract changes is not required in disclosure supporting the statutory prospectus. Because contract owners currently obtain disclosure about contract changes in a piecemeal fashion through different sequential updating disclosure, it may be helpful and constructive for contract owners to have a list in one place about contract changes in the updating prospectus. Because variable contract registrants have not used the summary prospectus format, however, it is challenging to compare what differences, if any, would exist between descriptions of contract changes in the summary materials compared to the full statutory prospectus or the accompanying post – effective amendment updates.

We support the SEC's view that "a variable contract summary prospectus under the proposed rule would not itself be deemed a part of the registration statement for purposes of section 11." We acknowledge the SEC's statement in the release that "proposed rule 498A would not have a comparable provision to that in rule 498 requiring that the information it the summary prospectus must be the same as in the statutory prospectus," and the SEC's observation that" the substance of the information itself would be the same, even though the language in both documents relating to the information may not be identical." These statements properly recognize that disclosure in the statutory prospectus is by design more fulsome, while the information in the summary prospectus is less fulsome and may not be identical to that in a statutory prospectus. The approaches recommended here underscore and compliment the SEC's objective to achieve streamlined, simplified, plain-English, and user-friendly disclosure.

- *Should the summary prospectus be subject to the stop order and other administrative provisions of section 8 of the Securities Act?* (Page 151).

In the release, the SEC states that "a summary prospectus would be subject to the stop order and other administrative provisions of section 8 of the Securities Act." We understand the SEC's desire to retain the stop order tool to preclude defective disclosure. We note, however, that the application of stop order authority in the summary prospectus context would be different from that applied in the statutory prospectus or post – effective amendment process due to the summary nature of disclosure in the summary prospectus. Thus, some flexibility concerning summary prospectus disclosure in the application of the stop order authority would be warranted. Additionally, for these same reasons section 11 liability under the Securities Act should not pertain to summary disclosure requirements.

- *Should we modify any of the proposed conditions related to the new option for satisfying portfolio company prospectus delivery requirements, or add any additional conditions? For example, should we-as proposed-specify that these materials must be available at the same website address as the variable contract materials that appear online, or should there be flexibility regarding the website address on which the portfolio company materials appear? (Page 161).*

We recommend that should there be flexibility regarding the website address on which the portfolio company materials appear. It does not make practical sense to specify that these materials must be available at the same website address as the variable contract materials that appear online. All links to all materials for all products should not be required on one page. Companies take different approaches and have developed different systems for embedding links for added information, and flexibility should be enabled in the initiative.

- *Although the proposed rule specifies that the materials posted online must be in human-readable format, should we also require that the materials be posted online in machine-readable format to promote the gathering and dissemination of information by data aggregators?* (Page 161).

The costs of requiring the materials to be posted online in machine-readable formats greatly outweigh the benefits. The gathering and dissemination of information by data aggregators has little application to variable contracts. While openness to technological advances is worth considering generally in the initiative, it is not warranted here.

- *Under the rule as proposed, persons relying on the new delivery option would not be required to deliver interim prospectus supplements to investors. Should we instead require that interim prospectus supplements be delivered?* (Page 162).

ACLI supports the proposed approach in the rule that persons relying on the new delivery option would not be required to deliver interim prospectus supplements for portfolio companies. ACLI concurs with the statement in the SEC's Release that it would be confusing to consumers to require delivery of interim portfolio company prospectus supplements to contract holders who have not received the original document. No change from the proposed rule is necessary here.

- *Would the proposed legend on the initial and updating summary prospectuses provide sufficient notice to investors that portfolio company prospectuses may be amended from time to time?* (Page 162).

Yes, we agree that the proposed legend on the initial and updating summary prospectuses provide sufficient notice to investors that portfolio company prospectuses may be amended from time to time. This approach has worked well in the mutual fund context.

- *Alternatively, should we require that a separate notice be given to investors to alert them of the online availability of prospectus supplements?* (Page 162).

ACLI opposes the notion that a separate notice be given to investors to alert them of the online availability of prospectus supplement. We agree with the SEC's reasoning in the Release that there is no need for separate notice requirements. As the Release aptly notes, the legend to the summary prospectus Appendix listing all the portfolio companies contains a notice advising consumers that they should review the portfolio company prospectuses and noting that the prospectuses are amended from time to time. This is sufficient. The SEC's rationale here makes good sense.

- *Investors that have variable contracts with registrants that provide alternative disclosures would receive different disclosure documents, and hence different sets of information, than they would receive under the proposed summary prospectus regime. Which approach do you believe is most beneficial for investors and why?* (Page 173).

Because contract holders in discontinued contract situations have already made their initial purchase decision, the alternate disclosure requirements make good sense, particularly given that new purchases will not occur. Requiring the delivery of the full summary disclosure prospectus regime in these situations could have the unintended consequence of creating confusion for existing contract owners that cannot purchase additional interests under discontinued contract situations. As discussed more fully below, ACLI supports Approach 1 for discontinued variable contracts.

Definitions in the Proposed Rule

- *Should we include any additional, or exclude any proposed, defined terms? Should we modify the definitions of any defined terms? For example, does the proposed definition of "class" adequately distinguish among classes of a variable contract?* (Page 152).

While we do not suggest any specific additions or exclusions to the defined terms, we note that flexibility should be provided to permit a registrant's use of alternative terms used by the company in its contracts that reflect the substance of the defined terms in the proposal. For example, some companies use the term "policy" rather than the proposal's defined term "contract." The same may be true regarding a VLI "contract" versus a" policy." It would be unnecessarily confusing to consumers if the term were required when the registrant appropriately used the term "policy" in its state approved materials and SEC registration statement. Reasonable flexibility for the use of alternative terms to discuss the substance required by the rule should be permitted, especially in view of the initiative's goal of understandable, unconfusing disclosure. Readability should be the top priority. The rule should not force registrants to use terms that are not germane or do not apply.

Terminology in the Summary Prospectus

We support the SEC's desire to "future proof"[61] the rule, keep it from becoming rapidly outdated, and to get it right because "it will be on the books for a long time."[62] To this end, we recommend the SEC allow registrants to use different terms from those specified in the proposal that have substantially the same meaning. Registrants should not be required to use terms in their disclosure that are not used in their contracts. As a matter of practice, the SEC has approved in the current disclosure review process the use of terminology different from that prescribed in the variable contract registration forms to accommodate the actual, conceptually similar terminology that the registrant uses in its contract. For example, the SEC staff has allowed some registrants to use the term "withdrawal charge" that appears in their contract rather than the prescribed disclosure term "surrender charge" that does not appear in their contract but shares a substantially similar meaning. Likewise, there may be features that evolve in the design of variable contracts in the future that should be permitted to be used in disclosure documents. These "special terms" will be described in the contract and defined in the disclosure documents. The creation of such a flexible approach to terminology prescribed in the

[61] *See* SEC Division of Investment Management Director Dalia Blass speech *Keynote Address: ALI CLE 2018 Conference on Life Insurance Company Products* (Nov. 8, 2018) at https://www.sec.gov/news/speech/speech-blass-110818#_ftn6 (last visited on January 16, 2019) ["This rule – if it gets adopted – could be on the books for a long time. I don't want a rule that is going to be out of date the minute it is adopted – we want to future-proof it."].
[62] *Id.*

proposed disclosure documents would be reasonable and will keep the rule relevant, updated, and "future proof" because "it will be on the books for a long time."[63]

Optional Method to Satisfy Portfolio Company Prospectus Delivery Requirements and the New Option to Satisfy Prospectus Delivery Requirements

- *Should the rule permit the use of the new option for satisfying portfolio company prospectus delivery requirements? Should this aspect of the proposed rule be optional as proposed or required if the variable contract uses a summary prospectus?* (Page 160).

The new option for portfolio company prospectus delivery requirements fulfills the initiative's objectives of readability, accessibility and ease of use. The SEC should permit the use of the new option for satisfying portfolio company prospectus delivery requirements, as discussed in the release. We agree with the SEC's concern that the volume of disclosure materials variable contract owners currently receive may prevent them from reading the materials or fully understanding these products. We also concur with the SEC's expressed concern that investors may not read or understand information if the accompanying underlying portfolio company prospectuses are not highlighted in a summary fashion. In the interest of flexibility and adjustments to the new standards, it would be appropriate to permit the new option concerning portfolio company prospectus delivery requirements, but not to require it, to allow companies to determine what they consider appropriate in light of their products, markets and customers. Flexible, not forced, use of the new option will help variable contract registrants concerning, for example, fund performance depictions and will give registrants time to build this process out.

The summary prospectus initiative wisely recognizes that consumers would be disinclined to read or understand essential information if the variable contract summary prospectus is accompanied by hundreds of pages of underlying prospectuses. These concerns are sensibly addressed by allowing registrants to provide consumers with key information concerning portfolio companies in an appendix to the contract summary prospectus. In this way, consumers will not be inundated with excessive information, but will still have the option to acquire more detailed information about a portfolio company prospectus or other documents online, electronically or by paper. The release aptly acknowledges that insurance salespersons will play a significant role in continuing to provide information about portfolio companies to consumers, even if consumers were no longer receiving paper versions of portfolio company prospectuses. This is an apt recognition of the important role unique to the variable contract sales distribution process.

- *The rule as proposed would only permit the use of the new option for portfolio company prospectuses if the related variable contract uses an initial summary prospectus for each currently offered contract described under the related registration statement. Should we permit the use of the new option even if the related variable contract does not use a summary prospectus?* (Pages 160 – 61).

The SEC should allow the use of the new option for portfolio company prospectuses as a matter of enhanced readable consumer disclosure and should not limit it to instances where the variable contract uses an initial summary prospectus for each currently offered contract. Likewise, for the

[63] *Id.*

same reasons the SEC should permit the use of the new option even if the related variable contract does not use a summary prospectus, in the interest of reducing the totality of documentation that consumers must confront. These suggested approaches comport with the SEC's commendable goal of accessible, understandable, simplified disclosure.

- *Should we permit the use of the new option even if the portfolio company does not otherwise use a summary prospectus?* (Page 161).

The rule, as proposed, would only permit the use of the new option if the portfolio company uses a summary prospectus. We do not support this conditional approach, as the value of layered disclosure still applies even if a portfolio company offers only a statutory prospectus. We note that, according to the release, approximately 95% of mutual funds currently use a summary prospectus, and we do not see the benefit of providing a full statutory prospectus to all customers for those few funds that are not taking advantage of the summary prospectus option.

Should the final rules provide that a communication relating to a portfolio company (other than a prospectus permitted or required under section 10 of the Securities Act) is not deemed to be a prospectus under section 2(a) (10) of the Securities Act under the conditions specified by the rule? (Page 163).

ACLI supports a provision in the final rules that a communication relating to a portfolio company (other than a prospectus permitted or required under section 10 of the Securities Act) is not deemed to be a prospectus under section 2(a)(10) of the Securities Act under the conditions specified by the rule. This approach makes good sense and would helpfully clarify the status of communications concerning a portfolio company.

Treatment of Discontinued Variable Contracts

The release devotes substantial discussion to the SEC's proposed treatment of discontinued variable contracts and lists a series of associated questions about it. To set the stage for discussion, it may be helpful to recap the current practices governing discontinued contracts under the "Great-West" line of staff no-action letters.[64] In describing the background to this issue, the release explained that:

> An insurance company may choose to stop offering a variable contract to new investors while continuing to accept additional payments from existing investors. Each additional purchase payment under a variable contract is considered a "sale" under section 5 of the Securities Act requiring delivery of a current prospectus, and variable contract issuers generally maintain current prospectuses for their products through the filing of annual post-effective amendments to the registration statements.

[64] From 1977 to 1995 the staff of the Division of Investment Management issued a series of no-action letters stating that the staff would not recommend enforcement action if issuers did not update their variable contract registration statement and deliver updated prospectuses to existing customers for discontinued contracts, so long as certain conditions were met. *See*, e.g., Great-West Life and Annuity Insurance Company, SEC Staff No-Action Letter (pub. avail. Oct. 23, 1990) ("1990 Letter"); MML Bay State Life Ins. Co., SEC Staff No-Action Letter (pub. avail. Apr. 12, 1990); Transamerica Occidental Life Insurance Co., SEC Staff No-Action Letter (pub. avail. Mar. 16, 1990); Connecticut Mutual Life Insurance Company, SEC Staff No-Action Letter (pub. avail. Mar. 7, 1990). In the 1990 Letter, the staff said it would no longer respond to no-action requests in this area "unless they raise novel issues or involve more than 5,000 variable annuity or variable life insurance contracts."

> As the number of contracts outstanding declines over time, the proportion of fixed costs per contract and other burdens associated with maintaining a current registration statement and mailing prospectuses increase over a diminishing asset base. Unlike other types of registered investment companies that can liquidate when assets are reduced to such a level that continuing the fund is not viable, an insurance company is unable to liquidate or otherwise terminate a variable contract. We understand that an insurance company may sometimes seek to encourage investors to exchange into new contracts or make buyout offers, but it cannot unilaterally terminate an investor's contract.

Beginning in 1977, the staff addressed this dilemma unique to life insurers through a series of no-action letters stating that the staff would not recommend enforcement action if issuers did not update the variable contract registration statement and deliver updated prospectuses to existing investors, so long as certain conditions were met, including sending alternative disclosures to investors. These no-action letters and the associated disclosure conditions have successfully protected contract owners while accommodating the challenges of dwindling collective volume under contracts that life insurers cannot terminate or liquidate under state insurance laws. According to the release, the SEC estimates that more than half of variable contract Securities Act registration statements provide the alternative disclosures prescribed in the Great West line of no-action letters, as of the end of calendar year 2017.

Under the summary disclosure initiative, the SEC would preserve the position reflected in the "Great West" line of no-action letters that if an issuer of an existing contract that provides alternative disclosures does not file post-effective amendments to update a variable contract registration statement and does not provide updated prospectuses to existing investors, this would not provide a basis for enforcement action so long as investors receive specified alternative disclosures. The release explains that the SEC would take this position in recognition of the industry's practice that have developed consistently with the line of no-action letters, the costs and burdens that issuers of contracts operating in accordance with the no-action letters currently incur, and the costs and burdens that issuers would incur under the proposed summary prospectus framework.

Accordingly, the SEC would permit discontinued variable contracts operating consistently with the required conditions in the no-action letters as of the effective date of any final summary prospectus rules (the "Alternative Disclosure Contracts") to continue to operate in the same manner. ACLI strongly supports the SEC's sensible determination to preserve this practical regulatory relief. The regulatory relief has successfully protected contract owners while not imposing heavy cost and administrative burdens for life insurers that no longer have a critical mass of contracts and discontinue new sales. The process has worked well for over 40 years, and life insurers have developed compliance systems under the alternative disclosure conditions.

The release explains, however, that variable contract issuers that determine to discontinue contracts after the effective date of the final rule would instead be required to file post-effective amendments to update their registration statements and provide updated prospectuses under current regulatory requirements and could avail themselves of the summary prospectus framework as adopted. ACLI does not support this approach to contracts that are no longer marketed following the rule's effective date. Requiring legacy contracts to file post-effective amendments and to update and deliver them would be more costly, burdensome, and would not advance consumer protection or information access where new sales no longer occur.

A better alternative does, however, exist. ACLI supports “Approach 1” in the release as a balanced reasonable path for contracts that will become discontinued after the effective date of the final rule. Under Approach 1, the SEC would adopt final rules providing that a registrant would not have to comply with certain requirements to update the variable contract registration statement and deliver updated contract prospectuses to existing investors, so long as the registrant complies with the following conditions:

- Investors would receive an annual notice that includes information that is comparable to that which would be provided in an updating summary prospectus. Specifically, this notice would include: (1) the Key Information Table that would appear in an updating summary prospectus; (2) a brief description of any material changes to the offering relating to fees, the standard death benefits, other benefits available under the contract, and portfolio companies available under the contract; (3) a table that would include the same information about portfolio companies that would appear in the proposed appendix to the updating summary prospectus; and (4) legends informing investors that additional information about their contract—including the registrant’s financial statements (the depositor’s financial statements in the case of variable life insurance contracts) and portfolio company prospectuses and periodic reports to shareholders—is available online. Because this notice would not be a section 10(b) prospectus, it (unlike a summary prospectus under proposed rule 498A) would not be subject to liability under section 12(a)(2) of the Securities Act, although it would remain subject to the general antifraud provisions of the federal securities laws. The notice would be posted to the insurance company’s website.

- The financial statements provided to investors under the alternative disclosures in the Staff Letters would be filed with the Commission, posted to the insurance company’s website, and delivered to an investor upon request;

- Registrants would be permitted to use the optional method to satisfy portfolio company prospectus delivery requirements as provided under proposed rule 498A; and,

- Investors would continue to receive portfolio company shareholder reports and proxy materials.

Under Approach 1, registrants would be able to rely on Approach 1 if the contract is no longer offered to new purchasers, there are under 5,000 contract owners, and there have been no material changes during the period since the most recent update.

The release explains that Approach 1 reflects the SEC’s “belief that the proposed summary prospectus framework could give investors more pertinent information to use to help them make informed investment decisions, compared to the information under the circumstances that the” Great West line of no-action letters identify. The release further explains that “this approach seeks to provide many of the benefits to investors associated with the summary prospectus framework while limiting the burden of updating registration statements relating to contracts that are only offered to a limited number of investors.”

ACLI fully concurs with the SEC's rationale supporting Approach 1. While Approach 1 is limited to discontinued contracts with 5,000 or fewer contract owners, we note that the SEC also granted the relief to four entities[65] with greater than 5,000 contract owners, based on circumstances described in their no-action request. To achieve an enduring rule, it would be worthwhile going forward to provide a mechanism in the rule allowing registrants with greater than 5,000 contract owners to pursue an individual request for relief under the Approach 1. This would be in keeping with the SEC's goal to "future proof"[66] the rule and keep it from becoming rapidly outdated, because "it will be on the books for a long time."[67]

We address below several of the questions in the release associated with the proposed treatment of discontinued contracts.

- *Would adoption of a summary prospectus framework and related form amendments effectively relieve some of the current burdens and costs on variable contract issuers of updating registration statements, and delivering updated prospectuses, such that the Commission's position on Alternative Disclosure Contracts would not be necessary? (Pages 169-70).*

The costs and burdens of the proposed summary prospectus framework do not warrant elimination of the SEC's current position on discontinued contracts. Further, as noted above, delivery of the summary prospectus to contract owners of discontinued contracts could have the unintended and unnecessary consequence of confusion for persisting contract owners for whom the new summary disclosure is not especially relevant. ACLI strongly opposes the elimination of the administrative practices permitted under the line of no-action letters. The costs would greatly exceed the very marginal benefits of such an action.

- *Are fees and charges for variable contracts currently established based on an expectation that the insurer will be able to provide alternative disclosures at some point, such as if a product launch is unsuccessful or if the insurer stops selling new contracts so that the number of investors diminishes over time?* (Page 170).

Yes, the foreknowledge that a less expensive cost structure is available if a product needs to be discontinued allows life insurers to experiment and helps encourage the development of new products that can enhance consumers' financial or retirement security. Our members have generally not fielded complaints from contract owners receiving the disclosure under the SEC staff's no-action positions. It would be unconstructive to eliminate the current administrative positions when they are not the source of any demonstrated disclosure problems. In addition, SEC staff resources would be less

[65] See Metropolitan Letter (42,910 investors); Monarch Life Insurance Co., SEC Staff No-Action Letter (pub. avail. June 9, 1992) (5,900 investors); New York Life Insurance and Annuity Corp., SEC Staff No-Action Letter (pub. avail. Nov. 15, 1989) (13,713 investors); Security Benefit Life Insurance Company, SEC Staff No-Action Letter (pub. avail. July 2, 1987) (28,019 investors).

[66] *See* SEC Division of Investment Management Director Dalia Blass speech *Keynote Address: ALI CLE 2018 Conference on Life Insurance Company Products* (Nov. 8, 2018) at https://www.sec.gov/news/speech/speech-blass-110818#_ftn6 (last visited on January 16, 2019) ["This rule – if it gets adopted – could be on the books for a long time. I don't want a rule that is going to be out of date the minute it is adopted – we want to future-proof it."].

[67] *Id.*

effectively deployed in reviewing new disclosure if the current positions were eliminated--an unproductive cost with little marginal value for contract owners. The long-standing practices under the staff positions have worked well for many years. It does not make sense, therefore, to require registrants to incur cost or burdens to construct and implement the new summary disclosure practices under these arrangements.[68]

- *Should the ability to provide alternative disclosures be limited to contracts with a maximum of 5,000 investors (or participants in the case of group contracts)? (Page 170).*

As discussed above, it would be worthwhile to provide a mechanism in the rule allowing registrants with greater than 5,000 contract owners to pursue an individual request for relief under Approach 1. This would be in keeping with the SEC's goal to "future proof"[69] the rule and keep it from becoming rapidly outdated, because "it will be on the books for a long time."[70]

- *Would either of Approach 1 or Approach 2 facilitate the disclosure of useful information to investors in a better way than the information they would receive under the proposed summary prospectus regime?* (Pages 181-182).

As noted above, Approach 1 would successfully facilitate the disclosure of useful information to contract owners in a better manner than the information they would receive under the proposed summary prospectus regime. Life insurers indicate that they have not fielded concerns from contract owners about the disclosure practices under the SEC staff no-action position.

- *Under Approach 1, should the most-recently-updated prospectus and registration statement be made available to investors either by request or online? If not, why not?* (Page 183).

In situations where new sales of variable contracts have been discontinued, it makes less sense to distribute the most recently-updated prospectus and registration statement because the initial sale has already occurred, and further sales are unavailable. If there were to be a requirement to provide the most recently-updated prospectus and registration statement, it would be most cost-effective to make them available electronically.

XII. Life Insurers' Current Regulatory Framework

An updated assessment of the current regulatory framework is important to fully considering the SEC's summary disclosure initiative. To that end, life insurance companies and their associated

[68] As one example of unnecessary new recurring expenses that could evolve if the staff positions were rescinded, one of our members referenced the cost of auditor consent with each registrations statement. This would add recurring hard dollar costs and the new practices would provide consumers with no added value. The rescission of the staff positions could also trigger soft costs of continually updating disclosure where there is no strong reason to change the disclosure process afforded entities that have discontinued contracts.

[69] *See* SEC Division of Investment Management Director Dalia Blass speech *Keynote Address: ALI CLE 2018 Conference on Life Insurance Company Products* (Nov. 8, 2018) at https://www.sec.gov/news/speech/speech-blass-110818#_ftn6 (last visited on January 16, 2019) ["This rule – if it gets adopted – could be on the books for a long time. I don't want a rule that is going to be out of date the minute it is adopted – we want to future-proof it."].

[70] *Id.*

persons currently fulfill a broad array of regulations administered by state insurance departments, the SEC, DOL, FINRA, and various state securities departments. These standards buttress simplified disclosure by assuring an integrated network of consumer protection through these rules.

Existing comprehensive regulations govern important aspects of the customer relationship, including suitability standards, disclosure, advertising, supervision, maintenance of customer account assets, data collection, training, compensation, and supervision of associated persons. In general, the federal securities laws and FINRA rules govern individual variable insurance contracts. In some cases, insurance products invoke both federal and state laws. Several additional consumer protections are currently pending under the SEC's Regulation BI initiative and parallel developments in the NAIC's Suitability in Annuity Transactions Model Regulation. Collectively, this body of regulatory provisions and oversight provide important consumer protection and strong enforcement tools[71] that buttress the SEC's proposed summary disclosure initiative. Some of these regulatory protections are highlighted in Appendix A.

XIII. Opportunity for Supplemental Input about forthcoming Reg. BI & Form CRS Actions

ACLI, like many commentators, reviewed and analyzed the SEC's three coextensive initiatives inviting comment on Reg. BI, Form CRS, and Investment Adviser Interpretations carefully. Because the SEC's action on these proposals is interrelated with the summary disclosure initiative, it remains important to provide an opportunity to voice detailed input. Due to the length and depth of the initiatives, the SEC should entertain supplemental commentary on the summary disclosure initiative for a reasonable period following the comment deadline.[72] This flexible approach will facilitate thorough input and scrutiny essential to federal agency rulemaking.

[71] The Treasury Report emphasizes that "Treasury also recommends that the DOL and the SEC engage with state insurance regulators regarding the impact of standards of care on the annuities market. Given the size and scale of the annuities market, federal regulators should coordinate with the states in order to achieve consistent standards of conduct across product lines." Treasury report *A Financial system that Creates Economic Opportunities-Asset Management and Insurance* (Oct. 2017) https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-That-Creates-Economic-Opportunities-Asset_Management-Insurance.pdf (last viewed Aug. 2, 2018) at 69.

[72] Industry groups like ACLI circulate regulatory proposals, elicit membership input, develop a consensus, and circulate draft letters of comment before submission. This worthwhile, but time intensive, process is difficult to execute in 90 days, particularly given the proposal's significance and complexity. The special time burdens confronting regulated industries and large organizations in digesting regulatory proposals were explicitly recognized by the Administrative Conference of the United States in its publication entitled *A Guide to Federal Agency Rulemaking* ("*Guide*"), which notes that:

> [i]nterested persons often are large organizations, which may need time to coordinate an organizational response, or to authorize expenditure of funds to do the research needed to produce informed comments.

See, A Guide to Federal Agency Rulemaking (1983) at 124. The American Bar Association updated and republished this *Guide* in 1998. *See* Lubbers, A Guide to Federal Agency Rulemaking, Third Edition (1998), American Bar Association, Government and Public Lawyers Division and Section of Administrative Law and Regulatory Practice. Subsequent citations to the Guide are to the updated and revised ABA publication.

The *Guide* reviews the legislative history of the Administrative Procedure Act (APA) and emphasizes that the notice of proposed rulemaking "must be sufficient to fairly apprise interested parties of the issues involved, so

On December 20, 2018, ACLI filed a request[73] for comment period extension of 45 to 60 days, noting that the detailed and significant initiative merits careful analysis that will be challenging to fully execute within the stated comment. Our request noted that the proposal reflects a very constructive approach to streamlined, functional disclosure and observed that an extended comment period would enable commenters to develop more valuable and informed input, especially in light of the approximately 689 specific detailed questions, appendices and granular rule and form amendments. We noted that a short comment period extension would better enable responses to questions in the release that required an industry-wide survey to properly answer.

On February 5, 2019, SEC staff indicated by voice mail and email that the request for a comment period was declined. Significantly, however, the transmissions stated that the staff was sympathetic to ACLI's concerns and will accept comment letters after the deadline or additional comments via a supplement. This was a constructive solution to the issues raised in our request for a comment period extension and we appreciate the staff's responsiveness. We understand the logistical challenges of the recent government closure on our request for an extension.

Subsequently, the SEC staff alerted us late February 13, 2019, that on further consideration and following a third request for extension, that the staff revisited the issue and determined to extend the comment deadline. The staff explained that this action would be published immediately before the February 14 comment deadline. An SEC press release[74] indicates that the comment period would be extended for 30 days until March 15, 2019. We appreciate the staff's extension of the comment period. This formally published extension will allow interested parties to participate more fully or to supplement their submissions, which will facilitate an even better rulemaking and commentary process. Because we had focused upon the then operative February 15 deadline and prepared the substance of this letter, we determined to submit it today to give the staff more time to consider the comments reflected in the letter. ACLI will, however, evaluate a number of additional issues that we can share with the staff in a supplemental submission. Thank you for your courtesy and outreach as this process evolved.

XIV. Conclusion

ACLI strongly supports the proposed summary disclosure initiative for variable annuities and variable life insurance. This project reflects a win for consumers, salespersons, life insurers and the environment. To further improve this impressive endeavor, we have recommended refinements to the initiative in our responses to questions in the release. Because of the high correlation between

that they may present responsive data or argument." *(*Administrative Procedure Act: Legislative History, S. Doc. No.24879-258 (1946)) *See* Guide at 196. The *Guide* further explains that rules developed through notice and comment procedures must be rational, and that notice and opportunity for comment under §553 of the APA should properly "give interested persons a chance to submit available information to an agency to enhance the agency's knowledge of the subject matter of the rulemaking." *See* Guide at 197. The *Guide* also points out that "informal rulemaking procedures should provide interested persons an opportunity to challenge the factual assumptions on which the agency is proceeding and to show in what respect such assumptions are erroneous." *Id.* at 182 and 196.

[73] https://www.sec.gov/comments/s7-23-18/s72318-4830158-177071.pdf . The Committee of Annuity Insurers also filed a parallel request for comment period extension dated January 22, 2019 at https://www.sec.gov/comments/s7-23-18/s72318-4844316-177211.pdf .

[74] https://www.sec.gov/news/press-release/2019-11

summary disclosure, financial literacy and retirement and financial security, the proposal's layered disclosure approach can help ameliorate financial literacy challenges in a functional manner and enhance American families' retirement and financial security.

The proposal should continue the SEC's well-reasoned positions on disclosure for variable contracts that are no longer actively marketed or in the future may change to a status of no longer actively marketed. The summary disclosure initiative commendably creates a more balanced regulatory and disclosure environment for financial products competing in the same markets.

Careful awareness and coordination about the cumulative disclosure under proposed Regulation Best Interest, Form CRS, the summary disclosure initiative, and required disclosure under state insurance laws will help prevent information overload that thwarts the noble objectives of the proposal. We support the SEC's desire to "future proof"[75] the rule, keep it from becoming rapidly outdated, and to get it right because "it will be on the books for a long time."[76] We commend the staff for skillfully marshalling a large and important project through to completion.

We greatly appreciate your attention to our views. If any questions develop, please let me know.

Sincerely,

Carl B. Wilkerson

Carl B. Wilkerson

[75] *See* SEC Division of Investment Management Director Dalia Blass speech *Keynote Address: ALI CLE 2018 Conference on Life Insurance Company Products* (Nov. 8, 2018) at https://www.sec.gov/news/speech/speech-blass-110818#_ftn6 (last visited on January 16, 2019) ["This rule – if it gets adopted – could be on the books for a long time. I don't want a rule that is going to be out of date the minute it is adopted – we want to future-proof it."].
[76] *Id.*

Federal and State Regulations Governing the Sale of Fixed and Variable Annuities:
Comprehensive Protections for Financial and Retirement Product Consumers

Table of Contents

FINRA Rule 2330: Suitability and Supervision in the Sale of Variable Annuity Contracts

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers
March 28, 2017

I. Scope of This Outline Segment

A. FINRA Rule 2330 [Formerly NASD Rule 2821], which governs suitability and supervision in the sale of variable annuity contracts, was approved by the SEC in 2008, and was under development since 2004. The rule evolved through six different stages, five at the SEC, and one at FINRA.

B. This outline segment will summarize the elements of Rule 2330, and discuss its administrative history to illuminate FINRA's purpose and intent.

II. Substantive Overview: Rule 2330 has four primary provisions

A. Requirements governing recommendations, including a suitability obligation, specifically tailored to deferred variable annuity transactions;

B. Principal review and approval obligations;

C. A specific requirement for broker-dealers to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the rule's standards; and,

D. A targeted training requirement for broker-dealers' associated persons, including registered principals.

III. The Rule's Requirements in Greater Detail

A. Revised Rule 2330 established the following specific requirements:

1. *Recommendation Requirements.* When recommending a deferred variable annuity transaction, Rule 2330 requires broker-dealers and salespersons to have a reasonable basis to believe that the: customer *has been informed of, in a general fashion,* the various features of the deferred variable annuity,

a) customer *would benefit from* certain features of a deferred variable annuity (e.g., tax-deferred growth, annuitization or a death benefit); and

b) the deferred variable annuity *as a whole* and the underlying sub-accounts or riders are suitable for the particular customer.

c) the particular deferred variable annuity that the registered representative is recommending, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and the riders and similar product enhancements are suitable (and in the case of an exchange, the transaction as a whole also is suitable) for the customer based on the information the registered representative is required to make a reasonable effort to obtain.

2. Revised Rule 2330 requires these determinations to be *documented and signed* by the salesperson recommending the transaction.

a) Rule 2330 would also require salespersons to make *reasonable efforts* to obtain information concerning customers' age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the variable annuity, investment time horizon, existing investment and insurance holdings, liquidity needs, liquid net worth, risk tolerance, tax status and other information used by the salesperson in making recommendations.

3. *Supervisory Review.* Rule 2330(c) requires that a principal review each variable annuity purchase or exchange within seven business days after the signed application arrives at the broker-dealer's office of supervisory jurisdiction in good order. A registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity.

a) In reviewing the transaction, the registered principal would need to take into account the extent to which:

- the customer would benefit from certain features of a deferred variable annuity;
- the customer's age or liquidity needs make the investment inappropriate; and,
- the customer involved an exchange of a deferred variable annuity: will incur surrender charges, face a new surrender period, lose death or existing benefits,
- have increased mortality and expense fees, appears to have a need for any potential product enhancements and improvements,

or had another deferred variable annuity exchange within the preceding 36 months.

- Under Rule 2330, the supervisory review standards must be signed and documented by the registered principal that reviewed and approved the transaction.

4. *Supervisory Procedures.* Rule 2330 requires broker-dealers to establish and maintain specific written supervisory procedures reasonably designed to achieve and evidence compliance with the standards in Rule 2330. The broker-dealer must have procedures to screen and have principal review of the recommendations requirements in Rule 2330, and determine whether the salesperson has a particularly high rate of effecting deferred variable annuity exchanges.

5. *Training.* Under the proposal, broker-dealers would need to develop and document specific training policies or programs designed to ensure that salespersons recommending transactions, and registered principals who review transactions, in deferred variable annuities comply with the requirements of Rule 2330 and that they understand the material features of deferred variable annuities, including liquidity issues, sales charges, fees, tax treatment, and market risks.

6. *Automated Supervisory Review*. FINRA's submission on the rule indicated that the rule would not preclude firms from using automated supervisory systems, or a mix of automated and manual supervisory systems, to facilitate compliance with the rule.

a) In addition, FINRA delineated what, at a minimum, a principal would need to do if his or her firm intends to rely on automated supervisory systems to comply with the proposed rule.

b) Specifically, a principal would need to (1) approve the criteria that the automated supervisory system uses, (2) audit and update the system as necessary to ensure compliance with the proposed rule, (3) review exception reports that the system creates, and (4) remain responsible for each transaction's compliance with the proposed rule.

c) Finally, FINRA noted that a principal would be responsible for any deficiency in the system's criteria that would result in the system not being reasonably designed to comply with the rule.

7. *Tax Qualified Plans.* Rule 2330 does not apply to variable annuity transactions made in connection with tax-qualified, employer-sponsored retirement or benefit plans that either are defined as a "qualified plan" under Section 3(a)(12)(C) of the Exchange Act or meet the requirements of Internal Revenue Code Sections 403(b) or 457(b), unless, in the case of any plan, the

broker-dealer makes recommendations to individual plan participants regarding the variable annuity.

IV. Review and Explanation of (Revised) Rule 2330

A. Supervisory review standards changed

1. FINRA enlarged the time period for supervisory review to seven days after the signed application arrives at the broker-dealer's OSJ in good order.

a) Compare to *prior* draft: "Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but *no later than seven business days after the customer signs the application*, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity."

b) Compare to earlier draft: the third amendment required the principal must review and approve the transaction "[n]o later than *two business days following* the date when a member or person associated with a member *transmits a customer's application* for a deferred variable annuity to the issuing insurance company for processing or *five business days from the transmittal date* if additional contact with the customer or person associated with the member is necessary in the course of the review."

2. FINRA rationale: ensuring that all broker-dealers have adequate time to perform a thorough principal review of these transactions.

a) In view of the variety of features and provisions in connection with the issuance of deferred variable annuity contracts, FINRA became persuaded that principal review of variable annuity sales requires greater time than reviews of many other securities transactions.

b) The provision of a reasonable amount of time for pre-transmittal review, however, posed potential problems related to other rules concerning the prompt handling of customer funds.

(1) For instance, FINRA Rule 2330 states generally that member firms shall not make improper use of customer funds, and FINRA Rule 2820 specifically requires member firms to "transmit promptly" the application and the purchase payment for a variable contract to the issuing insurance company.

(2) Similarly, Rules 15c3-1 and 15c3-3 under the 1934 Act require certain member firms to promptly transmit and forward funds.

(3) Rules 15c3-1(c)(9) and (10) under the 1934 Act define the terms "promptly transmit and deliver" and "promptly forward" funds as meaning "no later than noon of the next business day after receipt of such funds."

3. FINRA solution to regulatory conflicts with prompt pricing standards:

a) FINRA asked for, and obtained from the SEC, regulatory relief regarding Rules 15c3-1 and 15c3-3 when the same circumstances exist. As a companion to the rule approval, the SEC provided an exemptive order from the prompt pricing provisions.

b) FINRA made clear that a broker-dealer that is holding an application for a deferred variable annuity and a non-negotiated check from a customer written to an insurance company for a period of seven business days or less would not be in violation of FINRA Rules 2330 if the reason that the application and check are being held is to allow a principal to complete his or her review of the transaction pursuant to proposed Rule 2330.

B. Recommendation requirements revised

1. FINRA revised proposed Rule 2821to state that "[n]o member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member *has a reasonable basis to believe* that the transaction is suitable in accordance with Rule 2310."

2. FINRA is substituting the phrase "has a reasonable basis to believe" for "has determined," which appeared in the prior draft of the rule.

3. FINRA rationale: FINRA softened the review requirement in response to comments that the reasonable basis standard was more strict than with other similar financial products.

C. Non-recommended transactions conditionally excluded. FINRA revised the rule conditionally so that it does not apply to non-recommended transactions, such as situations where the member is acting solely as an order taker. FINRA believed Rule 2821 should not prevent a fully informed customer from making his or her own investment decision.

1. Conditional exclusion from rule, however.

a) A registered principal "may authorize the processing of the transaction if the registered principal determines that the transaction was not recommended and that the customer, after being informed of the reason why the registered principal has not approved the transaction, affirms that he or she wants to proceed with the purchase or exchange of the deferred variable annuity."

2. FINRA rationale:

a) Change allows a customer to decide to continue with the non-recommended purchase or exchange of a deferred variable annuity notwithstanding the broker-dealer's belief that the transaction would be viewed as unsuitable if it had been recommended.

b) The new requirement that the principal independently determine that the transaction was not recommended adds another layer of protection. Requirement "should discourage salespersons from attempting to bypass compliance requirements for recommended sales by simply checking the 'not recommended' box on a form."

c) Customers must indicate an explicit intent to continue with the non-recommended transaction notwithstanding the unsuitability determination, which will help ensure that the customer's decision is an informed one.

D. *"Undue concentration" standard eliminated.* FINRA eliminated prior requirements that registered principals consider "the extent to which the amount of money invested would result in an undue concentration in a deferred variable annuity."

E. The annuity or deferred variable annuities should be evaluated in "the context of the customer's overall investment portfolio."

1. FINRA Rationale:

a) Requirement was unclear and could cause confusion. Because other provisions in Rule 2330 already capture the important aspects of this "undue concentration" determination, FINRA has eliminated it as superfluous.

F. Generic disclosure allowed

1. Under recommendation requirements, FINRA clarified that required disclosure may be generic and not specific to the product. Clarification now requires that "the customer has been informed, *in general terms*, of various features of deferred variable annuities. . . ."

2. FINRA rationale:

a) Simply a clearer statement of original rule's intent.

G. "Unique features" requirement relaxed and expanded

1. Provision now states that salesperson must have "a reasonable basis to believe that . . . the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit."

2. FINRA Rationale:

a) FINRA accepted commenters' position that there are other financial products that have features similar to those of a deferred variable annuity, so a requirement that the customer would benefit from the *unique* features was relaxed to benefiting from *certain* features.

b) Living benefits added to the list of certain features that may be beneficial for customer in addition to death benefit.

H. Required surveillance practices for replacement activities clarified

1. FINRA indicated that principal need not examine *every* transaction when salesperson has a potentially higher rate of replacement sales. FINRA emphasized instead review on a periodic basis via exception reporting rather than as part of the principal review of each exchange transaction

2. FINRA revised the supervisory procedures guarding against inappropriate replacement practices so that, "the member also must (1) implement surveillance procedures to determine if the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable FINRA rules, or the federal securities laws ("inappropriate exchanges") and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges."

FINRA Rule 2320: FINRA Rules Governing Non-Cash Compensation in the Sale of Variable Contracts and Mutual Funds

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March 28, 2017

I. **Scope of This Outline Segment**

A. This Outline Segment addresses the permitted uses of non-cash compensation in the sale of variable contracts and mutual funds. FINRA significantly modified this rule to reduce the range of permitted non-cash compensation arrangements.

B. FINRA's non-cash compensation rule does not apply to fixed annuities because they are excluded from the definition of security under the Federal securities laws.

1. Fixed index annuities are excluded from categorization as securities under the Harkin Amendment to the Dodd-Frank Act, the Harkin Amendment conditions its protections to compliance with the NAIC's Suitability in Annuity Transactions Model Regulation or substantially similar features of that amendment.

2. Absent compliance with the NAIC's Suitability in Annuity Transactions Model Regulation or similar provisions, fixed index annuities could lose their immunity from the Federal securities laws and distributors of this product could, therefore, be subject to FINRA requirements, including the non-cash compensation rule.

II. **FINRA Rules Governing Non-Cash Compensation**.

A. In 1998, FINRA adopted Rule 2320 which governs non-cash compensation. A parallel non-cash compensation rule exists for mutual funds in FINRA Rule 2341(L)(5). A supplemental FINRA Q & A addresses a number of questions on the rules' applicability to specific situations, and contains a good thumbnail summary about the rules.

B. FINRA Rule 2320 prevents abuses and strictly limits non-cash compensation in the sale of variable insurance products to:

1. Gifts of up to $100 per associated person annually;

2. An occasional meal, ticket to a sporting event or theater, or comparable entertainment;

3. Payment or reimbursement for training and education meetings held by broker-dealers or issuers/sponsors for the purpose of educating associated persons of broker-dealers, so long as certain conditions are met;

4. In-house sales incentive programs of broker-dealers for their own associated persons; and,

5. Contributions by any company or other FINRA member to a broker-dealer's permissible in-house sales incentive program, subject to explicit conditions.

C. Non-cash compensation arrangements between a member and its associated persons or a non-member company and its sales personnel who are associated persons of an affiliated member, are conditioned on:

1. The member's or nonmember's non-cash compensation arrangement, if it includes variable contract securities, is based on the total production of associated persons with respect to all variable contract securities distributed by the member;

2. The non-cash compensation arrangement requires that the credit received for each variable contract security is equally weighted;

3. No unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or nonmember's organization of a permissible non-cash compensation arrangement; and

4. The record keeping requirement in the rule is satisfied. Rule 2320 requires broker-dealers to maintain records of all non-cash compensation received by the broker-dealer or its associated persons in permitted non-cash compensation.

D. FINRA Pending Proposal to Revise Non-Cash Compensation Rules.

1. In August 2016, FINRA proposed several amendments to the non-cash compensation rules that are pending closure and SEC approval. The proposed FINRA amendments would:

a) Consolidate the rules under a single rule series in the FINRA rulebook;

b) Increase the gift limit from $100 to $175 per person per year and include a *de minimis* threshold below which firms would not have to keep records of gifts given or received;

c) Amend the non-cash compensation rules to cover all securities products, rather than only direct participation programs (DPPs), variable insurance contracts, investment company securities and public offerings of securities; and,

d) Incorporate existing guidance and interpretive letters into the rules.

2. Additionally, FINRA proposed a revised approach to internal sales contests for non-cash compensation such that if payment or reimbursement of expenses associated with the non-cash compensation arrangement is preconditioned on achievement of a sales target, the non-cash compensation arrangement must:

a) Be based on the total production with respect to all securities products; and,

b) Not be based on conditions that would encourage an associated person to recommend particular securities or categories of securities.

3. Finally, FINRA proposed to incorporate into the amended rules a principles-based standard for business entertainment that would require firms to adopt written policies and supervisory procedures for business entertainment arrangements.

a) The records must include: the names of the offerors, companies or other broker-dealers making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the broker-dealer and its associated persons with the rule.

NAIC Suitability in Annuity Transactions Model Regulation: A Coordinated Approach to Suitability and Supervision in the Sale of Individual Annuity Contracts

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I. NAIC Suitability and Supervision Responsibilities in NAIC Model Regulation Governing Individual Annuity Sales

A. The National Association of Insurance Commissioners (NAIC) adopted several evolving sets of revisions to its model regulation governing suitability and supervision in the sale of individual annuity contracts.

1. The NAIC's initial regulation was entitled the Senior Protection in Annuity Transactions Regulation, and governed suitability and supervision in annuity transactions with "senior consumers" age 65 or older.

2. The NAIC's 2006 revision to this regulation applied it to all individual annuity sales. To reflect the broader application of the regulation, it was re-titled the Suitability in Annuity Transactions Model Regulation. This regulation incorporated suitability and supervision practices parallel to those under the federal securities laws and FINRA rules.

3. In 2010, the NAIC added further amendments to the Suitability in Annuity Transactions Model Regulation. Among other things, the 2010 NAIC revisions to the regulation established new restrictions on supervisory delegation to third-party and reliance on producer suitability recommendations, established a new producer training requirement (which must be completed by producers prior to their being able to solicit the sale of annuities), and expanded powers of Commissioners to levy sanctions and penalties.

B. The evolving iterations of the NAIC model regulation can be found at NAIC Model Regulation Service II-275-1 (2010). Over 30 states have implemented the 2010 version of the model regulation and two have proposed the regulation for adoption. 14 states have adopted the 2006 version of the regulation. Over time, these states are expected to incorporate the 2010 revisions as they update their regulations.

C. Because the 2010 amendments to the model regulation are built upon the original 2006 model, the 2006 model is discussed first. The 2010 modifications to the model are summarized separately below, following the 2006 regulation's summary.

D. ACLI supports strong suitability standards to ensure annuity sales recommendations are suitable and will promote consumer confidence in making informed annuity purchase decisions.

II. Approach of the 2006 Revised NAIC Regulation

A. The regulation establishes standards and procedures governing recommendations in annuity transactions, to ensure "that insurance needs and financial objectives of consumers at the time of the transaction are appropriately addressed."

B. The regulation imposes suitability and supervision duties for insurers and insurance producers, including requirements for maintaining written procedures and conducting periodic reviews of records to detect and prevent unsuitable sales practices.

III. Scope and Governing Framework of the 2006 Revised NAIC Regulation

A. The regulation applies to any recommendation to purchase or exchange an annuity made to a consumer by an insurance producer, or an insurer where no producer is involved, that results in the purchase or exchange recommended.

1. "Annuity" means a *fixed annuity or variable annuity* that is *individually solicited*, whether the product is classified as an individual or group annuity [Section 5 (A)].

2. "Recommendation" means advice provided by an insurance producer, or an insurer where no producer is involved, to an individual consumer that results in a purchase or exchange of an annuity in accordance with that advice [Section 5(D)].

B. The regulation does not apply to annuity transactions involving:

1. Direct response solicitations where there is no recommendation based on information collected from the consumer under the regulation;

2. Contracts funding specified retirement plans:

a) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);

b) A plan described by Sections 401(a), 401(k), 403(b), 408(k) or 408(p) of the Internal Revenue Code (IRC), as amended, if established or maintained by an employer;

c) A government or church plan defined in Section 414 of the IRC, a government or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the IRC;

d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor;

3. Settlements of, or assumptions of, liabilities associated with personal injury litigation or any dispute or claim resolution process; or

4. Formal prepaid funeral contracts.

IV. Duties Imposed Under the Regulation [Section 6]

A. **Suitability Standard**: In recommending to a consumer the purchase of an annuity or the exchange of an annuity that results in another insurance transaction or series of insurance transactions, the insurance producer, or the insurer where no producer is involved, shall have reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer as to his or her investments and other insurance products and as to his or her financial situation and needs.

1. "Insurer" means a company required to be licensed under the laws of this state to provide insurance products, including annuities.

2. "Insurance producer" means a person required to be licensed under the laws of this state to sell, solicit or negotiate insurance, including annuities.

3. Note: this suitability standard directly parallels the general standard of FINRA Suitability Rule 2310(a), set forth at http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466 .

B. **Suitability Ingredients** [Section 6(A)]: Prior to the execution of a purchase or exchange of an annuity resulting from a recommendation, an insurance producer, or an insurer where no producer is involved, shall make reasonable efforts to obtain information concerning:

1. The consumer's financial status;

2. The consumer's tax status;

3. The consumer's investment objectives; and

4. Such other information used or considered to be reasonable by the insurance producer, or the insurer where no producer is involved, in making recommendations to the consumer.

5. Note: the suitability ingredients above precisely track those in FINRA Suitability Rule 2320(b) set forth at http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1159000466 .

6. An insurer or insurance producer's recommendation under the suitability standard and ingredients must be reasonable under all the circumstances actually known to the insurer or insurance producer at the time of the recommendation [Section 6(c)(2)].

a) Neither an insurance producer, nor an insurer where no producer is involved, has any obligation to a consumer under the suitability standard [Section 6(a)] related to any recommendation if a consumer:

(1) Refuses to provide relevant information requested by the insurer or insurance producer;

(2) Decides to enter into an insurance transaction that is not based on a recommendation of the insurer or insurance producer; or

(3) Fails to provide complete or accurate information.

(4) Note: these narrow exclusions directly parallel FINRA approaches to suitability in Rule 2310.

C. **Supervision Standard**

1. For insurers:

a) An insurer either (i) shall assure that a system to supervise recommendations that is reasonably designed to achieve compliance with the suitability standards in the regulation is established and maintained, or (ii) shall establish and maintain such a system, including, but not limited to:

(1) Maintaining written procedures; and

(2) Conducting periodic reviews of its records that are reasonably designed to assist in detecting and preventing violations of this regulation.

b) To fulfill the supervision standard, an insurer may contract with a third party, including a general agent or independent agency, to establish and maintain a system of supervision as required by Section 6(D)(1) regarding insurance producers under contract with, or employed by, the third party.

(1) To utilize a third party for supervision, an insurer must make reasonable inquiry to assure that the third party is performing the functions required under the regulation, and must take reasonable action under the circumstances to enforce the contractual obligation of the third party to perform the functions.

(2) An insurer may comply with its obligation to make reasonable inquiry by doing all of the following:

(a) Annually *obtain a certification* from a third party senior manager who has responsibility for the delegated functions that the manager has a reasonable basis to represent, and does represent, that the third party is performing the required functions; and

(b) Based on reasonable selection criteria, periodically select third parties for review to determine whether the third parties are performing the required functions. The insurer must perform those procedures to conduct the review that are reasonable under the circumstances.

c) Insurers that contract with a third party to perform supervision and that comply with the certification and periodic review procedures will fulfill their supervisory responsibilities under the regulation.

d) Note: the supervisory approaches implemented in the regulation parallel those in FINRA Rule 3010(a).

e) No one may provide a certification under the regulations supervisory delegation unless:

(1) The person is a senior manager with responsibility for the delegated functions; and

(2) The person has a reasonable basis for making the certification

2. For insurance producers:

a) A general agent and independent agency either must (i) adopt a system established by an insurer to supervise recommendations of its insurance producers that is reasonably designed to achieve compliance with the regulation, or (ii) establish and maintain such a system, including, but not limited to:

(1) Maintaining written procedures; and

(2) Conducting periodic reviews of records that are reasonably designed to assist in detecting and preventing violations of this regulation.

3. Scope of required system of supervision for insurers and producers:

a) An insurer, general agent or independent agency is not required to review, or provide for review of, all insurance producer solicited transactions; or

b) An insurer, general agent or independent agency is not required to include in its system of supervision an insurance producer's recommendations to consumers of products other than the annuities offered by the insurer, general agent or independent agency.

c) Note: these clarifications to the scope of the supervisory requirements parallel those applied under FINRA Rule 3010.

4. Deference to FINRA Suitability rule for variable annuity sales:

a) Compliance with FINRA's suitability rule will satisfy the regulation's suitability requirements for variable annuity recommendations.

b) Deference to FINRA suitability standards and practices in variable annuity sales does not, however, limit the insurance commissioner's ability to enforce the regulation.

D. **Recordkeeping**

1. Insurers, general agents, independent agencies and insurance producers must maintain or be able to make available to the commissioner records of the information collected from the consumer and other information used in making the recommendations that were the basis for insurance transactions for [a specified number of] years after the insurance transaction is completed by the insurer.

2. An insurer is permitted, but shall not be required, to maintain documentation on behalf of an insurance producer.

3. Records required to be maintained by this regulation may be maintained in paper, photographic, microprocess, magnetic, mechanical or electronic media or by any process that accurately reproduces the actual document.

E. **Enforcement Powers and Mitigation Provisions**

1. To implement the regulation, the state insurance commissioner may order:

a) An insurer to take reasonably appropriate corrective action for any consumer harmed by the insurer's, or by its insurance producer's, violation of this regulation;

b) An insurance producer to take reasonably appropriate corrective action for any consumer harmed by the insurance producer's violation of this regulation; and

2. Any applicable penalty under the state code may be reduced or eliminated if corrective action for the consumer was taken promptly after a violation was discovered.

V. Overview of the Modifications in the 2010 Revised NAIC Suitability in Annuity Transactions Model Regulation

A. Insurance producers are required to obtain information about the customer's needs and financial objectives when formulating a recommendation for an annuity purchase and must have reasonable belief that the recommendation is suitable. (NAIC Model Sec. 6(A)&(B)).

B. Insurers must assure that a system is in place to supervise compliance with the Model, including review of producers' recommendations. (NAIC Model Sec. 6(F)(1)(d)).

C. An insurer must conduct reviews of its records to assist in detecting and preventing violations of the regulation. (NAIC Model Sec. 6(F)(1)(e).

D. When an insurer contracts with a third party to establish a system of supervision, the insurer must monitor and audit, as appropriate, to assure that the third party is performing the required functions. (NAIC Model Sec. 6(F)(2)(b)(i)).

E. When an insurer relies on a third party to perform required suitability functions, the third party, when requested by the insurer, must give a certification that it is performing the functions in compliance with the regulation. (NAIC Model Sec. 6(F)(2)(b)(ii)).

F. Sales of annuities made in compliance with stringent federal securities rules pertaining to suitability and supervision (FINRA Rule 2330) satisfy the requirements under the Model. (NAIC Model Sec. 6(H)).

G. An insurance producer shall not solicit the sale of an annuity unless the producer has adequate knowledge of the product and shall be in compliance with the insurer's product training standards. (NAIC Model Sec. 7(A).

H. Insurance producers who engage in the sale of annuities must complete an annuity training course approved by the appropriate State. (NAIC Model Sec. 7(B)).

I. The Commissioner may order that an insurer or producer take appropriate corrective action for any consumer harmed by the insurer's, or producer's, violation of the regulation. (NAIC Model Sec. 8(A)(1)&(2)).

The NAIC Annuity Disclosure Model Regulation:
Disclosure Standards in Annuity Distribution

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I. Scope of Outline

A. This outline summarizes the elements of the NAIC Annuity Disclosure Model Regulation, the required Disclosure Statement and the required NAIC Buyer's Guide to Fixed, Indexed and Variable Annuities.

B. The NAIC Annuity Disclosure Model Regulation can be found at NAIC Model Reporting Service 245-I (April 2016).

II. Objective of the Annuity Disclosure Model Regulation

A. To provide standards for the disclosure of certain minimum information about annuity contracts to protect consumers and foster consumer education.

1. The regulation specifies the minimum information which must be disclosed and the method and timing of delivering it.

2. The regulation seeks to ensure that purchasers of annuity contracts understand certain basic features of annuity contracts.

III. Annuities Covered by the Regulation

A. All group and individual annuity contracts, except:

1. Registered or non-registered variable annuities.

2. Immediate and deferred annuities having only non-guaranteed elements.

3. Annuities used to fund:

a) An employee pension plan which is covered by the Employee Retirement Income Security Act (ERISA);

b) A plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer,

c) A governmental or church plan defined in Section 414 or a deferred compensation plan of a state or local government or a tax exempt organization under Section 457 of the Internal Revenue Code; or

d) A nonqualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

4. Structured Settlement Annuities.

5. Note: Under the model regulation, states may optionally elect to exclude charitable gift annuities and structured settlement annuities also.

IV. Information Mandated in Required NAIC Disclosure Statement

A. The generic name of the contract, the company product name, if different, form number, and the fact that it is an annuity;

B. The insurer's name and address;

C. A description of the contract and its benefits, emphasizing its long-term nature, including examples where appropriate:

1. The guaranteed, non-guaranteed and determinable elements of the contract, and their limitations, if any, and an explanation of how they operate;

2. An explanation of the initial crediting rate, specifying any bonus or introductory portion, the duration of the rate and the fact that rates may change from time to time and are not guaranteed;

3. Periodic income options both on a guaranteed and non-guaranteed basis;

4. Any value reductions caused by withdrawals from or surrender of the contract;

5. How values in the contract can be accessed;

6. The death benefit, if available, and how it will be calculated;

7. A summary of the federal tax status of the contract and any penalties applicable on withdrawal of values from the contract; and

8. Impact of any rider, such as a long-term care rider.

D. Specific dollar amount or percentage charges and fees, which must be listed with an explanation of how they apply.

E. Information about the current guaranteed rate for new contracts that contains a clear notice that the rate is subject to change.

F. Insurers must define terms used in the disclosure statement in language understandable by a typical person in the target market.

V. Required NAIC Buyer's Guide to Fixed Deferred Annuities (appears at the end of the outline).

A. A Buyer's Guide prepared by the NAIC provides information about different aspects of annuities, such as

1. What an annuity is.

2. Descriptions of the different kinds of annuities.

    a) Single premium or multiple premium.

    b) Immediate or deferred.

    c) Fixed or variable.

3. How interest rates are set for the deferred variable annuity.

    a) Explanation of current interest rate.

    b) Explanation of minimum guaranteed rate.

    c) Explanation of multiple interest rates.

4. Description of charges in the contract.

    a) Surrender or withdrawal charges.

    b) Free withdrawal features.

    c) Contract fee.

    d) Transaction fee.

    e) Percentage of premium charge.

    f) Premium tax charge.

5. Fixed Annuity Benefits

    a) Annuity income payments.

    b) Annuity payment options.

        (1) Life only.

        (2) Life annuity with period certain.

        (3) Joint and survivor.

VI. Timetable for Delivery of Required Disclosure Statement and Buyers' Guide:

A. At or before the time of application if annuity application is taken in a *face-to-face meeting*.

B. No later than five (5) business days after the completed application is received by the insurer, if annuity application is taken by means *other than in a face-to-face meeting*.

1. With applications received from a *direct solicitation through the mail*:

    a) Inclusion of a Buyer's Guide and Disclosure Statement in the direct mail solicitation satisfies the requirement for delivery no later than five (5) business days after receipt of the application.

2. *For applications received via the Internet:*

    a) Taking reasonable steps to make the Buyer's Guide and Disclosure Statement available for viewing and printing on the insurer's website satisfies the requirement for delivery no later than five (5) business day of receipt of the application.

3. Annuity solicitations in other than face-to-face meetings must include a statement that the proposed applicant may contact the insurance department of the state for a free annuity Buyer's Guide. Alternatively, the insurer may include a statement that the prospective applicant may contact the insurer for a free annuity Buyer's Guide.

4. *Extended Free-Look Period*: where the Buyer's Guide and disclosure document are not provided at or before the time of application, a free look period of no less than fifteen (15) days shall be provided for the applicant to return the annuity contract without penalty. The free look runs concurrently with any other free look provided under state law or regulation.

VII. Required Report to Contract Owners

A. For annuities in the payout period with changes in non-guaranteed elements and for the accumulation period of a deferred annuity, the insurer must provide each contract owner with a report, *at least annually*, on the status of the contract that contains at least the following information:

1. The beginning and end date of the current report period;

2. The accumulation and cash surrender value, if any, at the end of the previous report period and at the end of the current report period;

3. The total amounts, if any, that have been credited, charged to the contract value or paid during the current report period; and

4. The amount of outstanding loans, if any, as of the end of the current report period.

VIII. The NAIC Annuity Buyers' Guide is accessible through an embedded link on page 51.

NAIC Insurance and Annuities Replacement Model Regulation:
A Systemic Approach to Appropriate Sales Practices

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I. NAIC Insurance and Annuities Replacement Model Regulation

A. In June 2000, the NAIC adopted substantial amendments to the 1998 Insurance and Annuities Replacement Model Regulation. This regulation establishes substantial protections for consumers through required systems of supervision, control, monitoring, and recordkeeping for insurers and producers. Additionally, the regulation requires plain-English notices, and signed disclosure about the replacement transaction.

1. The NAIC's Model Regulation and amendments promote uniformity among state insurance regulations.

2. Citation: Insurance and Annuities Replacement Model Regulation, NAIC Model Regulation Service-July 2006 at III-621-1.

B. **Approach of the amended regulation**

1. The amended regulation establishes duties for insurance producers, replacing insurers, and existing insurers designed to protect consumers.

    a. For example, insurers using insurance producers must, among other things:

        (1) Maintain a *system of supervision and control*;

        (2) Have the *capacity to monitor* each producer's life and annuity replacements for that insurer;

        (3) Ascertain that required *sales material and illustrations are complete and accurate*; and

        (4) *Maintain records* of required notification forms and illustrations that can be produced.

    b. A required notice of replacement must be presented, read to consumers, and signed by the producer and consumer.

2. The regulation lists illustrative violations, and establishes penalties that may include the revocation or suspension of a producer's or company's license, monetary fines, and forfeiture of commissions or compensation. Commissioners may require insurers to make

restitution, and restore policy values with interest when violation are material to the sale. [*See*, Section 8 of the regulation].

C. Overview of Issue

   1. A replacement occurs when an individual uses existing life insurance policy or annuity contract values to purchase a new policy or contract.

   2. A replacement may involve the use of the entire value of an existing policy or contract, as in the case of a surrender, or it may involve the use of only a portion of the existing values.

   3. Under the NAIC Model as amended in 2000, the use of *any* portion of the values of an existing policy or contract to purchase a new policy or contract constitutes replacement, including borrowing, assigning dividends, lapsing, or forfeiting.

      a. External replacement occurs when a company replaces the life or annuity product of another company.

      b. Internal replacement occurs when a company replaces a life or annuity contract that it has already issued.

D. *Purpose* of the Amended NAIC Replacement Regulation

   1. To regulate the activities of insurers and producers with respect to the replacement of existing life insurance and annuities.

   2. To protect the interests of life insurance and annuity purchasers by establishing minimum standards of conduct to be observed in replacement or financed purchase transactions, and to:

      a. Assure that purchasers receive information with which a decision can be made in his or her own best interest;

      b. Reduce the opportunity for misrepresentation and incomplete disclosure; and

      c. Establish penalties for failure to comply with the regulation.

E. Regulation *Applies to Variable Life Insurance and Variable Annuity Replacements*

   1. The term *replacement* is defined in the regulation to mean a transaction in which a new policy or contract is to be purchased, and it is known or should be known to the proposing producer, or to the proposing insurer if there is no producer, that by reason of the transaction, an existing policy or contract has been or is to be:

      a. Lapsed, forfeited, surrendered or partially surrendered, assigned to the replacing insurer or otherwise terminated;

b. Converted to reduced paid-up insurance, continued as extended term insurance, or otherwise reduced in value by the use of nonforfeiture benefits or other policy values;

c. Amended so as to effect either a reduction in force of for which benefits would be paid;

d. Reissued with any reduction in cash value; or

e. Used in a financed purchase.

2. The regulation excuses variable life and variable annuity contracts from requirements in Sections 5(A)(2) and 6(B) to provide illustrations or policy summaries.

   a. In place of the policy summaries and illustrations requirement, the regulation mandates “premium or contract distribution amounts and identification of the appropriate prospectus or offering circular” instead.

   b. In all other respects, the regulation fully applies to individual variable contract replacements.

F. *Exceptions* from regulation for group contracts

1. The regulation does not apply to transactions involving:

   a. Policies or contracts used to fund:

      (1) An employee pension or welfare benefit plan that is covered by the Employee Retirement and Income Security Act (ERISA);

      (2) A plan described by Sections 401(a), 401(k) or 403(b) of the Internal Revenue Code, where the plan, for purposes of ERISA, is established or maintained by an employer;

      (3) A governmental or church plan defined in Section 414, a governmental or church welfare benefit plan, or a deferred compensation plan of a state or local government or tax exempt organization under Section 457 of the Internal Revenue Code; or

      (4) A non-qualified deferred compensation arrangement established or maintained by an employer or plan sponsor.

   b. Group life insurance or group annuities where there is no direct solicitation of individuals by an insurance producer.

c. Credit life insurance.

G. Duties of Producers and Insurers in Replacement Transactions

1. Duties of insurers that use producers [Section 4.]

a. Under the regulation, each insurer must:

(1) *Maintain a system of supervision and control* to insure compliance with the requirements of this regulation that shall *include at least* the following:

(a) *Inform its producers of the requirements of the regulation* and incorporate the requirements of the regulation into all relevant *producer training manuals* prepared by the insurer;

(b) *Provide* to each producer *a written statement of the company's position with respect to the acceptability of replacements* providing guidance to its producer as to the appropriateness of these transactions;

(c) *A system to review the appropriateness* of each replacement transaction *that the producer does not indicate is in accord with the regulation's standards;*

(d) Procedures to *confirm* that the *requirements* of this regulation have been *met*; and

(e) Procedures to *detect transactions that are replacements of existing policies* or contracts by the existing insurer, but that have not been identified as such by the applicant or producer.

(2) *Have the capacity to produce*, upon request, and make available to the Insurance Department, *records of each producer's*:

(a) *Replacements*, including financed purchases, as a percentage of the producer's total annual sales for life insurance and annuity contracts not exempted from this regulation;

(b) *Number of lapses* of policies and contracts by the producer as a percentage of the producer's total annual sales for life insurance and annuity contracts not exempted from this regulation;

(c) Number of transactions that are *unidentified replacements of existing policies* or contracts by the existing insurer detected by the company's monitoring system as required by Section (4)(A)(5) of the regulation; and

(d) *Replacements, indexed by replacing producer and existing insurer*.

(3) Require with or as a part of each application for life insurance or an annuity a signed statement by both the applicant and the producer as to whether the applicant has existing policies or contracts;

(4) Require with each application for life insurance or an annuity that indicates an existing policy or contract a completed notice regarding replacements as contained in Attachment 1 to the regulation;

(5) When the applicant has existing policies or contracts, retain completed and signed copies of the notice regarding replacements in its home or regional office for at least five years after the termination or expiration of the proposed policy or contract;

(6) When the applicant has existing policies or contracts, obtain and retain copies of any sales material as required by Section 3(E) of the regulation, the basic illustration and any supplemental illustrations used in the sale and the producer's and applicant's signed statements with respect to financing and replacement in its home or regional office for at least five years after the termination or expiration of the proposed policy or contract

(7) Records required to be retained by the regulation may be maintained in paper, photograph, microprocess, magnetic, mechanical or electronic media or by any process which accurately reproduces the actual document.

2. Duties of Replacing Insurers that Use Producers [Section 6].

a. Where a replacement is involved in the transaction, the replacing insurer shall:

   (1) Verify that the required forms are received and are in compliance with the regulation;

   (2) Notify any other existing insurer that may be affected by the proposed replacement within five business days of receipt of a completed application indicating replacement or when the replacement is identified if not indicated on the application, and mail a copy of the available *illustration or policy summary* for the proposed policy or available disclosure document for the proposed contract within five business days of a request from an existing insurer; [*note*: this illustration and policy summary requirement does not apply to variable contracts.]

   (3) Be able to produce copies of the notification regarding replacement required in Section 4(B), *indexed by producer, in its home or regional office* for at least five years or until the next regular examination by the insurance department of a company's state of domicile, whichever is later; and

   (4) Provide to the policy or contract owner notice of the right to return the policy or contract within thirty (30) days of the delivery of the contract and receive an unconditional full refund of all premiums or considerations paid on it, including any policy fees or charges or, in the case of a *variable or market value adjustment policy or contract*, a payment of the cash surrender value provided under the policy or contract plus the fees and other charges deducted from the gross premiums or considerations or imposed under such policy or contract.

b. In transactions where the replacing insurer and the existing insurer are the same or subsidiaries or affiliates under common ownership or control [*internal replacements*] allow credit for the period of time that has elapsed under the replaced policy's or contract's incontestability and suicide period up to the face amount of the existing policy or contract. With regard to *financed purchases* the credit may be limited to the amount the face amount of the existing policy is reduced by the use of existing policy values to fund the new policy or contract.

c. If an insurer *prohibits the use of sales material other than that approved* by the company, as an alternative to the requirements of Section 3(E) the insurer may:

(1) Require with each application a statement *signed by the producer* that:

- Represents that the producer used only company approved sales material;
- *Lists*, by identifying number or other descriptive language, the *sales material that was used*; and
- States that copies of all sales material were left with the applicant in accordance with Section 3(D); and

o Within ten days of the issuance of the policy or contract:

(a) Notify the applicant by sending a letter or by verbal communication with the applicant *by a person whose duties are* ***separate from the marketing area*** *of the insurer*, that the producer has represented that copies of all sales material have been left with the applicant in accordance with Section 3(D);

(b) Provide the applicant with a *toll free number* to contact *company personnel involved in the compliance function* if such is not the case; and

(c) Stress the importance of retaining copies of the sales material for future reference; and

o Keep a copy of the letter or other verification in the policy file at the home or regional office for at least five years after the termination or expiration of the policy or contract.

3. Duties of the Existing Insurer [Section 6].

a. Where a replacement is involved in the transaction, the existing insurer shall:

(1) Upon notice that its existing policy or contract may be replaced or a policy may be part of a financed purchase, *retain copies* of the notification in its home or regional office, *indexed by replacing insurer*, notifying it of the

replacement for at least five years or until the conclusion of the next regular examination conducted by the Insurance Department of its state of domicile, whichever is later.

(2) Send a letter to the policy or contract owner of the right to receive information regarding the existing policy or contract values including, if available, an in force illustration or policy summary if an in force illustration cannot be produced within five business days of receipt of a notice that an existing policy or contract is being replaced. The information shall be provided within five business days of receipt of the request from the policy or contract owner.

(3) Upon receipt of a request to borrow, surrender or withdraw any policy or contract values, send to the applicant a notice, advising the policy or contract owner of the effect release of policy or contract values will have on the non-guaranteed elements, face amount or surrender value of the policy or contract from which the values are released. The notice shall be sent separate from the check if the check is sent to anyone other than the policy or contract owner. In the case of *consecutive automatic premium loans or systematic withdrawals* from a contract, the insurer is only required to send the notice at the time of the first loan or withdrawal.

4. Duties of Producers [Section 4].

   a. A producer who initiates an application must submit to the insurer, with or as part of the application, a statement signed by both the
   applicant and the producer as to whether the applicant has existing policies or contracts. If the answer is "no," the producer's duties with respect to replacement are complete.

   b. If the applicant answered "yes" to the question regarding existing coverage referred to in Subsection (A), the producer shall present and read to the applicant, not later than at the time of taking the application, a notice regarding replacements in the form as described in Attachment 1 to the regulation or other substantially similar form approved by the commissioner. *The notice shall be signed by both the applicant and the producer* attesting that the notice has been read aloud by the producer or that the applicant did not wish the notice to be read aloud (in which case the producer need not have read the notice aloud) and left with the applicant.

   c. The notice shall list all life insurance policies or annuities proposed to be replaced, properly identified by name of insurer, the insured or annuitant, and policy or contract number if available; and shall include a statement as to whether each policy or contract will be replaced or whether a policy will be used as a source of financing for the new policy or contract. If a policy or contract number has not been issued by the existing insurer, alternative identification, such as an application or receipt number, shall be listed.

d. In connection with a replacement transaction *the producer shall leave with the applicant* at the time an application for a new policy or contract is completed *the original or a copy of all sales material*. With respect to electronically presented sales material, it shall be provided to the policyholder in printed form no later than at the time of policy or contract delivery.

e. Except as provided in Section 5(C) of the regulation, in connection with a replacement transaction the producer shall submit to the insurer to which an application for a policy or contract is presented, a copy of each document required by this section, *a statement identifying any preprinted or electronically presented company approved sales materials used*, and *copies of any individualized sales materials*, including *any illustrations* used in the transaction

H. Selected Definitions

1. Section 2(D) defines the term *financed purchase* as "the purchase of a new policy involving the actual or intended use of funds obtained by the withdrawal or surrender of, or by borrowing from values of an existing policy to pay all or part of any premium due on the new policy."

a. If a withdrawal, surrender, or borrowing involving the policy values of an existing policy are used to pay premiums on a new policy owned by the same policyholder *within thirteen months before or after the effective date of the new policy* and is known by the replacing insurer, or if the withdrawal, surrender, or borrowing is shown on any illustration of the existing and new policies made available to the prospective policyowner by the insurer or its producers, it will be *deemed prima facie evidence of a financed purchase.*

2. Section 2(I) defines the term registered contract as "a variable annuity contract or variable life insurance policy subject to the prospectus delivery requirements of the Securities Act of 1933."

I. Several aspects of the amended NAIC model regulation parallel SEC and FINRA positions concerning Section 1035 exchanges and bonus annuity sales.

1. Selected list of parallel regulatory concepts

    a. FINRA Guideline on Variable Life Insurance Distribution: NTM 00-44 (June 2000).

    b. FINRA Guidelines on Supervisory Responsibilities: NTM 99-45 (June 1999).

    c. FINRA Statement on Variable Annuity Distribution: NTM 99-35 (May 1999).

    d. SEC Office of Compliance Inspections and Examinations: Indicators of "Good" Internal Controls in Variable Contract Distribution.

        (1) A compilation of the SEC's indicators drawn from speeches and seminar comments is discussed in Wilkerson, *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 20.

    e. SEC Examination of Variable Annuity "Bonus" Programs

        (1) Several of the items requested in the SEC's inspection letter requested documents and information that the amended NAIC Model Replacement Regulation also addresses.

            (a) Scope of documents requested in the SEC's examinations was outlined in *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 6.

    a. FINRA and SEC inspection sweeps focusing on "Section 1035 exchanges" of variable contracts and "life financing" arrangements (1998 and 1996.)

        (1) These sweeps and the documentation they elicited were discussed in *Variable Product Distribution: A Continuing Study of Compliance Examinations, Inspections Sweeps and Evolving Regulatory Standards*, ACLI Compliance Section Annual Meeting (July 19, 2000) at 11 and 15.

Attachment 1 to this Outline on the Model Replacement Regulation

IMPORTANT NOTICE: REPLACEMENT OF LIFE INSURANCE OR ANNUITIES

This document must be signed by the applicant and the producer, if there is one, and a copy left with the applicant.

You are contemplating the purchase of a life insurance policy or annuity contract. In some cases this purchase may involve discontinuing or changing an existing policy or contract. If so, a replacement is occurring. Financed purchases are also considered replacements.

A replacement occurs when a new policy or contract is purchased and, in connection with the sale, you discontinue making premium payments on the existing policy or contract, or an existing policy or contract is surrendered, forfeited, assigned to the replacing insurer, or otherwise terminated or used in a financed purchase.

A financed purchase occurs when the purchase of a new life insurance policy involves the use of funds obtained by the withdrawal or surrender of or by borrowing some or all of the policy values, including accumulated dividends, of an existing policy, to pay all or part of any premium or payment due on the new policy. A financed purchase is a replacement.

You should carefully consider whether a replacement is in your best interests. You will pay acquisition costs and there may be surrender costs deducted from your policy or contract. You may be able to make changes to your existing policy or contract to meet your insurance needs at less cost. A financed purchase will reduce the value of your existing policy or contract and may reduce the amount paid upon the death of the insured.

We want you to understand the effects of replacements before you make your purchase decision and ask that you answer the following questions and consider the questions on the back of this form.

1. Are you considering discontinuing making premium payments, surrendering, forfeiting, assigning to the insurer, or otherwise terminating your existing policy or contract? ___ YES ___ NO

2. Are you considering using funds from your existing policies or contracts to pay premiums due on the new policy or contract? ___ YES ___ NO

If you answered "yes" to either of the above questions, list each existing policy or contract you are contemplating replacing (include the name of the insurer, the insured, and the contract number if available) and whether each policy will be replaced or used as a source of financing:

INSURER NAME
CONTRACT OR POLICY#
INSURED OR ANNUITANT: REPLACED (R) OR FINANCING (F)

1.

2.

3.

Make sure you know the facts. Contact your existing company or its agent for information about the old policy or contract. [If you request one, an in force illustration, policy summary or available disclosure documents must be sent to you by the existing insurer.] Ask for and retain all sales material used by the agent in the sales presentation. Be sure that you are making an informed decision.

The existing policy or contract is being replaced because ______________________
____.

I certify that the responses herein are, to the best of my knowledge, accurate:

____

Applicant's Signature and Printed Name Date

____ ______________

Producer's Signature and Printed Name Date

____ ______________

I do not want this notice read aloud to me. __________ (Applicants must initial only if they do not want the notice read aloud.)

A replacement may not be in your best interest, or your decision could be a good one. You should make a careful comparison of the costs and benefits of your existing policy or contract and the proposed policy or contract. One way to do this is to ask the company or agent that sold you your existing policy or contract to provide you with information concerning your existing policy or contract. This may include an illustration of how your existing policy or contract is working now and how it would perform in the future based on certain assumptions. Illustrations should not, however, be used as a sole basis to compare policies or contracts. You should discuss the following with your agent to determine whether replacement or financing your purchase makes sense:

PREMIUMS:	Are they affordable? Could they change? You're older--are premiums higher for the proposed new policy? How long will you have to pay premiums on the new policy? On the old policy?
POLICY VALUES:	New policies usually take longer to build cash values and to pay dividends. Acquisition costs for the old policy may have been paid, you will incur costs for the new one. What surrender charges do the policies have? What expense and sales charges will you pay on the new policy? Does the new policy provide more insurance coverage?
INSURABILITY:	If your health has changed since you bought your old policy, the new one could cost you more, or you could be turned down. You may need a medical exam for a new policy. Claims on most new policies for up to the first two years can be denied based on inaccurate statements. Suicide limitations may begin anew on the new coverage.

IF YOU ARE KEEPING THE OLD POLICY AS WELL AS THE NEW POLICY:

How are premiums for both policies being paid?
How will the premiums on your existing policy be affected?
Will a loan be deducted from death benefits?
What values from the old policy are being used to pay premiums?

IF YOU ARE SURRENDERING AN ANNUITY OR INTEREST SENSITIVE LIFE PRODUCT:

Will you pay surrender charges on your old contract?
What are the interest rate guarantees for the new contract?
Have you compared the contract charges or other policy expenses?

OTHER ISSUES TO CONSIDER FOR ALL TRANSACTIONS:

What are the tax consequences of buying the new policy?
Is this a tax free exchange? (See your tax advisor.)
Is there a benefit from favorable "grandfathered" treatment of the old policy under the federal tax code?
Will the existing insurer be willing to modify the old policy?

How does the quality and financial stability of the new company compare with your existing company?

(Attachment 2 to Replacement Outline)

NOTICE REGARDING REPLACEMENT
REPLACING YOUR LIFE INSURANCE POLICY OR ANNUITY?

Are you thinking about buying a new life insurance policy or annuity and discontinuing or changing an existing one? If you are, your decision could be a good one--or a mistake. You will not know for sure unless you make a careful comparison of your existing benefits and the proposed policy or contract's benefits.

Make sure you understand the facts. You should ask the company or agent that sold you your existing policy or contract to give you information about it.

Hear both sides before you decide. This way you can be sure you are making a decision that is in your best interest.

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NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation American Council of Life Insurers

I. NAIC Model Regulation on the Use of Senior-Specific Certifications and Professional Designations in the Sale of Life Insurance and Annuities.

A. This NAIC regulation directly parallels the North American Securities Administrators Association (NASAA) credentialing regulations and was developed in close coordination with NASAA and supported by NASAA.

B. See http://www.nasaa.org/content/Files/Senior_Model_Rule110807.pdf

C. The NAIC regulation and an accompanying bulleting can be obtained on the NAIC website at http://www.naic.org/Releases/2008_docs/senior_sales.htm .

II. Purpose of the NAIC Regulation

A. The regulation establishes standards to protect consumers from misleading and fraudulent marketing practices with respect to the use of senior-specific certifications and professional designations in the solicitation, sale or purchase of, or advice made in connection with, a life insurance or annuity product.

B. The regulation will apply to any solicitation, sale or purchase of, or advice made in connection with, a life insurance or annuity product by an "insurance producer," that is defined as a person required to be licensed under the laws of this State to sell, solicit or negotiate insurance, including annuities.

III. Prohibited Uses of Senior-Specific Certifications and Professional Designations [Section 5]

A. Under the regulation, it will be an unfair and deceptive act or practice in the business of insurance within the meaning of the Unfair Trade Practices Act for an insurance producer to use a senior-specific certification or professional designation that indicates or implies in such a way as to mislead a purchaser or prospective purchaser that insurance producer has special certification or training in advising or servicing seniors in connection with the solicitation, sale or purchase of a life insurance or annuity product or in the provision of advice as to the value of or the advisability of purchasing or selling a life insurance or annuity product, either directly or indirectly through publications or writings, or by issuing or promulgating analyses or reports related to a life insurance or annuity product.

B. The prohibited use of senior-specific certifications or professional designations includes, but is not limited to, the following:

1. Use of a certification or professional designation by an insurance producer who has not actually earned or is otherwise ineligible to use such certification or designation;

2. Use of a nonexistent or self-conferred certification or professional designation;

3. Use of a certification or professional designation that indicates or implies a level of occupational qualifications obtained through education, training or experience that the insurance producer using the certification or designation does not have; and

4. Use of a certification or professional designation that was obtained from a certifying or designating organization that:

    a) Is primarily engaged in the business of instruction in sales or marketing;

    b) Does not have reasonable standards or procedures for assuring the competency of its certificants or designees;

    c) Does not have reasonable standards or procedures for monitoring and disciplining its certificants or designees for improper or unethical conduct; or

    d) Does not have reasonable continuing education requirements for its certificants or designees in order to maintain the certificate or designation.

5. Under the regulation, there is a rebuttable presumption that a certifying or designating organization is not disqualified solely for purposes of subsection A(2)(d) when the certification or designation issued from the organization does not primarily apply to sales or marketing and when the organization or the certification or designation in question has been accredited by:

    a) The American National Standards Institute (ANSI);

    b) The National Commission for Certifying Agencies; or

    c) Any organization that is on the U.S. Department of Education's list entitled "Accrediting Agencies Recognized for Title IV Purposes."

6. In determining whether a combination of words or an acronym standing for a combination of words constitutes a certification or

professional designation indicating or implying that a person has special certification or training in advising or servicing seniors, factors to be considered shall include:

a) Use of one or more words such as “senior,” “retirement,” “elder,” or like words combined with one or more words such as “certified,” “registered,” “chartered,” “advisor,” “specialist,” “consultant,” “planner,” or like words, in the name of the certification or professional designation; and

b) The manner in which those words are combined.

7. For purposes of this NAIC regulation, a job title within an organization that is licensed or registered by a State or federal financial services regulatory agency is not a certification or professional designation, unless it is used in a manner that would confuse or mislead a reasonable consumer, when the job title:

a) Indicates seniority or standing within the organization; or

b) Specifies an individual’s area of specialization within the organization.

8. Under this subsection, financial services regulatory agency includes, but is not limited to, an agency that regulates insurers, insurance producers, broker-dealers, investment advisers, or investment companies as defined under the Investment Company Act of 1940.

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The Impact of State Insurance Consulting Laws and Related Provisions on Insurance Producers Performing Financial Planning Services

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
American Council of Life Insurers

I. The Impact of State Insurance Consulting Laws and Related Provisions on Insurance Producers Performing Financial Planning Services

A. Background

1. A degree of variability exists in state insurance statutes and regulations concerning financial planning by life insurance agents.

2. Careful review of the various state laws and regulations is valuable in confirming proper procedures and activities.

B. NAIC Unfair Trade Practices Act provisions governing financial planning:

1. §2(M) of the NAIC Unfair Trade Practices Act defines an unfair financial planning practice by an insurance producer to be:

a) Holding himself or herself out directly or indirectly to the public as they "financial planner," "investment advisor," "consulted," "financial counselor," or any other specialists engaged in the business of giving financial planning for advice relating to investments, insurance, real estate tax matters or trust and estate matters when such person is in fact engaged only in the sale of policies.

b) Engaging in the business of financial planning without disclosing to the client prior to the execution of the agreement provided for in paragraph 3 [of this regulation], or solicitation of the sale of a product or service that:

(1) He or she is also an insurance salesperson, and

(2) That a commission for the sale of the insurance products will be received in addition to a fee for financial planning, if such is the case.

c) This NAIC provision forbids fees other than commission for financial planning by insurance producers, unless such fees are based upon a written agreement, signed by the client in advance; a copy of the agreement must be given to the client at the time it is signed.

C. Insurance Consulting Laws

1. Many states have adopted statutes or regulations generally referred to as "insurance consulting" provisions that seek to protect insurance product policyholders by preventing the receipt of insurance commissions and insurance consulting fees concerning the same sale.

2. It is unlikely that this body of law was intended to govern broad-spectrum of financial planning conducted by insurance agents in today's market. Nonetheless, financial planning and investment advisory activities could inadvertently trigger the scope and terms of the insurance consulting laws.

a) Insurance consulting laws evolved to address problems of a traditional life insurance environment, not more recent developments such as financial planning for investment advice.

b) While the application of the insurance consulting laws to financial planning is not clear, potential coverage could be triggered in two ways:

(1) Fee and commission financial planning arrangements that also involve a recommendation and ultimate purchase of insurance product;

(2) Commission only financial planning arrangements that involve the recommendation and ultimate purchase of an insurance product.

c) Insurance consulting laws generally fall into two categories:

(1) States prohibiting insurance agents from receiving both consulting fees and sales commissions in connection with the same assurance product sale.

(a) See, e.g., Connecticut Insurance Code §38 – 92h (an individual serving as a quote certified insurance consultant" is prohibited from receiving both sales commission and a consultant's commission in connection with the sale of insurance).

(2) States permitting insurance agents to obtain both consulting fees and sales commissions in connection with the same insurance product sale, providing clear

disclosure about the joint receipt of a fee and commission is communicated.

(a) See, e.g., Arkansas Insurance Department Bulletin No. 1185 (May 10, 1985): "the obvious intent of this section [§66 -- 3023 (3)] is to permit genuine utilization of the [property/casualty and life/disability] agent's expertise, for compensation, but to require proper disclosure to the client and to prevent price gouging by unscrupulous persons."

(b) See also, New Mexico Insurance Rule 80-3-6 (c) which states that "terms such as financial planner, investment advice or, financial consultant, or financial counseling shall not be used in such a way as to imply that the insurance agent is generally engaged in an advisory business in which compensation is unrelated to sales, unless such is actually the case.

(3) A compilation of state laws and regulations about insurance consulting laws and investment advisor provisions is set forth below.

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A Comprehensive System of State Regulation Governs the Distribution of Insurance and Annuity Contracts

Carl B. Wilkerson, Vice President & Chief Counsel-Securities & Litigation
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A. State Insurance Regulation

Through a network of statutes and regulations, state insurance departments heavily regulate the operations, products, and sales of life insurance companies. Life insurers and their salespersons must satisfy this regulatory structure in their state of domicile and every jurisdiction in which they distribute life insurance and annuities. Uniformity of regulation is accomplished throughout the states by means of model statutes and regulations promulgated by the National Association of Insurance Commissioners (the "NAIC"). Many of the insurance statutes and regulations promulgated and enforced by state insurance departments fulfill regulatory goals quite similar to those of the state securities administrators. The summary below highlights the broad scope and comprehensiveness of certain state insurance statutes and regulations. While only a small portion of the larger universe of state insurance regulation, this regulations are directly relevant in evaluating the market conduct structure governing insurance salespersons engaged in the delivery of financial planning and broker-dealer services. This discussion is intended to fill in other areas not covered in the preceding outline materials to this submission.

B. Unfair Trade Practices

Virtually every state has enacted a version of the NAIC Model Unfair Trade Fair Practices Act which was developed to regulate trade practices in the insurance business by defining and prohibiting practices that constitute unfair methods of competition or unfair deceptive acts or practices.[1]

A variety of the activities defined to be unfair trade practices directly parallel the purpose and scope of state securities codes. Section 4(A) involves misrepresentations and false advertising of insurance policies, and identifies unfair trade practices to include any estimate, illustration, circular or statement, sales misrepresentation, omission or comparison that misrepresents the benefits, advantages, conditions or terms of any policy, among other things.

Section 4(B) involves false information and advertising generally. This provision defines an unfair trade practice to include making, publishing or disseminating in a newspaper, magazine or other publication, on any radio/television station any assertion,

[1]This model statute governs items previously subject to Section 5 of The Federal Trade Commission Act. Congress observed that continued regulation of insurance by the states was in the public interest. *See*, legislative history of NAIC Unfair Trade Practices Act, NAIC Model Regulation Service at 880-20(1993).

representation or statement about an insurer or its business, which is untrue, deceptive or misleading.

Knowingly making any false statement of any material fact to insurance regulators, or in documents that will be publicly disseminated, is defined to be an unfair trade practice in Section 4(B) of the Model Unfair Trade Practices Act. This proscription is consistent with the truthfulness and accuracy of reports, records and representations required of Broker/Dealers by the NASD and the SEC under the federal securities laws.

Section 4(J) involves the failure to maintain marketing and performance records, and defines as an unfair trade practice the failure of an insurer to maintain its books, records, documents, and other business records in such an order that data regarding complaints, claims, reading, underwriting and marketing are accessible and retrievable for examination by the insurance commissioner. Data for at least the current calendar year in the two preceding years must be maintained under this standard. This provision directly parallels the scope and purpose of NASD Conduct Rule 3110 regarding books and records.

Section 4(K) defines the failure of any insurer to maintain a complete record of all the complaints it received since the date of its last market conduct examination to be an unfair trade practice. The records of complaints must indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of each complaint and the time it took to process each.[2] For purposes of this subsection, the term "complaint" means any written communication primarily expressing a grievance.

Like state securities administrators, insurance commissioners have the power to examine and investigate the affairs of every insurer operating in the insurance department's state "in order to determine whether such insurer has been or is engaged in any unfair trade practice prohibited by [the Unfair Trade Practices Act]."[3] Several provisions embellish this important authority.

For example, Section 7 of the Unfair Trade Practices Act gives insurance commissioners extensive authority to initiate hearings concerning unfair trade practices, to compel witnesses, appearances, production of books, and service of process. Section 7 sets forth detailed administrative and procedural practices, in order to assure due process and quasi-judicial formality.

Section 8 of the Unfair Trade Practices statute authorizes insurance commissioners finding insurers guilty of unfair trade practices to issue written findings and enforcement orders requiring the insurer to cease and desist from engaging in the act or practice. The insurance commissioner also has the discretionary authority to suspend and revoke

[2]The NAIC has also promulgated a Model Regulation for Complete Records to be maintained pursuant to Section 4(K) of the NAIC Unfair Trade Practices Act. *See*, NAIC Model Regulation Service at 844-1(1992).This regulation sets forth a complaint record form, content requirements, maintenance requirements, and standards concerning the format of complaint records.

[3] *See* Section 6, Power of Commissioner, Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-9(1993).

the insurer's license if the insurer knew or reasonably should have known that its conduct violated the Unfair Trade Practices Act, and to order penalties of $1,000 for each violation up to an aggregate penalty of $100,000, unless the violation was committed flagrantly in conscious disregard of the act, in which case the penalty may be up to $25,000 for each violation to an aggregate total penalty of $250,000. A similar monetary violation may be imposed under Section 11 for violations of cease and desist orders. The act also provides for judicial review of insurance commissioner orders and authorizes immunity from prosecution for witnesses who attend, testify or produce books, records or other paper correspondence.[4]

These significant powers that may be used by insurance commissioners to enforce violations of unfair trade practice proscriptions, together with the recordkeeping, reporting and inspection powers of the Act, provide a package of regulatory tools directly analogous to state securities codes, the NASD Rules of Conduct and SEC regulations governing market conduct practices and the prosecution of violations. In a sum, the unfair trade practice laws provide meaningful proscriptions that eliminate the need for duplicative regulation of variable contracts.

C. NAIC Model Fraud Laws and Fraud Legislation

Enactment of state fraud statutes represents another significant insurance regulatory development. Recent market conduct issues have resulted in some insurance departments requiring insurer management to assume increased responsibility for supervision of sales activities. Other states have taken an approach similar to that of New York and Pennsylvania by requiring insurer review of market conduct compliance, thus placing direct responsibility at the corporate officer level. This widespread action dovetails with the objectives of the Federal Crime Control Statute and the Federal Sentencing guidelines, discussed below.

While states have taken different approaches to the issue, the majority of states addressing the fraud issue enacted legislation similar to the NAIC Model Fraud Laws.[5]

D. Market Conduct Examinations

Nearly every jurisdiction has enacted a version of the NAIC Model Law on Examinations.[6] This Act is designed to provide an effective and efficient system for examining the activities, operations, financial condition and affairs of all persons transacting the business of insurance in each state and concerning individuals otherwise subject to the insurance commissioner's jurisdiction. The Act is intended to enable commissioners to adopt a flexible system of examinations and allocate resources deemed appropriate and necessary for the administration of the insurance laws of each state. The Model Law on Examinations sets forth standards for the conduct of

[4] *See* Sections 8, 9, 10, 11 and 14 of the Model Unfair Trade Practices Act, NAIC Model Regulation Service at 880-10 through 13(1994).

[5] *See* NAIC Insurance Fraud Prevention Model Act, NAIC Model Reporting Service at 680-1(1995).

[6] *See* NAIC Model Regulation Service at 390-1(1991).

examinations, commissioner authority, scope, and scheduling of examinations. It also details the scope of examination reports which shall be comprised of only facts appearing on books, records or other documents of the company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined.[7]

Significantly, this Model Act dovetails with the NAIC Market Conduct Examiner's Handbook, an extremely detailed manual for examiners to assure that examiners follow comprehensive, uniform practices and procedures. The Examiner's Handbook is divided into seven different sections and contains 58 different standards. Among other things, the Examiner's Handbook addresses complaint handling, marketing and sales, producer licensing, and company operations/management.[8]

[7]*See* Sections 3, 4, and 5 of the Model Law on Examinations, NAIC Model Regulation Service at 390-5 (1991). Section 5 also sets forth detailed provisions for orders and administrative procedures in the conduct of hearing and adoption of a report on examination.

[8]Certain standards under the complaint handling section illuminate the depth and scope of the market conduct examination. Several standards are set forth below in this note as representative examples.

Complaint Handling**-Standard 2**

The company has adequate complaint handling procedures in place and communicates such procedures to policyholders.

Review Procedures and Criteria

Review manuals to verify complaint procedures exist. Procedures in place should be sufficient to require satisfactory handling of complaints received as well as internal procedures for analysis in areas developing complaints. There should be a method for distribution of and obtaining and recording response to complaints. This method should be sufficient to allow response within the time frame required by state law.

Company should provide a telephone number and address for consumer inquiries.

Complaint Handling**-Standard 3**

The company should take adequate steps to finalize and dispose of the complaint in accordance with applicable statutes, rules and regulations and contract language.

Review Procedures and Criteria

Review complaints documentation to determine if the company response fully addresses the issues raise. If the company did not properly address/resolve the complaint, the examiner should ask company what corrective action it intends to take.

Commentary:

Reference to the examiner's general instructions on Handbook page VIII-14 (November 1995) reveals that an inquiry broader in scope than the mere resolution of a given complaint is expected. For example, the Handbook contains the following instructions: "The examiner should review the frequency of similar complaints and be aware of any pattern of specific type of complaints....Should the types of complaints generated be cause for unusual concern, specific measures should be instituted to investigate other areas of the company's operation."

Complaint Handling**-Standard 4**

Throughout most of 1995 and 1996, the NAIC significantly revised the Market Conduct Examiner's Handbook. The NAIC, together with industry input, sought to expand and enhance tools fostering the detection and prevention of marketplace abuse in the life insurance industry. Market conduct examinations are extremely comprehensive and serve as a means of positive reinforcement, by discouraging deficient practices that will be detected on examination, resulting in remedial action, and insurance department intervention.

E. Agents' Licensing and Testing

The NAIC Agents and Brokers Licensing Model Act,[9] which appears virtually in every state, governs the qualifications and procedures for licensing insurance and annuity agents and brokers. This model law sets forth examination and licensing standards in great detail, and has a specific category for variable annuities and variable life insurance contracts. Licensed salespeople must be deemed by the insurance commissioner to be competent, trustworthy, financially responsible, and of good personal and business reputation. Insurance brokers must also fulfill experience requirements. Section 8 of this regulation governs license denial, non-renewal and termination, giving the insurance commissioner broad discretion to suspend, revoke or refuse to issue or renew a license upon finding any of a variety of conditions including materially untrue statements, violation or noncompliance with insurance laws, withholding, misappropriating or converting customer moneys, conviction of a felony or misdemeanor involving moral turpitude, forgery, or cheating on licensing examinations, among other things.

F. Agent Investigation: Character and Background Investigation Requirements

Most jurisdictions require that insurance producer license applicants be competent, trustworthy, and of good moral character in order to obtain a license. However, some now expressly require appointing insurers to certify that they have investigated the applicant's character and background and have found the applicant to be qualified and worthy of a license. Similar to FINRA, some jurisdictions implement fingerprinting as part of the background check. Related to these requirements is the portion of the NAIC Producer Licensing Model Act that allows the commissioner to refuse to issue an insurance producer's license if the commissioner finds that the individual has committed any act that is a ground for denial, suspension or revocation of the license. A law survey on this topic appears at the end of this segment of the appendix.

G. Continuing Education for Agents and Brokers

In granting insurance agents and brokers licenses, most states also impose significant continuing education standards that parallel in objective and scope the continuing

The time frame within which the company responds is in accordance with applicable statutes, rules, and regulations.

Review Procedures and Criteria
Review complaints to ensure company is maintaining adequate documentation. Determine if the company response is timely. The examiner should refer to state laws for the required time frame.

[9] *See* NAIC Model Regulation Service at 210-1 (2008).

education standards recently developed by the securities industry together with the NASD. As in other areas seeking uniformity, the NAIC has promulgated the Agents and Brokers Licensing Model Act.[10] Under Section 5 of this model regulation, licensed agents must annually satisfy courses or programs of instruction approved by insurance commissioners in each state according to a minimum number of classroom hours, which typically is in the range of 25 class room hours per year for life and annuity salespersons. The courses include those presented by the Life Underwriter Training Council Life Course Curriculum, the American College's Chartered Life Underwriter and Chartered Financial Planner curriculum, and the Insurance Institute of America's programs in general insurance, for example. Like FINRA's initial and ongoing educational requirements for registered representatives, state insurance regulators understand that testing, licensing and demonstration of continued competence through continuing education is critically important in the distribution of insurance and annuity products. A law survey on this topic appears at the end of this segment of the appendix.

H. Variable Contract Statutes

Life insurance companies are authorized to issue separate accounts funding variable life insurance and annuity contracts upon fulfilling a variable contract statute in their domestic state, which typically follows the NAIC Model Variable Contract Law.[11] This NAIC model statute gives the insurance commissioner exclusive authority to regulate the issuance and sale of variable contracts and to issue rules and regulations appropriate to carry out the act's purpose. This model act and associated regulations that appear under state insurance law gives an additional, important measure of regulatory scrutiny and purchaser protection.

Collectively, the NAIC statutes and regulations provide a significant network of comprehensive regulation over many important aspects affecting the marketing and sale of variable contracts that closely reflect the purpose and scope of analogous concepts of securities regulation.

I. Insurance Producer Database

From a market conduct perspective, life insurers have committed to a single, industry-accessible national producer database to facilitate their ability to track pertinent information regarding licensed producers. Access to information having a bearing on the producer's background, qualifications and competency is a valuable tool to insurers in the employment/appointment screening process. Moreover, widespread availability of such information makes it more difficult for a producer with significant disciplinary history to continue illegal or unethical practices by "company jumping."

NIPR (National Insurance Producer Registry) is a non-profit affiliate of the National Association of Insurance Commissioners (NAIC). It was created in October 1996 to develop and operate a national repository for producer license information (PDB) and to establish a network to facilitate the electronic exchange of producer information.

[10] *See* NAIC Model Regulation Service at 215-1 (2015).

[11] *See* NAIC Model Regulation Service at 260-1 (2015).

The Producer Database (PDB) is an electronic database consisting of information relating to insurance agents and brokers (producers) accessible through the NIPR Gateway on a subscription basis through the Internet. Internet PDB links participating state regulatory licensing systems into one common system establishing a repository of producer information. Internet PDB also contains or references producer information from sources such as the Regulatory Information Retrieval System (RIRS) of the NAIC. Its development is based, in part, on the belief that the widespread availability of such information will make it more difficult for a producer with significant disciplinary history to continue illegal or unethical practices.

The NIPR Gateway is an electronic communication network that links state insurance regulators with the entities they regulate to facilitate the electronic exchange of producer information; including license applications, appointments, and terminations. To date, data standards have been developed for the exchange of appointment and not-for-cause termination information. All data flowing through the NIPR Gateway will conform to these standards.

Through Internet PDB, industry is able to access all public information related to a producer provided by participating states, including licensing, demographics and final regulatory actions. The product is designed to assist insurers in exercising due diligence in the monitoring of agents and brokers to reduce the incidence of fraud. Currently, Internet PDB contains information on over 2.9 million producers. Information available includes:

- Demographics-name, date of birth, addresses
- License Summary-state of license, license number, issue date, expiration date, license type/class, residency, lines of authority, status, status reason, status/reason effective date.
- Continuing Education-CE compliance indicator, CE renewal date, CE credits needed.
- Certificates and Clearance-date issued, issuing state, receiving state, certification or clearance indicator.
- Regulatory Actions-State of action, entity role, origin of action, reason for action, enter date penalty/fine/forfeiture, effective date, file reference, time/length of dates.
- Appointment Information-Effective date, termination date, reasons for termination.

Currently all 50 states, DC and PR participate in the PDB.

In many respects, this producer data base parallels the purpose and scope of FINRA's Central Records Depository or CRD. Through the NIPR data base, problem producers can be tracked and deterred from the insurance business.

The NAIC Buyer's Guide for Deferred Annuities provides plain-English, streamlined, simplified disclosure about fixed, variable and index annuities that allows apples to apples comparisons essential to informed purchase decisions. It contains a valuable list of core questions that consumers should ask salesperson when considering an annuity. The Buyer's Guide is not attached to this Appendix because of its digital size. We recommend clicking through the above link to fully visualize the valuable content, readability, and its use of white space and color.