FINANCIAL SERVICES INSTITUTE | VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

**VIA ELECTRONIC MAIL -** rule-comments@sec.gov

March 15, 2019

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

**Re: Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts | File Number: S7-23-18**

Dear Secretary Fields:

On October 30, 2018, the US Securities and Exchange SEC (SEC) requested comments on proposed rule amendments (Proposal) updating the disclosure requirements for variable annuity and variable life insurance contracts (collectively, Variable Contract).[1] The Proposal would allow companies to satisfy their prospectus delivery obligations using a two-tiered disclosure approach.[2] First, companies would deliver a document summarizing the Variable Contract's terms, risks, and benefits. [3] A more comprehensive disclosure document would be made available to investors online or, if requested, in paper format.[4]

The Financial Services Institute[5] (FSI) appreciates the opportunity to comment on this important Proposal. FSI supports the Proposal. In fact, FSI has long supported a two-tiered disclosure approach as a way to simplify disclosure.[6] As FSI pointed out in its comment letter in response to the Commission's analogous mutual fund summary prospectus rule, FSI believes that

[1] U.S. Securities and Exchange Commission, 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 (83 Fed. Reg. 61730) (November 30, 2018) (Proposal) at p. 1, available at https://www.sec.gov/rules/proposed/2018/33-10569.pdf.

[2] *Id*.

[3] *Id*.

[4] *Id*.

[5] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

[6] *See, e.g.,* Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Jay Clayton, Chairman, U.S. Securities and Exchange SEC(October 30, 2017) (advocating for a "two-tiered disclosure regime consisting of a concise disclosure document to be supplemented with more detailed disclosures posted to the Financial Institution's web site") available at https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2657870-161400.pdf; Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Brent J. Fields, Secretary, U.S. Securities and Exchange SEC(August 7, 2018) available at https://www.sec.gov/comments/s7-07-18/s70718-4181966-172528.pdf (FSI Comment Letter in Response to SEC Proposed Regulation Best Interest); Letter from Dale E. Brown, CAE, President & Chief Executive Officer, Financial Services Institute, to Nancy M. Morris, Secretary, US Securities and Exchange SEC(February 28, 2008) available at https://www.sec.gov/comments/s7-28-07/s72807-94.pdf (FSI Comment Letter in Response to Mutual Fund Summary Prospectus Rule).

investor disclosures are best enhanced when they are simplified.[7] The Proposal also represents a positive step towards achieving increased regulatory harmonization by substantially aligning Variable Contract disclosure requirements with those of mutual funds. FSI encourages the SEC to look for additional opportunities to achieve similar harmonization.

FSI does, however, ask that the SEC give careful consideration to whether the Proposal provides companies with adequate notice of the form, nature, and scope of their prospectus delivery obligations. Failure to provide sufficient notice in the text of the rule itself may result in the need for clarifying guidance. As FSI members have recently experienced, clarifying guidance may have the unintended consequence of resulting in "rulemaking by guidance".

## Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives.[8] These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD).

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals.

## Discussion

FSI appreciates the opportunity to comment on the Proposal. FSI's comments will not address technical details of the Proposal such as the extension of the access equals delivery framework for Variable Contracts, codification of the Great-West no action for discontinued Variable Contracts or revision of "N" forms to accommodate the registration of non-variable insurance products. Instead, FSI's comments will address particular concerns that are particularly relevant to its members, such as simplified streamlined disclosures, regulatory harmonization, adequate notice in respect of regulatory disclosure obligations and the need for ongoing collaboration between state and federal financial regulators. These concerns are discussed in greater detail below.

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[7] See FSI Comment Letter in Response to Mutual Fund Summary Prospectus Rule n.5 at p.1.

[8] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

## I. The Proposal Furthers Investor Protection By Adopting a Plain-English, Investor-Friendly, Two-Tiered Disclosure Approach

A. Background

The Proposal gives companies the option of providing new investors with an initial summary prospectus containing important information regarding the Variable Contract's benefits, risks and features[9] with cross-references or hyperlinks to the corresponding section of the full and more comprehensive prospectus (Statutory Prospectus).[10] Proposed rule 498A specifies the nature, and order, of the information that must be included in the initial summary prospectus.[11] For instance, companies could include information concerning more than one class of contracts; but could not include information concerning: i) multiple contracts; ii) information regarding features or options that are not currently offered to new investors;[12] or iii) information that is not expressly permitted under the proposed rule.[13] Importantly, the SEC encourages companies to ensure that disclosures are prepared in plain-English and investor-friendly format.[14]

Companies would also have the option of providing existing investors with an annual updating summary prospectus containing: i) a subset of the information contained in the initial summary prospectus; as well as ii) contract changes from the prior year.[15] Similar to the initial summary prospectus, the Proposal specifies the content of the updating summary prospectus.[16] A key difference between the initial and updating summary prospectuses is that companies would be able to include information concerning multiple contracts in the updating summary prospectus.[17]

The Proposal still requires the delivery of Statutory Prospectuses, as well as other information, such as the Contract's Statement of Additional Information. [18] However, companies may deliver that information through a hyperlink in the summary prospectus or at a website specified in the summary prospectus.[19] Statutory prospectuses and other additional information must not only be publicly accessible but must also be made available, at no charge, to the investor.[20]

The Proposal would also include the option to make portfolio company prospectuses available by posting the portfolio company's summary and Statutory Prospectuses online, at a website address hyperlinked in the Contract's summary prospectus, or at a website specified in the prospectus.[21] Essential information about the portfolio company would need to be included in the Contract's summary prospectus.[22]

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[9] See Proposal at p. 22.
[10] See proposed rule 498A(b)(5)(ii)
[11] See proposed rule 498A(b)(5).
[12] *Id.* at 32.
[13] *Id.* at 33.
[14] *Id.* at 63.
[15] *Id.* at pgs. 23 – 24.
[16] See proposed rule 498A(c)(6).
[17] See proposed rule 498A (c)(2).
[18] *Id* at p. 24.
[19] *Id.*
[20] *Id.*
[21] *Id.* at pgs. 24 – 25.
[22] *Id.* at p. 24.

B. Applicable Standard

Section 5(b)(2) of the Securities Act of 1933 (Securities Act) requires the Contracts to be accompanied, or preceded, by a prospectus.[23] That section of the Securities Act has been interpreted to, similarly, require that companies deliver portfolio company prospectuses to investors who have allocated purchase payments to the portfolio company.[24] The Securities Act also delineates statutory requirements for prospectus information,[25] while granting the SEC authority to adopt rules and regulations that would allow companies to summarize, or omit, some of that information.[26] For the SEC to adopt rules or regulations pursuant to that authority, the rules or regulations should be in the public's interest or in furtherance of investor protection.[27] The Proposal would further investor protection in several respects, as discussed below.

C. The Proposal's Two-Tiered Disclosure Furthers Investor Protection

As FSI noted in its comment letter in response to Proposed SEC Regulation Best Interest:

> "FSI has long advocated for a two-tier[ed] client disclosure regime …. This initial disclosure would then be supplemented with more detailed disclosures posted to the firm's website or otherwise made available to the investor in a format or formats they prefer."[28]

The Proposal, which would adopt that two-tiered disclosure approach, fosters investor protection by: i) simplifying the disclosure process through the delivery of an initial summary document; and ii) encouraging companies to offer disclosures in plain-English and in a format that is easily digestible by investors.

The plain-English, easily digestible format would serve to increase investors' understanding of the product, and the simplified summary would diminish the "information overload" that often results from lengthy and complex disclosure documents. Moreover, both of those changes would increase the likelihood of investors reading the disclosure or, at least, the summary disclosure. Investors could also use the corresponding links to easily access the information they find particularly relevant or helpful. Along the same lines, including superfluous disclosure information that has no value, or relevance, to the investor, (e.g., features no longer offered to new investors) may result in investors becoming confused about how, and whether, certain information pertains to them or their investment. Most importantly, and as the SEC points out in the Proposal, simplification is particularly important in the context of Variable Contracts because many states offer investors a "free look" period, during which the investor may review the contract and elect to return it for a full refund.[29]

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[23] See Sec. 5(b)(2) of the Securities Act (making it unlawful "to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements [subsection 10 (a) of the Securities Act]").

[24] See Registration Forms for Insurance Company Separate Accounts that Offer Variable Annuity Contracts, Investment Company Act Release No. 14575 (June 14, 1985) [50 FR 26145 (June 25, 1985)] at fn.49.

[25] See Sec. 10(a) of the Securities Act.

[26] See Sec. 10(b) of the Securities Act.

[27] *Id.*

[28] See FSI Comment Letter in Response to SEC Proposed Regulation Best Interest n. 6 at p. 3.

[29] *Id.* at 32.

## II. The Proposal's Two-Tiered Disclosure is an Important Step in Harmonizing Disclosure Requirements and FSI Encourages the SEC to Look for Further Opportunities to Harmonize Regulatory Disclosure Requirements

FSI supports the Proposal because it substantially aligns the frameworks surrounding mutual fund, and Variable Contract, prospectus delivery. FSI believes that regulatory harmonization should be a goal, wherever practicable. Subjecting companies, firms and investors to varying disclosure requirements requires companies and firms to adopt different policies, procedures, and standards. This decreases efficiency and increases compliance burdens. Further, these differences, in many cases, do not produce investor protection benefits. Instead, for people with diverse investments, the differences may lead to confusion or decreased clarity. Thus, FSI commends the SEC on taking this important and proactive step in advancing regulatory harmonization.

FSI encourages the SEC to look for other opportunities to harmonize disclosure obligations. FSI understands that an effective disclosure must contain *text* that is tailored to the risks, benefits, and features of a particular investment. However, the *manner or form* of required disclosures, should, to the extent practicable, be consistent across the industry and investments. For instance, where, such as here, the SEC is proposing to allow a summary disclosure document, accompanied by a link to a more detailed and comprehensive disclosure document it should consider allowing that manner of disclosure in other contexts. Nonetheless, FSI members have reported being subject to adverse regulatory action for summarizing conflicts-of-interest in their Form ADV, while hyperlinking to more detailed conflict disclosure on the firm's website. As recognized by the Proposal, that is an effective method of disclosing important information to investors. Thus, FSI encourages the SEC to reconsider its position regarding two-tiered ADV disclosures.

## III. Prior to Adopting a Final Rule, FSI Encourages the SEC to Collaborate with State Regulators to Discourage State Variable Disclosure Bills

Congress long ago delegated insurance regulation to the states.[30] However, that delegation preceded variable annuities[31] which are a cross-section between a securities product and an insurance product. Variable Contracts, therefore, subject companies to both insurance and securities regulation. Thus, state and federal collaboration is vital so that firms are not dissuaded from offering Variable Contracts because of regulatory duplication, competing regulatory requirements, or prohibitive compliance costs. Failure to do so constructively forces firms to stop offering Variable Contracts and leaves investors with fewer investment choices – an outcome that is, certainly, not in investors' best interest.

The National Association of Insurance Commissioners' (NAIC's) Annuity Disclosure Model Regulation (NAIC Model Rule) imposes state disclosure standards for variable annuities.[32] However, the NAIC Model Rules provides that Standards for the Disclosure Document and Buyer's Guide, set forth in the model rule, shall only apply to variable annuities unless, and until, "... the SEC has adopted a summary prospectus rule or FINRA has approved for use a simplified disclosure form applicable to variable annuities or other registered products".[33]

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[30] See 15 U.S.C. §§ 1011-1015.
[31] See Variable Annuities: A Bad Wrap, Kathy ChuDow Jones, Wall Street Journal (Oct. 4, 2004), available at https://www.wsj.com/articles/SB109664823398533900.
[32] See National Association of Insurance Commissioners Annuity Disclosure Model Regulation, available at https://www.naic.org/store/free/MDL-245.pdf.
[33] *Id.* at Sec. 3 (D)(1).

Not all states had adopted the NAIC Model Rule and may have independent disclosure requirements. Thus, FSI urges the SEC to: i) proactively collaborate with the state regulators; and ii) encourage them to consider the SEC's Variable Contract disclosure requirements sufficient to satisfy any analogous state requirements.

## IV. To Avoid Rulemaking by Guidance, the Final Rule Should Fully Specify the Nature and Scope of the Disclosure Obligations

SEC Chairman Jay Clayton recently explained that the disclosure requirements must be based on the principles of materiality, comparability, flexibility, efficiency and responsibility (or liability).[34] Flexibility is a vital aspect of these requirements. Chairman Clayton noted that rigid requirements may lead to misleading disclosure.[35] Nonetheless, the risk of rule-based requirements being too rigid, must be weighed against the Commission's obligation to engage in clear, concise and substantive rulemaking that provides firms with adequate notice of their obligations under the rule. Further, while guidance is appropriate for clarifying existing obligations, the SEC should not establish new obligations by issuing guidance. Establishing regulatory obligations by guidance can be the catalyst to "rulemaking by guidance".

By way of example, FSI members have reported a pervasive pattern of "rulemaking by guidance" in respect of share class selection disclosures. In that context, firms did not have adequate notice of the obligations, or omissions, that would constitute a violation of the applicable rules. Notice was absent from the rule. The SEC pointed to notice given to the industry through published guidance and enforcement action. The guidance and case law did not include the requisite specificity to place firms on notice. Even if they had, neither are rules creating binding obligations on firms. Similarly, if the Proposal does not contain the necessary specificity, it may be vulnerable to unintended instances of rulemaking by guidance.

The SEC should give firms increased flexibility to effect their disclosure obligations; so long as they are effected in compliance with the text of the rule. Even so, the SEC should not take enforcement action on any unfulfilled disclosure obligations that are not memorialized in the final rule because, enforcement action is, in its simplest terms, action taken for violations of applicable securities rules and regulations. It is not action taken on the basis of individual SEC staff opinions or on *ad hoc* interpretations of those opinions. Action taken on either of those bases is termed rulemaking by guidance, which is inappropriate and robs firms of notice of their obligations; formal input on the form, substance, and nature of those obligations; and of a compliance period to prepare for those obligations. Thus, to avoid this, the SEC should ensure that the requirements of the final rule are sufficiently detailed so that firms understand what constitutes compliance with the rule.

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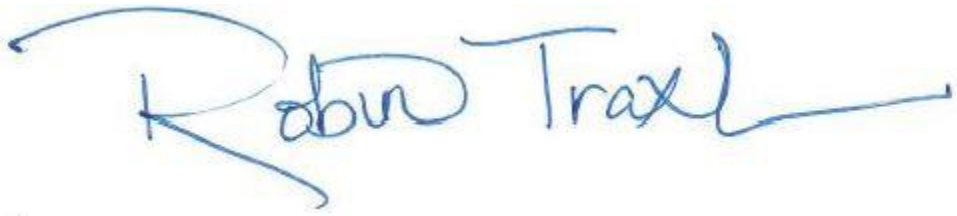
[34] See Remarks for Telephone Call with SEC Investor Advisory Committee Members (February 9, 2019) available at https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-call-020619.
[35] *Id*.

## Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the SEC on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at [redacted].

Respectfully submitted,



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