

MEMORANDUM

TO: Proposed Rule: Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts (Release No. IC-33286; File No. S7-23-18)

FROM: Dan Chang
Senior Counsel, Division of Investment Management

RE: Meeting with Representatives of the Committee of Annuity Insurers

DATE: May 31, 2019

On May 29, 2019, Sarah G. ten Siethoff (Associate Director, Division of Investment Management (“IM”)), Brian M. Johnson (Assistant Director, IM); William J. Kotapish (Assistant Director, IM); Naseem Nixon (Senior Special Counsel, IM), Michael Kosoff (Senior Special Counsel, IM), Keith Carpenter (Senior Special Counsel, IM), Harry Eisenstein (Senior Special Counsel, IM), Michael Pawluk (Senior Special Counsel, IM), Sumeera Younis (Branch Chief, IM), Dan Chang (Senior Counsel, IM), Amy Miller (Senior Counsel, IM), Sonny Oh (Senior Counsel, IM), Alberto H. Zapata (Senior Counsel, IM), Patrick F. Scott (Senior Counsel, IM), DeCarlo McLaren (Special Counsel, IM), Daniel Deli (Financial Economist, Division of Economic and Risk Analysis (“DERA”)), Walter Hamscher (Senior IT Program Manager, DERA), and PJ Hamidi (Senior Counsel, DERA) met with the following representatives from the Committee of Annuity Insurers:

- Shane Daly, Vice President & Associate General Counsel, AXA Equitable
- Scott Durocher, Assistant Vice President & Senior Counsel, Lincoln Financial
- Jamie Castro, Managing Counsel, Nationwide Financial
- Bill Evers, Vice President & Chief Counsel, Prudential Financial
- Jordan Thomsen, Vice President & Corporate Counsel, Prudential Financial
- Steve Roth, Partner, Eversheds Sutherland
- Dodie Kent, Partner, Eversheds Sutherland
- Ron Coenen, Associate, Eversheds Sutherland

Among other things, the participants discussed the SEC’s proposal relating to updated disclosure requirements and a summary prospectus for variable annuity and variable life insurance contracts.

Participants at the meeting provided the attached materials.

May 29, 2019

**Updated Disclosure Requirements and
Summary Prospectus for Variable Annuity and
Variable Life Insurance Contracts**

The COMMITTEE
—of—
ANNUITY
INSURERS

Introductions

AXA Equitable

Shane Daly

Vice President & Associate General
Counsel

Lincoln Financial

Scott Durocher

Assistant Vice President & Senior Counsel

Nationwide Financial

Jamie Casto

Managing Counsel

Prudential Financial

Bill Evers

Vice President & Chief Counsel

Jordan Thomsen

Vice President & Corporate Counsel

Eversheds Sutherland

Steve Roth

Partner

Dodie Kent

Partner

Ronald Coenen Jr.

Associate

Our Member Companies

AIG
Allianz Life
Allstate Financial
Ameriprise Financial
Athene USA
AXA Equitable Life Insurance Company
Brighthouse Financial, Inc.
Fidelity Investments Life Insurance Company
Genworth Financial
Global Atlantic Financial Group
Great American Life Insurance Co.
Guardian Insurance & Annuity Co., Inc.
Jackson National Life Insurance Company
John Hancock Life Insurance Company
Lincoln Financial Group
Massachusetts Mutual Life Insurance Company
Metropolitan Life Insurance Company
National Life Group

Nationwide Life Insurance Companies
New York Life Insurance Company
Northwestern Mutual Life Insurance Company
Ohio National Financial Services
Pacific Life Insurance Company
Protective Life Insurance Company
Prudential Insurance Company of America
Sammons Financial Group
Symetra Financial Corporation
Talcott Resolution
The Transamerica Companies
TIAA
USAA Life Insurance Company

Agenda

- Grandfather currently Great-Wested contracts and adopt going-forward relief for future blocks of discontinued contracts.
- Reconsider the necessity of including fund-by-fund expense ratios and performance in the proposed fund appendix.
- Update the SEC’s interpretative guidance related to e-delivery to provide investors with the freedom to receive disclosure documents in the manner of their choosing.
- Eliminate the need for accumulation unit values entirely.
- Clarify that the “essentially identical” standard does not represent a departure from current practice with respect to the structure of prospectuses and registration statements.
- Permit insurers to continue to freely choose terminology with regard to contract features and charges.

Great West Relief is Fundamental to the Variable Product Industry & Benefits and Protects Investors

The Great-West line of no-action letters is premised on the fact that variable products are contractual obligations, that in-force contracts typically do not materially change, and that the ongoing information most relevant to existing contract owners relates to their investment options.

Why the Relief is Fundamental to us . . .

Unlike mutual funds, which can be liquidated, we are unable to terminate insurance contracts by paying-out our contract owners' account values.

How Investors Benefit . . .

Great-West helps us manage the increasingly disproportionate “soft” and “hard” costs and human resources associated with blocks of discontinued contracts. In doing so:

- ✓ It helps us manage costs which could otherwise be passed through to our contract owners.
- ✓ It enhances our capacity and tolerance for product innovation.

How Investors are Protected . . .

Investors are Always Protected When it Counts

The Great-West line of no-action letters established a framework for discontinued contracts supported by UIT separate accounts that preserves essential 1933 and 1934 Act protections.

- With respect to the contract –
 - Most investor protections under the federal securities laws continue without interruption.
 - Section 11 and Section 12(a)(1) liabilities expire three years after the last effective date, but reattach whenever there is a material change to the contract – the only time when Great-West contract owners are presented with new material information about their contracts.
- With respect to investment options/underlying funds –
 - All investor protections under the federal securities laws continue to apply without interruption.
 - Great-West contract owners' ongoing investment decisions relate to the contractual rights they purchased when the contract was issued and focus on the underlying funds (*i.e.*, investment of new premiums and reallocation of contract values).

Compared to other offerings, variable contract owners enjoy enhanced protections.

- Federal securities laws (including robust protection under Section 11 that may span decades).
- State insurance and contract law.

In any event, Approach 2 would bring all liabilities in-line with active registration contracts.

	Active Registration Contracts	Great-Wested Contracts	Contracts under Approach 1	Contracts under Approach 2
§§ 11 & 12(a)(1) 1933 Act	Protections apply differently, but investors are always protected when it counts Section 11 – Protection against material misstatements and omissions in registration statements Section 12(a)(1) – Protection against Section 5 violations 1 / 3 year statute of limitation running from date of discovery or violation / date of effectiveness			
	Protection reattaches at least annually with each post-effective amendment	Protection expires three years after last effective date, but continues to apply to investment options and reattaches whenever there are material changes to the contract	Same application as Great-Wested contracts	Same application as active registration contracts
§ 12(a)(2) 1933 Act	Protection applies identically to all contracts Protection against material misstatements or omissions in connection with offers and sales 1 / 3 year statute of limitations running from date of discovery / date of offer or sale			
§ 17 1933 Act	Protection applies identically to all contracts General anti-fraud provision of the 1933 Act (generally no private right of action) 5 year statute of limitations running from date of violation			
Rule 10b-5 1934 Act	Protection applies identically to all contracts General anti-fraud provision under the 1934 Act 2 / 5 year statute of limitations running from date of discovery / date of fraud			
§ 34(b) 1940 Act	Protection applies identically to all contracts Protection against material misstatements or omissions (generally no private right of action) 5 year statute of limitations running from date of violation			

Departures from Registration/Disclosure Requirements

As a matter of public policy, registration and disclosure accommodations are not uncommon under the federal securities laws – Great-West relief is not extraordinary

- Suspension of 1934 Act registration/reporting obligations for issuers with a small number of security holders (Section 12(g)(4); Rule 12g-1; Rule 12h-3)
- Exclusion from typical 1940 Act amendment requirements for closed-end investment companies that provide alternative disclosures in annual reports (Rule 8b-16)
- Exclusion from 1933 Act regulation for transactions not involving a public offering (Section 4(a)(2); Regulation D)
- Exclusion from 1940 Act regulation for issuers with a small number of security holders (Section 3(c)(1); Section 3(c)(7))
- Exclusion from requirement to file a new 1933 Act registration statement every three years for various delayed and continuous offerings (Rule 415, e.g., dividend reinvestment plans)
- Significant accommodations to facilitate capital formation under the JOBS Act

Cost Savings – Estimated Cost of Maintaining a Registration Statement Versus a Great-Wested Contract

Based on information provided by certain members, internal business and legal teams typically spend approximately 310 hours in connection with the update of a single active registration statement.

- In this regard, the “soft” costs associated with updating a single registration statement are estimated to be an average of \$25,000.

Based on the same sources of information, the “hard” costs associated with updating a registration statement (including costs associated with, e.g., outside counsel, auditor, typesetting, and mailing) are estimated to be an average of \$170,000.

Estimated Average Total: \$195,000

*** We note that these total time and cost estimates significantly exceed those included in the proposal.

Estimated Cost of Maintaining a Registration Statement Versus a Great-West Contract, cont'd

Based on the same sources of information, internal business and legal teams typically spend approximately 85 hours in connection with the annual documents provided to a single block of Great-West contract owners.

- Accordingly, the soft costs associated with this process are estimated to be on average \$6,800.

The hard costs associated with “updating” a representative Great-West contract (including costs associated with, e.g., outside counsel, auditor, typesetting, and mailing) are estimated to be on average \$14,200.

Estimated Average Total: \$21,000

***These estimates include drafting and mailing a supplement to Great-West contract owners.

The Cost-Savings Under the Summary Prospectus Framework is Not an Adequate Replacement

- We estimate that the annual cost of the proposed USP disclosure regime would be approximately the same as the current cost of updating a registration statement, less the costs of printing and mailing the statutory contract and fund prospectuses, plus the cost of preparing, printing, and mailing the USP.
- We estimate that the annual cost of hypothetical Approach 1 would be approximately the same as the cost of supporting a currently Great-Wested contract, less the costs of printing and mailing financial statements and fund prospectuses, plus any additional cost of preparing, filing, printing, and mailing an annual notice.
- We estimate that the annual cost of hypothetical Approach 2 would be approximately the same as the cost of hypothetical Approach 1, plus auditor costs related to filing financial statements.

In effect, the estimated cost differential between the proposed USP disclosure regime and a hypothetical forward-looking approach would approximate the cost differential between updating a current registration statement versus supporting a Great-Wested contract.

The Fund Appendix – If Fund Data is the “Trade-Off” for Online Delivery, Require only when Delivering Online

In General –

- Insurers should not have liability for inaccurate information provided by fund companies.
- Fund disclosures belong in the fund disclosure documents as part of layered disclosure.

Fund Expense Ratios –

- Insurers cannot “drop-in” the expense ratios presented in fund shareholder reports.
- Obtaining fund expense ratios on a timely and accurate basis is always challenging, often problematic, and sometimes impossible.
- “Timely” for many insurers is as early as April 1st , which is when some insurers start printing prospectuses. A single error or change can have significant consequences.

Fund Performance –

- Fund year-end performance is already stale as of May 1 and only gets staler.
- There are ample user-friendly sources with up-to-date contract and fund performance.

If disclosing this fund data in the fund appendix is the “trade-off” for online delivery of fund prospectuses, make it a requirement associated with online delivery.

Investor Freedom to Elect Manner of Delivery

- Investors should be able to easily elect a preferred manner of delivery for the documents associated with their investments, including prospectuses and other disclosure documents.
- The SEC's 1995, 1996, and 2000 interpretive releases provide guidance on how to accomplish e-delivery. They paved the way for e-delivery, but e-delivery is still severely underutilized.
 - The SEC estimated that only 15% of variable contract disclosure documents are e-delivered.
 - The Committee believes that the SEC overestimated e-delivery elections.
 - The Committee also believes that a much higher percentage of variable contract investors actually prefer e-delivery to paper.
- The problem rests with the unresolved and uncertain application of the E-SIGN Act, which limits the manner in which consent for e-delivery may be obtained.
- **The SEC should update its guidance (or take other action) so that E-SIGN does not restrict the ability of investors to choose how they receive their disclosure documents. This would embrace modernization and future-proofing.**

Vision: Investors can simply check a box in a variable contract application indicating how they would like to receive future information about their contracts, with no additional steps required.

Accumulation Unit Values Should be Eliminated Entirely

- AUVs are no longer a proxy for the price of purchasing a variable annuity contract.
- *Any comparison to a mutual fund NAV is no longer apt.*
- Variable annuity contract owners' expenses are highly dependent on the combination of features they elect. Contracts generally offer extensive feature optionality, each feature with its own fee, and features are not mutually exclusive. Such fees are predominantly assessed at the contract level and are not reflected in the AUVs, making an AUV confusing and potentially misleading.
- *The variability of the charge structure for today's variable annuity is more akin to a variable life insurance contract.*
- The AUV tables are cumbersome, hard to navigate, stale as of the date of the prospectus, and overwhelmingly inapplicable to an individual investor's allocations.
- **A contract owner's unit values are readily available from the insurer, and contract owners typically receive unit values for the subaccounts in which they are invested at least annually, as well as a detailed summary of all contract charges deducted.**

The “Essentially Identical” Standard

- Under the proposal, a single statutory prospectus may describe multiple contracts only if the contracts are “essentially identical.” Also under the proposal, a single registration statement may include prospectuses for multiple contracts only if the contracts are “essentially identical.”
- The examples under the proposal suggest that the essentially identical standard may be unduly restrictive and inconsistent with current practice. They are also conflicting.
- The standard and the associated examples raise concerns that the proposal represents a departure from current practice. They also raise concerns that insurers may be forced to unwind prospectuses and registration statements.
- Suggestions for the Adopting Release:
 - **Confirm no intention to depart from current practice, preserving reasonable flexibility to (i) describe different versions of the same contract in a single prospectus and (ii) have prospectuses for reasonably related contracts in a single registration statement.**
 - **Confirm that insurers will not be forced to unwind prospectuses or registration statements as a result of the rulemaking.**

Existing and Prior Terminology

- Prospectuses, contracts, and marketing materials have long used terminology for fees and charges that differs from the terminology in proposed Item 4 of Form N-3, N-4, and N-6.
 - There is a wide variety of terminology used in the industry.
 - Many insurers use existing policy forms for new offerings.
- Investors would likely be confused by receiving an ISP that uses different terminology than other related documents (such as the contract itself).
- Existing contract owners would certainly be confused by receiving new documents (such as a USP) that suddenly use new and different terminology than the documents they have been receiving for years.
- The imposition of any standardized terminology might obligate an insurer to re-file numerous contract forms with numerous state insurance departments, and the approval process for such filings could take many months or even years.
- **The Commission should permit insurers the flexibility to use existing and prior terminology, as well as new terminology in the future, in the Fee Table (in the ISP, the USP, and the Statutory Prospectus) and in other sections.**

Questions