SEC Adopts New Variable Contract Summary Prospectus Rule

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New Streamlined Disclosure Approach for Variable Contracts

Yesterday, the Securities and Exchange Commission (SEC) adopted Rule 498A - the long-awaited variable contract summary prospectus rule. The new rule represents the culmination of years of coordinated and hard work by the SEC staff and variable contract industry participants to provide variable contract investors with the same type of summary prospectuses that mutual fund investors have enjoyed for years.

New Rule 498A is intended to help investors make informed investment decisions regarding variable annuity and variable life insurance contracts. While the new rule is optional, it will likely be widely used by insurers because it permits them to provide investors with a paper summary prospectus setting forth essential product information in a concise format and to provide other disclosure documents, such as full product prospectuses and Statements of Additional Information, underlying fund summary and full prospectuses, and underlying fund shareholder reports, simply by making them available online.

Benefits of the New Rule

The new rule will provide significant benefits to investors and issuing insurance companies:

• It will 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.

- It will permit insurers and distributors 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 and other disclosure documents available online.

- The new rule also will consider insurers and distributors 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.

Requirements for Using Summary Prospectuses

Insurers that want to provide investors with summary prospectuses are required to do several things:

- Prepare new “Initial Summary Prospectuses” that will be given to new investors, generally in paper form, and file these “ISPs” with the SEC. ISPs must include, among other things, the “Key Information Table” (KIT) and Fund Appendix as proposed.

- Prepare new “Updating Summary Prospectuses” that will be provided to existing contract owners, again in paper form, and file these new “USPs” with the SEC. As with ISPs, USPs must include, among other things, the KIT and Fund Appendix, as well as a summary of any changes to the information required by certain sections of the new Form N-4 or N-6.

- Update existing prospectuses to fall in line with new registration form requirements.

- Post to a website full product prospectuses and Statements of Additional Information (SAIs), underlying fund summary and full prospectuses, SAIs, and shareholder reports.

New Treatment of Great-Wested Contracts

A controversial aspect of the initial rule proposal was its proposed treatment of “Great-Wested” contracts. For one, it was not at all clear whether the SEC would at least “grandfather” existing Great-Wested contracts as of the effective date of the new rule and if so, what requirements would be imposed. Second, it was not clear going forward what requirements would apply to newly Great-Wested or “discontinued” contracts.

Grandfathered Contracts. The Commission decided to grandfather contracts discontinued by July 1, 2020, and to permit insurers to take one of two alternative approaches to updating documents:
• **Conventional Alternative Disclosures.** Insurers may continue to use existing Great-West procedures where the “alternative disclosure” documents (e.g., insurer financial statements and underlying fund prospectuses) are provided to contract owners in paper form; or

• **Modernized Alternative Disclosures.** Use a new “modernized” alternative disclosure approach where a new updating “Notice Document” would be filed with the SEC and provided in paper form to contract owners. This Notice Document would contain the same type of updating information provided by the new USPs. Additionally, insurers would be required to post to a website underlying fund summary and full prospectuses, SAIs, and shareholder reports, as well as the financial statements that under existing Great-West procedures are provided to existing contract owners in paper form. These financial statements would apparently not be required to be filed with the SEC.

It does not appear that the SEC’s new no-action position permitting the “modernized” alternative disclosure document delivery approach could be used for May 1, 2020 mailings; the currently required alternative disclosure documents would need to be delivered in paper form. Therefore, as a practical matter, they could first be used for May 1, 2021 updates.

Now, the “real work” begins for insurers and their business partners – tasks will include, among others, developing timelines, coordinating with underlying funds to amend participation agreements, updating prospectuses in accordance with the new registration form disclosure requirements, identifying contracts that may be discontinued prior to July 1, 2020, deciding whether to use the “Modernized Alternative Disclosure” approach for discontinued contracts, and developing and maintaining compliance procedures for the website. There will be a number of interpretive questions that will arise, as well as implementation questions regarding aspects of the rule such as filing requirements and calculation of underlying funds perform.

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