EVERSHEDS SUTHERLAND

RILA revolution:

SEC adopts tailored registration framework for RILAs and MVAs

On July 1, 2024, the Securities and Exchange Commission (SEC) adopted rule and form amendments to provide a tailored registration framework for registered index-linked annuities (RILAs) and registered market value adjustment annuities (MVAs).[1] The new framework will *require* RILAs and MVAs to be registered on Form N-4, the same form used to register variable annuities (VAs). To address the risks and feature functionalities of RILAs and MVAs, the SEC significantly amended Form N-4, although certain of the amendments are also applicable to VAs.

This alert summarizes the most important aspects of the SEC rulemaking. It assumes a working knowledge of the RILA and MVA product designs. If needed, a helpful overview of how RILAs and MVAs generally work can be found in the Adopting Release, available here.

The new Form N-4 framework is a welcome and long-awaited regulatory overhaul. For decades, insurance companies in the RILA or MVA market have been navigating the complexities and burdens of registering securities on Form S-1 or Form S-3 – the SEC's default registration forms under the Securities Act of 1933 (1933 Act), and the same registration forms used by public companies selling stocks and bonds. Foremost among the many ill-fitted aspects of the S-1/S-3 framework, RILA/MVA issuers are required to prepare GAAP financial statements (absent exemptive relief) as well as robust company-related disclosures (designed for investors in stocks or bonds, not purchasers of insurance contracts). The burdens associated with the S-1/S-3 framework are so complicating and resource-intensive for insurers that they have been a serious barrier to market entry and innovation, even as RILA sales ballooned in recent years.

Fortunately, the new Form N-4 framework will largely eliminate these concerns, and in that sense, the new Form N-4 framework is indeed a revolution.

Highlights Of The New Framework

RILAs and MVAs will now share the same SEC disclosure and filing framework as VAs.

- ***Form N-4:*** RILAs and MVAs (including RILA/MVA investment options in combination contracts) will be registered on Form N-4.[2] Forms S-1 and S-3 will no longer apply. *See* "II. Amendments to Form N-4" for more information about the Form N-4 amendments.

- ***Use of SAP Financial Statements:*** The conditional GAAP relief in Form N-4 has been extended to RILAs and MVAs. RILA and MVA issuers will be permitted to use statutory (SAP) financial statements specifically designed for insurance companies, in lieu of GAAP financial statements, to the same extent as VA issuers. *See* "III. Financial Statement Requirements."

- ***No Public Company Disclosures:*** The SEC limited company-related disclosures (as opposed to product-related disclosures) to the items that were already included in Form N-4 (*e.g.*, name, address, material legal proceedings, financial statements).[3] As such, RILA and MVA prospectuses on Form N-4 will not include disclosure for management's discussion and analysis of financial condition and results of operations (MD&A), executive compensation, industry risk

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[1] Release Nos. 33-11294; 34-100450; IC-35273; File No. S7-16-23 (Adopting Release). This rulemaking is the direct result of congressional legislation enacted in 2022, commonly referred to as the RILA Act, which required the SEC to adopt a registration form tailored for RILAs. *See* Division AA, Title I of the Consolidated Appropriations Act, 2023 (Pub. L. No. 117-328).

[2] RILA and MVA registration statements on Form N-4 will be subject to Inline XBRL tagging requirements.

[3] There is one minor exception. RILA/MVA issuers must comply with Item 304 of Regulation S-K if there has been a recent change in or disagreement with an independent accountant.

factors, etc. Nor will they include the SEC's highly controversial climate risk disclosures.

- ***Extension of VA Filing Rules:*** Rules 485 and 497 under the 1933 Act will apply to RILA and MVA post-effective amendments and supplements, respectively. The extension of Rule 485 is especially important, as it will finally allow RILA/MVA issuers to go immediately effective on routine annual updates and other eligible amendments. Rule 415 under the 1933 Act has also been amended to eliminate 3-year refreshes (*i.e.*, the requirement to file a new registration statement every three years).

- ***Summary Prospectuses:*** The SEC extended Rule 498A – the summary prospectus rule for variable insurance contracts – to RILAs and MVAs. Subject to the requirements of Rule 498A (such as website posting), RILA/MVA issuers will be permitted to use initial summary prospectuses (ISPs) with new customers and updating summary prospectuses (USPs) with existing customers, with the statutory prospectus available upon request.

- ***Registration Fees:*** Registration fees for RILAs/MVAs on Form N-4 will be paid annually in arrears on a net basis via Form 24F-2. *See* "IV. Registration Fees."

As further discussed under "VII. Important Dates," the effective date for the rulemaking is September 23, 2024. May 1, 2026 is the compliance date, by which time all RILAs and MVAs (as well as VAs) registered with the SEC must be in compliance with the new Form N-4 framework.

Amendments To Form N-4

Form N-4 has been significantly amended to add disclosure requirements for RILAs and MVAs.[4] The amendments reflect the SEC's focus on clearly communicating material information related to RILAs and MVAs, which the SEC consider to be complex products. Of course, most of the SEC's amendments call for basic information about a RILA's or MVA's features and risks. For example, the amended instructions require summary and detailed explanations of how gains and losses are calculated using a RILA's bounded return structure (*i.e.*, index, crediting period, upside feature, downside feature), similar to what was included in a S-1/S-3 prospectus. However, other amendments call for novel disclosures and, in some cases, disclosures that commenters did not support as part of the SEC's proposal. The following highlights those more noteworthy amendments.

Current Upside Rates

The amendments require RILA issuers to disclose the current upside rate(s) (*e.g.*, cap rate, participation rate) available for each index-linked option as part of the prospectus. This is a departure from historical practice, as current upside rates have traditionally been disclosed outside of the prospectus (in sales kits, online, and/or through other communications). But in recognition of the burdens and difficulties that would be associated with frequent prospectus updates (as current upside rates often change on a monthly, weekly, or even daily basis), Form N-4 will permit RILA issuers to disclose current upside rates *by posting them on a website*. The website must be publicly accessible, free of charge, and expressly incorporated by reference into the prospectus. The incorporated webpage will be legally part of the prospectus, and disclosure liability will fully attach to the information included on the website.

Any RILA issuer that opts to disclose its current upside rates via a website (as opposed to supplementing the prospectus using Rule 497 supplements) must annually file an exhibit to the registration statement containing the upside rates that were in effect during the previous calendar year for each index-linked option.

- The adoption of this novel "website approach" for disclosing current upside rates is an extraordinary outcome for insurers. It was proffered to the SEC by the insurance industry as a way to avoid the mandatory "497 approach" that the SEC originally proposed.

- The website approach may serve as a groundbreaking precedent for electronic delivery frameworks in other SEC contexts.

Maximum Potential Loss

Numerous sections of the prospectus must include maximum potential loss disclosure. The prescribed disclosures relate to (i) the maximum amount of loss an investor could experience from negative index performance at the end of the crediting period, and/or (ii) the maximum amount of loss that could be incurred from a negative "contract adjustment" (*i.e.*, negative interim value adjustment or negative MVA). The prescribed disclosures are both narrative and numeric in nature. For example, and entirely depending on the product design being described, a RILA issuer may need to disclose (in several places) that an investor could lose 90% of their investment at the end of a crediting period for an index-linked option with a -10% buffer, and could lose 100% of their investment due to a negative contract adjustment.

- For other securities (including variable contracts and mutual funds), the SEC does not require maximum potential loss disclosure, even when those investments provide no downside protection. The SEC recognized this in the Adopting Release, but justified these disclosures on the grounds that loss protection is a central feature of RILAs, and that RILA investors particularly need to understand the limited scope of any such protection. Commenters argued that the prescribed disclosures grossly overstate the risk of loss associated with RILAs.

[4] Please note that this alert does not include an item-by-item breakdown of the amended form and does not cover every amended form item.

Characterization of Contract Adjustments as Charges

Contract adjustments are gain or loss calculations that may be triggered when amounts are withdrawn or otherwise removed from a RILA or MVA investment option. They may come in the form of an interim value adjustment under a RILA, or a market value adjustment under either a RILA or an MVA. Several Form N-4 amendments adopted by the SEC come very close to characterizing contract adjustments as fees and charges under the contract. For example, the first section of the KIT has been renamed "Fees, Expenses, and Adjustments;" the Fee Table will include a *new* table titled "Adjustments"; and additional disclosure about contract adjustments will be included in the charges section, which has been re-titled "Charges and Adjustments."

- Commenters argued that contract adjustments should not be characterized in this manner because they are not conventional charges and can actually result in gain. The SEC recognized this in the Adopting Release but views the economic consequences of negative contract adjustments as akin to transaction charges. Accordingly, the SEC decided that contract adjustment disclosure should appear in close proximity to fee and charge disclosure.

Guaranteed Downside and Upside Rates

In several sections of the prospectus, RILA issuers will have to either (a) prominently disclose any minimum limits on index losses that will always be available under the contract (*e.g.*, guaranteed minimum buffer rate or floor rate) or (b) if there is no such minimum limit, state that the company does not guarantee that the contract will always offer index-linked options that limit index losses, which would mean loss of the entire amount invested. Similarly, and also in several sections of the prospectus, RILA issuers will have to prominently state the "lowest limit" on index gains that may be established under the contract (*e.g.*, guaranteed minimum cap rates).

- *Commenters argued that these types of disclosures would indirectly regulate product design, which is the province of the states. In response, the SEC somewhat backed-off by not necessarily requiring guaranteed downside rates, as reflected above, though it still settled on requiring guaranteed upside rates.*

- *Even the SEC's compromise on guaranteed downside rates is not especially meaningful, as RILA issuers who do not guarantee minimum downside rates may not be comfortable stating that their RILAs may not offer <u>any</u> index-linked options with downside protection.*

Index Disclosures

In addition to index disclosures to which RILA issuers have grown accustomed (*e.g.*, disclosures about an index's methodologies, risks, and return calculations), the SEC amended Form N-4 to require a novel index performance bar chart. The bar chart must show the annual return for each of the last 10 calendar years (or for the life of the index if less than 10 years). The bar chart must also reflect index returns after applying a hypothetical 5% cap and -10% buffer. The bounded return structure overlay is generally standardized. Additional performance presentations are not permitted.

Investment Option Appendix

Building on Form N-4's existing Fund Appendix, which provides basic information about a VA's underlying mutual funds in a tabular format, the SEC expanded the appendix to also cover RILA, MVA, and unregistered fixed investment options, as applicable. In doing so, the SEC has re-titled the appendix "Investment Options Available Under the Contract."

As part of the expanded appendix, a new table must be included for each RILA option offered under a contract. The table will generally include (i) the name of the index, (ii) the type of index, (iii) the length of the crediting period, (iv) the index crediting methodology, (v) the current limit on index loss if held until the end of the crediting period (*i.e.*, the downside feature and rate); and (vi) the minimum limit on index gain that may be established for the life of the index-linked option (*i.e.*, upside feature and guaranteed minimum rate). RILA issuers must also include certain footnotes to the table (*e.g.*, stating that the index is a "price return" index). Also, another new table is required for each MVA and unregistered fixed option offered under a contract. For each such option, the table must state the name of the option, the length of the interest term, and the minimum guaranteed interest rate. Each table is to be accompanied by legends prescribed by the SEC.

Re-Presentation of the Overview and Key Information Table

The SEC's amendments swap the order of the Overview section (Item 2) and the Key Information Table (KIT) (Item 3), with the Overview now appearing immediately before the KIT. In addition, the final amendments require the KIT to be reformatted into a prescribed Q&A format. The line items of the KIT must be rephrased into questions, with the related response beginning with a bold "Yes" or "No" except as otherwise provided by the form. These changes (among others) apply to *all* contracts registered on Form N-4, including RILAs, MVAs, and VAs, and carry over to initial summary prospectuses under Rule 498A.

Financial Statement Requirements

Under the S-1/S-3 framework, if a RILA/MVA issuer wished to use SAP financial statements in lieu of GAAP financial statements in its SEC registration statement, the issuer had to go through a lengthy exemptive relief process pursuant to Rule 3-13 of Regulation S-X. This relief had only been available, if at all, to RILA/MVA issuers on Form S-1. Under Form N-4, RILA/MVA issuers will be permitted to use SAP financial statements to the same extent as currently permitted for VA issuers. As with VAs, the GAAP relief built-into Form N-4 is conditional and generally depends on whether the issuer is otherwise preparing GAAP financial statements and/or GAAP information for itself or a parent company.

Also, under the S-1/S-3 framework, if a RILA/MVA issuer files a new registration statement or amendment off-cycle (generally outside of the May 1 annual update timeframe), Rule 3-12 of Regulation S-X calls for unaudited interim financial statements (stub financial statements). These stub financial statements, when applicable, are in addition to the audited year-end financial statements that are always required. Form N-4 includes relief from stub financial statement requirements, and this relief will apply to RILAs and MVAs. However, this relief is limited in that there are some circumstances under which stub financial statements are required under Form N-4. For example, stub financial statements will be necessary if the effective date is within 90 days after fiscal year end and audited financial statements for the prior fiscal year are not yet available. Stub financial statements may also be necessary if the insurance company's financial statements have never been included in a 1933 Act registration statement for an annuity or life insurance product.

- These changes are transformative for the RILA space. The need to prepare GAAP financials statements was a large barrier to market entry, and stub financial statement requirements significantly hindered the ability of RILA issuers to readily change their product offerings in reaction to market volatility, consumer demand, etc.

Registration Fees

The SEC amended Rule 456 and Form 24F-2 to require RILA and MVA issuers to pay registration fees using the same method as for VAs. As a result, when registering a RILA or MVA on Form N-4, (i) an indeterminate amount of securities will be deemed to be registered upon effectiveness, and (ii) registration fees must be paid annually in arrears, based on net sales, within 90 days after fiscal year-end on Form 24F-2. Importantly, insurance companies will be allowed to take credits for RILA/MVA interests that were previously registered on Form S-1/S-3 and remained unsold upon converting to Form N-4.

- Access to the 24F-2 framework will reduce registration fees compared to the S-1/S-3 framework, which requires registration fees to be paid in advance and prohibits the netting of sales and redemptions. The 24F-2 framework also eliminates the possibility that a RILA/MVA issuer may violate the 1933 Act by inadvertently overselling its registered interests, which is a major concern under the S-1/S-3 framework.

Reporting Under The 1934 Act

Upon registering a RILA or MVA with the SEC, Section 15(d) of the 1934 Act requires the issuer to begin filing periodic and current reports—including annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K—unless a reporting exemption otherwise applies. The new framework *does not* change this regulatory scheme. The registration of a RILA or MVA on Form N-4 will continue to trigger 1934 Act reporting absent an applicable exemption.

Under the S-1/S-3 framework, RILA/MVA issuers registered on Form S-3 are necessarily required to file 1934 Act reports (it is a condition of Form S-3), but RILA/MVA issuers on Form S-1 have generally avoided 1934 Act reporting by relying on Rule 12h-7. Rule 12h-7 is a conditional exemption for insurance companies that register insurance products with the SEC. Under the new Form N-4 framework, RILA/MVA issuers that wish to avoid 1934 Act reporting will likewise need to rely upon and comply with Rule 12h-7.

One important condition of Rule 12h-7, set forth in Rule 12h-7(e), requires the insurer to take steps reasonably designed to ensure that a trading market for the security does not develop. As part of that condition, the insurer must require advance written notice of assignments and reserve the right to refuse assignments on a non-discriminatory basis, *except to the extent prohibited by state law* (anti-assignment clause requirement). The anti-assignment clause requirement may prove problematic for some RILA/MVA issuers on Form S-3 that want to stop 1934 Act reporting upon converting to Form N-4. These issuers may not have included an anti-assignment clause in their outstanding policy forms, possibly raising questions about their ability to begin relying on Rule 12h-7. In response to commenters raising this potential problem, the SEC stated that the issuer would not need to modify its outstanding contracts to include an anti-assignment clause where doing so would be prohibited by state law. This appears to provide a potential path for S-3 issuers to begin relying on Rule 12h-7 even though their *outstanding* contracts may not include anti-assignment provisions.

- For states that permit anti-assignment provisions, insurers will need to analyze on a state-by-state basis whether the general inability to unilaterally endorse a contract, i.e., absent contract owner consent, with a more restrictive provision is sufficient to fit under the state prohibition exception in Rule 12h-7(e).
- With regard to any newly issued RILA/MVA contracts registered on N-4, it appears that such contracts would need to include anti-assignment clauses for contracts issued in those states that permit such clauses. Notably, the Interstate Insurance Product Regulation Commission (Compact) Uniform Product Standards defer to state law on this point. As such, the permissibility of an anti-assignment clause would not depend on whether a contract is approved through the Compact.

Advertising

Amendments to Rule 156

The SEC amended Rule 156 to encompass RILA and MVA sales literature. Rule 156 is an interpretive rule under the 1933 Act that provides non-exhaustive factors to be weighed in consideration of whether investment company sales literature may be materially misleading. Without modifying any of those factors, the SEC expanded Rule 156 beyond investment company sales literature to also include RILA and MVA sales literature.

As part of the Adopting Release, when explaining the Rule 156 amendments, the SEC highlighted certain RILA (and MVA) advertising practices that are "particularly susceptible" to materially misleading statements. Most notably, these include (i) portraying a RILA contract as a low cost or no cost investment, without qualifying statements or explanations regarding explicit/implicit costs; (ii) making statements regarding index returns without explaining the difference between a price return index and a total return index; (iii) describing a RILA as a growth product without noting features that may limit gains (*e.g.*, caps); (iv) generally advertising an index-linked option feature (*e.g.*, the specific index, upside feature, downside feature) that is not guaranteed to be available for the life of the contract without disclosing the insurer's discretion in offering that feature; (v) highlighting downside protections without noting the costs and limitations associated with those protections; and (vi) the inclusion of historical RILA performance, given the sensitivity of returns to personal circumstances and the frequency at which RILA terms can change.

- There is no compliance period for the Rule 156 amendments. It would be prudent for insurers to promptly review their RILA and MVA marketing materials in light of the SEC's guidance.
- RILA illustrations will continue to be an area to watch. We expect presentation, formatting, and content requirements associated with RILA illustrations will continue to evolve as the SEC and FINRA further refine their views on RILA advertising practices.

Rule 482 & Rule 433

The SEC *did not* extend Rule 482 under the 1933 Act to RILAs or MVAs. Rule 482 is a liberal, free writing advertising rule that facilitates the ability of investment companies to advertise their securities. It is available for VAs, which are investment company securities. While Rule 482 ads are subject to some conditions (*e.g.*, legends), there is no requirement for a Rule 482 ad to be accompanied or preceded by the prospectus. This stands in stark contrast to Rule 433, as discussed below.

Because the SEC did not extend Rule 482 to RILAs and MVAs, the free writing advertising rule applicable to RILAs and MVAs will continue to be Rule 433 under the 1933 Act. Rule 433 sets forth the conditions for using free writing prospectuses (FWPs). One such condition relates to prospectus delivery. Generally speaking, under Rule 433, RILA/MVA issuers registered on Form S-3 are not subject to a prospectus delivery requirement when using FWPs, whereas RILA/MVA issuers registered on Form S-1 must ensure that the prospectus accompanies or precedes an FWP.

The prospectus delivery requirement under Rule 433, when applicable, has a severe impact on an issuer's ability to advertise on a broad basis, such as in print or on television. It is practically impossible (using conventional methods) to deliver a prospectus to every viewer of a television commercial or every reader of a print ad. As a result, for RILA/MVA issuers on Form S-1, broad-based advertising has generally been limited to the online setting, where they can use active hyperlinks to deliver the prospectus. Conversely, RILA/MVA issuers on Form S-3 have not been so constrained, and some have taken full advantage of that flexibility under Rule 433.

Insurance companies hoped that the SEC would make it easier to advertise RILAs and MVAs, if not by expanding Rule 482, then by eliminating the prospectus delivery requirement under Rule 433 insofar as it may apply to a RILA/MVA issuer. The SEC did not do either. Instead, the SEC adopted a technical amendment to Rule 433 that preserves the status quo. With this amendment, issuers that file reports under the 1934 Act and would otherwise be eligible to use Form S-3 (but for the requirement to register RILAs/MVAs on Form N-4) will not be subject to the prospectus delivery requirement when using FWPs for their RILAs/MVAs. All other RILA/MVA issuers, *i.e.*, those that do not file reports under the 1934 Act, will be subject to the prospectus delivery requirement when using FWPs.

- The SEC's unwillingness to amend Rule 482 is especially disappointing. Yet, there appears to be some hope for the future. In the Adopting Release, the SEC acknowledged that amendments to Rule 482 "would benefit from further consideration" and invited further engagement on the issues. We fully expect the insurance industry to continue its pursuit of a more uniform advertising framework for SEC-registered insurance products.

Important Dates

The effective date for the rulemaking is September 23, 2024. The general compliance date will be May 1, 2026. Issuers with RILAs, MVAs, or VAs should take note of the following:

- ***New RILAs/MVAs:*** Any new RILAs or MVAs must be registered on Form N-4 if the effective date is to be on or after May 1, 2026.

  Even though it may be permissible to file a new RILA/MVA on Form S-1/S-3 prior to the compliance date, there may be few reasons for doing so, especially because any new S-1/S-3 registration statement would need to be converted to Form N-4 no later than May 1, 2026.

- ***Existing RILAs/MVAs:*** Any RILA or MVA registered on Form S-1 or S-3 must be converted to Form N-4 no later than May 1, 2026.

  RILA/MVA issuers can convert their S-1/S-3 registration statements by filing a post-effective amendment pursuant to Rule 485(a) under the 1933 Act (subject to SEC staff review). For issuers with multiple RILA/MVA registration statements, template relief may be requested pursuant to Rule 485(b)(1)(vii).

- ***VAs:*** VA issuers must comply with the Form N-4 amendments applicable to VAs no later than May 1, 2026.

For standalone VAs (not combination VAs/RILAs or VAs/MVAs), issuers may comply with the amendments by filing a post-effective amendment pursuant to Rule 485(b), which may go immediately effective and is not subject to SEC staff review and comment.

- ***Rule 156 Amendments:*** There is no compliance period for the Rule 156 amendments. Rule 156, as amended, will cover RILAs and MVAs as of the effective date.
- The SEC's guidance relating to Rule 156 could be read as a roadmap for a future enforcement action. It would be prudent for RILA/MVA issuers to promptly review their marketing materials, at least to the extent possible prior the compliance date.

Potential Future Rulemakings

While this rulemaking represents a tremendous victory for the insurance industry and the growth of the RILA market, several important issues remain unresolved, such as the following:

- ***Rule 482 Amendments:*** Amendments to Rule 482 are still needed to align the advertising frameworks for SEC registered insurance products.
- ***RILUs and VLs:*** The SEC did not adopt conforming amendments to Form N-6. Conforming amendments are needed to provide a tailored registration form for registered index-linked universal life insurance (RILUs), an emerging product category. Until then, RILUs will continue to be registered on Form S-1/S-3. Conforming amendments are also needed to realign the form instructions under Form N-4 and Form N-6 for VAs and variable life insurance policies (VLs), respectively.
- ***CDAs:*** The SEC did not amend Form N-4 to cover contingent deferred annuities (CDAs), another emerging product category. Like RILUs, CDAs will continue to be registered on Form S-1/S-3 until there is a tailored registration form.
- ***No Broad GAAP or Regulation S-K Relief:*** The SEC did not provide any relief allowing insurance companies to use SAP financial statements in lieu of GAAP financial statements, or omit company-related disclosures required by Regulation S-K, for insurance products that remain registered on Form S-1/S-3 (such as RILUs or CDAs).

In general, the SEC viewed these matters as outside the scope of this rulemaking, but recognizes that they warrant further consideration for potential future rulemakings. Insurance companies will push for these issues to have a place in the SEC's future rulemaking agenda.

Conclusion

A tailored RILA and MVA registration form and comprehensive SEC regulatory framework is nothing short of groundbreaking for the registered insurance space. Investors will be presented with the information they need, in a reader-friendly format, to better understand RILA and MVA risks and benefits, and RILA and MVA issuers will finally be operating within an SEC regulatory framework that is fitted to insurance offerings. The rule and form amendments will undoubtedly facilitate industry growth and pave the way for retirement product innovation.

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed or the Eversheds Sutherland attorney with whom you regularly work.

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