UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MENT MANAGEMENT

November 7, 1996

Dear Registrant:

This letter provides general guidance to variable annuity, variable life, and other insurance company investment contract registrants in connection with the preparation of disclosure documents and other filings with the Securities and Exchange Commission ("Commission"). These comments represent the views of the Division of Investment Management ("Division") and do not necessarily reflect the views of the Commission. Prior industry comment letters may also contain additional information of interest to insurance company registrants.

I. PROSPECTUS IMPROVEMENT

In past letters to registrants, the staff has encouraged registrants to improve prospectuses by making them more concise, direct, and understandable. Some registrants have undertaken efforts to produce prospectuses that are more user-friendly and readable. We continue to encourage registrants to review their prospectuses with the goal of eliminating unnecessary legal terms, jargon, and long and complicated disclosure. *See* General Instruction I of Form N-4; General Instruction I of Form N-3; General Instruction G of Form N-1A. The staff has assisted, and will continue to assist, registrants who review, rewrite, and improve fund prospectuses. Registrants are encouraged to submit drafts of revised prototype prospectuses for review by the staff prior to filing.

The staff also encourages registrants to consider whether the use of a variable annuity profile in conjunction with the prospectus would facilitate investor understanding. *See* Letter from Heidi Stam, Associate Director, to Mark J. Mackey, President & Chief Executive Officer, National Association for Variable Annuities (June 4, 1996).

II. RECENT DEVELOPMENTS

A. Fee Disclosure

The staff is giving particular scrutiny to disclosure of fees in its review of separate account prospectuses. The Division has recently emphasized the need for disclosure in a separate account prospectus to communicate clearly to investors in one place the combined effect of all fees and charges, including rule 12b-1 fees, imposed by the separate account and the underlying fund. *See* Letter from Heidi Stam, Associate Director, to American Council of Life Insurance, Investment Company Institute, and National Association for Variable Annuities (May 30, 1996). The relatively complex fee structure of many variable annuity

and variable life insurance products makes it particularly important that all fees and charges be clearly communicated to investors in an integrated and understandable format. Registrants are encouraged to review their fee disclosure and make appropriate changes.

B. Allocation of Premiums During Variable Life Insurance Free-Look Period

Several recently-filed registration statements have raised the issue of whether rule 22c-1 under the Investment Company Act of 1940 ("Investment Company Act" or "1940 Act") prohibits an insurer from requiring that premiums be allocated to a general account investment option during the free-look period of a variable life policy. The staff has determined that it will not object to such a requirement when the variable life policy provides for a refund of premiums, rather than a refund that reflects investment experience, upon exercise of the free-look right. When the variable life policy provides for a refund of premiums, an insurer also may require that premiums be allocated to a money market investment option during the free-look period. *See* Separate Accounts Funding Flexible Premium Variable Life Insurance Contracts, Inv. Co. Act Rel. No. 15651 n. 87 (Mar. 30, 1987).

In the case of a variable annuity contract, the staff has previously determined that an insurer may require that purchase payments be allocated to a money market investment option during the free-look period. *See* MONY America Variable Account A (pub. avail. Oct. 26, 1988); LBVIP Variable Annuity Account I (pub. avail. Jan. 22, 1988); Fidelity Investments Variable Annuity Account I (pub. avail. Dec. 8, 1987). The staff has, however, declined to grant no-action assurance to permit mandatory allocation to an insurer's general account during the free-look period of a variable annuity contract. *See* Xerox Variable Annuity Account One (pub. avail. Apr. 30, 1991). Given the staff's determination that allocating variable life premiums to the general account during the free-look period is not prohibited by rule 22c-1 when the policy provides for a refund of premiums, the staff would be willing to reconsider the free-look issue in the context of variable annuities.

C. Partial Withdrawals from Variable Life Insurance Policies

Several recently-filed registration statements have raised the issue of whether flexible premium variable life insurance policies may restrict partial withdrawals without violating the redeemability requirements of the Investment Company Act. *See* Investment Company Act §§ 2(a)(32), 22(c), 27(i)(2)(A); Rule 22c-1. The staff has determined that it will not object to such restrictions. *See* Rule 6e-3(T)((b)(13)(iv) (exemption from redeemability requirements for flexible premium variable life). Partial withdrawals from variable annuity contracts may not, however, be restricted during the pay-in period. *See* Adoption of Rules 14a-2, 15a-3, 16a-1, 32a-2, 22e-1, 27c-1, 27a-1, 27a-2, 27a-3 and 0-1(e), Inv. Co. Act Rel. No. 5738 (Jul. 10, 1969); Letter to Registrants from Brenda D. Sneed, Assistant Director, Office of Insurance Products (Nov. 3, 1995).

III. PROCEDURAL MATTERS

A. Recent Legislation

On October 11, 1996, President Clinton signed into law H.R. 3005, the National Securities Markets Improvement Act of 1996 (the "Act"). Section 205 of the Act amends Sections 26 and 27 of the Investment Company Act, replacing the existing specific limits on the amount, type, and timing of charges that apply to variable insurance contracts. Instead, aggregate charges under variable insurance contracts are required to be "reasonable in relation to the services rendered, the expenses expected to be incurred, and the risks assumed by the insurance company." Act § 205(a) (adding Investment Company Act § 26(e)(2)(A)).

1. Pending Applications

The Act's "reasonableness" standard is effective immediately, generally rendering unnecessary individual exemptive relief relating to contract charges, *e.g.*, mortality and expense risk applications, stair-step applications, and "DAC" tax applications. Any applicant with a pending request for exemptive relief that has been rendered moot by the Act should request that its application be withdrawn. Such requests should be made in writing and directed to the staff member assigned to review the application.

2. "Reasonableness" Representation in Registration Statements

The Act requires the sponsoring insurance company for a variable insurance contract to represent in the contract's registration statement that the charges deducted meet the statutory "reasonableness" test. Registrants should note that this representation requirement is effective beginning on the earlier of (i) August 1, 1997, or (ii) the earliest effective date of any registration statement or amendment for a variable insurance contract following October 11, 1996. The staff has received several questions about the representation requirement; the staff's answers follow.

Q1: Where should the required representation be located?

A1: The required representation should be included with the undertakings required by the applicable registration statement. *See* Form N-3, Part C, Item 37; Form N-4, Part C, Item 32; Form S-6, Undertaking to File Reports.

Q2: What language should be used to make the required representation?

A2: Registrants should use language that fully communicates the content prescribed by the Act.

Q3: What action should a registrant take if it inadvertently omitted the required representation from an initial registration statement for a variable insurance contract (or an amendment thereto) that became effective after October 11, 1996?

A3: An amendment pursuant to rule 485(b) of the Securities Act of 1993 ("1933 Act") may be used to add the required representation.

Q4: Does the inclusion of the required representation in a post-effective amendment otherwise eligible for filing pursuant to rule 485(b) make the amendment ineligible for filing pursuant to rule 485(b)?

A4: No. The amendment remains eligible for filing pursuant to rule 485(b).

Q5: Does the representation requirement apply to a registrant that obtained an exemptive order for the deduction of contract charges prior to enactment of the legislation?

A5: Yes. The "reasonableness" requirement of the statute is effective immediately and supplants existing exemptive orders. A registrant with an existing exemptive order therefore is required to comply with the representation requirement in the manner specified by the Act.

Q6: The staff has permitted variable insurance registrants that are no longer selling contracts to cease filing post-effective amendments and delivering updated prospectuses in certain circumstances. *See* Great-West Life and Annuity Insurance Co. (pub. avail. Oct. 23, 1990). Is such a registrant required to file a post-effective amendment including the "reasonableness" representation?

A6: The registrant generally would be required to file a post-effective amendment including the "reasonableness" representation. It would be acceptable for the amendment to contain the "reasonableness" representation only, with the content of the previously-filed registration statement incorporated by reference. Because such a registrant would not otherwise be amending the registration statement, the registrant would have until August 1, 1997, to make the required amendment.

B. Reorganization of the Office of Insurance Products

The Office of Insurance Products has been reorganized in order to streamline its operations. The Office has been split into two branches, each headed by a Branch Chief responsible for all matters within the branch, including disclosure review, exemptive applications, and legal interpretations. Kevin Kirchoff and Patrice Pitts have been named as Branch Chiefs.

Each registrant will be assigned to a particular branch and to a particular staff member within the branch. The assigned branch and staff member will handle all matters related to the registrant except in cases, such as workload imbalances, where the Office must reallocate work to perform it more efficiently. In the first instance, registrants should direct all questions to the assigned staff member or Branch Chief.

The Office has completed the process of assigning registrants to branches and staff members. Registrants may ascertain their branch and staff assignments by contacting Evelyn Malone, (202) 942-0670. In order to avoid unnecessary reallocation of work, matters filed with the Office prior to the reorganization will be handled by the staff member to whom they were previously assigned.

The position of Chief Financial Analyst has also been created within the Office. The Chief Financial Analyst will oversee the financial and accounting aspects of matters within the Office and provide financial and accounting expertise to both branches. Cindy Rose has been named as Chief Financial Analyst.

The reorganization has been undertaken to improve the efficiency of Office operations by increasing staff familiarity with the operations and disclosure documents of particular registrants, consolidating responsibility for related matters, providing registrants with a consistent staff contact, and providing greater focus on financial and accounting issues. We believe that the reorganization will maximize the use of scarce Commission resources and facilitate more expeditious handling of registrant matters.

C. Applicability of Rule 485(b) to Performance Information and Addition of Underlying Funds

Recently, several registrants have asked whether performance information may be added to a registration statement through a post-effective amendment filed pursuant to rule 485(b). The staff has no objection to the use of a rule 485(b) amendment to update performance numbers that were included in a previous filing. The staff believes, however, that an amendment pursuant to rule 485(a) is appropriate when other changes are being made to performance information. For example, if a registrant is adding a category of performance information to a registration statement for the first time or modifying a calculation method, a rule 485(a) amendment should be used.

Several registrants have also asked whether a rule 485(b) amendment may be used to add underlying funds to a separate account prospectus. Paragraph 485(b)(1)(viii) states that rule 485(b) may be used by a separate account registrant to make changes that reflect changes to disclosure in the registration statement of the investment company in which the separate account invests all of its assets. This includes the addition of a new series to the investment company in which a separate account invests all of its assets. *See* Post-Effective Amendments to Investment Company Registration Statements, Inv. Co. Act Rel. No. 20486 (Aug. 17, 1994), at 8. The staff also would not object to the use of a rule 485(b)

amendment to add underlying funds to a separate account prospectus in situations outside the strict parameters of paragraph 485(b)(1)(viii), *i.e.*, when a new underlying fund is not a series of the investment company in which a separate account invests all of its assets.

D. Selective Review and Paragraph 485(b)(1)(ix)

The staff continues to encourage registrants to use the administrative procedures available to streamline the review of disclosure filings.

1. Selective Review

Registrants are encouraged to request selective review of filings. A request should be made in the transmittal letter accompanying the filing. The request should include: (i) a statement indicating whether the disclosure has been reviewed by the staff in some other context; (ii) a statement identifying prior filings that the registrant considers similar to, or intends as precedent for, the current filing; (iii) a summary of the material changes made in the current registration statement from the previous filings; and (iv) any specific areas that warrant particular attention. A registrant should mark the current filing to show changes from the previously reviewed filing. *See* Revised Procedures for Processing Registration Statements, Post-Effective Amendments and Preliminary Proxy Materials Filed by Registered Investment Companies, Investment Co. Act Rel. No. 13768 (Feb. 15, 1984). The Office of Insurance Products generally will accord selective review to a Form N-1A registration statement for an underlying fund based on prior review of a similar filing by the Division's Office of Disclosure and Review.

The staff sometimes receives transmittal letters that indicate generally that a filing is similar to, or based on, another previously reviewed filing, without requesting selective review or specifically identifying the changes from the previous filing. Registrants should note that, in these cases, the staff may not have sufficient information to accord selective review without further direction from the registrant. To avoid any delay associated with the staff seeking further clarification, registrants are encouraged to use the selective review procedures outlined above in the first instance.

2. Paragraph 485(b)(1)(ix)

Paragraph 485(b)(1)(ix) provides that a rule 485(b) filing may be made for any purpose that the Commission approves. The authority to approve additional purposes under paragraph 485(b)(1)(ix) has been delegated to the Assistant Director, Office of Insurance Products. Registrants have, for example, been granted approval under paragraph 485(b)(1)(ix) when they were simultaneously making a number of filings that contained identical changes, rendering separate staff review of each filing duplicative. Any registrant desiring to make a request under paragraph 485(b)(1)(ix) should direct a written request to the Assistant Director, Office of Insurance Products. Prior to submitting the formal written

request, the registrant may wish to discuss it with the appropriate Branch Chief or staff member.

E. Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR")

1. Filing a New Contract to be Sold Through an Existing Separate Account

New fee payment procedures have resulted in a change to the mechanism for filing a new contract to be sold through an existing separate account. Previously, in this situation, the Form N-4 had to be submitted twice (once under EDGAR submission type "N-4" or "N-4 EL" with a 1933 Act tag, and a second time under submission type "POS AMI" with a 1940 Act tag) to avoid inappropriate assessment of 1940 Act fees. Dual transmissions are no longer necessary because the applicable 1940 Act fee has been eliminated, making inappropriate fee assessment no longer an issue. *See* Changes in Selected Rules in Order to Eliminate Fees Previously Adopted by the Commission Pursuant to the Independent Offices Appropriations Act of 1952, Inv. Co. Act Rel. No. 22224 (Sept. 17, 1996).

Now, in this situation, registrants should make a single filing using the appropriate Form N-4 submission type ("N-4" or "N-4 EL") with a tag indicating that the filing is pursuant to both 1933 and 1940 Acts (pursuant to the 1933 Act to register the new contract, pursuant to the 1940 Act to reflect the addition of the new contract to the separate account). This should be accomplished by including the < ACT > tag in the submission header followed by "33 40."

2. Filing Form 24F-2 when the Registrant Nets Across Multiple Contracts

A registered separate account that offers multiple registered contracts generally has one 1940 Act number (for the separate account) associated with multiple 1933 Act numbers (one for each contract). When paying registration fees pursuant to rule 24f-2, the separate account may net sales and redemptions across those contracts. To do this on Form 24F-2, registrants should:

(a) file one Form 24F-2 (EDGAR submission type "24F2-NT") under any one of the 1933 Act numbers and pay the total filing fee that reflects netting of sales and redemptions across all contracts in connection with that form; and

(b) file a Form 24F-2 for each other 1933 Act number (each other contract), noting on the first page of each such Form 24F-2 that the filing fee has been paid in connection with another Form 24F-2 which should be identified by its 1933 Act file number.

To accomplish (a) and (b), above, registrants may prepare a single document that contains the calculation of the filing fees and states with which 1933 Act number the total

filing fee is being paid. That document should then be filed for every 1933 Act number associated with the separate account.

Registrants should always place the 1933 Act number ("2-," "33-," or "333-"), *not* the 1940 Act number ("811-" or "812-"), in the submission header of the 24F2-NT.

* * * * *

We hope that this letter will assist you in preparing your filings.

Sincerely,

Susan Nash

Susan Nash
Assistant Director
Office of Insurance Products