

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release No. IC-14625; S7-35-84]

Separate Accounts Funding Flexible Premium Variable Life Insurance Contracts

AGENCY: Securities and Exchange Commission.

ACTION: Adoption of rule amendments.

SUMMARY: The Commission is adopting amendments to two paragraphs of rule 6e-3(T) under the Investment Company Act of 1940. The amendments revise conditions under which insurance company separate accounts are permitted to offer flexible premium variable life insurance contracts ("flexible life") by permitting insurance companies to offer incidental insurance benefits and cover substandard underwriting risks in a manner consonant with the design of flexible life. The Commission is not at this time adopting a permanent rule.

EFFECTIVE DATE: The rule amendments will become effective July 17, 1985.

FOR FURTHER INFORMATION CONTACT: Brian M. Kaplowitz, Special Counsel, (202) 272-2061, or Robert E. Plaze, Attorney, (202) 272-2622, Office of Insurance Products and Legal Compliance, Division of Investment Management, Securities and Exchange Commission, 450 5th Street NW., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") today is adopting amendments to rule 6e-3(T) (17 CFR 270.6e-3(T)) under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) ("Act"). Rule 6e-3(T) provides extensive exemptive relief from various provisions of the Act for insurance company separate accounts offering flexible premium variable life insurance contracts ("flexible life" or "flexible contracts").¹ These amendments are designed to reconcile rule 6e-3(T) with the offering of certain "riders"² and the covering of certain risks in connection with flexible contracts. Specifically, the amendments grant additional exemptive relief to permit the deduction from cash

values of (1) the cost of incidental insurance benefits ("incidental insurance charges")³ and (2) charges imposed because the insured does not meet standard underwriting requirements ("substandard risk charges"). In addition, the amendments revise the definition of "payment" for the purpose of measuring compliance with various sales load limitation and refund provisions by including within the term "payment" amounts attributable to incidental insurance and substandard risk charges in flexible contracts in which these amounts are deducted from cash values.

Background and Discussion

On November 14, 1984, the Commission issued a release adopting on a temporary basis rule 6e-3(T) as a comprehensive exemptive rule for separate accounts proposing to offer flexible life. The adopting release also solicited comments on the rule.⁴

The Commission received thirteen letters of comment on rule 6e-3(T).⁵ Six of these letters addressed the need to revise the rule in order that incidental insurance and substandard risk charges be treated under the Act's sales load provisions in a manner that would allow the charges for these items to be deducted from cash value.⁶ While the Commission is not yet prepared to adopt the rule on a permanent basis, it believes that amendment of rule 6e-3(T) along the aforesaid lines should facilitate the life insurance industry designing flexible contracts which are consistent with the policies of the Act.⁷

³ "Incidental Insurance Benefits" are defined in paragraph (c)(2) of Rule 6e-3(T).

⁴ Investment Company Act Release 14234 ("Release 14234"). See *supra* note 1. Shortly thereafter the Commission proposed conforming amendments to rule 6e-2 under the Act (17 CFR 270.6e-2), a companion rule to rule 6e-3(T), that grants separate accounts offering scheduled premium variable life insurance contracts exemptive relief from the Act. Investment Company Act Release 14421 (March 15, 1985) (50 FR 11709 (March 25, 1985); 32 SEC Docket 1295 (April 2, 1985)).

⁵ The comment letters included two extensive comments, one from an industry trade group, and the other from a law firm on behalf of an insurance company.

⁶ One applicant has been granted exemptive relief in order to offer flexible contracts in the manner described above. See Investment Company Act Releases 14428 (Mar. 19, 1985) (notice), and 14475 (Apr. 17, 1985) (order). The modifications to rule 6e-3(T) the Commission is today adopting codify this relief insofar as it relates to paragraphs (b)(13)(iii)(E) and (c)(7) of the rule.

⁷ This release should be considered the operative interpretive document insofar as it may conflict with the discussion of rule 6e-3(T) in sections II.B.12.c of I.L.C.7 of Release 14234.

A. Paragraph (b)(13)(iii)(E)—Deductions from Cash Value

Paragraph (b)(13)(iii)(E) provides relief from sections 27(c)(2) (15 U.S.C. 80a-27(c)(2)) and 26(a)(2) (15 U.S.C. 80a-26(a)(2)) to permit certain specified fees and charges to be deducted from account assets. However, that paragraph does not provide relief to deduct incidental insurance or substandard risk charges.

Flexible life is designed so that virtually all charges, including incidental insurance and substandard risk charges, may be collected by deductions from a flexible contract's cash value.⁸ Moreover, deducting these charges from premium payments prior to allocation of the net premium to the separate account may not be feasible because the insured is not obligated, under flexible life, to make periodic payments.⁹ In order to permit a flexible contract containing a rider for incidental benefits or covering substandard risks to operate as designed, the Commission has determined to revise paragraph (b)(13)(iii)(E).

B. Paragraph (c)(7)—Definition of Payment

The term "payment" is defined by paragraph (c)(7) in two ways depending on where it is used in the rule. Generally, "payment" means gross premiums paid. For purposes of calculating sales load and any refund of sales load, however, paragraph (c)(7) defines "payment" as the gross premium paid less certain charges for incidental insurance benefits or substandard risks. This bifurcated approach was intended to assure that the sales load and refund provisions apply only to the amount of sales load charged for the variable benefits.¹⁰

In this respect, paragraph (c)(7) is identical to paragraph (c)(7) of rule 6e-2, which regulates scheduled premium variable life insurance contracts ("scheduled life" or "scheduled contracts"). Scheduled contracts are characterized generally by the deduction of charges from each premium payment with the net premium then allocated to the separate account. When computing sales load and any required refund, these charges are simply subtracted from the annual scheduled premium payment and the relevant percentage limitations are applied to the remainder. However, in the case of

⁸ Some charges, such as sales load, certain administrative fees, and premium taxes, may be deducted from payments.

⁹ See discussion *infra*.

¹⁰ Release 14234 at section II.C.7.

¹ For a description of flexible life, see Investment Company Act Release 13632 (Nov. 23, 1983) (48 FR 54043 (Nov. 30, 1983)); 29 SEC Docket 365 (Dec. 6, 1983)) and Investment Company Act Release 14234 (Nov. 14, 1984) (48 FR 47208 (Dec. 3, 1984)); 31 SEC Docket 1113 (Nov. 27, 1984)).

² "Riders" to insurance contracts are supplements used to modify or add to coverages the contract otherwise provides.

flexible contracts, it is necessary to deduct incidental insurance and substandard risk charges from cash value because the need for charges to support them is constant while the timing and amount of payments are unpredictable.

The lack of relationship between premium payments and deductions of incidental insurance and substandard risk charges precludes application of a bifurcated sales load computation without use of a set of artificial assumptions. According to an industry commentator, there appears to be no practical means to attribute these charges to payments prospectively since it cannot be known in advance how the frequency or amount of payments will relate to these periodic deductions from cash value.

The inclusion of these charges within the definition of "payment" in one sense will result in a greater amount of permissible sales load because the base against which sales load is measured, i.e., "payments" during a contract period, will expand to the extent a portion of a payment is attributable to incidental insurance or substandard risk charges. However, the deduction of incidental insurance and substandard risk charges periodically from cash value, rather than from payments, results in insureds having larger amounts of their premium payments allocated to the separate account and added to their cash values. Larger cash value benefits the insured by reducing the basic insurance charge and giving the insured the opportunity for greater investment return. Based on these considerations, the Commission has determined to amend paragraph (c)(7).

Paragraph (c)(7), as amended, excludes from the definition of "payment" incidental insurance and substandard risk charges only when those charges are deducted from premium payments in the same manner as scheduled contracts subject to rule 6e-2.¹¹ To the extent those charges are deducted from cash values, however, they are to be included within the definition of "payment."

List of Subjects in 17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities.

¹¹ If either of those charges is deducted from premium payments before allocation of the net premium to the separate account, it must be excluded from the definition of "payment" for purposes of measuring sales load and refund rights, i.e., each charge is treated independently.

Text of Amendments to Rule 6e-3(T)

In accordance with the foregoing Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 270—[AMENDED]

1. The authority citation of Part 270 continues to read in part as follows:

Authority: Sections 6(e) and 38(a) of the Investment Company Act of 1940, as amended, 15 U.S.C. 80a-6(e) and 37(a). * * *

2. By revising paragraphs (b)(13)(iii) (E) and (c)(7) of § 270.6e-3(T) to read as follows:

§ 270.6e-3(T) Temporary exemptions for flexible premium variable life insurance separate accounts.

* * * * *

(b) * * *

(13) * * *

(iii) * * *

(E) The deduction of premium taxes imposed by any state or other governmental entity, the cost of insurance, charges assessed for incidental insurance benefits or if the insured does not meet standard underwriting requirements, and, if the separate account is organized as a management investment company, an investment advisory fee;

* * * * *

(c) * * *

(7) "Payment," as used in paragraphs (b)(13)(i), (b)(13)(ii), and (b)(13)(v)(A) of this Rule and in sections 27(a)(2) and 27(h)(2) solely with respect to flexible contracts, means for a contract period the gross premiums paid less any portion of such gross premiums deducted for the item specified in paragraph (c)(4)(viii) and, if deducted prior to the allocation of net premiums to the separate account, for the items specified in paragraphs (c)(4)(vi) and (c)(4)(vii) of this Rule. "Payment," as used in any other section of this Rule, means the gross premiums paid or payable for the flexible contract, *Except*, that "Payment" shall not include any amount deducted by the life insurer to recover excess sales loading previously applied to keep the contract in force pursuant to paragraph (b)(13)(iv)(B)(2) of this Rule.

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Regulatory Flexibility Act Certification

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 605(b)), the Chairman of the Commission previously certified that rule 6e-3(T) will not have a significant economic impact on a substantial number of small entities. No comments were received on that certification. The amendments do not alter the basis for this determination.

Paperwork Reduction Act

These amendments to rule 6e-3(T) are not subject to the Act because they do not impose an information collection requirement.

Administrative Procedure Act

Because this rulemaking is exemptive in nature, the Commission finds, pursuant to section 553(d)(1) of the Administrative Procedure Act (5 U.S.C. 553(d)(1)), that the 30 day delay in effectiveness is not required, and, accordingly, the rule amendments will become effective immediately upon publication in the Federal Register. The Commission has determined, pursuant to section 553(b)(B) of the Administrative Procedure Act (5 U.S.C. 553(b)(B)), that there is no need to republish rule 6e-3(T) to obtain additional comment on its decision to amend this rule since the issues were raised by both Investment Company Act Releases 1362 (Nov. 23, 1983) (48 FR 54043 (Nov. 30, 1983); 29 SEC Docket 365 (Dec. 6, 1983)) and 14234 and in fact were commented upon.

By the Commission.

John Wheeler,
Secretary.

July 10, 1985.

[FR Doc. 85-16948 Filed 7-16-85; 8:45 am]

BILLING CODE 8010-01-M

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Part 558

New Animal Drugs for Use in Animal Feeds; Tylosin

AGENCY: Food and Drug Administration.

ACTION: Final rule.

SUMMARY: The Food and Drug Administration (FDA) is amending the animal drug regulations to reflect approval of a supplemental new animal drug application (NADA) filed for Feed Service Co., Inc., providing for the manufacture of 5- and 20-gram-per-pound tylosin premixes used to make complete feeds for swine, beef cattle, and chickens.

EFFECTIVE DATE: July 17, 1985.

FOR FURTHER INFORMATION CONTACT: Benjamin A. Puyot, Center for Veterinary Medicine (HFV-135), Food and Drug Administration, 5600 Fishers Lane, Rockville, MD 20857, 301-443-1414.

SUPPLEMENTARY INFORMATION: Feed Service Co., Inc., 303 Lundin Blvd., P.O. Box 688, Mankato, MN 56001, is the sponsor of a supplement to NADA 111-637 submitted on its behalf by Elanco Products Co. The supplement provides