

will be deducted if the Contractholder returns the Variable Contract during the free look period. Second, any Cost Reduction Credit or Eligible Person Credit that is added to the Contract Value of a Pacific One, Pacific Portfolios, PSVA, Pacific Innovations Select and PL&A Innovations Select Contractholder who returns his or her Variable Contract during the free look period will also be deducted from the amount ultimately returned to the Contractholder.

16. The relief sought in the Application is intended to permit PL Insurers to deduct the amounts of any Credit Enhancement, Cost Reduction Credit or Eligible Person Credit added to the Contract Value of any Variable Contract or Future Variable Contract, funded by a Separate Account or a Future Account, offering such credits in cases where Contractholders return their Variable Contract or Future Variable Contract during the free look period.

17. Under the current practice in effect for each applicable Variable Contract, the amount of the Credit Enhancement or the Eligible Person Credit added to a Contractholder's Contract Value is returned to a PL Insurer where free look rights are exercised, together with any gains or losses on the amount credited.<sup>4</sup> In addition, PSVA Contractholders receive any Contract fees and charges that Pacific Life may have deducted from the credited amounts.

18. If the relief sought in the Application is granted, Applicants would change the amount that Contractholders with any Credit Enhancement, Cost Reduction Credit or Eligible Person Credit would receive if they exercised their rights under the applicable free look policy. If the relief applied for in the Application is granted, Contractholders exercising their free look rights would not receive the amounts added to their Contract Value in the form of Credit Enhancements, Cost Reduction Credits or Eligible Person Credits, but such Contractholders would realize the gains or incur the losses on the credit amounts.

### Applicants' Legal Analysis

1. Applicants seek exemptive relief pursuant to section 6(c) from sections 2(a)(32), 22(c), and 27(i)(2)(A) of the 1940 Act and rule 22c-1 thereunder to the extent deemed necessary to permit

the PL Insurers: (1) To recapture any Credit Enhancement when a Contractholder returns a Variable Contract and/or Future Variable Contract during the free look period; and (2) to recapture any Cost Reduction Credits and Eligible Person Credits when a Contractholder returns a Variable Contract or Future Variable Contract during the free look period.

2. Subsection (i) of section 27 of the 1940 Act provides that section 27 does not apply to any registered separate account funding variable insurance contracts, or to the sponsoring insurance company and principal underwriter of such separate account, except as provided in paragraph (2) of that subsection. Paragraph (2) provides that it shall be unlawful for such a separate account or sponsoring insurance company to sell a contract funded by the registered separate account unless "(A) such contract is a redeemable security."

3. Section 2(a)(32) of the 1940 Act defines "redeemable security" as any security, other than short-term paper, under the terms of which the holder, upon presentation to the issuer, is entitled to receive approximately his or her proportionate shares of the issuer's current net assets, or the cash equivalent thereof.

4. Because the amount returned to a Contractholder who cancels a Variable Contract during the free look period does not include the amount of any Credit Enhancement, Cost Reduction Credit or Eligible Person Credit conditionally added to the Contractholder's Contract Value, the Contractholder arguably is not receiving his or her proportionate share of the applicable Separate Account's then-current net assets. Applicants assert, however, that the recapture of the Credit Enhancement offered under Pacific Value or the Cost Reduction Credit and the Eligible Person Credit offered under the Variable Contracts, as described in the Application, would not deprive a Contractholder of his or her proportionate share of the issuer's current net assets. Any Credit Enhancements, Cost Reduction Credits or Eligible Person Credits added to the Contract Value of a Contractholder are expressly conditioned on the Contractholder's decision to keep the Variable Contract beyond the free look period. Further, Applicants assert that a Contractholder's interest in the amount of a Credit Enhancement, Cost Reduction Credit or an Eligible Person Credit allocated to his or her Contract Value is not vested until the applicable free look period has expired without return of the Variable Contract in

question. Unless and until the amount of the Credit Enhancement, Cost Reduction Credit or Eligible Person Credit is vested (*i.e.*, at the end of the free look period), Applicants believe that the relevant PL Insurer retains the right and interest in the amount of the Credit Enhancement, Cost Reduction Credit or the Eligible Person Credit.

5. Applicants further contend that it would be patently unfair to allow a Contractholder exercising his or her free look right to retain the Credit Enhancement or the Cost Reduction Credit or the Eligible Person Credit under a Variable Contract that has been returned for a refund after a period of only a few days. If PL Insurers could not recapture the amounts of such credits, individuals could purchase a Variable Contract, and simply return it for a quick profit. This could deter PL Insurers from offering the Credit Enhancement, the Cost Reduction Credit and Eligible Credit under Variable Contracts or Future Variable Contracts.

6. Moreover, because the amount of the Credit Enhancement, Cost Reduction Credit or Eligible Person Credit is not vested during the free look period, Applicants state that it is arguable that any earnings or losses attributable to these credits should also be returned to the relevant PL Insurer as the sponsoring insurance company. PL Insurers have taken and will continue to take this approach unless and until the relief requested under the Application is granted. However, if and when the Commission grants the relief requested in the Application, any gains or losses attributable to the amount of the Credit Enhancement, Cost Reduction Credit or the Eligible Person Credit will be allocated to the Contractholders.

7. Section 22(c) of the 1940 Act authorizes the Commission to make rules and regulations applicable to registered investment companies and to principal underwriters of, and dealers in, the redeemable securities of any registered investment company to accomplish the same purposes as contemplated by section 22(a). Rule 22c-1 thereunder prohibits a registered investment company issuing a redeemable security, a person designated in such issuer's prospectus as authorized to consummate transactions in such security, and a principal underwriter of, or dealer in, such security, from selling, redeeming, or repurchasing any such security except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security.

<sup>4</sup> However, if the amount of a Credit Enhancement, Cost Reduction Credit or Eligible Person Credit, together with any gains on such credits, exceed the withdrawal charge percentage applicable for a particular Variable Contract, the PL Insurer will refund the amount of the excess.