

24. The prohibitions on mixed and shared funding might reflect concern regarding possible different investment motivations among investors. When Rule 6e-2 was adopted, variable annuity separate accounts could invest in mutual funds whose shares also were offered to the general public. At the time of the adoption of Rule 6e-2, therefore, the Commission staff contemplated underlying funds with public shareholders as well as variable life insurance separate account shareholders. The Commission staff may have been concerned with the potentially different investment motivations of public shareholders and variable life insurance contract owners. There also may have been some concern with respect to the problems of permitting a state insurance regulatory authority to affect the operations of a publicly-available mutual fund and to affect the investment decisions of public shareholders.

25. For reasons unrelated to the Act, however, Internal Revenue Service Revenue Ruling 81-225 (September 25, 1981) effectively deprived most variable annuities funded by publicly-available mutual funds of their tax-benefited status. The Tax Reform Act of 1984 codified the prohibition against the use of publicly-available mutual funds as investment media for variable contracts (including variable life contracts). Section 817(h) of the Code, in effect, requires that the investments made by variable annuity and variable life insurance separate accounts be "adequately diversified." If a separate account is organized as a unit investment trust that invests in a single fund or series, then the separate account will not be diversified. In this situation, however, section 817(h) of the Code, in effect, provides that the diversification test will be applied at the underlying fund level, rather than at the separate account level, but only if "all of the beneficial interests" in the underlying fund "are held by one or more insurance companies (or affiliated companies) in their general account or in segregated asset accounts." Accordingly, a unit investment trust separate account that invests solely in a publicly-available mutual fund will not be adequately diversified. In addition, any underlying mutual fund, including any fund that sells shares to separate accounts, in effect, would be precluded from selling its shares to the public. Consequently, there will be no public shareholders of the Funds.

26. Applicants state that shared funding by unaffiliated insurance companies does not present any issues that do not already exist when a single

insurance company is licensed to do business in several or all states. When insurers are domiciled in different states, it is possible that the particular state insurance regulatory body in a state in which one insurance company is domiciled could require action that is inconsistent with the requirements of insurance regulators in other states in which other insurance companies are domiciled. The fact that a single insurer and its affiliates offer their insurance products in different states does not create a significantly different or enlarged problem.

27. Applicants further state that shared funding by unaffiliated insurers is, in this respect, no different than the use of the same investment company as the funding vehicle for affiliated insurers, which Rules 6e-2(b)(15) and 6e-3(T)(b)(15) permit under various circumstances. Affiliated insurers may be domiciled in different states and be subject to differing state law requirements. Affiliation does not reduce the potential, if any exists, for differences in state regulatory requirements. In any event, the conditions set forth below are designed to safeguard against, and provide procedures for resolving, any adverse effects that differences among state regulatory requirements may produce. For example, if a particular state insurance regulator's decision conflicts with the majority of other state regulators, the affected insurer(s) will be required to withdraw their separate accounts' investment from the relevant Fund.

28. Applicants submit that the rights of an insurance company under Rules 6e-2(b)(15) and 6e-3(T)(b)(15) to disregard the voting instructions of contract owners do not raise any issues different from those raised by the authority of state insurance regulators over separate accounts. Under Rules 6e-2(b)(15) and 6e-3(T)(b)(15), an insurer may disregard the voting instructions of the contract owners only with respect to certain specified items. Affiliation does not eliminate the potential, if any exists, for divergent judgments as to the advisability or legality of a change in investment policies, principal underwriter or investment adviser initiated by contract owners. The potential for disagreement is limited by the requirements in Rules 6e-2 and 6e-3(T) that the insurance company's disregard of voting instructions be reasonable and based on specific good-faith determinations.

29. A particular insurer's disregard of voting instructions, nevertheless, could conflict with the majority of contract owner voting instructions. The insurer's

action possibly could be different than the determination of all or some of the other insurers (including affiliated insurers) that the voting instructions of contract owners should prevail, and could either preclude a majority vote approving the change or represent a minority view. If the insurer's judgment represents a minority position or would preclude a majority vote, then the insurer may be required, at the affected Fund's election, to withdraw its separate account's investment from the Fund, and no charge or penalty would be imposed as a result of such withdrawal.

30. Applicants state that there is no reason why the investment policies of the Funds would or should be materially different from what these policies would or should be if the Funds funded only variable annuity contracts or variable life insurance policies, whether flexible or scheduled premium policies. Each type of insurance product is designed as a long-term investment program. The Funds will not be managed to favor or disfavor any particular Participating Insurance Company or type of variable contract. There is no reason to believe that different features of various types of contracts, including the "minimum death benefit" guarantee under certain variable life insurance and variable annuity contracts, will lead to different investment policies for different types of variable contracts. To the extent that the degree of risk may differ as between variable annuity contracts and variable life insurance policies, the differing insurance charges imposed, in effect, adjust any such differences and equalize the insurer's exposure in either case. No one investment strategy can be identified as appropriate to a particular insurance product. Each pool of variable annuity and variable life insurance contract owners is composed of individuals of diverse financial status, age, insurance, and investment goals. A fund supporting even one type of insurance product must accommodate these diverse factors in order to attract and retain purchasers. Permitting mixed and shared funding will provide economic justification for the continuation of the Existing Funds and will facilitate the establishment of Future Funds serving diverse goals.

31. Applicants do not believe that the proposed sale of shares of the Funds to Qualified Plans, Other Investors and General Accounts will increase the potential for material irreconcilable conflicts of interest between or among different types of investors. In considering the appropriateness of the requested relief, Applicants have