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September 19, 1990

BY TELECOPY

Mr. Jeff Dahnke
Pre-Merger Notification Office
Federal Trade Commission

Dear Mr. Dahnke:

This letter is to follow-up on our telephone conversation regarding how a life insurance company or life insurance holding company should treat "separate account assets" and "annuity and other fund deposits" in determining "annual net sales" and "total assets" for purposes of the size-of-person test.

As I explained to you during our telephone conversation, "separate account assets" are reflected on the balance sheet of a life insurance company or on the consolidated balance sheet of a life insurance holding company as a separate item with an offsetting entry for separate account liabilities. Separate accounts are established under the insurance laws of the various states. Although a separate account may or may not be registered as a unit investment trust under the Investment Company Act of 1940, this inquiry relates only to separate accounts which are so registered. The separate accounts, which are themselves registered as unit investment trusts, invest the assets from the sale of variable life and annuity products in shares of specified funds or unit investment trusts.

By law and for statutory accounting purposes, the assets and liabilities of the separate accounts are clearly identified and distinguished from other assets and liabilities of the insurance company. For your information we have enclosed a copy of Section

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2933 of the Delaware Insurance Code which authorizes separate accounts. The attached statutory language is representative of separate account authorizations in other state insurance codes.

Separate account assets applicable to policies and contracts cannot be charged with liabilities arising out of any other business the insurance company may conduct. Although for reporting purposes separate account assets are reflected on the balance sheet (with an offsetting entry for separate account liabilities), the separate accounts are treated as separate entities under the Investment Company Act of 1940 and separate audited financial statements are required and prepared for them.

Separate account assets are carried at net asset value, which approximates market value, and generally represent policyowner and contractowner funds maintained in the accounts to meet specific investment objectives and unamortized deferred policy loads and other charges due the insurance company from policyowners and contractowners over a specified period. Net investment income and realized and unrealized capital gains and losses related to the separate account assets are not reflected in the statements of operations of an insurance company or insurance holding company.

We understand that the Commission has changed its position as stated in Interpretive Letter No. 98, permitting the "netting" of an asset and a liability in applying the size-of-person test, where an asset has an identical offsetting liability specifically related to the asset. However, we believe the facts with respect to registered separate accounts are significantly different than those dealt with in Interpretive Letter No. 98. Unlike the advertising monies dealt with in Interpretive Letter No. 98, separate accounts constitute specific assets segregated pursuant to express statutory authority. By law, separate account assets allocable to policies and contract obligations are not subject to the general liabilities of the insurance company and must be separately identified, and the income, gains and losses thereon are separately accounted for. The separate account is legally a separate fund and the contractholders look to the separate account to satisfy their contract rights; no one else, including the other policyholders and other creditors of the insurance.

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company have any rights against the funds in the separate accounts allocable to such contract liabilities. In effect, the separate accounts represent separate mutual funds established by the insurance company. Treating separate account assets as assets of the insurance company for purposes of the size-of-person test is akin to treating the assets of a mutual fund as assets of the fund's investment adviser.

Interpretive Letter No. 96 states that title insurers that file asset balance sheets under the format of the National Association of Insurance Commissioners (NAIC) Annual Statement Blank for Title Insurance (Form 9) may use "admitted value" on their most recent Form 9 for their "total assets" under §801.11(c)(2). We note that life insurance companies using the NAIC Annual Statement Blank for Life and Accident and Health Insurance (Form 1) must report total assets excluding separate accounts, reflecting the fact that funds in the separate account which are allocable to contract liabilities are not available to satisfy the claims of other policyholders and other creditors. In substance, the separate accounts stand in the position of reinsurer of a portion of the insurance company's risk. Clearly, the reserves of a reinsurer would not be considered assets of the original insurer. Similarly, the assets of the separate accounts, which are analogous to the reserves established by a reinsurer, should not be viewed as assets of the insurance company for purposes of the size-of-person test.

Interpretive Letter No. 96 provides that life insurance companies that in their last regularly prepared annual report of operations used the format of Form 1 should refer to "total net premiums written" (i.e., net of reinsurance ceded) as their "annual net sales" within the meaning of §801.11(c)(1). "Total net premiums written" is reflected on line 20(d) of "Exhibit 1-Part 1, Premiums and Annuity Considerations" and carried over to line 1 of the "Summary of Operations" on Form 1.

"Annuity and other fund deposits" are amounts paid by contract owners to the insurance company under an annuity contract or other insurance policy. A contractually determined portion of "annuity and other fund deposits" received by the insurance company must be deposited in the separate accounts.

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Unlike premiums, the "annuity and other fund deposits" and "transfers to separate accounts" items are reflected separately on the Summary of Operations section of Form 1 at line 1A and line 24A. However, under generally accepted accounting principals they are "netted" in reporting revenue. Since Interpretive Letter No. 96 permits the insurance company to "net" reinsurance payments against gross premiums for purposes of the "annual net sales" determination, it seems appropriate that the insurance company would also "net" the amount of "transfers to separate accounts" against "annuity and other fund deposits". Such offset is analogous to the treatment of reinsurance provided by Interpretive Letter No. 96 and reflects the same underlying economic reality (i.e., a portion of the economic risks associated with the contract are transferred to the separate account in the same way reinsurance transfers certain risks to the reinsurer).

We request that the Commission concur in our analysis that "transfers to separate accounts" may be netted against "annuity and other fund deposits" for purposes of determining "annual net sales" under §801.11(c)(1) and that "separate account assets" of a life insurance company should not be included in determining "total assets" of such company for purposes of §801(c)(2).

Please direct any questions you may have regarding this letter to the undersigned or [REDACTED] of this office.

Very truly yours,
[REDACTED]

cc: [REDACTED]

advised that §801.1(c)(7) requires insurance company to include assets held in a separate account for size of person test. - JDahnke
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right or absence of right of participation is reasonably related to the premium charged and the insurer is otherwise not in violation of sections 2809 (unfair discrimination—life insurance, annuities, and health insurance) or 2310 (rebates—life, health and annuity contracts) of this title.

§ 2933. Pension, profit sharing, annuity agreements; separate accounts

(a) A domestic life insurer may establish one or more separate accounts, and may allocate thereto, in accordance with the terms of a written contract or agreement, any amounts paid to the insurer in connection with a pension, retirement or profit sharing plan or an annuity which are to be applied to provide benefits payable in fixed or in variable dollar amounts or in both.

(b) The amounts allocated to each such account and accumulations thereon may be invested and reinvested as provided in section 1822 (special investments of pension, profit sharing or annuity funds) of this title.

(c) The income, if any, and gains and losses, realized or unrealized, on each such account shall be credited to or charged against the amounts allocated to the account in accordance with the agreement, without regard to other income, gains or losses of the insurer. The assets of each such account shall have a value at least equal to the reserves and other contract liabilities with respect to such account. That portion of the assets of each such account equal to the reserves and other contract liabilities with respect to such account shall not be chargeable with liabilities arising out of any other business which the insurer may conduct.

(d) Assets allocated to a separate account shall be valued at their market value on the date of valuation, or if there is no readily available market, then in accordance with the terms of the applicable contract or agreement; except, that the portion of the assets of such separate account at least equal to the insurer's reserve liability with regard to the guaranteed benefits and funds referred to in section 1822 of

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this title, if any, shall be valued in accordance with rules otherwise applicable to the insurer's assets.

(e) If the contract or agreement provides for payment of benefits in variable amounts, it shall state the essential features of the procedure to be followed by the insurer in determining the dollar amount of such variable benefits. Any such contract or agreement and any certificate issued thereunder shall state that such dollar amount may decrease or increase and shall state in its first page that the benefits thereunder are on a variable basis.

(f) No insurer shall be authorized to deliver within this State any such contract or agreement providing benefits in variable amounts until the insurer has satisfied the Commissioner that its condition or methods of operation in connection with the issuance of such contracts or agreement will not render its operation hazardous to the public or its policyholders in this State. In determining the qualification of an insurer requesting such authority, the Commissioner shall consider, among other things,

(1) The history and financial condition of the insurer;

(2) The character, responsibility and general fitness of the officers and directors of the insurer; and

(3) In the case of an insurer other than a domestic insurer, whether the statutes or regulations of the jurisdiction of its incorporation provide a degree of protection to policyholders and the public substantially equal to that provided by this section and rules and regulations issued hereunder.

(g) Any domestic life insurer which establishes one or more separate accounts pursuant to subsection (a) above, may amend its charter to provide for special voting rights and procedures for such separate account contract owners giving them jurisdiction over matters relating to investment policy, investment advisory services and selection of certified public accountants, in relation to the administration of the assets in any such separate account. This provision shall not in any way affect existing laws pertaining to the voting rights of the insurer's policyholders.

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