

future separate accounts) and its (or their) investors. First SunAmerica will maintain and make available to the Commission upon request a memorandum setting forth the basis for such determination.

8. First SunAmerica further represents that the assets of the Separate Account and any future separate accounts that rely on the requested order will be invested only in management investment companies that undertake, in the event they should adopt a plan for financing distribution expenses pursuant to Rule 12b-1 under the 1940 Act, to have such plan formulated and approved by their board of directors, the majority of whom are not "interested persons" of the management investment company within the meaning of Section 2(a)(19) of the 1940 Act.

### Conclusion

Applicants submit that for the reasons and upon the facts set forth above, the exemptions from Sections 26(a)(2) and 27(c)(2) of the 1940 Act to the extent necessary to permit the deduction of mortality, expense risk, and distribution expense charges from the assets of the Separate Account under the Contracts and under any future contracts, and from the assets of any future separate accounts offering contracts which are materially similar to the Contracts, meet the statutory standards of Section 6(c) of the 1940 Act. Accordingly, the Applicants assert that the requested exemptions are necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the 1940 Act.

For the Commission, by the Division of investment Management, pursuant to delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

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[Rel. No. IC-20873; No. 812-8854]

### Golden American Life Insurance Company, et al.

January 31, 1995.

**AGENCY:** Securities and Exchange Commission ("SEC" or "Commission").

**ACTION:** Notice of Application for an Order under the Investment Company Act of 1940 ("1940 Act").

**APPLICANTS:** Golden American Life Insurance Company ("Golden American"), Separate Account A of Golden American ("Account A"), Any Other Separate Account Established By

Golden American In The Future To Support Variable Life Insurance Contracts Issued by Golden American ("Future Accounts"), and Directed Services, Inc. ("DSI").

**RELEVANT 1940 ACT SECTIONS:** Order requested under section 6(c) granting exemptions from the provisions of Sections 26(a)(2)(C), 27(c)(1) and 27(c)(2) of the 1940 Act and from paragraphs (b)(1), (b)(12)(i), (b)(13)(iv) and (c)(4)(v) of Rule 6e-2 and of Rule 6e-3(T), and from Rule 22c-1 thereunder.

**SUMMARY OF APPLICATION:** Applicant request an order that would permit them to deduct a charge from premium payments to compensate Golden American for its increased federal tax burden resulting from the application of Section 848 of the Internal Revenue Code of 1986, as amended, to the receipt of such payments under certain variable life insurance contracts. Applicants also propose to deduct the charge on a deferred basis from contract cash value, with the balance of any unrecovered amount being deducted upon surrender.

**FILING DATE:** The application was filed on February 23, 1994.

**HEARING OR NOTIFICATION OF HEARING:** An order granting the Application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on February 27, 1995, and should be accompanied by proof of service on Applicants in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the requestor's interest, the reason for the request, and the issues contested. Persons may request notification of a hearing by writing to the Secretary of the Commission.

**ADDRESSES:** Secretary, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549. Applicants: c/o Golden American, 280 Park Avenue, New York, New York 10017.

**FOR FURTHER INFORMATION CONTACT:** Yvonne M. Hunold, Senior Counsel, or Wendy F. Friedlander, Deputy Chief, at (202) 942-0670, Office of Insurance Products (Division of Investment Management).

**SUPPLEMENTARY INFORMATION:** The following is a summary of the application; the complete application is available for a fee from the Commission's Public Reference Branch.

### Applicant's Representations

1. Golden American is a stock life insurance company and an indirect subsidiary of Bankers Trust Company ("Bankers").

2. Account A is a separate account established by Golden American and registered under the 1940 Act as a unit investment trust. Each of Account A's 10 divisions invests in a corresponding portfolio of The GCG Trust ("GCG Trust"), a registered open-end management company. Account A is, and any Future Account will be, used to fund certain variable life insurance contracts issued by Golden American, including the GoldenSelect VLI and GoldenSelect VL10 Contracts ("Contracts"). A registration statement to register the Contracts under the Securities Act of 1933 has been filed with the Commission. Applicants state that the Contracts will be issued in reliance on the applicable provisions of either Rule 6e-2 or Rule 6e-3(T).

3. DSI, the principal underwriter for the Contracts, is an indirect wholly-owned subsidiary of Bankers and an affiliate of Golden American. DSI is a registered broker-dealer under the Securities Exchange Act of 1934 and a member of the National Association of Securities Dealers, Inc.

4. Applicants propose to deduct a charge to reimburse Golden American for the increase in its federal income taxes resulting from the application of Section 848 of the Internal Revenue Code of 1986 ("Code"), as amended, to the receipt of premium payments under the Contracts. The charge will be reasonably related to Golden American's increased federal tax burden. The charge will be deducted either from (a) premiums received, or (b) Contract cash value on a deferred basis in a series of equal periodic installments, with the balance of any unrecovered amount to be deducted upon early surrender of a Contract. The deduction will be the same notwithstanding the manner in which it is deducted.

5. The Omnibus Budget Reconciliation Act of 1990 ("OBRA 1990"), amending Section 848 of the Code, requires life insurance companies of capitalize and amortize over ten years certain general expenses for the current year. Prior law allowed these expenses to be deducted in full from the current year's gross income. Section 848, as amended, effectively accelerates the realization of income from specified contracts and, consequently, the payment of taxes on that income. Taking into account the time value of money, Section 848 increases the insurance company's tax burden because the

amount of general deductions that must be capitalized and amortized is measured by the premiums received under the Contracts.

6. The amount of deductions subject to Section 848 equals a percentage of the current year's net premiums received (*i.e.*, gross premiums minus return premiums and reinsurance premiums) under life insurance or other contracts categorized under this Section. The Contracts will be categorized under Section 848 as life insurance contracts requiring 7.7% of the net premiums received to be capitalized and amortized under the schedule set forth in Section 848(c)(1).

7. The increased tax burden on every \$10,000 of net premiums received under the Contracts is quantified by Applicants as follows. For each \$10,000 of net premiums received in a given year, Golden American must capitalize \$770 (*i.e.*, 7.7% of \$10,000), and \$38.50 of this amount may be deducted in the current year. The remaining \$731.50 (\$770 less \$38.50) is subject to taxation at the corporate tax rate of 35% and results in \$256.03 (.35%×\$731.50) more in taxes for the current year than Golden American otherwise would have owed prior to OBRA 1990. However, the current tax increase will be offset partially by deductions allowed during the next ten years, which result from amortizing the remainder of the \$770 (\$77 in each of the following nine years and \$38.50 in year ten).

8. It is Golden American's business judgment that it is appropriate to use a discount rate of at least 10% in evaluating the present value of its future tax deductions for the following reasons. Capital that Golden American must use to pay its increased federal tax burden under Section 848 will be unavailable for investment. The cost of capital used to satisfy this increased tax burden essentially will be Golden American's targeted rate of return (*i.e.*, the return sought on invested capital), which is in excess of 10%. Accordingly, Applicants submit that the targeted rate of return is appropriate for use in this present value calculation. To the extent that the 10% discount rate is lower than Golden American's actual targeted rate of return, the calculation of this increased tax burden will continue to be reasonable over time, even if the corporate tax rate applicable to Golden American is reduced, or its targeted rate of return is lowered.

9. In determining the targeted rate of return used in arriving at the discount rate, Golden American considered a number of factors, which it represents are appropriate factors to consider. First, Golden American identified the level of

investment return that can be expected to be earned risk-free over the long term. This rate is based upon the expected yield on a 30-year U.S. Treasury Bond. Golden American then increased this rate by the market risk premium demanded by equity investors as compensation for the risks associated with equity investments. The market risk premium is based on the average excess return earned by investing in equities as compared to that earned by investing in risk-free instruments (*i.e.*, long-term U.S. Treasury Bonds). Finally, the resulting rate was modified to reflect the relative volatility of an equity investments in Bankers, Golden American's indirect parent.

10. Using a federal corporate tax rate of 35% and assuming a discount rate of 10%, the present value of the tax effect of the increased deductions allowable in the following ten years, which partially offsets the increased tax burden, comes to \$160.40. The effect of Section 848 on the Contracts is therefore an increased tax burden with a present value of \$95.63 for each \$10,000 of net premiums (*i.e.*, \$256.03 less \$160.40).

11. Golden American does not incur incremental federal income tax when it passes on state premium taxes to Contract Owners because state premium taxes are deductible in computing federal income taxes. Conversely, federal income taxes are not deductible in computing Golden American's federal income taxes. To compensate Golden American fully for the impact of Section 848, Golden American must impose an additional charge to make it whole for the \$95.63 additional tax burden attributable to Section 848, as well as the tax on the additional \$95.63 itself, which can be determined by dividing \$95.63 by the complement of 35% federal corporate income tax rate (*i.e.*, 65%), resulting in an additional charge of \$147.12 for each \$10,000 of net premiums, or 1.47%.

12. Based on its prior experience, Golden American reasonably expects to fully take almost all future deductions. It is Golden American's judgment that a 1.38% charge would reimburse it for the increased federal income tax liabilities under Section 848. Applicants represent that the 1.38% charge will be reasonably related to Golden American's increased federal income tax burden under Section 848. This representation takes into account the benefit to Golden American of the amortization permitted by Section 848 and the use of a 10% discount rate (which is equivalent to Golden American's targeted rate of return) in computing the future deductions resulting from such amortization. Golden American believes

that the 1.38% charge would have to be increased if future changes in, or interpretations of, Section 848 of any successor provision result in a further increased tax burden due to receipt of premiums. The increase could be caused by a change in the corporate tax rate, or in the 7.7% figure, or in the amortization period.

#### Applicants' Legal Analysis

1. Applicants request an order under Section 6(c) of the 1940 Act granting exemptions from Section 27(c)(2) of the 1940 Act to allow the deduction of a charge from premiums to compensate Golden American for its increased federal tax burden based on receipt of these premiums under the Contracts. The charge will be in an amount that is reasonably related to Golden American's increased federal tax burden. Applicants also request exemptions from subparagraph (c)(4)(v) of Rules 6e-2 and 6e-3(T) under the 1940 Act to permit the proposed deductions to be treated as other than "sales load," as defined under Section 2(a)(35) of the 1940 Act, for purposes of Section 27 and the exemptions from various provisions of that Section found in Rules 6e-2 and 6e-3(T), respectively. Applicants assert that it is appropriate to deduct a charge for an insurer's increased tax burden attributable to premiums received, and to exclude the deduction of this charge from sales load, because it is a legitimate expense of the company and not for sales and distribution expenses.

2. Applicants further request an order under Section 6(c) for exemptions from Sections 26(a)(2)(C), 27(c)(1) and 27(c)(2) of the 1940 Act, paragraphs (b)(1), (b)(12)(i), (b)(13)(iv) of Rules 6e-2 and 6e-3(T) and Rule 22c-1 thereunder, to permit the deduction of the charge from Contract cash value in deferred, equal periodic installments, as an alternative to a deduction of the charge from premium payments, to compensate Golden American for its increased tax burden under Section 848. Any unrecovered amount of the deferred charge will be deducted from such assets upon an early surrender of a Contract.

3. Section 6(c) authorizes the Commission, by order and upon application, to exempt any person, security, or transaction, or class of persons, securities, or transactions, from any provisions of the 1940 Act. The Commission grants relief under Section 6(c) to the extent an exemption is "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the 1940 Act]."

4. Account A is, and the Future Accounts will be, regulated under the 1940 Act as issuers of periodic payment plan certificates. Accordingly, Account A, the Future Accounts, Golden American (as depositor), and DSI (as principal underwriter) are deemed to be subject to Section 27 of the 1940 Act.

5. Section 27(c)(2) prohibits the sale of periodic payment plan certificates unless the following conditions are met. The proceeds of all payments (except amounts deducted for "sales load") must be held by a trustee or custodian having the qualifications established under Section 26(a)(1) for the trustees of unit investment trusts. These proceeds also must be held under an indenture or agreement that conforms with the provisions of Section 26(a)(2) and Section 26(a)(3) of the 1940 Act.

6. "Sales load" is defined under Section 2(a)(35), in relevant part, as:

The difference between the price of a security to the public and that portion of the proceeds from its sale which is received and invested or held for investment by the issuer (or in the case of a unit investment trust, by the depositor or trustee), less any portion of such difference deducted for trustee's or custodian's fees, insurance premiums, issue taxes, or administrative expenses or fees which are not properly chargeable to sales or promotional activities.

Sales loads on periodic payment plan certificates are limited by Sections 27(a)(1) and 27(h)(1) to a maximum of 9% of total payments.

7. Certain provisions of Rules 6e-2 and 6e-3(T) provides a range of exemptive relief. Rule 6e-2 provides exemptive relief if the separate account issues scheduled premium variable life insurance contracts as defined in Rule 6e-2(c)(1). Rule 6e-3(T) provides exemptive relief if the separate account issues flexible premium variable life insurance contracts, as defined in subparagraph (c)(1) of that Rule.

8. Applicants state that paragraph (b)(13)(iii) of Rule 6e-2 implicitly provides, and paragraph (b)(13)(iii) of Rule 6e-3(T) explicitly provides, exemptive relief from Section 27(c)(2) permit an insurer to make certain deductions, other than sales load, including the insurer's tax liabilities from receipt of premium payments imposed by states or by other governmental entities. Applicants assert that the proposed deduction with respect to Section 848 of the Code arguably is covered by subparagraph (b)(13)(iii) of each Rule. Applicants note, however, that the language of paragraph (c)(4) of the Rules appears to require that deductions for federal tax obligations from receipt of premium payments be treated as "sales load."

9. Applicants state that paragraph (b)(1), together with paragraph (c)(4), of each Rule provides an exemption from the Section 2(a)(35) definition of "sales load" by substituting a new definition to be used for purposes of each respective Rule. Rule 6e-2(c)(4) defines "sales load" charged on any payment as the excess of the payment over certain specified charges and adjustments, including a deduction for state premium taxes. Rule 6e-3(T)(c)(4) defines "sales load" during a period as the excess of any payments made during that period over certain specified charges and adjustments, including a deduction for state premium taxes. Under a literal reading of paragraph (c)(4) of the Rules, a deduction for an insurer's increased federal tax burden does not fall squarely into those itemized charges or deductions, arguably causing the deduction to be treated as part of "sales load."

10. Applicants state that the public policy that underlies paragraph (b)(13) of each Rule, and particularly subparagraph (b)(13)(i), like that which underlies paragraphs (a)(1) and (h)(1) of Section 27, is to prevent excessive sales loads from being charged for the sale of periodic payment plan certificates. Applicants submit that this legislative purpose is not furthered by treating a federal income tax charge based on premium payments as a sales load because the deduction is not related to the payment of sales commissions or other distribution expenses. Applicants assert that the Commission has concurred with this conclusion by excluding deductions for state premium taxes from the definition of sales load in paragraph (c)(4) of each Rule.

11. Applicants submit that the source for the definition of "sales load" found in paragraph (c)(4) of each Rule supports this analysis. Applicants believe that, in adopting paragraph (c)(4) of each Rule, the Commission intended to tailor the general terms of Section 2(a)(35) to variable life insurance contracts to ease verification by the Commission of compliance with the sales load limits of subparagraph (b)(13)(i) of each Rule. Just as the percentage limits of Section 27(a)(1) and 27(h)(1) depend on the definition of sales load in Section 2(a)(35) for their efficacy, Applicants assert that the percentage limits in subparagraph (b)(13)(i) of each Rule depend on paragraph (c)(4) of each Rule, which does not depart, in principal, from Section 2(a)(35).

12. Applicants submit that the exclusion from the definition of "sales load" under Section 2(a)(35) of deductions from premiums for "issue

taxes" suggests that it is consistent with the policies of the 1940 Act to exclude from the definition of "sales load" in Rules 6e-2 and 6e-3(T) deductions made to pay an insurer's costs attributable to its federal tax obligations. Additionally, the exclusion of administrative expenses or fees that are "not properly chargeable to sales or promotional activities" also suggests that the only deductions intended to fall within the definition of "sales load" are those that are properly chargeable to sales or promotional activities. Applicants state that the proposed deductions will be used to compensate Golden American for its increased federal tax burden attributable to the receipt of premiums and not for sales or promotional activities. Therefore, Applicants believe the language in Section 2(a)(35) further indicates that not treating such deductions as sales load is consistent with the policies of the 1940 Act.

13. Finally, Applicants submit that it is probably an historical accident that the exclusion of premium tax in subparagraph (c)(4)(v) of Rules 6e-2 and 6e-3(T) from the definition of "sales load" is limited to state premium taxes. When these Rules were each adopted and, in the case of Rule 6e-3(T), later amended, the additional Section 848 tax burden attributable to the receipt of premiums did not yet exist.

14. As noted above, Section 27(c)(2) prohibits the sale of periodic payment plan certificates unless the proceeds, other than sales loads, are deposited with and held by a qualified trustee or custodian, as defined in Section 26(a)(1), under a trust agreement that satisfies the requirements of Sections 26(a)(2) and (a)(3). Section 26(a)(2) prohibits payments from the assets of a registered unit investment trust to its depositor or principal underwriter, or their affiliates or agents, unless the payment is reasonable compensation for performing certain bookkeeping and other administrative duties.

15. Section 27(c)(1) prohibits the sale of a period payment plan certificate by any registered investment company, its depositor or its underwriter, unless the certificate is a redeemable security. "Redeemable security" is defined in Section 2(a)(32) as any security which entitles the holder to receive a proportionate share of the issuer's current net assets, or the cash equivalent. Rule 22c-1, in part, prohibits a registered investment company from selling, redeeming or repurchasing a redeemable security it has issued except at a price based on the current net asset value of the security.

16. Rule 6e-3(T)(b)(1) provides an exemption from Sections 26(a) and 27(c)(1) and Rule 22c-1 in connection with any sales load deducted under Rule 6e-3(T), other than from premiums. Rule 6e-2 does not have a corresponding provision. Rule 6e-3(T)(12)(i) provides, in relevant part, an exemption from Section 27(c)(1) and Rule 22c-1 provided that, to the extent that the calculation of cash value reflects deductions for administrative expenses and fees or sales loads, such deductions need only be made at such times as specified in the Contracts. Although Rule 6e-2(b)(12) provides similar exemptions, it does not provide for the deduction of deferred administrative expenses and fees or deferred sales load. Finally, Rule 6e-3(T)(b)(13)(iv)(C) provides that, subject to other provisions of that Rule, sales loads and administrative expenses or fees may be deducted upon redemption. Rule 6e-2(b)(13)(iv) does not provide similar exemptions. Applicants believe that the omissions noted herein reflect the Commission's assumption at the time it promulgated Rule 6e-2 that sales loads would only be deducted from premiums, rather than a policy decision to forbid other arrangements.

17. Applicants state that it is appropriate to deduct the 1.38% charge on a deferred basis for the same reasons that it is proper to deduct the charge directly from premiums. Nevertheless, Applicants believe they may not be able to rely on paragraphs (b)(1), (b)(12)(i), or (b)(13)(i) of Rules 6e-2 and 6e-3(T) because the deferred charge may be deemed other than an "administrative charge" or other than sales load under Rule 6e-3(T), and because the imposition of deferred charges was not contemplated when Rule 6e-2 was adopted.

18. Applicants submit that the deferred charge is more favorable to a Contract Owner than the direct charge from premiums for the following reasons. First, the premium payments available for investment and, thus, the investment itself, will be greater than it would be if such a charge was deducted from premiums. Second, the total amount charged to any Contract Owner is not more than it would be if it was taken directly from premiums paid. Finally, Contract Owners will obtain these advantages without incurring any additional cost.

19. Applicants further submit that it is equally proper to deduct any remaining amount of the deferred charge upon early surrender of a Contract, and that the deduction will not violate Sections 2(a)(32) or 27(c)(1) or Rule 22c-1. First, any remaining

amount of the charge deducted upon early surrender is the same amount that would have been deducted if the Contract had not been surrendered. Further, this charge represents a burden borne by Golden American for which it is entitled to be reimbursed. Applicants assert that the deduction upon surrender of any unrecovered amount should not be construed as a restriction on redemption. Finally, Applicants maintain that the Contracts are and will be redeemable securities, and that the deduction of any remaining charge upon surrender represents a legitimate deduction under the Contracts.

20. Applicants believe that the exemptions provided by paragraph (b)(1), (b)(12)(i), and (b)(13)(iv) of Rules 6e-2 and 6e-3(T) do not appear to embrace the deduction of the proposed charge on a deferred basis. Rule 6e-2 was adopted when there was less flexibility regarding premium payments and fewer policy features were available to issuers than have subsequently been permitted. In contrast, Rule 6e-3(T) contemplated deferred sales loads and deferred administrative charges, but not the proposed charge.

Applicants submit that: (a) No policy reason exists for the omission of relief for such a deferred charge from the provisions of Rules 6e-2 or 6e-3(T); (b) the deferred charge structure has been accepted as an appropriate feature of life insurance products under Rule 6e-3(T), as well as pursuant to exemptive relief granted by the Commission; (c) the existence of products with deferred charges provides investors a valuable choice; and (d) the Commission has supported efforts to expand investor choice without sacrificing investor protection.

21. Applicants assert that the standards of Section 6(c) are satisfied because the requested relief is appropriate in the public interest and consistent with the purposes of the 1940 Act and the protection of investors. The exemptive relief would: (a) Permit a larger portion of each premium to be immediately invested under a Contract; (b) eliminate the need for Golden American to file additional exemptive applications for each Contract to be issued through a Future Account with respect to the same issues under the 1940 Act that have been addressed in this Application; thus (c) promoting competitiveness in the variable life insurance market by avoiding delay, reducing administrative expenses and maximizing efficient use of resources; and thereby (d) enhancing Golden American's ability to effectively take advantage of business opportunities as they arise. If Golden American were

required to repeatedly seek exemptive relief with respect to the same issues addressed in this Application, investors would not receive any benefit or additional protection thereby and might be disadvantaged as a result of increased overhead expenses.

#### Conditions for Relief

1. Golden American will monitor the reasonableness of the charge to be deducted pursuant to the requested exemptive relief.

2. The registration statement for each Contract under which the above-referenced charge is deducted will: (a) Disclose the charge; (b) explain the purpose of the charge; and (c) state that the charge is reasonable in relation to Golden American's increased federal tax burden under Section 848 of the Code.

3. The registration statement for each Contract providing for the above-referenced deduction will contain as an exhibit an actuarial opinion as to: (a) The reasonableness of the charge in relation to Golden American's increased federal tax burden under Section 848 of the Code resulting from the receipt of premiums; (b) the reasonableness of the targeted rate of return that is used in calculating such charge; and (c) the appropriateness of the factors taken into account by Golden American in determining such targeted rate of return.

#### Conclusion

For the reasons and upon the facts set forth above, Applicants submit that the requested exemptions to permit Golden American to deduct 1.38% of premium payments under the Contracts are appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the 1940 Act.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 95-2903 Filed 2-6-95; 8:45 am]

BILLING CODE 8010-01-M

#### Issuer Delisting; Notice of Application To Withdraw From Listing and Registration; (Three-Five Systems, Inc., Common Stock, \$0.01 Par Value) File No. 1-4373

February 1, 1995.

Three-Five Systems, Inc. ("Company") has filed an application with the Securities and Exchange Commission ("Commission"), pursuant to Section 12(d) of the Securities Exchange Act of 1934 ("Act") and Rule