

**SECURITIES AND EXCHANGE  
COMMISSION****17 CFR Parts 239 and 274**

[Release Nos. 33-8147; IC-25802; File No. S7-07-02]

RIN 3235-A139

**Disclosure of Costs and Expenses by  
Insurance Company Separate  
Accounts Registered as Unit  
Investment Trusts That Offer Variable  
Annuity Contracts****AGENCY:** Securities and Exchange  
Commission**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission is adopting amendments to the registration form for insurance company separate accounts that are registered as unit investment trusts and that offer variable annuity contracts. The amendments revise the format of the fee table to require disclosure of the range of total expenses for all of the mutual funds offered through the separate account, rather than disclosure of the expenses of each fund. In addition, the Commission is amending the fee table of the registration form for variable life insurance policies to require disclosure of the range of total expenses of all of the mutual funds offered, consistent with the amendments to the fee table of the registration form for variable annuities.

**DATES:** *Effective Date:* December 23, 2002.

*Compliance Dates:*

1. *Initial Compliance Date:* All new registration statements, and post-effective amendments that are annual updates to effective registration statements, filed on Form N-4 or Form N-6 on or after January 1, 2003, must comply with the amendments to Form N-4 or Form N-6, respectively.

2. *Final Compliance Date:* All insurance company separate accounts that are registered as unit investment trusts and that currently offer variable annuity contracts or variable life insurance policies with effective registration statements must comply with the amendments to Form N-4 or Form N-6, respectively, for post-effective amendments that are annual updates to their registration statements on Form N-4 or N-6 filed on or after January 1, 2003, and no later than January 1, 2004.

**FOR FURTHER INFORMATION CONTACT:** Katy Mobedshahi, Senior Counsel, (202) 942-0721, Office of Disclosure Regulation, Division of Investment Management, Securities and Exchange Commission,

450 Fifth Street, NW, Washington, DC 20549-0506.

**SUPPLEMENTARY INFORMATION:** The Securities and Exchange Commission ("Commission") is adopting amendments to Form N-4 [17 CFR 239.17b; 17 CFR 274.11c], the form used by separate accounts organized as unit investment trusts and offering variable annuity contracts to register under the Investment Company Act of 1940 [15 U.S.C. 80a-1 *et seq.*] ("Investment Company Act") and to offer their securities under the Securities Act of 1933 [15 U.S.C. 77a *et seq.*] ("Securities Act"). The Commission is also adopting amendments to Form N-6 [17 CFR 239.17c; 17 CFR 274.11d], the form used by separate accounts organized as unit investment trusts and offering variable life insurance policies to register under the Investment Company Act and to offer their securities under the Securities Act.

**I. Discussion***A. Disclosure of Range of Portfolio  
Company Expenses*

Form N-4 is the registration form used by insurance company separate accounts organized as unit investment trusts that offer variable annuity contracts to register under the Investment Company Act and to register their securities under the Securities Act. Form N-4 requires that a prospectus for a variable annuity contract include a fee table, similar to the fee table required by Form N-1A for mutual funds.<sup>1</sup> The fee table of Form N-4 requires disclosure of the costs and expenses that a variable annuity contractowner will bear, directly or indirectly. This includes the annual operating expenses for each mutual fund in which a contractowner may invest ("Portfolio Company").<sup>2</sup>

Today, the Commission is adopting amendments that will require that the fee table of Form N-4 disclose the range of expenses for the Portfolio Companies offered through the separate account, rather than the expenses of each Portfolio Company. As we stated in the release proposing these amendments ("Proposing Release"), we believe that the use of a range of Portfolio Company expenses is warranted in order to simplify fee tables for variable annuity

<sup>1</sup> Item 3(a) of Form N-4.

<sup>2</sup> Variable annuity separate accounts registered as unit investment trusts are divided into sub-accounts, each of which invests in a different Portfolio Company. Each contractowner selects the sub-accounts, and thus the Portfolio Companies, in which his or her account value is invested. A "Portfolio Company" may be a registered investment company, or a series of a registered investment company, in the case of a series

contracts, which have grown longer and more complex.<sup>3</sup> The number of investment options available through a typical variable annuity contract has expanded considerably in recent years.<sup>4</sup> Variable annuity fee tables have also become more complicated in recent years because insurers have increasingly offered variable annuity contracts with a variety of so-called "unbundled" optional features, each of which has a separate charge.<sup>5</sup>

We received four comment letters on the proposed amendments.<sup>6</sup> Two of the commenters supported the proposed requirement for disclosure of the range of expenses for all of the Portfolio Companies offered, while one commenter favored disclosure of the expenses of each Portfolio Company in the variable annuity prospectus.

We continue to believe that our approach will assist investors in understanding the fees and charges that they will pay for a variable annuity contract. The amendments will streamline the fee table in the contract prospectus and make it more understandable, while at the same time investors will continue to have access to information about the fees and expenses of each Portfolio Company. We recently amended Form N-1A, the form used by mutual funds to register under the Investment Company Act and to offer their securities under the Securities Act, to require that every mutual fund that offers its shares as an investment option for a variable annuity contract include a fee table in its prospectus.<sup>7</sup> Investors

<sup>3</sup> Investment Company Act Release No. 25521 (Apr. 12, 2002) [67 FR 19886, 19886 (Apr. 23, 2002)].

<sup>4</sup> Rick Carey, *9-Month Variable Annuity Sales Fell 17.8% To \$113 Billion Last Year*, National Underwriter Life & Health/Financial Services Edition, March 11, 2002, at 16 (estimating that average number of funds available in a variable annuity contract increased from five in 1988 to 33 in 2001).

<sup>5</sup> Timothy C. Pfeifer, *Growing Rider Use Furthers Flexibility But Also Complexity*, National Underwriter Life & Health/Financial Services Edition, Sept. 3, 2001, at 22 (describing growth in optional riders on both variable annuities and variable life insurance).

<sup>6</sup> The comment letters and a summary of comments prepared by our staff are available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth St., NW., Washington, DC 20549, in File No. S7-07-02. Public comments submitted electronically and a summary of comments are also available electronically on our website at [www.sec.gov](http://www.sec.gov).

<sup>7</sup> Investment Company Act Release No. 25522 (Apr. 12, 2002) [67 FR 19847, 19860 (Apr. 23, 2002)] ("N-6 Adopting Release"); Item 3 of Form N-1A. Prior to this amendment, a mutual fund that offered its shares exclusively as investment options for variable life insurance policies and variable annuity contracts was permitted to omit the fee table from its prospectus. See Investment Company Act Release No. 16766 (Jan. 23, 1989) [54 FR 4772 (Jan. 31, 1989)] (adopting Form N-4 fee table and

in variable annuity contracts now have access to information about the fees and expenses of each Portfolio Company in the prospectus for the Portfolio Company.<sup>8</sup> The amendments that we are adopting to the fee table of Form N-4 will require a statement referring investors to the Portfolio Company prospectuses for more detail concerning Portfolio Company fees and expenses. In addition, the requirement that the fee table of Form N-4 include the range of Portfolio Company expenses will clearly indicate to investors the maximum fees that may be charged by any of the Portfolio Companies offered, so investors will receive disclosure in the variable annuity contract prospectus of the highest possible amount of Portfolio Company expenses that they may pay.

We note, further, that the amendments we are adopting to Form N-4 will permit registrants to continue to include disclosure of the fees and expenses for each Portfolio Company in the fee table of Form N-4, in addition to the required disclosure of the range of expenses for the Portfolio Companies. This approach will provide registrants with the flexibility to include this detailed information when they determine that it would be helpful, and not overwhelming, to investors.<sup>9</sup>

We are, however, modifying our proposal to require disclosure of the range of total Portfolio Company expenses.<sup>10</sup> Our proposal would have required line item disclosure of the range of each of several categories of Portfolio Company expenses, including management fees, distribution (12b-1) fees, and other expenses, as well as total annual operating expenses. Two commenters suggested that we require disclosure of the range of total annual operating expenses only, rather than the ranges of the various categories. The commenters reasoned that disclosing the minimum and maximum expenses for several categories of expense, as well as total annual operating expenses, would result in two columns of category expenses in the fee table that would not necessarily add up to the minimum and maximum total operating expenses shown. For example, if Portfolio Company A had management fees of 0.5%, 12b-1 fees of 0.25%, other

expenses of 0.3%, and total expenses of 1.05%; Portfolio Company B had management fees of 0.9%, 12b-1 fees of 0%, other expenses of 0.25%, and total expenses of 1.15%; and Portfolio Company C had management fees of 1.0%, 12b-1 fees of 0%, other expenses of 0.25%, and total expenses of 1.25%, then the range of total expenses for all three Portfolio Companies required to be disclosed would be 1.05% to 1.25%, rather than the sum of the minimum and maximum category expenses columns, which would be 0.75% (0.5% + 0% + 0.25%) to 1.55% (1.0% + 0.25% + 0.3%). We were persuaded by the commenters that this result might confuse investors, rather than simplifying disclosure. In order to help investors understand the types of expenses that are included in total Portfolio Company operating expenses, we are revising the caption in the Portfolio Company expenses section of the fee table to state explicitly that total expenses include management fees, distribution (12b-1) fees, and other expenses.<sup>11</sup>

We are also amending Form N-6, the registration form for insurance company separate accounts that are registered as unit investment trusts and that offer variable life insurance policies, to require disclosure of the range of total expenses for all the Portfolio Companies, rather than line item disclosure of the range of each category of expenses.<sup>12</sup> We had indicated in the Proposing Release that if we modified the proposed amendments to the fee table of Form N-4 in response to comments, we intended to make conforming changes to Form N-6.<sup>13</sup>

#### B. Other Fee Table Changes

We are adopting other amendments to the format and instructions for the fee table of Form N-4 substantially as proposed, with minor changes to address commenters' suggestions.

**Expense Reimbursement and Fee Waiver Arrangements.** We are adopting, as proposed, a requirement that Portfolio Company operating expenses be disclosed before expense reimbursement and fee waiver arrangements. Expenses after reimbursement or waiver could be disclosed in a footnote.<sup>14</sup>

**Expense Example.** We are adopting, substantially as proposed, amendments to the expense example and accompanying instructions of the fee table of Form N-4. These amendments would require an expense example based on the maximum expenses charged by any of the Portfolio Companies.<sup>15</sup> Registrants would be permitted to provide an additional example, based on the minimum expenses charged by any of the Portfolio Companies.<sup>16</sup> In lieu of providing examples based on the maximum and minimum expenses charged by the Portfolio Companies offered through the contract, a registrant would be permitted to include expense examples for each of the Portfolio Companies.<sup>17</sup>

In response to a commenter's suggestion, we are modifying the Instructions to the expense example of Item 3(a) regarding conversion of annual contract fees to a percentage basis by providing that the total amount of the contract fees collected during the year should be divided by the total average net assets for the contract (which includes both general account and separate account assets), rather than only separate account assets, as we had proposed and as the instructions to Item

amendments to the fee table of Form N-4 consistent with the approach taken under Form N-1A, to permit the addition of one line to the fee table showing the range of net Portfolio Company operating expenses after taking account of contractual limitations that require reimbursement or waiver of expenses. This additional line would be placed immediately under the "Total Annual [Portfolio Company] Operating Expenses" line of the fee table and would have to use appropriate descriptive captions. A footnote to the fee table would be required to describe the contractual arrangement. See Proposing Release, *supra* note 3, 67 FR at 19887 n.15.

<sup>15</sup> Instruction 21(b) to Item 3(a) of Form N-4. Under Form N-1A, the staff has permitted mutual funds with fees that are subject to a contractual limitation that requires reimbursement or waiver of expenses to take account of the reimbursement or waiver in calculating the example required by the fee table of Item 3, but only for the duration of the contractual limitation. Funds may not assume that the reimbursement or waiver will continue for periods subsequent to the contractual limitation period in calculating expenses shown in the example. Cf. Letter from Barry D. Miller, Associate Director, Division of Investment Management, SEC, to Craig S. Tyle, General Counsel, Investment Company Institute (Oct. 2, 1998) (permitting funds with fees that are subject to a contractual limitation that requires reimbursement or waiver to add two lines to the fee table showing the amount of the reimbursement or waiver and total net expenses). We intend that the staff construe the amendments to the expense example requirements of Form N-4 consistent with the approach it has taken with the expense example of the fee table of Form N-1A, to permit expense examples to take into account contractual limitations on Portfolio Company operating expenses that require reimbursement or waiver of expenses, but only for the period of the contractual limitation.

<sup>16</sup> Instruction 21(b) to Item 3(a) of Form N-4.

<sup>17</sup> *Id.*

eliminating the fee table requirement in Form N-1A for Portfolio Companies offering shares exclusively to insurance company separate accounts).

<sup>8</sup> Investors in variable annuity contracts receive the prospectuses for both the separate account unit investment trust and the Portfolio Companies they have selected.

<sup>9</sup> Instruction 20 to Item 3(a) of Form N-4; Instruction 4(f) to Item 3 of Form N-6.

<sup>10</sup> Item 3(a) and Instruction 17(a) to Item 3(a) of Form N-4.

<sup>11</sup> Item 3(a) of Form N-4. If none of the Portfolio Companies offered by a variable annuity contract charge distribution (12b-1) fees, the reference to these fees may be omitted.

<sup>12</sup> Item 3 and Instructions 4 and 5 to Item 3 of Form N-6.

<sup>13</sup> Proposing Release, *supra* note 3, 67 FR at 19888.

<sup>14</sup> Instructions 18(a), 19, and 22(a) to Item 3(a) of Form N-4. We intend that the staff construe the

3(a) of Form N-4 currently require.<sup>18</sup> This revision will result in a more accurate calculation of the annual contract fee percentage, by attributing the contract fee to both separate account and general account assets.

In addition, in response to a commenter's suggestion, we are revising the narrative that would be required to precede the expense example, to clarify that expenses reflected in the example include separate account fees and charges, as well as the maximum expenses charged by any of the Portfolio Companies.<sup>19</sup>

*Requirement to Disclose All Fees and Charges.* We are adopting, as proposed, an instruction to the fee table of Form N-4 that would require registrants to disclose all recurring fees and charges, including fees and charges for all optional features.<sup>20</sup> One commenter suggested that we clarify the instruction requiring disclosure of all recurring fees and charges, to indicate that mutually exclusive fees (such as fees for mutually exclusive death benefit options) do not need to be presented in the fee table. We disagree with this approach because it would result in charges for some available features not being disclosed. As a result, investors who are considering these features would be unable to assess their cost. Registrants may, however, indicate, through a footnote or other means, that charges for certain features shown in the fee table are mutually exclusive. We note that registrants should not include multiple mutually exclusive fees in the expense example, but should include the highest of these charges. For example, if a contract offers two mutually exclusive death benefit options, with mortality and expense risk charges of 1.25% and 1.40%, respectively, the expense example should reflect a mortality and expense risk charge of 1.40%.

## II. Effective Date and Compliance Date

The effective date of these amendments is December 23, 2002. All new registration statements, and post-effective amendments that are annual updates to effective registration statements, filed on Form N-4 or N-6 on or after January 1, 2003, must comply with these amendments. The final compliance date for filing amendments to effective registration statements to conform to these amendments is January 1, 2004. A registrant may, at its option, comply with the requirements of these

amendments to Forms N-4 and N-6 at any time after the effective date.

As noted above, the Commission recently amended Form N-1A, the registration form for mutual funds, to require a Portfolio Company that offers its shares exclusively as investment options for variable annuity contracts and variable life insurance policies to include a fee table in its prospectus.<sup>21</sup> Registrants on Form N-1A are required to comply with this amendment with respect to all new registration statements, and post-effective amendments that are annual updates to effective registration statements, filed on or after September 1, 2002.<sup>22</sup> During the transition period, a separate account that is registered on Form N-4 or Form N-6 should include in Item 3(a) of Form N-4, or Item 3 of Form N-6, a fee table for any Portfolio Company whose Form N-1A has not been updated to include a fee table.<sup>23</sup>

## III. Cost/Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules on affected persons and entities. In the Proposing Release, we requested comment and specific data regarding the costs and benefits of the proposed amendments, but received none.

Form N-4 is the registration form used by insurance company separate accounts organized as unit investment trusts that offer variable annuity contracts to register under the Investment Company Act and to register their securities under the Securities Act.<sup>24</sup> Form N-4 requires that a prospectus for a variable annuity contract include a fee table showing the costs and expenses that a variable annuity contractowner will bear, directly or indirectly, including the annual operating expenses for each mutual fund in which a contractowner may invest ("Portfolio Company"). The amendments adopted today will revise the fee table in the prospectus of Form N-4 to require registrants to disclose the range of total expenses for all of the Portfolio Companies offered, rather than separately disclosing the fees and expenses of each Portfolio Company. Registrants will still be permitted to include additional disclosure of the fees

and expenses of each Portfolio Company offered through a sub-account of the registrant. Use of a range of Portfolio Company expenses is warranted in order to streamline and improve fee tables for variable annuity contracts, which have grown increasingly longer and more complex in recent years as the number of investment options available through a typical variable annuity contract has expanded. In addition, the amendments that we are adopting include a conforming change to the fee table of Form N-6, to require disclosure of only the range of total expenses for all the Portfolio Companies, and not line item disclosure of the range of each category of expenses.

The amendments will also make other technical changes conforming the format and the instructions for the fee table of Form N-4 more closely to the fee tables in Forms N-6 and N-1A, and for purposes of consistency with the disclosure of the range of Portfolio Company expenses, as described in the Proposing Release. These changes will improve transparency of fee disclosure. These amendments, discussed in more detail in the Proposing Release, include the following:

- Revising the expense example in the fee table to require only an example based on the maximum expenses charged by any Portfolio Company.
- Making other modifications to the format of the example.
- Prescribing narrative explanations to precede each section of the fee table.
- Adding an instruction requiring disclosure of all recurring fees and charges other than Portfolio Company operating expenses.

### A. Benefits

We believe that the amendments adopted today to Form N-4 will benefit investors by making the variable annuity prospectus easier for investors to understand. As noted above, disclosure of a range of Portfolio Company expenses should make fee tables for variable annuity contracts, which have grown increasingly longer and more complex in recent years, shorter and more comprehensible. Investors will continue to have access to information about the fees and expenses of each Portfolio Company in the prospectus for the Portfolio Company. The amendments will also modify the expense example of the Form N-4 fee table, consistent with the use of the range of Portfolio Company expenses in the fee table.

The amendments will make technical changes to the format and instructions of the fee table of Form N-4, in order to improve transparency of the fees and

<sup>18</sup> Instruction 21(f) to Item 3(a) of Form N-4; Instruction 21(e) to Item 3(a) of current Form N-4.

<sup>19</sup> Item 3(a) and Instructions 21(a) and (b) to Item 3(a) of Form N-4.

<sup>20</sup> Instruction 15 to Item 3(a) of Form N-4.

<sup>21</sup> See *supra* note 7 and accompanying text.

<sup>22</sup> N-6 Adopting Release, *supra* note 7, 67 FR at 19860 (discussing compliance date for amendment to Form N-1A).

<sup>23</sup> *Id.* at 19860 n.83.

<sup>24</sup> Under a variable annuity contract, purchase payments are invested in an insurer's separate account created under state law and legally segregated from the assets of the insurer's general account. The separate account offers the contract owner a number of investment options, which generally consist of mutual funds.

charges that contractowners will pay, to make the Form N-4 fee table more consistent with its counterpart in Form N-6, and to reflect changes in the types of fees and charges assessed by variable annuity contracts since the fee table of Form N-4 was adopted. We believe these changes may improve disclosure of variable annuity fees and expenses to investors. It is difficult to quantify the effects of this improved disclosure, though we note that the changes we are adopting are limited in nature.

The amendments may also result in slightly reduced printing and mailing costs to registrants. Disclosure of the range of Portfolio Company expenses rather than the expenses of each Portfolio Company may shorten the typical variable annuity prospectus, because disclosure of these expenses sometimes comprises a full page, or more, of a variable annuity prospectus.<sup>25</sup> We do not expect that any of the other changes in the amendments will lengthen the variable annuity prospectus, as these changes will largely affect the format in which fee and expense information is to be presented, rather than the quantity of information presented. Based on a print run of 20,000 copies for a typical variable annuity prospectus, and printing and mailing costs of \$0.05 per page, the reduction in printing and mailing costs attributable to the proposed amendments may equal \$1,000 for a typical variable annuity contract.<sup>26</sup> Based on an estimate of 814 variable annuity contracts currently being actively marketed, therefore, these printing and postage savings could total \$814,000 annually.<sup>27</sup>

In addition, conforming the disclosure requirements for Portfolio Company expenses in variable annuity prospectuses to those in variable life prospectuses may simplify the process of preparing registration statements for some registrants, because frequently insurance companies that issue variable

annuities also issue variable life insurance.<sup>28</sup> We believe that these cost savings will be relatively small, however.

Finally, the conforming amendments we are adopting to the fee table of Form N-6 will reduce the potential for confusion to investors that may occur if the disclosure of the range of minimum and maximum expenses for each category of Portfolio Company operating expenses results in two columns that do not add up to the range of minimum and maximum total operating expenses. This change will streamline the Form N-6 fee table, while continuing to ensure that investors have access to fee information about the Portfolio Companies in which they invest.

#### *B. Costs*

Although the amendments to the fee table of Form N-4 are limited and many of them are technical in nature, they differ from the current requirements of the fee table of Form N-4, which have been in place since 1989. Therefore, variable annuity issuers may incur a one-time cost for training in order for their personnel, particularly lawyers and others who are responsible for supervising the preparation of filings on Form N-4, to review and analyze the disclosure requirements of the amendments to Form N-4. Because the amendments will make mostly minor changes to the current format of the Form N-4 fee table, and will not require the disclosure of information that the current fee table does not require, we estimate that this cost will be fairly small. We lack data necessary to make a more precise estimate of the cost resulting from the amendments, but we estimate that this cost will be approximately \$500 for each insurance company that sponsors separate accounts that are registered on Form N-4 and issue variable annuity contracts that are actively being sold. Further, we estimate that there are 94 such insurance companies.<sup>29</sup> We therefore estimate the one-time cost attributable to the proposed amendments to Form N-4 to be \$47,000. We requested comment on these cost estimates in the Proposing Release, but received none.

We do not expect that the amendments to Form N-4 will result in any net effect on the aggregate hour

burden for completing and filing Form N-4. We expect that in preparing their fee tables for Form N-4, registrants will still need to collect information about the expenses for each Portfolio Company offered through the contract, in order to determine the minimum and maximum total operating expenses of the Portfolio Companies offered through the contract. We also expect that the other proposed amendments modifying the format and instructions of the Form N-4 fee table to conform more closely to the Form N-6 fee table will have no net effect on the burden hours for completing and filing Form N-4, because they will not require disclosure of any additional information by issuers.

Finally, we do not anticipate that the conforming changes we are making to the fee table of Form N-6 will result in any increased costs to issuers or investors. Issuers will be required to disclose only the range of total Portfolio Company operating expenses, rather than the range of each category of expenses as well as the range of total expenses. In addition, issuers have only recently begun using new Form N-6, or have not yet begun doing so. Therefore, any cost for training personnel to apply the amendment to the fee table of Form N-6 may be incorporated in the overall cost for training personnel in the disclosure requirements of Form N-6 as a whole.

#### **IV. Effects on Efficiency, Competition, and Capital Formation**

Section 2(c) of the Investment Company Act, section 2(b) of the Securities Act, and section 3(f) of the Securities Exchange Act of 1934 require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is consistent with the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.<sup>30</sup> The Commission has considered these factors. We requested comments regarding the effects of the proposed amendments on efficiency, competition and capital formation and received none.

The amendments to Form N-4 and Form N-6 are expected to have minimal effects on efficiency and competition among issuers of variable insurance products. As adopted, the amendments will revise the fee table in the prospectus of Form N-4 to require registrants to disclose the range of expenses for all the Portfolio Companies offered through the separate account, rather than disclosing separately the

<sup>25</sup> The amendments will require a registrant to include a statement referring investors to Portfolio Company prospectuses for more detail concerning Portfolio Company fees and expenses. This required statement would not impose any additional disclosure burden on registrants, because the instructions to Form N-4 currently require a similar cross-reference to the Portfolio Company prospectuses. See General Instruction 1 to Item 3(a) of current Form N-4.

<sup>26</sup> An insurance company that issues variable annuities provided the staff with estimates of the typical print run of a prospectus and the associated printing and mailing costs.

<sup>27</sup> The estimate of 814 variable annuity contracts is based on the number of contracts tracked by Morningstar, Inc. Morningstar, Principia Pro Plus, Variable Annuities/Life (May 2002). While Morningstar tracks a substantial majority of variable annuity contracts, it does not track all existing contracts.

<sup>28</sup> We estimate, based on an analysis of data from the EDGAR filing system for 2000 and 2001, that approximately two-thirds of insurers issuing variable annuities also issue variable life insurance policies.

<sup>29</sup> The estimate of the number of insurance companies issuing variable annuities is based on the staff's analysis of data from the EDGAR filing system for 2000 and 2001.

<sup>30</sup> 15 U.S.C. 77b(b), 78c(f), and 80a-2(c).

fees and expenses of each Portfolio Company. The amendments will make certain other technical changes to conform the format and instructions to the fee table of Form N-4 more closely to its counterparts in Form N-6 and Form N-1A. In addition, the amendments will revise the fee table of Form N-6 to require disclosure of the range of total expenses for all the Portfolio Companies offered, and not disclosure of the range of each category of Portfolio Company expenses, consistent with the amendments to the fee table of Form N-4. The amendments will allow fee table disclosure of Portfolio Company expenses in both Form N-4 and Form N-6 to be shorter, and generally make fee table disclosure clearer and more understandable to investors. However, we do not expect the amendments to have any significant effect on competition and efficiency because they will not change the quantity of information about fees and expenses that investors in variable annuity contracts receive. Similarly, it is unclear whether the amendments to Form N-4 and Form N-6 will affect capital formation.

#### V. Paperwork Reduction Act

As explained in the Proposing Release, certain provisions of Form N-4 contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 [44 U.S.C. 3501 *et seq.*]. The title for the collection of information is "Form N-4 under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Separate Accounts Organized as Unit Investment Trusts." The information collection requirements imposed by Form N-4 are mandatory. Responses to the collection of information will not be kept confidential. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

We published a notice soliciting comments on the collection of information requirements of Form N-4 in the Proposing Release. The Commission did not receive any comments on the Paperwork Reduction Act portion of the Proposing Release.

Form N-4 (OMB Control No. 3235-0318) was adopted pursuant to section 8(a) of the Investment Company Act [15 U.S.C. 80a-8] and section 5 of the Securities Act [15 U.S.C. 77e].<sup>31</sup> As

stated above, the purpose of Form N-4 is to meet the registration and disclosure requirements of the Securities Act and Investment Company Act and to enable separate accounts organized as unit investment trusts that offer variable annuity contracts to provide investors with information necessary to evaluate an investment in a variable annuity contract.

The Commission proposed to amend Form N-4 to conform the disclosure of Portfolio Company expenses in the fee table to the format used in Form N-6, the registration form for insurance company separate accounts registered as unit investment trusts that offer variable life insurance policies. Under the proposed amendments, registrants on Form N-4 will be required to disclose only the range of the expenses for all of the Portfolio Companies in which the separate account invests. Variable annuity investors will continue to have access to complete information about the Portfolio Company fees and expenses because disclosure of the fees and expenses for each Portfolio Company will be included in its prospectus under the requirements of Form N-1A. The amendments will also make other technical changes in order to conform the format and instructions for the fee table of Form N-4 to its counterparts in Form N-6 and Form N-1A.

We do not expect that the amendments to Form N-4 will result in any net effect on the aggregate hour burden for completing and filing Form N-4, and therefore the amendments to Form N-4 will not impose any additional collection of information on registrants. We expect that in preparing their fee tables for Form N-4, registrants will still need to collect information about the total operating expenses for each Portfolio Company offered through the contract, in order to determine the minimum and maximum expenses of the Portfolio Companies. We also expect that the other amendments modifying the format of the Form N-4 fee table to conform more closely to the fee tables of Forms N-6 and N-1A will have no net effect on the burden hours for completing and filing Form N-4, because they will not require any additional information to be disclosed.

In addition, we expect that the conforming amendments we are adopting to Form N-6, the registration form for insurance company separate accounts that are registered as unit

investment trusts and that offer variable life insurance policies, requiring disclosure of only the range of total expenses for all of the Portfolio Companies offered through the separate account rather than line item disclosure of the range of each category of expenses as well as the range of total expenses, will have no effect on the burden of completing Form N-6. Form N-6 already requires variable life insurance issuers to calculate the range of total expenses for each Portfolio Company offered through a variable life insurance policy, and therefore the amendments will not impose any additional costs on issuers.

#### VI. 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 has certified that the proposed amendments to Form N-4 would not, if adopted, have a significant economic impact on a substantial number of small entities. The initial certification was attached to the Proposing Release as Appendix A. We requested comments on the certification, but received none.

Pursuant to Section 605(b) of the Regulatory Flexibility Act [5 U.S.C. 605(b)], the Commission certifies that the amendments to Form N-6 adopted as part of this Adopting Release will not have a significant economic impact on a substantial number of small entities. The amendments will revise the fee table of Form N-6 to require only disclosure of the range of total expenses for all of the Portfolio Companies offered through a variable life insurance policy, rather than line item disclosure of the range of each category of expenses as well as the range of total expenses. The economic impact of the amendments will not be significant. Form N-6 already requires variable life insurance issuers to calculate the range of total expenses for each Portfolio Company offered through a variable life insurance policy, and therefore the amendments will not impose any additional costs on issuers.

#### VII. Statutory Authority

The amendments to Form N-4 and Form N-6 are being adopted pursuant to sections 5, 7, 8, 10, and 19(a) of the Securities Act [15 U.S.C. 77e, 77g, 77h, 77j, and 77s(a)] and sections 8, 24, 30, and 38 of the Investment Company Act [15 U.S.C. 80a-8, 80a-24, 80a-29, and 80a-37].

<sup>31</sup> OMB approved the collection of information requirements contained in Form N-6 (OMB Control No. 3235-0503) The title for the collection of information is "Form N-6 Under the Investment

Company Act of 1940 and the Securities Act of 1933, Registration Statement of Variable Life Insurance Separate Accounts Registered as Unit Trust."

**List of Subjects**

17 CFR Part 239

Reporting and recordkeeping requirements, Securities.

17 CFR Part 274

Investment companies, Reporting and recordkeeping requirements, Securities.

**Text of Form Amendments**

For the reasons set out in the preamble, the Commission amends Chapter II, Title 17 of the Code of Federal Regulations as follows.

**PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933**

1. The general authority citation for Part 239 continues to read as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll(d), 79e, 79f, 79g, 79j, 79l, 79m, 79n, 79q, 79t, 80a-8, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

\* \* \* \* \*

**PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940**

2. The authority citation for Part 274 is revised to read as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

Section 274.101 is also issued under secs. 3(a) and 302, Pub. L. 107-204, 116 Stat. 745.

3. Form N-4 (referenced in §§ 239.17b and 274.11c), Item 3(a), is amended by:

- a. Revising Item 3(a);
- b. Revising Instructions: General Instructions 1, 3, and 5;
- c. Removing the heading "Portfolio Company Annual Expenses" preceding Instruction 15;
- d. Removing Instructions 16 through 21;
- e. Redesignating Instruction 15 as Instruction 16;
- f. Adding new Instruction 15;
- g. Adding the heading "Annual [Portfolio Company] Operating Expenses" to precede newly redesignated Instruction 16; and
- h. Adding new Instructions 17 through 22.

The additions and revisions read as follows:

**Note:** The text of Form N-4 does not and these amendments will not appear in the Code of Federal Regulations.

**Form N-4**

\* \* \* \* \*

**Item 3. Synopsis**

(a) Include the following information, in plain English under rule 421(d) under the Securities Act [17 CFR 430.421(d)]:

The following tables describe the fees and expenses that you will pay when buying, owning, and surrendering the contract. The first table describes the fees and expenses that you will pay at the time that you buy the contract, surrender the contract, or transfer cash

value between investment options. State premium taxes may also be deducted.

Contractowner Transaction Expenses:	
Sales Load Imposed on Purchases (as a percentage of purchase payments) .....	_____ %
Deferred Sales Load (as a percentage of purchase payments or amount surrendered, as applicable) ...	_____ %
Surrender Fees (as a percentage of amount surrendered, if applicable) .....	_____ %
Exchange Fee .....	_____ %

The next table describes the fees and expenses that you will pay periodically during the time that you own the contract, not including [portfolio company] fees and expenses.

[Annual] Contract Fee.  
Separate Account Annual Expenses (as a percentage of average account value)

Mortality and Expense Risk Fees .....	_____ %
Account Fees and Expenses .....	_____ %
Total Separate Account Annual Expenses .....	_____ %

The next item shows the minimum and maximum total operating expenses charged by the portfolio companies that you may pay periodically during the time that you own the contract. More detail concerning each [portfolio company's] fees and expenses is contained in the prospectus for each [portfolio company].

<i>Total Annual [Portfolio Company] Operating Expenses</i>	Minimum	Maximum
(Expenses that are deducted from [portfolio company] assets, including management fees, distribution [and/or service] (12b-1) fees, and other expenses)	_____ %	_____ %

**Example**

This Example is intended to help you compare the cost of investing in the contract with the cost of investing in other variable annuity contracts. These costs include contract owner transaction expenses, contract fees, separate account annual expenses, and [portfolio company] fees and expenses.

The Example assumes that you invest \$10,000 in the contract for the time periods indicated. The Example also assumes that your investment has a 5% return each year and assumes the maximum fees and expenses of any of the [portfolio companies]. Although your actual costs may be higher or lower, based on these assumptions, your costs would be:

(1) If you surrender your contract at the end of the applicable time period:

1 year	3 years	5 years	10 years
\$ _____	\$ _____	\$ _____	\$ _____

(2) If you annuitize at the end of the applicable time period:

1 year	3 years	5 years	10 years
\$ _____	\$ _____	\$ _____	\$ _____

(3) If you do *not* surrender your contract:

1 year	3 years	5 years	10 years
\$ _____	\$ _____	\$ _____	\$ _____

**Instructions**

**General Instructions**

1. Include the narrative explanations in the order indicated. A Registrant may modify a narrative explanation if the explanation contains comparable information to that shown.

\* \* \* \* \*

3. A Registrant may omit captions if the Registrant does not charge the fees or expenses covered by the captions. A Registrant may modify or add captions if the captions shown do not provide an

accurate description of the Registrant's fees and expenses.

\* \* \* \* \*

5. In the Contractowner Transaction Expenses, [Annual] Contract Fee, and Separate Account Annual Expenses tables, the Registrant must disclose the maximum guaranteed charge, unless a specific instruction directs otherwise. The Registrant may disclose the current charge, in addition to the maximum charge, if the disclosure of the current charge is no more prominent than, and does not obscure or impede understanding of, the disclosure of the maximum charge. In addition, the Registrant may include in a footnote to the table a tabular, narrative, or other presentation providing further detail regarding variations in the charge. For example, if deferred sales charges may decline over time, the Registrant may

include in a footnote a presentation regarding the scheduled reductions in the deferred sales charges.

\* \* \* \* \*

15. If the Registrant (or any other party pursuant to an agreement with the Registrant) imposes any other recurring charge other than annual portfolio company total operating expenses, add another caption describing it and list the (maximum) amount or basis on which the charge is deducted.

*Total Annual [Portfolio Company] Operating Expenses*

\* \* \* \* \*

17. (a) If a Registrant has multiple sub-accounts, it should disclose the minimum and maximum "Total Annual [Portfolio Company] Operating Expenses" for any portfolio company. "Total Annual [Portfolio Company] Operating Expenses" include all expenses that are deducted from a portfolio company's assets. The amount of expenses deducted from a portfolio company's assets are the amounts shown as expenses in the portfolio company's statement of operations (including increases resulting from complying with paragraph 2(g) of rule 6-07 of Regulation S-X [17 CFR 210.6-07]).

(b) "Total Annual [Portfolio Company] Operating Expenses" do not include extraordinary expenses as determined under generally accepted accounting principles (see Accounting Principles Board Opinion No. 30). If extraordinary expenses were incurred by any portfolio company that would, if included, materially affect the minimum or maximum amounts shown in the table, disclose in a footnote to the table what the minimum and maximum "Total Annual [Portfolio Company] Operating Expenses" would have been had the extraordinary expenses been included.

18. (a) Base the percentages of "Total Annual [Portfolio Company] Operating Expenses" on amounts incurred during the most recent fiscal year, but include in expenses amounts that would have been incurred absent expense reimbursement or fee waiver arrangements. If a portfolio company has a fiscal year different from that of the Registrant, base the expenses on those incurred during either the period that corresponds to the fiscal year of the Registrant, or the most recently completed fiscal year of the portfolio company. If the Registrant or a portfolio company has changed its fiscal year and, as a result, the most recent fiscal year is less than three months, use the fiscal year prior to the most recent fiscal year as the basis for determining "Total

Annual [Portfolio Company] Operating Expenses."

(b) If there have been any changes in "Total Annual [Portfolio Company] Operating Expenses" that would materially affect the information disclosed in the table:

(i) Restate the expense information using the current fees as if they had been in effect during the previous fiscal year; and

(ii) In a footnote to the table, disclose that the expense information in the table has been restated to reflect current fees.

(c) A change in "Total Annual [Portfolio Company] Operating Expenses" means either an increase or a decrease in expenses that occurred during the most recent fiscal year or that is expected to occur during the current fiscal year. A change in "Total Annual [Portfolio Company] Operating Expenses" does not include a decrease in operating expenses as a percentage of assets due to economies of scale or breakpoints in a fee arrangement resulting from an increase in a portfolio company's assets.

19. A Registrant may reflect minimum and maximum actual total [portfolio company] operating expenses that include expense reimbursement or fee waiver arrangements in a footnote to the table. If the Registrant provides this disclosure, also disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, or whether it can be terminated at any time at the option of a portfolio company.

20. A Registrant may include additional tables showing annual operating expenses separately for each portfolio company immediately following the required table of "Total Annual [Portfolio Company] Operating Expenses." The additional tables should be prepared in the format, and in accordance with the Instructions, prescribed in Item 3 of Form N-1A [17 CFR 239.15A; 17 CFR 274.11A] for disclosing "Annual Fund Operating Expenses."

*Example*

21. For purposes of the Example in the table:

(a) Assume that the percentage amounts listed under "Separate Account Annual Expenses" remain the same in each year of the 1-, 3-, 5-, and 10-year periods, except that an adjustment may be made to reflect reduced annual expenses resulting from completion of the amortization of initial organization expenses;

(b) Assume deduction of the maximum percentage amount of

expenses shown under "Total Annual [Portfolio Company] Operating Expenses," and that this amount remains the same in each year of the 1-, 3-, 5-, and 10-year periods, except that an adjustment may be made to reflect reduced annual expenses resulting from completion of the amortization of initial organization expenses. An additional example that assumes deduction of the minimum percentage amount of expenses shown under "Total Annual [Portfolio Company] Operating Expenses" may also be provided, immediately following the required expense example based on maximum portfolio company expenses. In lieu of providing the required example based on maximum portfolio company expenses, a Registrant may include separate expense examples based on the expenses of each portfolio company;

(c) Assume the maximum sales load that may be deducted from purchase payments is deducted;

(d) For any breakpoint in any fee, assume that the amount of the Registrant's (and the portfolio company's) assets remains constant as of the level at the end of the most recently completed fiscal year;

(e) Assume no exchanges or other transactions;

(f) Reflect any [annual] contract fee by dividing the total amount of [annual] contract fees collected during the year that are attributable to the contract offered by the prospectus by the total average net assets that are attributable to the contract offered by the prospectus. Add the resulting percentage to "Separate Account Annual Expenses," and assume that it remains the same in each year of the 1-, 3-, 5-, and 10-year periods;

(g) Reflect any contingent deferred sales load by assuming a complete surrender on the last day of the year;

(h) Provide the information required in the third section of the Example only if a sales load or other fee is charged upon a complete surrender; and

(i) Include in the Example the information provided by the caption "If you annuitize at the end of the applicable time period" only if the Registrant charges fees upon annuitization that are different from those charged upon surrender.

22. *New Registrants.* For purposes of this Item, a "New Registrant" is a Registrant that does not include in Form N-4 financial statements reporting operating results or that includes financial statements for the Registrant's initial fiscal year reporting operating results for a period of 6 months or less.

The following Instructions apply to New Registrants:

(a) Base the percentages in "Total Annual [Portfolio Company] Operating Expenses" on payments that will be made, but include in expenses amounts that will be incurred without reduction for expense reimbursement or fee waiver arrangements, estimating amounts of expenses that are not established pursuant to contract. Disclose in a footnote to the table that "Total Annual [Portfolio Company] Operating Expenses" are based, in part, on estimated amounts for the current fiscal year.

(b) A New Registrant may reflect in a footnote to the table expense reimbursement or fee waiver arrangements that are expected to reduce the minimum and/or maximum

total [portfolio company] operating expenses shown in the table. If the New Registrant provides this disclosure, also disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, or whether it can be terminated at any time at the option of a portfolio company.

(c) Complete only the 1- and 3-year period portions of the Example, and estimate any [annual] contract fees collected.

\* \* \* \* \*

4. Form N-6 (referenced in § 239.17c and § 274.11d), Item 3 is amended by:

a. Revising the introductory text and fee tables; and

b. Revising Instructions 4 and 5.

The revisions read as follows:

**Note:** The text of Form N-6 does not and these amendments will not appear in the *Code of Federal Regulations*.

**Form N-6**

\* \* \* \* \*

**Item 3. Risk/Benefit Summary: Fee Table**

Include the following information, in plain English under rule 421(d) under the Securities Act [17 CFR 230.421(d)], after Item 2:

The following tables describe the fees and expenses that you will pay when buying, owning, and surrendering the Policy. The first table describes the fees and expenses that you will pay at the time that you buy the Policy, surrender the Policy, or transfer cash value between investment options.

**TRANSACTION FEES**

Charge	When charge is deducted	Amount deducted
Maximum Sales Charge Imposed on Premiums (Load)		
Premium Taxes		
Maximum Deferred Sales Charge (Load)		
Other Surrender Fees		
Transfer Fees		

The next table describes the fees and expenses that you will pay periodically during the time that you own the Policy,

not including [Portfolio Company] fees and expenses.

**PERIODIC CHARGES OTHER THAN [PORTFOLIO COMPANY] OPERATING EXPENSES**

Charge	When charge is deducted	Amount deducted
Cost of Insurance*: Minimum and Maximum Charge		
Charge for a [Representative Contractowner]		
Annual Maintenance Fee		
Mortality and Expense Risk Fees		
Administrative Fees		

\*[Footnote: Include disclosure required by Instruction 3(b).]

The next item shows the minimum and maximum total operating expenses charged by the portfolio companies that

you may pay periodically during the time that you own the contract. More detail concerning each [Portfolio

Company's] fees and expenses is contained in the prospectus for each [Portfolio Company].

Total Annual [Portfolio Company] Operating Expenses	Minimum	Maximum
(Expenses that are deducted from [Portfolio Company] assets, including management fees, distribution [and/or service] (12b-1) fees, and other expenses)	_____ %	_____ %

*Instructions*

\* \* \* \* \*

**4. Total Annual [Portfolio Company] Operating Expenses.**

(a) The Registrant may substitute the term used in the prospectus to refer to the Portfolio Companies for the bracketed portion of the caption provided.

(b) If a registrant has multiple sub-accounts, it should disclose the minimum and maximum "Total Annual [Portfolio Company] Operating Expenses" for any Portfolio Company. "Total Annual [Portfolio Company] Operating Expenses" include all expenses that are deducted from a Portfolio Company's assets. The amount of expenses deducted from a Portfolio Company's assets are the amounts shown as expenses in the Portfolio Company's statement of operations (including increases resulting from complying with paragraph 2(g) of rule 6-07 of Regulation S-X [17 CFR 210.6-07]).

(c) "Total Annual [Portfolio Company] Operating Expenses" do not include extraordinary expenses as determined under generally accepted accounting principles (*see* Accounting Principles Board Opinion No. 30). If extraordinary expenses were incurred by any Portfolio Company that would, if included, materially affect the minimum or maximum amounts shown in the table, disclose in a footnote to the table what the minimum and maximum "Total Annual [Portfolio Company] Operating Expenses" would have been had the extraordinary expenses been included.

(d)(i) Base the percentages of "Total Annual [Portfolio Company] Operating Expenses" on amounts incurred during the most recent fiscal year, but include in expenses amounts that would have been incurred absent expense reimbursement or fee waiver arrangements. If a Portfolio Company has a fiscal year different from that of the Registrant, base the expenses on those incurred during either the period

that corresponds to the fiscal year of the Registrant, or the most recently completed fiscal year of the Portfolio Company. If the Registrant or a Portfolio Company has changed its fiscal year and, as a result, the most recent fiscal year is less than three months, use the fiscal year prior to the most recent fiscal year as the basis for determining "Total Annual [Portfolio Company] Operating Expenses."

(ii) If there have been any changes in "Total Annual [Portfolio Company] Operating Expenses" that would materially affect the information disclosed in the table:

(A) Restate the expense information using the current fees as if they had been in effect during the previous fiscal year; and

(B) In a footnote to the table, disclose that the expense information in the table has been restated to reflect current fees.

(iii) A change in "Total Annual [Portfolio Company] Operating Expenses" means either an increase or a decrease in expenses that occurred during the most recent fiscal year or that is expected to occur during the current fiscal year. A change in "Total Annual [Portfolio Company] Operating Expenses" does not include a decrease in operating expenses as a percentage of assets due to economies of scale or breakpoints in a fee arrangement resulting from an increase in a Portfolio Company's assets.

(e) A Registrant may reflect minimum and maximum actual total [Portfolio Company] operating expenses that include expense reimbursement or fee waiver arrangements in a footnote to the table. If the Registrant provides this disclosure, also disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, or whether it can be terminated at any time at the option of a Portfolio Company.

(f) A Registrant may include additional tables showing annual operating expenses separately for each Portfolio Company immediately following the required table of "Total

Annual [Portfolio Company] Operating Expenses." The additional tables should be prepared in the format, and in accordance with the Instructions, prescribed in Item 3 of Form N-1A [17 CFR 239.15A; 17 CFR 274.11A] for disclosing "Annual Fund Operating Expenses."

5. *New Registrants.* For purposes of this Item, a "New Registrant" is a Registrant that does not include in Form N-6 financial statements reporting operating results or that includes financial statements for the Registrant's initial fiscal year reporting operating results for a period of 6 months or less. The following Instructions apply to New Registrants:

(a) Base the percentages in "Total Annual [Portfolio Company] Operating Expenses" on payments that will be made, but include in expenses amounts that will be incurred without reduction for expense reimbursement or fee waiver arrangements, estimating amounts of expenses that are not established pursuant to contract. Disclose in a footnote to the table that "Total Annual [Portfolio Company] Operating Expenses" are based, in part, on estimated amounts for the current fiscal year.

(b) A New Registrant may reflect in a footnote to the table expense reimbursement or fee waiver arrangements that are expected to reduce the minimum and/or maximum total [Portfolio Company] operating expenses shown in the table. If the New Registrant provides this disclosure, also disclose the period for which the expense reimbursement or fee waiver arrangement is expected to continue, or whether it can be terminated at any time at the option of a Portfolio Company.

Dated: November 13, 2002.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 02-29312 Filed 11-18-02; 8:45 am]

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