

Board, 844 North Rush Street, Chicago, Illinois, 60611-2092 or [Ronald.Hodapp@rrb.gov](mailto:Ronald.Hodapp@rrb.gov) and to the OMB Desk Officer for the RRB, at the Office of Management and Budget, Room 10230, New Executive Office Building, Washington, DC 20503.

**Charles Mierzwa,**

*Clearance Officer.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-26716; File No. 812-13109]

### Principal Life Insurance Company, *et al.*; Notice of Application

January 3, 2005.

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

**ACTION:** Notice of application for an order under Section 6(c) of the Investment Company Act of 1940, as amended (the “Act”) granting exemptions from the provisions of Sections 2(a)(32), 22(c) and 27(i)(2)(A) of the Act and Rule 22c-1 thereunder.

*Applicants:* Principal Life Insurance Company (“Principal Life”), Principal Life Insurance Company Separate Account B (the “Account”), and Princor Financial Services Corporation (“Princor”) (collectively “Applicants”).

**SUMMARY:** Applicants seek an order to permit, under specified circumstances, the recovery of certain credits previously applied to purchase payments made under: (i) Certain deferred variable annuity contracts, described herein, that Principal Life issues through the Account (the contracts, including certain data pages and endorsements, are collectively referred to as the “Contracts”), and (ii) contracts that Principal Life may issue in the future through the Account, any of its other existing separate accounts, or any separate accounts that it may establish in the future (collectively, “Future Accounts”), which contracts are substantially similar in all material respects to the Contracts (the “Future Contracts”). Applicants also request that the order being sought extend to any other broker-dealer controlling, controlled by, or under common control with Principal Life, whether existing or created in the future, that serves as a distributor or principal underwriter of the Contracts or any Future Contracts offered through the Account or any Future Accounts (collectively, “Affiliated Broker-Dealers”).

**DATES: Filing Date:** The application was filed on July 16, 2004, and amended on October 18, 2004.

*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 Secretary of the Commission 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 January 31, 2005, 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 requester’s interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Secretary of the Commission.

**ADDRESSES:** Secretary, SEC, 450 5th Street, NW., Washington, DC 20549-0609. Applicants, c/o Principal Financial Group, 711 High Street, Des Moines, Iowa 50392.

**FOR FURTHER INFORMATION CONTACT:**

Rebecca A. Marquigny, Senior Counsel, or Zandra Y. Bailes, Branch Chief, Office of Insurance Products, Division of Investment Management, at (202) 942-0670.

**SUPPLEMENTARY INFORMATION:** The following is a summary of the application. The complete application may be obtained for a fee from the SEC’s Public Reference Branch, 450 Fifth Street, NW., Washington, DC 20549 (tel. (202) 942-8090).

#### Applicants’ Representations

1. Principal Life was organized under the laws of Iowa in 1879. It is authorized to transact life insurance and annuity business in 50 states and the District of Columbia. Principal Life is a stock life insurance company and a wholly owned subsidiary of Principal Financial Group Inc.

2. The Account was established in 1970 by Principal Life as a separate account under Iowa law and is registered with the Commission as a unit investment trust under the Act (File No. 811-02091). The Account funds the benefits available under the Contracts and other variable annuity contracts issued by Principal Life. The offering of the Contracts by Principal Life is registered under the Securities Act of 1933 (the “1933 Act”) (File No. 333-116220). That portion of the assets of the Account that is equal to the reserves and other contract liabilities with respect to the Account is not chargeable with liabilities arising out of any other

business of Principal Life. Any income, gains or losses, realized or unrealized, from assets allocated to the Account are, in accordance with the various contracts, credited to or charged against the Account without regard to other income, gains or losses of Principal Life.

3. Princor is an Iowa corporation controlled by Principal Financial Group, Inc., and is the principal underwriter of the Contracts. Princor is registered as a broker-dealer under the Securities Exchange Act of 1934, as amended, and is a member of NASD, Inc. Sales of the Contracts are made by registered representatives of broker-dealers authorized by Princor to sell the Contracts. Such registered representatives are also licensed insurance agents of Principal Life.

4. The Contracts are flexible purchase payment individual deferred combination fixed and variable annuity contracts. The Contracts may be issued either as tax-qualified contracts (“qualified Contracts”) or as non-tax-qualified contracts (“non-qualified Contracts”).

5. The minimum initial purchase payment is \$5,000 for non-qualified Contracts and \$2,000 for qualified Contracts. The minimum subsequent purchase payment is \$500. Lesser minimums may apply in the case of certain retirement plans or payroll deduction or automated investment programs. Principal Life may limit total Contract purchase payments to \$2,000,000.

6. At the time of issuance, a Contract owner may elect to purchase the Premium Payment Credit Rider (“Credit Rider”). If the Credit Rider is elected, Principal Life will add a 5% payment enhancement or credit to the owner’s Contract upon receipt of each purchase payment from the Contract owner during the first contract year (the “Credit”). After the first contract year, additional purchase payments will not receive a Credit. Principal Life will fund Credits from its general account assets and will allocate Credits among investment options (excluding certain fixed benefit options used for dollar cost averaging) in the same proportion as the applicable purchase payment. Principal Life will recover Credits (i) if the Contract owner returns the Contract for a refund during the “free look” period, and (ii) if the Contract owner elects to receive annuity payments prior to the third contract anniversary. Principal Life will not seek to recover any Credit in connection with partial withdrawals or surrenders of a Contract.

7. The free look period is the 10-day period (or such longer period required by a state) during which a Contract

owner may return a Contract after it has been delivered. Upon such return, the Contract owner generally will receive a full refund of the accumulated value of the Contract, less the amount of the Credits. The Contract owner will retain any net earnings attributable to the Credits or, if there has been a net decline in the value of the Credits, will bear the loss from such decline. Where applicable state law requires that the full amount of the purchase payment be refunded, the Contract owner will receive the greater of that amount or the Contract value less, in either case, the amount of the Credits.

8. The Contracts provide for the return of the Credit if the owner elects to receive annuity payments before the end of the third Contract year. The Contract owner will retain any net earnings attributable to the Credits or, if there has been a net decline in the value of the Credits, will bear the loss from the decline.

9. The Credits to be recovered will be taken from the sub-accounts under the Contract in which the Credits are invested in the same proportion that the accumulated value based on such sub-accounts bears to the accumulated value of the Contract. The recovery will be effected by redeeming the number of units from each sub-account that are necessary to fund that sub-account's share of the recovery. The number of units to be redeemed in each sub-account will be calculated based on the unit value for each sub-account determined at the time the withdrawal to recover the Credit is made. In the case of early annuitization, the withdrawal is made on the annuitization date, which is the date the accumulated value is applied to make annuity payments.

10. Contract owners may allocate their purchase payments among a fixed account, two different fixed, dollar cost averaging options (which will not be available to Contract owners who elect the Credit Rider), and a number of sub-accounts of the Account. Each sub-account invests in shares of a corresponding portfolio of an underlying mutual fund ("Underlying Fund"). Principal Life may, subject to compliance with applicable law, add other sub-accounts, eliminate or combine existing sub-accounts or transfer assets in one sub-account to another sub-account established by Principal Life.

11. The Contracts provide for the following charges: (i) A withdrawal or contingent deferred sales charge ("CDSC") as a percentage of amounts withdrawn attributable to purchase payments that have been in the Contract less than seven complete contract years,

with the applicable percentage charge declining from a maximum of 6% for withdrawals attributable to purchase payments that have been in the Contract for completed contract years zero, one and two to 0.0% for contract year seven and thereafter;<sup>1</sup> (ii) an annual contract fee that is the lesser of \$30 or 2% of the accumulated value (which may be waived under certain circumstances); (iii) a daily mortality and expense risk charge in an amount equal on an annual basis to 1.25% of the value of each variable investment option, deducted from each sub-account; and (iv) any applicable state or local premium taxes up to 3.5%, depending on the Contract owner's state of residence or the state in which the Contract was sold. Principal Life may impose a daily administrative charge in an amount not to exceed on an annual basis 0.15% of the value of each variable investment option, deducted from each sub-account. Principal Life imposes additional charges for an enhanced death benefit and other benefits provided by rider. It also reserves the right to impose a transaction fee for unscheduled withdrawals exceeding 12 in a contract year and a transfer fee for each unscheduled transfer. In addition, the Underlying Funds impose management, distribution and administrative fees which vary depending upon which Underlying Funds are selected. There is no withdrawal charge or CDSC made in connection with the annuitization of the Contract.<sup>2</sup>

12. If the Credit Rider is elected, the Contracts will provide for a higher CDSC, namely, a percentage of amounts withdrawn attributable to purchase payments that have been in the Contract less than nine complete contract years, with the applicable percentage charge declining from a maximum of 8% for withdrawals attributable to purchase payments that have been in the Contract for completed contract years zero and one, to 0.0% for contract year nine and thereafter.<sup>3</sup> In addition to the charges

<sup>1</sup> With respect to the seven-year withdrawal charge schedule, the CDSC is 6% for years zero, 1 and 2, 5% for year 3, 4% for year 4, 3% for year 5, 2% for year 6, and 0.0% for any year thereafter. There is never a withdrawal charge with respect to earnings accumulated in a Contract, certain other "free withdrawal" amounts or purchase payments that have been in the Contract for more than seven complete contract years.

<sup>2</sup> The CDSC is not applied against Credits which, for this purpose, are considered investment earnings, not purchase payments.

<sup>3</sup> With respect to the nine-year withdrawal charge schedule, the CDSC is 8% for years zero and one, 7% for year 2, 6% for year 3, 5% for year 4, 4% for year 5, 3% for year 6, 2% for year 7, 1% for year 8, and 0.0% for any year thereafter. There is never a withdrawal charge with respect to earnings accumulated in a Contract, certain other

enumerated above, the Credit Rider provides for a charge payable for the first 8 contract years, in an amount equal on an annual basis to 0.60% of the value of each variable investment option, deducted from each sub-account.

13. Because of the higher charges applicable to a Contract with the Credit Rider, the prospectus description of the Rider will include a statement to the effect that the amount of the Credits may be more than offset by the fees and charges associated with the Credit Rider. The prospectus also will state that there may be circumstances in which a Contract owner may be worse off for having the Credit Rider because of the higher charges. In addition, the prospectus will state that a purchaser of a Contract will be worse off with the Credit Rider if, at the time of recapture of the Credit, the Contract has experienced a negative investment performance. This is because the Credit recovered by Principal Life will not reflect the adverse performance attributable to the Credit, as a result of which the Contract value will be less than the value it would otherwise have been had the Credit not been made.

#### Applicants' Legal Analysis

1. Section 6(c) of the Act authorizes the Commission to exempt any person, security or transaction, or any class or classes of persons, securities or transactions from the provisions of the Act and the rules promulgated thereunder if and to the extent that such 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 Act. Applicants request that the Commission, pursuant to Section 6(c) of the Act, grant the exemptions requested below with respect to the Contracts, and any Future Contracts funded by the Account or Future Accounts, that are issued by Principal Life and underwritten or distributed by Princor or Affiliated Broker-Dealers. Applicants undertake that Future Contracts will be substantially similar in all material respects to the Contracts. Applicants believe that the requested exemptions are appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policies and provisions of the Act.

2. Applicants previously have received exemptive relief to permit,

"free withdrawal" amounts or purchase payments that have been in the Contract more than nine complete contract years.

with respect to an earlier class of contracts, the recapture of a credit in connection with exercise of a free look right.<sup>4</sup> That order encompassed relief for “future contracts,” contracts substantially similar in all material respects to the earlier class of contracts. Applicants assert that the Contracts described in the current application and amended application differ from the prior class of contracts by providing more investment options and certain enhanced guaranteed benefits available by rider. In addition to the Credit Rider, the new class of Contracts may also be combined with the Investment Protector Plus Rider or the Enhanced Death Benefit Rider, options not available to the old class of contracts.<sup>5</sup> Because of the substantial differences between the old class of contracts and the new class of Contracts (depending on the riders selected for the new class), Applicants represent that they do not believe the new Contracts fall within the scope of “future contracts” as contemplated under the prior order granting relief to recapture a credit. Consequently, Applicants are seeking the relief set forth below.

3. Applicants seek exemption pursuant to Section 6(c) from Sections 2(a)(32), 22(c), and 27(i)(2)(A) of the Act and Rule 22c-1 thereunder to the extent deemed necessary to permit Principal Life to recover Credits previously applied to purchase payments under the Contracts or Future Contracts if a Contract owner returns the Contract or Future Contract for a refund during the free look period or annuitizes the Contract prior to the end of the third contract year. The Commission previously has granted similar exemptive relief to permit the recovery of certain bonus credit amounts previously credited.

4. Subsection (i) of Section 27 of the Act provides that Section 27 does not apply to any registered separate account funding variable insurance contracts, or to the sponsoring insurance company and principal underwriter of such account, except as provided in paragraph (2) of the subsection.

<sup>4</sup> *Principal Life Insurance Company, et al.*, Investment Company Act Release Nos. 24725 (Nov. 2, 2000) (Notice) and 24752 (Nov. 28, 2000) (Order) (SEC File No. 812-12136).

<sup>5</sup> The Investment Protector Plus Rider provides a guaranteed minimum withdrawal benefit regardless of the Contract's surrender value, subject to various conditions including a bar on the use of certain sub-accounts. The Enhanced Death Benefit Rider provides an optional death benefit that pays the greater of the standard death benefit (determined in the same manner as under the old class of contracts) or a death benefit that has as a floor premiums paid plus interest at 5% per annum with an adjustment for partial withdrawals.

Paragraph (2) provides that it shall be unlawful for such a separate account or sponsoring insurance company to sell a contract funded by the registered separate account unless such contract is a redeemable security. Section 2(a)(32) defines a “redeemable security” as any security, other than short-term paper, under the terms of which the holder, upon presentation to the issuer, is entitled to receive approximately his or her proportionate share of the issuer's current net assets, or the cash equivalent thereof.

5. Applicants submit that the recovery of Credits in the circumstances set forth in the application does not deprive a Contract owner of his or her proportionate share of the issuer's current net assets. Applicants state that a Contract owner's interest in the Credits allocated to the accumulated value of his or her Contract is not fully vested until after the end of the third contract year. Applicants submit that until this period has expired and the Credits have fully vested, Principal Life retains the rights and interests described herein. Therefore, Applicants represent that when Principal Life recovers any Credits, it is merely retrieving its own assets; the Contract owner is not deprived of a proportionate share of the Account's assets because the Contract owner's interest in such Credit has not vested in all respects.

6. Under the Credit Rider, Principal Life provides Credits from its general account on a guaranteed basis. Applicants assert that in undertaking this financial obligation, Principal Life contemplates that a Contract owner will retain a Contract over an extended period, consistent with the long-term nature of the Contracts. Applicants assert that Principal Life designed its product so that it would recover its costs (including the Credit) over an anticipated duration while a Contract is in force. Applicants further assert that permitting a Contract owner to retain Credits upon an early annuitization could serve to encourage such annuitizations and the series of early withdrawals associated therewith in a manner inconsistent with the durations assumed in the design of the Contract. In addition, Applicants submit that permitting a Contract owner to retain Credits upon the exercise of the free look return could encourage the purchase of Contracts for a quick profit rather than with the intention of making a long-term investment.

7. Applicants submit that the exemptive relief requested is consistent with and serves the stated purpose of the National Securities Markets Improvement Act of 1996 (“NSMIA”) in

amending the Act to “provide more effective and less burdensome regulation.” Sections 26(e) and 27(i) were added to the Act to implement the purposes of NSMIA and Congressional intent. Applicants assert that the application of Credits to purchase payments under the Contracts should not raise any questions as to Principal Life's compliance with the provisions of Section 27(i). However, Applicants represent that to avoid any uncertainty as to full compliance with the Act, they request an exemption from Sections 2(a)(32) and 27(i)(2)(A) of the Act, to the extent deemed necessary, to permit the recovery of Credits under the circumstances described in the application with respect to Contracts and Future Contracts, without the loss of relief from Section 27 provided by Section 27(i).

8. Section 22(c) of the Act authorizes the Commission to make rules and regulations applicable to registered investment companies and to principal underwriters of, and dealers in, the redeemable securities of any registered investment company to accomplish the same purposes as contemplated by Section 22(a). Rule 22c-1 thereunder prohibits a registered investment company issuing a redeemable security, a person designated in such issuer's prospectus as authorized to consummate transactions in any such security, and a principal underwriter of, or dealer in, such security, from selling, redeeming, or repurchasing any such security except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security. Principal Life's recovery of Credits as described herein might arguably be viewed as involving the redemption of redeemable securities for a price other than one based on the current net asset value. Applicants believe that the recovery of Credits does not violate Section 22(c) and Rule 22c-1. Applicants assert that such recovery does not involve either of the harms that Rule 22c-1 was intended to eliminate or reduce, namely: (i) The dilution of the value of outstanding redeemable securities of registered investment companies through their sale at a price below net asset value or repurchase at a price above it, and (ii) other unfair results, including speculative trading practices. These harms resulted from the practice of basing the price of a mutual fund share on the net asset value per share determined as of the close of the market on the previous day. Such backward pricing allowed investors to

take advantage of increases or decreases in net asset value that were not yet reflected in the price, thereby diluting the value of outstanding fund shares.

9. Applicants submit that the recovery of Credits as described in the application and amended application does not pose such a threat of dilution. In effecting such recoveries, Principal Life will redeem accumulation units from the sub-accounts in which premiums have been invested on the basis of the net asset value determined at the time the withdrawal to recover the Credit is made. Under these circumstances, in Applicants' view, the recovery of the Credits does not involve dilution. Applicants also submit that the second harm that Rule 22c-1 was designed to address, namely speculative trading practices calculated to take advantage of backward pricing, will not occur as a result of the recovery of the Credits. Applicants argue that because neither of the harms that Rule 22c-1 was meant to address are found in the recovery of Credits, Rule 22c-1 and Section 22(c) should not be construed as applicable thereto. However, Applicants submit that to avoid any uncertainty in this regard, they request an exemption from the provisions of Section 22(c) and Rule 22c-1 to the extent deemed necessary to permit them to recover Credits under the Contracts and Future Contracts as described in the application and amended application.

10. Applicants submit that their request for an order that applies to Future Accounts and Future Contracts that are substantially similar in all material respects to the Contracts and underwritten or distributed by Prncor or Affiliated Broker-Dealers is appropriate in the public interest. Applicants assert that such an order would promote competitiveness in the variable annuity market by eliminating the need to file redundant exemptive applications, thereby reducing administrative expenses and maximizing the efficient use of Applicants' resources. Applicants state that investors will not receive any benefit or additional protection if Applicants are required repeatedly to seek exemptive relief presenting no issue under the Act that has not already been addressed. Having Applicants file additional applications would impair Applicants' ability to effectively take advantage of business opportunities as they arise. Applicants undertake that Future Contracts funded by the Account or Future Accounts which seek to rely on the order issued pursuant to the application will be substantially similar in all material respects to the Contracts.

*Conclusion:* Section 6(c) of the Act, in pertinent part, provides that the Commission, by order upon application, may conditionally or unconditionally exempt any person, security or transaction, or any class or classes of persons, securities or transactions, from any provision or provisions of the Act, or any rule or regulation thereunder, to the extent that such 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 Act. Applicants submit, for the reasons stated above, that their exemptive request meets the standards set out in Section 6(c) of the Act and that an order should, therefore, be granted.

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

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. E5-18 Filed 1-6-05; 8:45 am]

**BILLING CODE 8010-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50953; File No. SR-Amex-2004-104]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the American Stock Exchange LLC Relating to Regulation SHO

December 30, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 13, 2004, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in items I and II below, which items have been prepared by the Exchange. On December 22, 2004, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Amex has filed the proposal as a "non-controversial" rule change pursuant to section 19(b)(3)(A) of the Act<sup>4</sup> and Rule 19b-4(f)(6) thereunder,<sup>5</sup> which renders the proposal

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Amendment No. 1 to the proposed rule change (December 22, 2004). Amendment No. 1 replaced the Exchange's original filing in its entirety.

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>5</sup> 17 CFR 240.19b-4(f)(6). For the purposes of determining the effective date and calculating the

effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Amex proposes to amend Rules 7, 27, 108, 111, 118, 205, 208, 590, 783, 784 and 957 and eliminate obsolete Rules 792, 794 and 795 to conform its rules to the requirements of Regulation SHO<sup>6</sup> under the Act. The text of the proposed rule change is available for viewing at the places specified in item IV below.

### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in item IV below. The Amex has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

#### A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

##### 1. Purpose

The Commission has adopted Regulation SHO under the Act, thereby establishing new requirements relating to short sales.<sup>7</sup> Among other things, Regulation SHO (i) requires broker-dealers to mark sales of all equity securities as "long," "short" or "short exempt," specifying the standards for each, (ii) provides for the establishment of a pilot program under which short sales in specific securities will take

sixty-day period within which the Commission may summarily abrogate the proposed rule change under Section 19(b)(3)(C) of the Act, the Commission considers that period to commence on December 22, 2004, the date that the Exchange filed Amendment No. 1 to the proposed rule change. See 15 U.S.C. 78s(b)(3)(C).

<sup>6</sup> See Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004) (the "Adopting Release"), and accompanying orders: Securities Exchange Act Release No. 50104 (July 28, 2004), 69 FR 48032 (August 6, 2004) (the "Pilot Order"), and Securities Exchange Act Release No. 50747 (November 29, 2004), 69 FR 70480 (December 6, 2004) (the "Second Pilot Order"). The Adopting Release, the Pilot Order and the Second Pilot Order are hereinafter collectively referred to as "Regulation SHO."

<sup>7</sup> See the Adopting Release.