

the impact of Section 848, therefore, it would be necessary to allow CG Life to impose an additional charge that would make CG Life whole not only for the \$95.63 additional federal income tax burden attributable to Section 848 but also for the federal income tax on the additional \$95.63 itself. This federal income tax can be determined by dividing \$95.63 by the complement of the 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%.

13. Based on prior experience, CG Life expects that all of its current and future deductions will be fully taken. It is the judgment of CG Life that a charge of 1.15% would reimburse CG Life for the impact of Section 848 on CG Life's federal income tax liabilities. Applicants represent that the charge to be deducted by CG Life pursuant to the relief requested is reasonably related to the increased federal income tax burden under Section 848, taking into account the benefit to CG Life of the amortization permitted by Section 848, and the use by CG Life of a discount rate of 10% in computing the future deductions resulting from such amortization, such rate being the equivalent of CG Life's cost of capital.

14. While the application states that CG Life believes that a charge of 1.15% of premium payments would reimburse CG Life for the impact of Section 848 (as currently written) on CG Life's federal income tax liabilities, the application also states, however, that CG Life believes that it will have to increase this charge if any future change in, or interpretation of Section 848, or any successor provision, results in an increased federal income tax burden due to the receipt of premiums. Such an increase could result from a change in the corporate federal income tax rate, a change in the 7.7% figure, or a change in the amortization period.

Applicants' Legal Analysis

1. Applicants request an order of the Commission pursuant to Section 6(c) exempting them from the provisions of Section 27(c)(2) of the 1940 Act and Rule 6e-3(T)(c)(4)(v) thereunder to the extent necessary to permit deductions to be made from premium payments received in connection with the Contracts. The deductions would be in an amount that is reasonable in relation to CG Life's increased federal income tax burden related to the receipt of such premiums. Applicants further request an exemption from Rule 6e-3(T)(c)(4)(v) of the 1940 Act to permit the proposed deductions to be treated as other than "sales load" for the purposes of Section

27 of the 1940 Act and the exemptions from various provisions of that Section found in Rule 6e-3(T)(b)(13).

2. Section 6(c) of the 1940 Act provides, in pertinent part, that the Commission may, by order upon application, conditionally or unconditionally exempt any person, security or transaction from any provision of the 1940 Act 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 the provisions of the 1940 Act.

Section 27(a)(2) and Rule 6e-3(T)(c)(4)

1. Section 27(c)(2) of the 1940 Act prohibits the sale of periodic payment plan certificates unless the proceeds of all payments (except such amounts as are deducted for sales load) are held under an indenture or agreement containing in substance the provisions required by Sections 26(a)(2) and 26(a)(3) of the 1940 Act. Certain provisions of Rule 6e-3(T) provide a range of exemptive relief for the offering of flexible premium variable life insurance policies such as the Contracts. Rule 6e-3(T)(b)(13)(iii) provides, subject to certain conditions, exemptions from Section 27(c)(2) that include permitting a payment of certain administrative fees and expenses, the deduction of a charge for certain mortality and expense risks, and the "deduction of premium taxes imposed by any state or other governmental entity."

2. Rule 6e-3(T)(c)(4)(v) defines "sales load" charged during a contract period as the excess of any payments made during the period over the sum of certain specified charges and adjustments, including "a deduction for and approximately equal to state premium taxes."

3. Applicants submit that the deduction for federal income tax charges, proposed to be deducted in connection with the Contracts, is akin to a state premium tax charge in that it is an appropriate charge related to CG Life's tax burden attributable to premiums received. Thus, Applicants submit that the proposed deduction be treated as other than sales load, as is a state premium tax charge, for purposes of the 1940 Act.

4. Applicants argue that the requested exemptions from Rule 6e-3(T)(c)(4) are necessary in connection with Applicants' reliance on certain provisions of Rule 6e-3(T)(b)(13), and particularly on subparagraphs (b)(13)(i) of the Rule, which provides exemptions from Sections 27(a)(1) and 27(h)(1) of the 1940 Act. Issuers and their affiliates

may only rely on Rule 6e-3(T)(b)(13)(i) if they meet the Rule's alternative limitations on sales load as defined in Rule 6e-3(T)(c)(4). Applicants state that, depending upon the load structure of a particular Contract, these alternative limitations may not be met if the deduction for the increase in an issuer's federal tax burden is included in sales load. Although a deduction for an insurance company's increased federal tax burden does not fall squarely within any of the specified charges or adjustments which are excluded from the definition of "sales load" in Rule 6e-3(T)(c)(4), Applicants state that they have found no public policy reason for including these deductions in "sales load."

5. The public policy that underlies Rule 6e-3(T)(b)(13)(i), like that which underlies Sections 27(a)(1) and 27(h)(1) of the 1940 Act, is to prevent excessive sales loads from being charged in connection with the sale of periodic payment plan certificates. Applicants submit that the treatment of a federal income tax charge attributable to premium payments as sales load would not in any way further this legislative purpose because such a deduction has no relation to the payment of sales commissions or other distribution expenses. Applicants state that the Commission has concurred with this conclusion by excluding deductions for state premium taxes from the definition of "sales load" in Rule 6e-3(T)(c)(4).

6. Applicants assert that the source for the definition of "sales load" found in the Rule supports this analysis. Applicants state that the Commission's intent in adopting such provisions was to tailor the general terms of Section 2(a)(35) of the 1940 Act to variable life insurance contracts. Just as the percentage limits of Sections 27(a)(1) and 27(h)(1) depend on the definition of "sales load" in Section 2(a)(35) for their efficacy, the percentage limits in Rule 6e-3(T)(b)(13)(i) depend on Rule 6e-3(T)(c)(4) which does not depart, in principle, from Section 2(a)(35).

7. Section 2(a)(35) excludes deductions from premiums for "issue taxes" from the definition of "sales load" under the 1940 Act. Applicants submit that this suggests that it is consistent with the policies of the 1940 Act to exclude from the definition of "sales load" in Rule 6e-3(T) deductions made to pay an insurance company's costs attributable to its tax obligations. Section 2(a)(35) also excludes administrative expenses or fees that are "not properly chargeable to sales or promotional activities." Applicants argue that this suggests that the only deductions intended to fall within the