under the 1940 Act. The assets of the Separate Account are owned by CG Life, but are held separately from the other assets of CG Life and are not chargeable with liabilities incurred in any other business operation of CG Life. The income, capital gains and capital losses incurred on the assets of the Separate Account are credited to or charged against the assets of the Separate Account, without regard to the income, capital gains or capital losses arising out of any other business CG Life may conduct.

3. The Separate Account consists of a number of subaccounts, each of which invests exclusively in the shares of one of seven investment portfolios of four investment companies (the "Funds") registered under the 1940 Act. The number and identity of available Funds and investment portfolios may change from time to time.

- 4. In the future, the Board of Directors of CG Life may establish additional separate accounts (the "Future Accounts") which may serve as funding vehicles for group variable universal life insurance contracts issued by CG Life. The Future Accounts will be organized as unit investment trusts and will file registration statements under the Securities Act of 1933 and under the 1940 Act.
- CFA will serve as the distributor and principal underwriter of certain group variable universal life insurance contracts (the "Contracts") and any group variable universal life insurance contracts made available in the future (the "Future Contracts") through the Separate Account or Future Accounts. CFA is a wholly-owned subsidiary of CG Life. CFA is registered under the Securities Exchange Act of 1934 as a broker-dealer, and under the Investment Advisers Act of 1940 as an investment adviser. CFA is a member of the National Association of Securities Dealers.
- 6. In the Omnibus Budget Reconciliation Act of 1990, Congress amended the Internal Revenue Code of 1986 (the "Code") by, among other things, enacting Section 848 thereof. Section 848 changed the federal income taxation of life insurance companies by requiring them to capitalize and amortize over a period of ten years part of their general expenses for the current year. Under prior law, these expenses were deductible in full from the current year's gross income.

7. The amount of expenses that must be capitalized and amortized under Section 848 generally is determined with reference to premiums for certain categories of life insurance and other contracts ("specified contracts"). More

specifically, an amount of expenses equal to a percentage of the current year's net premiums (i.e., gross premiums minus return premiums and reinsurance premiums) must be capitalized and amortized for each specified contract. The percentage varies, depending on the type of specified contract in question, in accordance with a schedule set forth in Section 848.

8. The effect of Section 858 is to accelerate the realization of income from insurance contracts covered by that Section and, accordingly, the payment of taxes on the income generated by those contracts.

9. The Contracts and any Future Contracts to which a charge for the federal tax burden related to deferred acquisition costs (the "tax burden charge") will be applied are/will be among the specified contracts. They fall/will fall into the category of life insurance contracts under Section 848 for which 2.05% of the net premiums received must be capitalized and

10. The increased tax burden resulting from the application of Section 848 may be quantified as follows. For each \$10,000 of net premiums received by CG Life under the Contracts in a given year, CG Life may capitalize \$2.05 (i.e., 205% of \$10,000). \$10.25 of that \$205 may be deducted in the current year, leaving \$194.75 (i.e., \$205 minus \$10.25) subject to taxation at the corporate tax rate of 35 percent. This works out to an increase in tax for the current year of \$68.16 (*i.e.*, 0.35 x \$194.75) This increased federal income tax burden will be partially offset by deductions allowed during the next ten years as a result of amortizing the remainder of the \$205—\$20.50 in each of the following nine years, and \$10.25 in year ten.

11. To the extent the capital must be used by CG Life to satisfy its increased tax burden under Section 848, such profits are not available to CG Life for investment. CG Life submits that the cost of capital used to satisfy its increased federal income tax burden under Section 848 is, in essence, its after tax rate of return on capital. Because CG Life seeks an after tax rate of return of 15% on its invested capital,1

CG Life submits that a discount rate of 15% is appropriate for use in calculating the present value of its future tax deductions resulting from the amortization described above.

12. Using a corporate tax rate of 35 percent, and assuming a discount rate of 15 percent, the present value of the federal income tax effect of the increased deductions allowable in the following ten years is \$35.12. Because this amount partially offsets the increased tax burden, Section 848 imposes an increased tax burden on CG Life equal to a present value of \$33.04 (i.e., \$68.16 minus \$35.12) for each \$10,000 of net premiums received under the Contracts.

13 CG Life does not incur incremental federal income tax when it passes on state premium taxes to contract owners because state premium taxes are deductible when computing federal income taxes. In contrast, federal income taxes are *not* tax-deductible when computing an insurer's federal income taxes. Therefore, to offset fully the impact of Section 848, CG Life must impose an additional charge that would make it whole not only for the \$33.04 additional federal income tax burden attributable to section 848, but also for the tax on the additional \$33.04 itself. This additional charge can be computed by dividing \$33.04 by the complement of the 35% federal corporate income tax rate (i.e., 65%), resulting in an additional charge of \$50.83 for each \$10,000 of net premiums, or 0.51% of net premiums.

14. Based on its prior experience, CG Life expects that all of its current and future deductions will be fully taken. CG Life submits that a charge of 0.5% of net premium payments would reimburse it for the impact of Section 848 (as currently written) on its federal tax liabilities. CG Life represents that a 0.5% charge is reasonably related to its increased tax burden under Section 848, taking into account the benefit to CG Life of the amortization permitted by

the average current yield to maturity of CIGNA's outstanding long-term debt issues was 7.67 percent. Using a corporate tax rate of 35 percent, the after tax cost of debt for CG Life is 4.98 percent. An estimate for the cost of equity capital for CIGNAcomputed by using the Capital Asset Pricing Model—is 15.8 percent. Using these component costs of capital and their related proportions, the weighted average cost of capital for CIGNA is 13.7% (i.e., $[(0.19 \times 0.0498) + (0.81 \times 0.158])$

The remaining factors (e.g., itnerest rates, inflation, and the market's perception of how well CIGNA is doing) are unpredictable and can fluctuate widely over long periods of time, causing the cost of capital to vary at any given time. Taking these factors into account, as well as the analysis above, CG Life has concluded that the 15% cost of capital is appropriate and reasonable to use in calculating the tax burden charge.

 $^{^{\}rm 1}\,\mbox{In}$ determining the after tax rate of return used in arriving at this discount rate, CG Life considered a number of factors including: the cost of capital incurred by its parent, CIGNA; market interest rates; inflation; and the market's perception of how well CIGNA is doing.

As of December 31, 1994, 81% of the capital of CIGNA consisted of equity, with the remainder long-term debt. CIGNA's cost of capital can be determined using the proportions of financing components (i.e., debt and equity) to calculate a weighted average cost of capital. As of August 1995,