



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
INVESTMENT MANAGEMENT

May 30, 1996

ACT ICA
SECTION 12(b)
RULE _____
PUBLIC AVAILABILITY 5/30/96

PUBLIC

Gary E. Hughes, Esq.
Chief Counsel, Securities and Banking
American Council of Life Insurance
1001 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2599

Paul Schott Stevens, Esq.
General Counsel
Investment Company Institute
1401 H Street, N.W.
Washington, D.C. 20005-2148

Mark J. Mackey, Esq.
President & Chief Executive Officer
National Association for Variable Annuities
12030 Sunrise Valley Drive, Suite 110
Reston, Virginia 22091

Gentlemen:

We are writing to confirm to you the Division's current position regarding the use of plans adopted under rule 12b-1 of the Investment Company Act of 1940 ("12b-1 plans") in the variable insurance context. In the Division's view, no provision of the Investment Company Act precludes a mutual fund that serves as an investment vehicle for a variable insurance separate account ("underlying fund") from adopting and implementing a 12b-1 plan. We believe that this use of a 12b-1 plan raises important disclosure and regulatory issues and therefore urge careful review of these plans by funds, their boards of directors, and insurance company sponsors.

The Division recently considered the issues posed by the use of 12b-1 plans by underlying funds in reviewing post-effective amendments to a registration statement on Form N-1A filed by Scudder Variable Life Insurance Fund ("Fund"). The Fund is an open-end investment company with seven investment portfolios that offers its shares to life insurance company separate accounts for the purpose of funding variable annuities and variable life insurance. The post-effective amendments, which were filed pursuant to rule 485(a) under the Securities Act of 1933, disclosed that the Fund had adopted a 12b-1 plan to be implemented through a multiple class structure. On May 1, 1996, in accordance with rule 485(a), the post-effective amendments became effective automatically.

Under the terms of the Fund's 12b-1 plan, each participating portfolio may pay fees to the Fund's distributor for remittance to a life insurance company to cover various costs incurred or paid by the insurance company in connection with the distribution of shares of that portfolio designated as Class B shares. In response to inquiries from the Division about the purposes of the 12b-1 plan, the Fund explained that with more and more independent money management firms establishing mutual funds as underlying funding media for variable life insurance and annuity products, insurance companies are increasingly seeking financial and other assistance to cover their costs associated with indirectly marketing fund shares to contract owners. These costs include educating their agents concerning the funds, compensating their agents, and dealing with existing and prospective contract owner requests relating to the funds. The Fund's board of trustees concluded, among other reasons, that the payment of rule 12b-1 fees to insurers would motivate the insurers to better educate contract owners about the Fund and to maintain a high level of contract owner services.

In considering the Fund's post-effective amendments, the Division concluded that neither Section 12(b) of the Investment Company Act nor rule 12b-1, nor any other provision of the Investment Company Act or rules thereunder, prohibits the use of 12b-1 plans in connection with variable insurance contracts or otherwise treats underlying funds differently from other mutual funds. Consistent with rule 12b-1, the responsibility for determining whether a particular 12b-1 plan is beneficial to an underlying fund and contract owners rests with the fund's board of directors.

Notwithstanding its position that underlying funds may rely on rule 12b-1, the Division is concerned that the unique offering structure and hybrid nature of variable insurance contracts may complicate investor understanding of the use and effects of 12b-1 plans in this context. The Division therefore wishes to emphasize the responsibility of underlying fund boards of directors and insurance company sponsors to ensure that all regulatory and disclosure requirements pertaining to a 12b-1 plan are satisfied when an underlying fund seeks to adopt such a plan.

The Commission included specific procedural safeguards in rule 12b-1 for the protection of fund shareholders and to ensure the accountability of those who make the determination to use fund assets for distribution. A 12b-1 plan for an underlying fund must comply with all of the requirements of rule 12b-1, including director and shareholder approval requirements. Specifically, underlying fund directors are required to decide, in the exercise of their reasonable business judgment and in light of their fiduciary duties, that there is a reasonable likelihood that the 12b-1 plan will benefit the fund and its shareholders. Directors should assure themselves in each case that legitimate services will be rendered in return for payments under the 12b-1 plan. The Division further emphasizes that, in the context of a two-tiered variable insurance offering, the finding of benefit to fund shareholders requires the likelihood of a benefit to the individual contract owners, not the insurance company separate account, which is the technical owner of the fund's shares. Consistent

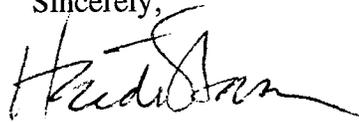
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with that approach, variable insurance contract owners, rather than separate accounts, must give any shareholder approval required by rule 12b-1.

The Division also expects that insurance company sponsors of variable contracts will fully disclose any rule 12b-1 fees of an underlying fund in the prospectus for the separate account. Disclosure in the separate account prospectus should communicate clearly to investors in one place the combined effect of all fees and charges, including rule 12b-1 fees, imposed by the separate account and the underlying fund. The Division intends to give particular scrutiny to disclosure of rule 12b-1 fees in its review of separate account registration statements filed with the Commission.

We would appreciate it if you would inform your members of the Division's views with respect to the use of 12b-1 plans in the variable insurance products area.

Sincerely,

A handwritten signature in black ink, appearing to read "Heidi Stam", with a long, sweeping underline.

Heidi Stam
Associate Director