

**MIXED AND SHARED FUNDING ORDERS*****Summary***

The staff of the Division of Investment Management has received inquiries regarding whether (i) a mutual fund that offers its shares as an investment option under a variable life and/or variable annuity contract is required to obtain a so-called “mixed and shared funding” Commission order prior to making any such offer; and (ii) a mutual fund that has previously obtained a mixed and shared funding order must, in all circumstances, comply with the terms and conditions of that order. This guidance addresses those inquiries and is intended, among other things, to clarify regulatory obligations and reduce unnecessary compliance burdens.

In the staff’s view, a mutual fund is not required to obtain a “mixed and shared funding” order prior to offering its shares as an investment option under a variable life and/or variable annuity contract. In addition, a fund that has previously obtained a mixed and shared funding order need not comply with the terms and conditions of that order if the exemptions granted by the order are not being relied upon by any person.<sup>1</sup>

***Background******What is Mixed and Shared Funding?***

In the context of variable insurance contracts, “mixed funding” refers to the sale of the shares of a mutual fund to various types of offerees, such as when a fund is used as an investment option in both variable annuity contracts and variable life insurance contracts or when a fund is used as an investment option in both variable life insurance contracts and retirement plans. “Shared funding” refers to the sale of the shares of a mutual fund as an investment option in variable insurance contracts issued by multiple unaffiliated insurance companies.



### What is the Origin of Restrictions on Mixed and Shared Funding?

Neither mixed funding nor shared funding is prohibited by the Investment Company Act of 1940 (the “1940 Act”). Commission rules applicable to variable life insurance,<sup>2</sup> however, provide certain exemptions that are conditioned on restrictions on mixed and shared funding. That is, those who seek to rely on the exemptions provided by the rules are required to comply with the restrictions on mixed and shared funding.

Specifically, these rules provide limited exemptions from sections 9(a), 13(a), and 15(a) and (b) of the 1940 Act. The exemptions apply to an insurance company separate account organized as a unit investment trust investing in underlying funds, which is the structure currently used by almost all insurers offering variable insurance contracts. Section 9(a) of the 1940 Act makes certain individuals, and companies of which such individuals are affiliated persons, ineligible to serve in certain capacities such as investment adviser or depositor of, or principal underwriter for, certain registered investment companies. The exemptions from Section 9(a) provided by the rules generally permit an insurance company—or an affiliate—that has an officer, director or employee who is ineligible under Section 9(a), to serve as investment adviser, depositor or principal underwriter with respect to an underlying fund, as long as the ineligible individual does not participate directly in the management or administration of the fund.<sup>3</sup> The exemptions from Sections 13(a), 15(a), and 15(b) permit an insurance company in narrowly circumscribed situations to disregard instructions of contract owners in voting underlying fund shares on matters relating to the appointment of an adviser or principal underwriter and on matters that could result in changes to the sub-classification of the fund or to its investment objectives.<sup>4</sup>

The rules generally limit these exemptions to cases where a separate account invests in an underlying fund whose shares are offered exclusively to variable life insurance separate accounts of a particular life insurer and other affiliated insurers (the “exclusivity provision”).<sup>5</sup> As a result of the exclusivity provision, a fund that sells its shares to a variable life insurance separate account may not engage in shared funding, i.e., also sell its shares to variable insurance separate accounts of an unaffiliated insurer, without jeopardizing the exemptions otherwise provided by the rules.

In the case of certain variable life insurance contracts, the exemptions are also subject to the requirement that funds not engage in mixed funding, i.e., sell to variable annuity separate accounts of the same insurer or an affiliated insurer.<sup>6</sup> In the case of other variable life insurance contracts, mixed funding is permitted without loss of the exemptions, subject to certain conditions.<sup>7</sup>

Mutual funds offered as investment options under variable insurance contracts typically are organized to serve as funding vehicles for both variable annuity and variable life insurance contracts, as well as retirement plans and other offerees. In addition, fund sponsors often seek to offer fund shares as funding vehicles for the variable insurance contracts of multiple, unaffiliated insurance companies. That is, they seek to engage in both mixed and shared funding. For some time, mutual funds that are offered under variable life insurance contracts have typically applied for mixed and shared funding orders.<sup>8</sup> These orders grant insurance companies and their affiliates the same exemptions from sections 9(a), 13(a), and 15(a) and (b) of the 1940 Act that are provided by the variable life insurance rules but without the limitation in the exclusivity provision of those rules, which restricts mixed and shared funding.

#### **How have insurance companies used the exemptions granted in mixed and shared funding orders?**

The staff has now had more than thirty years of experience with applications for mixed and shared funding orders. Based on our experience during that period, as well as discussions with industry representatives, despite many mutual funds obtaining mixed and shared funding orders, we understand that the exemptions are relied upon very infrequently and that there may be no instances of reliance on the exemptions granted from sections 13 and 15 of the 1940 Act.

#### ***Conclusion***

In light of infrequent reliance on mixed and shared funding orders, the staff has been asked to address requirements, if any, for obtaining those orders and complying with the terms and conditions of an existing mixed and shared funding order. In the staff's view, a mutual fund that offers its shares as an investment option in one or more variable annuity and/or variable life insurance contracts of affiliated and/or unaffiliated life insurers is not required to obtain a mixed and shared funding order prior to making any such offer. Indeed, a mutual fund is permitted to engage in both mixed and shared funding without obtaining such an order. If a fund engages in mixed funding or shared funding without obtaining a mixed and shared funding order, an insurer who issues the contracts under which that fund is an investment option—and the insurer's affiliates—will not have the benefit of the exemptions typically granted by those orders. The absence of these exemptions, however, may be of limited, or no, practical significance given the infrequency of reliance on the exemptions.

In addition, it is the staff's view that compliance with the terms and conditions of a previously issued mixed and shared funding order is not required if none of the insurers to whose separate accounts fund shares are being sold—or any affiliate of those insurers—are relying on the exemptions granted by the order but, instead, are complying with sections 9(a), 13(a), 15(a), and 15(b) of the 1940 Act or are relying on other exemptions in the Commission's rules or under another order.<sup>9</sup> Similarly, it is the staff's view that compliance with the conditions to the exemptions from sections 9(a), 13(a), 15(a), and 15(b) that are provided by the variable life insurance rules themselves, including restrictions on mixed and shared funding, is not required in cases where those exemptions are not relied upon, i.e., in cases of full compliance with sections 9(a), 13(a), 15(a), and 15(b) or in cases of reliance on other exemptions that are available in the Commission's rules or under an order.

The staff encourages life insurers that issue variable insurance contracts, funds that offer their shares as investment options under variable insurance contracts, and advisers to those funds to carefully consider the staff's views in determining whether to apply for mixed and shared funding orders. In addition, the staff encourages these persons to carefully consider whether any parties are relying on the exemptions granted in existing mixed and shared funding orders and, if not, whether continued compliance with the terms and conditions of those orders is necessary. Further, it is the staff's understanding that the terms of some participation agreements between insurers that issue variable insurance contracts and the funds that are investment options under those contracts require compliance with the terms and conditions of mixed and shared funding orders. In cases where the funds that have obtained mixed and shared funding orders and the insurers to whose separate accounts shares of those funds have been sold determine that there has been no reliance on the exemptions granted in those orders and none is anticipated, they may also want to consider whether to revise the terms of their participation agreements to eliminate such requirements.

### ***Endnotes***

- 1 The parties who can rely on the exemptions granted in these orders include insurance companies offering contracts under which the mutual fund shares are offered as an investment option, as well as advisers and underwriters of the fund that are affiliated with those insurance companies.
- 2 See rules 6e-2 and 6e-3(T) under the 1940 Act. Rule 6e-2 applies to variable life insurance contracts under which premium payments are to be paid in specified amounts at specified times in accordance with the terms of the contracts ("scheduled premium contracts"). See rule 6e-2(c)(1). Rule 6e-3(T) applies to variable life

insurance contracts under which premium payments generally are not fixed by the life insurer as to both timing and amount (“flexible premium contracts”). See rule 6e-3(T)(c)(1). Relatively few scheduled premium contracts are being offered today.

- 3 The exemptions from Section 9(a) are provided by rules 6e-2(b)(15)(i) and (ii) and 6e-3(T)(b)(15)(i) and (ii) under the 1940 Act.
- 4 Section 13(a) of the 1940 Act requires a registered investment company to obtain shareholder approval to make certain changes (e.g., changing from a mutual fund to a closed-end fund). Section 15(a) of the 1940 Act requires a registered investment company to obtain shareholder approval of investment advisory contracts, and Section 15(b) of the 1940 Act requires a registered investment company to obtain shareholder approval or approval by the board of directors of an underwriting contract with the principal underwriter. The exemptions from sections 13(a), 15(a), and 15(b) of the 1940 Act are provided by rule 6e-2(b)(15)(iii)(A) and (B) and by rule 6e-3(T)(b)(15)(iii)(A)(1) and (2) under the 1940 Act. Insurers serving as depositors of variable life insurance separate accounts the assets of which are invested in shares of mutual funds are the record owners of those shares, but are generally required to vote those shares in accordance with instructions of variable life contract owners whose assets are allocated to those funds. Investment Company Act Release No. 15651, Section B.4 (Mar. 30, 1987) [52 FR 11187, at 11190-91 (Apr. 8, 1987)].
- 5 Rules 6e-2(b)(15) and 6e-3(T)(b)(15) under the 1940 Act.
- 6 This additional restriction applies to scheduled premium contracts. See preamble to rule 6e-2(b)(15) under the 1940 Act.
- 7 This applies to flexible premium contracts. See preamble to rule 6e-3(T)(b)(15) under the 1940 Act. The conditions to this mixed funding relief include, among other things, that the fund board be composed of a majority of independent directors and that the board monitor for conflicts of interest among variable annuity contract owners and variable life insurance contract owners.
- 8 See, e.g., Variable Life Insurance Trust, *et al.*, Investment Company Act Release Nos. 30700 (Sept. 24, 2013) (notice) and 30749 (Oct. 22, 2013) (order); Wilshire Variable Life Insurance Trust, *et al.*, Investment Company Act Release Nos. 27701 (Feb. 16, 2007) (notice) and 27751 (Mar. 15, 2007) (order); Templeton Variable Products Series Fund, *et al.*, Investment Company Act Release Nos. 24018 (Sept. 17, 1999) (notice) and 24079 (Oct. 13, 1999) (order); The Manufacturers Life

Insurance Company of America, *et al.*, Investment Company Act Release Nos. 18070 (Mar. 29, 1991) (notice) and 18112 (Apr. 25, 1991) (order); MML Bay State Life Insurance Company, *et al.*, Investment Company Act Release Nos. 13418 (Aug. 2, 1983) (notice) and 13464 (Aug. 26, 1983) (order).

- 9 *Cf.* Maxim Series Fund, Inc., *et al.*, (pub. avail. July 31, 2009) (assurances provided to fund, adviser, and insurance companies that intended to comply with sections 9(a), 13(a), 15(a), and 15(b) of the 1940 Act rather than the terms and conditions of an existing mixed and shared funding order).

This *IM Guidance Update* summarizes the views of the Division of Investment Management regarding various requirements of the federal securities laws. Future changes in laws or regulations may supersede some of the discussion or issues raised herein. This *IM Guidance Update* is not a rule, regulation or statement of the Commission, and the Commission has neither approved nor disapproved of this *IM Guidance Update*.

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- ▲ protect investors
- ▲ promote informed investment decisions and
- ▲ facilitate appropriate innovation in investment products and services through regulating the asset management industry.

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