

11 NCAC 12 .0438 SEPARATE ACCOUNTS

The following requirements apply to the establishment and administration of variable life insurance separate accounts:

- (1) Establishment and Administration of Separate Accounts. An insurer issuing variable life insurance in this state shall establish one or more separate accounts pursuant to G.S. 58-7-95 of the insurance laws of this state:
 - (a) If no law or other regulation provides for the custody of separate account assets and if the insurer itself is not the custodian of such assets, all contracts for such custody shall be in writing and the commissioner of the insurer's state of domicile shall approve of both the terms of any such contract and the proposed custodian prior to the transfer of custody.
 - (b) An insurer shall not without the prior written approval of the commissioner employ in any material connection with the handling of separate account assets any person who:
 - (i) within the last 10 years has been convicted of any felony or a misdemeanor arising out of such person's conduct involving embezzlement, fraudulent conversion, or misappropriation of funds or securities or involving violation of Sections 1341 to 1343 of Title 18, United States Code; or
 - (ii) within the last 10 years has been found by any state regulatory authority to have violated or has acknowledged violation of any provision of any state insurance law involving fraud, deceit, or knowing misrepresentation; or
 - (iii) within the last 10 years has been found by federal or state regulatory authorities to have violated or has acknowledged violation of any provision of federal or state securities laws involving fraud, deceit, or knowing misrepresentation.
 - (c) All persons with access to the cash, securities, or other assets of the separate account shall be under good and sufficient bond.
 - (d) If an insurer establishes more than one separate account for variable life insurance, justification for the establishment of each additional separate account shall also be filed with the commissioner and shall be subject to his approval.
 - (e) The assets of such separate accounts established for variable life insurance policies shall be valued at least as often as variable benefits are determined but in any event at least monthly.
 - (f) A separate account exempt pursuant to Section 3(c)(11) of the Investment Company Act of 1940 because of the tax qualified status of the policies funded thereby shall not be used to fund other variable life insurance policies.
 - (g) Except for separate accounts exempt pursuant to Section 3(c)(11) of the Investment Company Act of 1940, variable life insurance separate accounts shall not be used for variable annuities or for the investment of funds corresponding to dividend accumulations or other policyholder liabilities not involving life contingencies.
- (2) Amounts in the Separate Account
 - (a) The insurer shall maintain in each variable life insurance separate account assets with a fair market value at least equal to the greater of the valuation reserves for the variable portion of the variable life insurance policies or the benefit base for such policies.
 - (b) The benefit base of any variable life insurance policy as of the beginning of any valuation period shall not be less than the sum of the following factors after deducting amounts of any indebtedness pursuant to .0436(4)(b) of this Section:
 - (i) the valuation net premium for such period for the variable portion of the policy minus the discounted cost of term insurance for such period, based on the tabular mortality and interest rates used in determining valuation reserves; and
 - (ii) the valuation terminal reserve, for the variable portion of the policy, at the end of the immediately preceding valuation period adjusted for the net investment return of such preceding period.
 - (c) In lieu of the minimum benefit base requirement specified in (2)(b) of this Rule, an insurer may otherwise qualify if it can be demonstrated, to the satisfaction of the commissioner, that the policy benefits obtained over a 20-year period from the date of issue by the use of the insurer's benefit base are at least substantially equivalent in value to the benefits obtained by the use of the minimum benefit base. The commissioner may specify the range of net investment return to be used in this demonstration.

- (d) Notwithstanding the actual reserve basis used for policies that do not meet standard underwriting requirements, the benefit base for such policies may be the same as for corresponding policies which do meet standard underwriting requirements.
- (3) Investments by the Separate Account
- (a) No sale, exchange, or other transfer of assets may be made by an insurer or any of its affiliates between any other investment account and one or more of its separate accounts unless:
 - (i) in case of a transfer into a separate account, such transfer is made solely to establish the account or to support the operation of the policies with respect to the separate account to which the transfer is made; and
 - (ii) such transfer, whether into or from a separate account, is made by a transfer of cash; but other assets may be transferred if approved by the commissioner in advance.
 - (b) Assets allocated to a variable life insurance separate account shall be held in cash or investments having a reasonably ascertainable market price. For purposes of this Rule, only the following shall be considered "investments having a reasonable ascertainable market price":
 - (i) liens in favor of the insurer against separate account policy reserves resulting from use by policyholders of cash values;
 - (ii) securities listed and traded on the New York Stock Exchange, the American Stock Exchange, or regional stock exchanges or successors to such exchanges having the same or similar qualifications;
 - (iii) securities listed on the NASDAQ System;
 - (iv) shares of an investment company registered pursuant to the Investment Company Act of 1940; Where such an investment company issues book shares in lieu of share certificates, such book shares shall be deemed to be adequate evidence of ownership;
 - (v) obligations of or guaranteed by the United States government, the Canadian government, any state, or municipality or governmental subdivision of a state;
 - (vi) commercial paper issued by business corporations when the total of such paper issued by the corporation does not exceed in value a guaranteed short line of credit by a bank;
 - (vii) certificates of deposit issued by financial institutions the deposits of which are insured by the FDIC or FSLIC; and
 - (viii) new bond or debt issued which may reasonably be expected to be listed on an exchange regulated by the Securities Exchange Act of 1934.
 - (c) Notwithstanding any other provision of law or the provisions of (b) of this Subsection, assets allocated to a variable life insurance separate account shall not be invested in:
 - (i) commodities or commodity contracts;
 - (ii) put and call options or combinations of such options;
 - (iii) short sales;
 - (iv) purchases on margins;
 - (v) letter or restrict stock;
 - (vi) units or other evidences of ownership of a separate account of another, except those registered under the Investment Company Act of 1940; or
 - (vii) real estate other than shares of a real estate investment trust listed as described in (b)(ii) of this Subsection.
- (4) Limitations on Ownership
- (a) A variable life insurance separate account shall not purchase or otherwise acquire the securities of any issuer, other than securities issued or guaranteed as to principal and interest by the United States, if immediately after such purchase or acquisition the value of such investment, together with prior investments of such separate account in such security valued as required by these regulations, would exceed 10 percent of the value of the assets of the separate account. The commissioner may waive this limitation in writing if he believes such waiver will not render the operation of the separate account hazardous to the public or the policyholders in this state.

- (b) No separate account shall purchase or otherwise acquire the voting securities of any issuer and its separate accounts, in the aggregate, will own more than 10 percent of the total issued and outstanding voting securities of such issuer. The commissioner may waive this limitation in writing if he believes such waiver will not render the operation of the separate account hazardous to the public or the policyholders in this state or jeopardize the independent operation of the issuer of such securities.
 - (c) The percentage limitation specified in (a) of this Subsection shall not be construed to preclude the investment of the assets of separate accounts in shares of investment companies registered pursuant to the Investment Company Act of 1940 if the investments and investment policies of such investment companies comply substantially with provisions of (3) of this Rule and other applicable portions of this Regulation.
- (5) Valuation of Assets of a Variable Life Insurance Separate Account
- (a) Investments of the separate account shall be valued at their market value on the date of valuation:
 - (i) Market value for investments traded on the recognized exchanges means the last reported sale price on the date of valuation. If there has been no sale on that date, the market value means the last reported bid quotation on the date of valuation.
 - (ii) Market value for investments listed on the NASDAQ System means the last representative bid quotation on the valuation date. If an investment ceases to be listed but continues to be traded over the counter, it shall be valued at the lowest bid quotation as it appears on the National Quotation Bureau sheets.
 - (iii) If the valuation date referred to in (i) and (ii) of this Subsection is a day when the exchange or the NASDAQ System is not open for business, the valuation date shall be the last date when the exchange of the NASDAQ System was open for business.
 - (b) If an investment ceases to be traded, it shall be valued at fair value as determined in good faith by or at the direction of the committee of the separate account, or, if there is no such committee, the Board of directors of the insurer but not in excess of the last reported bid quotation. Within 30 days notification of cessation of trading of any investment shall be reported by the insurer to the insurance commissioner of the state of domicile of the insurer. Such commissioner shall within a reasonable period of time determine the method of valuation or disposition of such investment.
- (6) Separate Account Investment Policy
- (a) The investment policy of a separate account operated by a domestic insurer filed under .0435(2)(e) of this Section shall not be changed without the approval of the insurance commissioner and any approval of variable life insurance policyholders that may be required under the Investment Company Act of 1940.
 - (b) With respect to changes of investment policy for which the commissioner must give his approval, the following regulations shall apply:
 - (i) Such approval shall be deemed to be given 60 days after the date the request for approval was filed with the commissioner, unless he notifies the insurer before the end of such 60 day period of his determination that the proposed change is a material change in the investment policy.
 - (ii) If the change is deemed material by the commissioner, he shall approve such change only if he determines that the change does not appear detrimental to the interest of the policyholders of the insurer or adverse to the operations of the insurer.
 - (iii) If a proposed change of investment policy is deemed material by the commissioner, any policyholder objecting to such change shall be given the right to request that, within 60 days of the effective date of the change, his policy be converted without evidence of insurability, under one of the following options, to a fixed benefit life insurance policy issued by the insurer or an affiliate:
 - (A) If the policy is in force on a premium paying basis, either:

- (I) conversion as of the original issue age to a substantially comparable permanent form of fixed benefit life insurance, based on the insurer's premium rates for fixed benefit life insurance at the original issue age, for an amount of insurance not exceeding the death benefit of the variable life insurance policy on the date of conversion; or
 - (II) conversion as of the attained age to a substantially comparable permanent form of fixed benefit life insurance for an amount of insurance not exceeding the excess of the death benefit of the variable life insurance policy on the date of conversion over its cash value on the date of conversion if the policyholder elects to surrender the variable life policy for its cash value, or the death benefit payable under any paid-up insurance option if the policyholder elects such nonforfeiture option under the variable life policy.
 - (B) If the policy is in force as paid-up variable life insurance, then conversion will be to a substantially comparable paid-up fixed benefit life insurance policy for an amount of insurance not exceeding the death benefit of the variable life insurance policy on the date of conversion. If conversion is made pursuant to (A)(I) or (II) of this Subsection, then there will be an equitable premium or cash value adjustment that takes appropriate account of the premiums and cash values under the original and new policies. A detailed statement of the method of computing such adjustment shall be filed with the commissioner.
- (7) Charges Against a Variable Life Insurance Separate Account
 - (a) The insurer may deduct only the following from the separate account:
 - (i) taxes or reserves for taxes attributable to investment gains and income of the separate account;
 - (ii) actual cost of reasonable brokerage fees and similar direct acquisition and sales costs incurred in the purchase or sale of separate account assets;
 - (iii) actuarially determined costs of insurance (tabular costs) and the release of reserves and benefit base consistent with the release of separate account liabilities;
 - (iv) charges for investment management expenses, including internal costs attributable to the investment management of assets of the separate account at a rate not in excess of that stated in the policy;
 - (v) charges for mortality and expense guarantees at a rate not in excess of that stated in the policy;
 - (vi) any amounts in excess of those required to be held in the separate account.
 - (b) Any charges against the separate account made by either an affiliate of the insurer or an unaffiliated fund shall be considered part of the charges limited by (a)(iv) and (v) of this Subsection. Any charge against the separate account, excluding taxes, shall not vary in accordance with the difference between the investment performance of the separate account and any index of securities prices or other measure of investment performance.
- (8) Standards of Conduct. Every insurer seeking approval to enter into the variable life insurance business in this state shall adopt by formal action of its board of directors and file with the commissioner a written statement specifying the standards of conduct of the insurer, its officers, directors, employees, and affiliates with respect to investments of variable life insurance separate accounts and variable life insurance operations. Such standards of conduct shall be binding on the insurer and those to whom it refers.
- (9) Conflicts of Interest
 - (a) Rules under any provision of the insurance laws of this state or any regulation applicable to the officers and directors of insurance companies with respect to conflicts of interest shall also apply to members of any separate account's committee or other similar body. No officer or director of such company nor any member of any managing committee or

body of a separate account shall receive directly or indirectly any commission or any other compensation with respect to the purchase or sale of assets of such separate account.

- (b) No provision of this Regulation shall be construed to prohibit:
 - (i) the investment of separate account assets in securities issued by one or more investment companies registered pursuant to the Investment Company Act of 1940 which is sponsored or managed by the insurer or an affiliate, and the payment of investment management or advisory fees on such assets;
 - (ii) an insurer or an affiliate to act as a broker or dealer in connection with the sale of securities to or by such separate account;
 - (iii) the rendering of investment management or investment advisory services by an insurer or affiliate, for a fee, subject to the provisions of this Regulation.
- (10) Investment Advisory Services to a Separate Account
 - (a) An insurer shall not enter into a contract under which any person undertakes, for a fee, to regularly furnish investment advice to such insurer with respect to any of its separate accounts maintained for variable life insurance policies unless:
 - (i) the person providing such advice is registered as an investment adviser under the Investment Advisers Act of 1940; or
 - (ii) the person providing such advice is an investment manager under the Employee Retirement Income Security Act of 1974 with respect to the assets of each employee benefit plan allocated to the separate account; or
 - (iii) the insurer has filed with the commissioner and continues to file annually the following information and statements concerning the proposed adviser:
 - (A) the name and form of organization, state of organization, and its principal place of business;
 - (B) the names and addresses of its partners, officers, directors, and persons performing similar functions or, if such an investment adviser by an individual, of such individual;
 - (C) a written standard of conduct complying in substance with the requirements of (9) of this Rule which has been adopted by the investment adviser and is applicable to the investment adviser, its officers, directors, and affiliates;
 - (D) a statement provided by the proposed adviser as to whether the adviser or any person associated therewith:
 - (I) has been convicted within 10 years of any felony or misdemeanor arising out of such person's conduct as an employee, salesman, officer or director of an insurance company, a bank, an insurance agent, a securities broker or an investment adviser; involving embezzlement, fraudulent conversion, or misappropriation of funds or securities, or involving the violation of Sections 1341, 1342, or 1343 or Title 18 of the United States Code;
 - (II) has been permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or as an employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity;
 - (III) has been found by federal or state regulatory authorities to have willfully violated or has acknowledged willful violation of any provision of federal or state securities laws or state insurance laws or of any such laws; or
 - (IV) has been censured, denied an investment adviser registration, had a registration as an investment adviser revoked or suspended, or been barred or suspended from being associated

with an investment adviser by order of federal or state regulatory authorities.

- (b) The commissioner may, after notice and opportunity for hearing, by order require such investment advisory contract to be terminated if he deems continued operation thereunder to be hazardous to the public or the insurer's policyholders.

History Note: Authority G.S. 58-2-40(1); 58-7-95;
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