

**MEMO# 21409**

August 1, 2007

# **Proposed Regulations On Diversification Requirements for Variable Contracts; Comments Requested**

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August 1, 2007

TO: 529 PLAN ADVISORY COMMITTEE No. 9-07

PENSION COMMITTEE No. 21-07

TAX COMMITTEE No. 33-07

VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 11-07 RE: PROPOSED  
REGULATIONS ON DIVERSIFICATION REQUIREMENTS FOR VARIABLE CONTRACTS;  
COMMENTS REQUESTED

Treasury has released proposed regulations that would modify the diversification requirements for variable contracts under Code section 817(h). The proposed regulations would expand the list of permitted investors that may hold beneficial interests in a regulated investment company ("RIC"), real estate investment trust ("REIT"), partnership or trust also owned by a segregated asset account. Under the proposed regulations, permitted investors also would include (1) qualified tuition programs ("529 Plans"); (2) trustees of foreign pension or retirement plans primarily for the benefit of nonresident aliens; and (3) accounts that are segregated from the general assets of the life insurance company that owns the account under Puerto Rican law.

Being permitted investors means that 529 Plans and foreign pension accounts could hold interests in the same investment vehicles as a segregated asset account without precluding the segregated account from looking through to the underlying assets of the RIC, REIT, partnership or trust to satisfy diversification requirements. The inclusion of 529 Plans as permitted investors for purposes of the diversification rules under section 817(h) would not eliminate the need for 529 Plans to satisfy all requirements under section 529 and related

regulations, including, for example, the requirement to select a “broad-based investment strategy” under Notice 2001-55, 2001-2 C.B. 299.

The proposed regulations also would eliminate a sentence in Reg. § 1.817-5(a)(2) that provides that the amount required to be paid to remedy an inadvertent diversification failure “shall be an amount based upon the tax that would have been owed by the policyholders if they were treated as receiving the income on the contract ... for such period or periods.” This sentence was stricken to eliminate confusion regarding the scope of IRS authority to deviate from the plain language of the regulations and to give the IRS flexibility to impose remedies of lesser amounts. The preamble notes that the requirements of Rev. Proc. 92-25, 1992-1 C.B. 741, including the amounts imposed to remedy an inadvertent failure to diversify, remain generally applicable.

Treasury has requested comments on the proposed regulations, including specific requests regarding (1) the clarity of the proposed regulations and how they can be made easier to understand; and (2) whether rules similar to those proposed to apply to Puerto Rican companies should apply to accounts segregated under the laws of other territories. The due date for comments is October 29, 2007. Please provide any comments regarding these regulations to the undersigned at [lrobinson@ici.org](mailto:lrobinson@ici.org) or 202-326-5835 no later than close of business on Friday, October 5, 2007.

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[Attachment](#)

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