

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. C11050005

TO: Department of Enforcement
NASD

RE: Jefferson Pilot Variable Corporation
BD No. 5178

Pursuant to Rule 9216 of NASD Code of Procedure, we submit this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against us alleging violations based on the same factual findings.

We understand that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council ("NAC") Review Subcommittee or Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against us; and
3. If accepted:
 - a. this AWC will become part of our permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against us;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about our disciplinary record;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. We may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any allegation in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects our testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

We also understand that our experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

Jefferson Pilot Variable Corporation (BD No. 5178) ("JPVC"), which has its principal place of business at One Granite Place, Concord, New Hampshire, has been a registered broker-dealer and member of NASD since 1970. JPVC is a wholly owned subsidiary of Jefferson Pilot Corporation ("JPC"). JPVC acts as the exclusive distributor for variable life insurance policies and variable annuity contracts issued by Jefferson Financial Insurance Company and by Jefferson-Pilot Life Insurance Company and by Jefferson Pilot LifeAmerica Insurance Company ("JPFIC"), JPC subsidiaries. JPVC has no prior NASD disciplinary history.

I.

WAIVER OF PROCEDURAL RIGHTS

We specifically and voluntarily waive the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against us;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, we specifically and voluntarily waive any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

We further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

II.

ACCEPTANCE AND CONSENT

- A. We hereby accept and consent, without admitting or denying the allegations or findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by NASD:

Background – JPVC's Distribution of VULS and Prospectus Sub-Account Transfer Limits

1. JPVC, which distributes both variable annuities and variable universal life insurance policies ("VULs"), operates as the exclusive distributor of the various Ensemble series VULs issued by JPF. VULs offer a fixed premium schedule and a minimum death benefit. They differ from traditional whole life insurance in that cash values are allocated to various sub-accounts, each reflecting investments in a particular mutual fund, that are separate from the general assets of the insurance company. Each of the VULs distributed by JPVC is offered under a Separate Account of JPF. The Separate Account is registered with the SEC as a Unit Investment Trust (UIT) under the Investment Company Act of 1940. More than one product (VULs and/or annuities) may be offered under the same Separate Account. Policyholders invest in units of the Separate Account that are distributed by JPVC.
2. When investing in a VUL, the policyholder can allocate funds across one or more of the mutual fund offerings available through that product. A Separate Account is comprised of several divisions (sometimes referred to as sub-accounts), each investing exclusively in shares of a single mutual fund portfolio. As policyholders allocate their funds to the various divisions of a Separate Account, they purchase units of those divisions. In turn, the Separate Account purchases shares of the corresponding mutual fund. The asset value of the units in the Separate Account will always be equal to the value of the shares held in the funds (including accumulated dividends).
3. From at least January 1, 2001 through December 31, 2003 (the "relevant time period"), the Ensemble VUL prospectuses provided that policyholders could make up to 20 transfers per Policy Year. Policyholders could, at any time, transfer all or part of their funds to or from any division or the Separate Account.

Supervisory Deficiencies Permitted Excessive Transfers within Sub-Accounts of JPVC Variable Universal Life Policies

4. Throughout the relevant time period, JPVC utilized an electronic policy administration system (the "Vantage System") to administer policyholder funds and corresponding sub-account transfers. The Vantage System could ostensibly recognize and block sub-account transfers in excess of

20 per Policy Year. Throughout the relevant period, however, this blocking feature was not functional. As a result, 292 Ensemble VUL policyholders exceeded the prospectus transfer limitations.

5. During the calendar year 2003, two of those Ensemble VUL policyholders, through the purchase and sale of sub-account units, had engaged in market timing in the shares of the JPVF International Equity Portfolio, American Century Variable Portfolios, Inc. VP International Fund, and Franklin Templeton Variable Insurance Products Trust Templeton Foreign Securities Fund. Market timing is essentially the frequent trading of mutual fund shares in order to take advantage of pricing inefficiencies or market movements. Mutual fund market timers seek to take advantage of short-term changes between the price of a fund's shares and the value of its underlying securities. Although market timing is not illegal, *per se*, research suggests that depending on the circumstances it may harm other mutual fund shareholders. For example, market timing may dilute the value of shares, disrupt the management of the mutual fund's investment portfolio, and raise fund transaction costs. As a result of their 116 transfers exceeding the VUL prospectus limits, the two market timers realized profits of \$238,697.
6. The other 290 policyholders had been following an investment strategy that required periodic rebalancing of their sub-account portfolio. Their excessive transfers involved 35 different sub-accounts, and each policyholder generally engaged in no more than one sub-account transfer per week. Although not market timers, these policyholders still exceeded the VUL prospectus transfer limitations by an average of approximately five.
7. From January 1, 2001 through December 31, 2003, JPVC's supervisory procedures and systems were not reasonably designed to detect and prevent sub-account transfers in excess of the limits set in the Ensemble VUL prospectuses. Specifically, JPVC failed to conduct any meaningful follow-up and review to determine whether the Vantage System was, in fact, working to detect and block excessive transfers. Given the firm's exclusive reliance on the Vantage System to monitor sub-account transfers, such follow-up and review was essential. JPVC also failed to monitor the sub-account transfers of the 290 policyholders engaged in a rebalancing strategy. The firm had reason to know that those policyholders were likely to approach, if not necessarily exceed, the prospectus transfer limitations, but did not take any additional measures to ensure their compliance. As a result of supervisory deficiencies, the firm failed to detect excessive transfers by 292 policyholders, including two mutual fund market timers, during the relevant period.
8. This conduct constitutes separate and distinct violations of NASD Conduct Rules 3010 and 2110.

B. We also consent to the imposition, at a maximum, of the following sanctions:

- A censure;
- a fine in the amount of \$325,000, payable within 30 days of the issuance of this AWC; and
- within 30 days of the issuance of this AWC, JPVC shall pay at least \$119,673 (in addition to \$119,024 the firm previously paid to JPVF International Equity Portfolio) to compensate the other affected mutual funds for losses sustained during the relevant time period because of the excessive transfers of mutual fund shares by the two market timing policyholders beyond the Policy Year limits set forth in the applicable prospectuses. JPVC shall apportion the \$119,673 between the two other affected funds as follows: American Century Variable Portfolios, Inc. VP International Fund (\$66,191) and Franklin Templeton Variable Insurance Products Trust Templeton Foreign Securities Fund (\$53,482).

In addition, we shall comply with the following undertakings within the time periods specified below (unless otherwise extended by NASD staff):

1. Certification of Payment to Mutual Funds

- a. Upon submission of this AWC, an officer of JPVC shall certify to NASD that it has determined a methodology appropriate under the circumstances to calculate the monetary amounts necessary to compensate the affected mutual funds for losses attributable to the excessive trading during the relevant time period, that it has determined an appropriate allocation of such amounts among the affected funds, and that JPVC deems such amounts and distribution as appropriate. JPVC shall also provide NASD staff with a written explanation of the methodology employed by the firm along with calculations, schedules and other supporting documentation relating to the determination of the monetary amount and distribution. NASD staff shall evaluate such information in determining whether to accept this AWC.
- b. Within 30 days of the issuance of this AWC, an officer of JPVC shall certify to NASD that payment in the amount of at least \$238,697 has been made in accordance with this AWC and the methodology and allocation described in the preceding paragraph a.

2. Certifications Relating to Excessive Transfers

- a. JPVC has reviewed all trading during the relevant time period to detect any and all instances of transfers deemed excessive under the terms of the prospectus at the relevant time. Upon submission of this AWC, an officer of JPVC shall certify to NASD in writing that, with respect to the relevant time period, and to the

best of JPVC's knowledge based upon reasonable inquiry, JPVC has disclosed to NASD all instances of transfers within VUL mutual fund sub-accounts that contravened the limitations set forth in the applicable prospectus.

- b. Within 90 days after issuance of the AWC, an officer of JPVC shall certify to NASD that the firm has reviewed its procedures regarding transfers and has systems and procedures in place that are reasonably designed to ensure that VUL prospectus policies are enforced.

The sanctions imposed herein shall be effective on a date set by NASD staff.

III.

OTHER MATTERS

- A. We understand that we may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. We understand that we may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.
- B. We agree to pay any monetary sanctions imposed on us within 30 days of our receipt of notice that this AWC has been accepted and that such payments are due and payable and have attached an Election of Payment form showing the method by which we propose to pay any fine imposed.
- C. We specifically and voluntarily waive any right to claim that we are unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

We certify that we have read and understand all of the provisions of this AWC and have been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce us to submit it.

Date: 2/25/05

Jefferson Pilot Variable Corporation,

By: W. T. B. H.
Title: VP & CEO

Accepted by NASD:

3/16/05
Date

Frederick F. McDonald, Jr.
District Director
Boston District Office

[Signature]
Paul M. Tyrrell
Regional Counsel
Boston District Office
Signed on behalf of the
Director of ODA,
by delegated authority

**Jefferson Pilot Variable Corporation's
Corrective Action Statement**

Jefferson Pilot Variable Corporation (JPVC) hereby submits this Corrective Action Statement regarding supervisory deficiencies resulting in excessive transfers occurring within the sub-accounts of JPVC variable universal life insurance policies. JPVC submits the following corrective action statement:

A programming error in Jefferson Pilot Financial Insurance Company's Vantage policy administration system contributed to the excessive transfers. After the programming error was discovered in July 2003, corrective action was taken. In November 2003, reimbursement was made to the underlying Jefferson Pilot Variable Fund International Portfolio policyholders that had been affected to reimburse policyholders whose policy values were impacted. This corrective action was prior to the June 2004 regulatory examination leading to this AWC. Upon discovery, action was taken to institute temporary procedures pending system correction, testing, and implementation. Systems corrections have been tested and implemented.

We believe that after the corrective action taken, our system is reasonably designed to ensure compliance with the securities laws and regulations.

This Corrective Action Statement is submitted by the Respondent. It does not constitute factual or legal findings by the NASD, nor does it reflect the views of the NASD or its staff.