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SEC Folds on Swing Pricing for Money Market Funds: Odds Lengthen Against Swing Pricing for Other Fun

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On July 12, the SEC adopted, on a 3–2 party line vote, so-called money market fund reforms. The reforms substitute a required redemption (liquidity) fee for proposed "swing pricing" for certain institutional money market funds. More specifically, the SEC adopted requirements for institutional prime and institutional tax-exempt money market funds to impose liquidity fees when a fund has daily net redemptions that exceed 5% of net assets, except where the fund's liquidity costs are de minimis. The SEC also authorized any non-government money market fund, whether institutional or retail, to impose a discretionary liquidity fee, if the fund's board of directors determines that a fee is in the best interest of the fund. The life insurance industry, along with the mutual fund industry, has strongly opposed swing pricing in the context of a November 2022 SEC proposal to mandate swing pricing for other types of funds, with comment letters from the American Council of Life Insurers, the Committee of Annuity Insurers, the Insured Retirement Institute, and the Teachers Insurance and Annuity Association of America. For background information about the nature of swing pricing and some of its pros and cons, see "SEC Would Mandate Swing Pricing: Badly Upending Most Funds' Procedures," *Expect Focus — Life, Annuity, and Retirement Solutions* (January 2023). The SEC's July 12 action raises two questions:

- What does it mean for non-money market funds generally?
- What does it mean for money-market funds and non-money market funds underlying separate accounts?

The SEC did not provide answers to either question. The SEC's action in connection with money market funds may reduce the likelihood of the SEC adopting a swing pricing requirement for non-money market funds. The odds seem good that the SEC will determine that the challenges of implementing swing pricing for non-money market funds are at least as great as implementing swing

pricing for money market funds. The SEC's July 12 action also reduces the possibility that an SEC proposal to exclude exchange-traded funds from the swing pricing mandate might give them a competitive advantage. Although the use of ETFs as underlying variable insurance product separate accounts currently is strictly limited by certain tax and operational considerations, steps are underway to alleviate these restrictions. See "ETFs in Variable Contracts: A New Marketing Opportunity," Expect Focus — Life, Annuity, and Retirement Solutions (May 2023). The SEC did not discuss the impact of its swing pricing proposals on the life insurance industry in either its November 2022 proposing release or its July 12 adopting release. This inattention continues an administrative history where the SEC develops regulatory policy in the context of mutual funds and only later retrofits the policy for variable insurance products. For example, the SEC took 11 years to authorize summary prospectuses for variable insurance products after it did so for mutual funds. SEC Chair Gary Gensler is widely respected for his broad and deep experience and expertise in the financial world. But he may have a blind spot for variable insurance products. He co-authored a book on investment products that stated, "There's no federal regulator ... of the variable annuity industry." Now he heads the industry's federal regulator, whose regulatory role he thus mistakenly denied. The SEC's adopting release states that "the Commission [had] expressed the view that swing pricing appeared to have operational benefits relative to liquidity fees." However, Gensler, in commenting on the SEC's action, stated his opposite opinion, saying "I believe that liquidity fees, compared with swing pricing, offer many of the same benefits and fewer of the operational burdens." In its July 12 adopting release, the SEC took only one action regarding variable insurance products. It amended Rule 2a-7 under the Investment Company Act to provide that "a variable insurance contract issued by a registered separate account funding variable insurance contracts or the sponsoring insurance company of such separate account may apply a liquidity fee ... to contract owners who allocate all or a portion of their contract value to a subaccount of the separate account that is either a money market fund or that invests all of its assets in shares of a money market fund." This accommodation was necessary, because, as a technical matter, deduction of any liquidity fee in connection with a registered separate account's redemption of underlying money market fund shares may mean that the registered separate account is (i) not paying redemption proceeds approximately equal to a variable contract owner's proportionate share of the separate account's current net assets and (ii) therefore not issuing contracts that are "redeemable securities" as required by section 27(i) of the Investment Company Act. The SEC did not address any other challenges related to implementing a liquidity fee in the context of funds underlying separate accounts.

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