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Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

September 17, 2013

Re: Money Market Fund Reform Initiative: Release No. 33–9408, IA–3616; IC–30551; File No. S7–03–13; RIN 3235–AK61.

Dear Ms. Murphy:

The American Council of Life Insurers ("ACLI") is a national trade association with 300 members that represent more than 90 percent of the assets and premiums of the life insurance and annuity industry. Life insurers operate separate accounts registered under the Investment Company Act of 1940 (1940 Act) that fund variable life insurance and variable annuity contracts. Most separate accounts are organized as unit investment trusts with a menu of different underlying portfolio choices, including money market funds. The proposed money market reform initiative, therefore, could affect money market funds underlying a registered separate account funding variable life insurance or variable annuity contracts. ACLI respectfully submits the following response to the SEC's request for comment on this regulatory proposal. We greatly appreciate the SEC's attention to our views.

I. Summary of Proposal

Most U.S. money market funds maintain and compute a stable share price for distribution, redemption and repurchases of their shares. This long-standing practice fulfills strict conditions under Rule 2a-7 under the 1940 Act and permits stable $1.00 per share values through the ''amortized cost'' method of valuing portfolio securities and the use of the ''penny-rounding'' method of pricing shares. Money market funds achieve a stable share price with a portfolio of high quality, short-term debt instruments that do not typically fluctuate under normal market conditions.

The SEC has proposed two alternatives for amending rules governing money market funds under the Investment Company Act of 1940.[1] According to the SEC's release, the two alternatives are designed to: address money market funds' susceptibility to heavy redemptions; improve their ability to manage and mitigate potential contagion from such redemptions, and, increase the transparency of their risks, while preserving, as much as possible, the benefits of money market funds. The release explains that these objectives were developed in response to the 2007-2008 market crisis when money market funds experienced significant redemptions.

[1] 18 Fed. Reg. 118 (June 19, 2013) at 36834 [http://www.gpo.gov/fdsys/pkg/FR-2013-06-19/pdf/2013-13687.pdf]

The first proposed alternative would require money market funds to sell and redeem shares based on the current market-based value of the securities in their underlying portfolios, rounded to the fourth decimal place (e.g., $1.0000), as a ''floating'' net asset value per share (''NAV'').

The second proposed alternative would require money market funds to impose a liquidity fee (unless the fund's board determines that it is not in the best interest of the fund) if a fund's liquidity levels fell below a specified threshold and would permit the funds to suspend redemptions temporarily, i.e., to ''gate'' the fund under the same circumstances. Under this proposal, the SEC indicates it could adopt either alternative by itself or a combination of the two alternatives.

Regarding the application of the two proposals to variable contracts funded by registered separate accounts, the proposing release indicates:

> In order to clarify the application of liquidity fees and gates to variable contracts, we also would amend rule 2a–7 to provide that, notwithstanding section 27(i) of the Act, a variable contract sold by a registered separate account funding variable insurance contracts or the sponsoring insurance company of such account may apply a liquidity fee or gate 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. Section 27(i)(2)(A) makes it unlawful for any registered separate account funding variable insurance contracts or the sponsoring insurance company of such account to sell a variable contract that is not a ''redeemable security.''[2]

The release expresses a clear intention to apply aspects of the money market reform initiative to money market funds underlying registered separate accounts.

II. Statement of Position

The rationale for the proposed money market reforms is not applicable to money market funds underlying registered separate accounts funding variable life insurance and variable annuities. The money market funds in variable contract separate accounts did not experience heavy withdrawals during the financial crisis. Additionally, the "fees and gates" alternative would conflict directly with state insurance requirements in many jurisdictions and the terms of already-issued annuity contracts and life insurance policies. It is appropriate, therefore, to provide an exclusion from the two alternative proposals for money market funds within a separate account registered under the 1940 Act. Congress and the SEC have recognized the differences between publicly available mutual funds and those in variable contract separate accounts, and have appropriately reflected these differences in the 1940 Act, in rules thereunder, and in interpretive policies.[3] The discussion below explains our positions.

[2] *Id* at 37008, note 302. The quoted language references proposed "fees and gates" Rule 2a–7(c)(2)(iv).

[3] For example, in its 1992 Investment Company Act Study, the SEC recommended modifications to Sections 26 and 27 of the 1940 Act to exempt variable contracts from sales load restrictions affecting mortality and expense risk charges in the contracts. *See, Protecting Investors: A Half Century of Investment Company Regulation* (1992) at 402 http://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf In1996, Congress endorsed the SEC's recommendation and amended the 1940 Act accordingly. In 1986, the SEC adopted Rule 151 under the Securities Act of 1933 to assist issuers of annuity contracts in determining whether a particular contract is "an annuity contract or optional annuity contract" entitled to rely upon the Section 3(a)(8) exclusion from the 1933 Act. Rule 6e-2 and Rule 6e-3(T) under the 1940 Act provide a series of exemptions from the Act in recognition of the insurance characteristics of scheduled premium variable life insurance and flexible premium life insurance respectively. Numerous SEC no-action and interpretive letters have provided relief from provisions of the 1940 Act that accommodate the unique insurance features of variable life insurance and variable annuities that did not fit properly within provisions of the 1940 Act. In short, Congress and the SEC

The proposing release indicates that money market funds experienced rapid, heavy redemptions during the 2007-2008 financial crisis, which could have triggered systemic problems due to the size and significance of short-term debt instruments in money market fund portfolios.[4] The release also notes eleven other instances of stress on money market funds that required support from money market fund sponsors to preserve the stable $1.00 per share value and prevent the funds from "breaking the buck." The observations and conclusions in the release were based on a November 30, 2012 report of the SEC's Division of Risk, Strategy and Financial Innovation (RSFI).[5]

The RSFI report provided comprehensive analysis of a variety of factors that may have contributed to significant redemptions in September 2008 and in the eleven other event cited.[6] The report did not, however, specifically analyze redemptions in money market funds underlying registered separate accounts during this time period.[7] The actual performance was quite different for money market funds underlying variable contract separate accounts. As highlighted below, from 2007 through 2011 the gross volume of assets in money market funds underlying variable contract separate accounts increased slightly from year to year, in direct contrast to "rapid, heavy redemptions" depicted in the RSFI report for publicly available money market funds.

Money Market Mutual Funds in Life Insurers' Registered Separate Accounts (Millions)[8]

2007	**2008**	**2009**	**2010**	**2011**
1,973	2,685	3,187	4,221	4,716

Application of the proposed reforms to money market funds underlying registered separate accounts funding variable life insurance and variable annuities is inappropriate and over-broad,

have historically recognized the unique aspects of variable contracts and have provided reasonable exemptions, exceptions and interpretive positions from the 1940 Act consistent with the protection of investors.

[4] *Id.* at 36843, Section C.

[5] *See Response to Questions Posed by Commissioners Aguilar, Paredes*, and Gallagher (Nov. 30, 2012) by SEC's Division of Risk, Strategy and Financial Innovation at http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf.

[6] For example, the report indicated:

> Although there are a number of possible explanations for investor redemptions in September 2008, it is difficult, if not impossible, to attribute the redemptions to any single explanation. That being said, there is a possibility that investor redemption behavior was attributable to the breaking of the buck by Reserve Fund and a "flight to quality" by risk averse investors. In addition, investor redemptions may have resulted from a flight by investors to funds offering liquidity, transparency, and performance. Finally, the influence on redemptions caused by the failure and, in some cases government-sponsored rescue, of prominent financial institutions, including The Bear Stearns Companies, Inc. ("Bear Stearns"), Lehman Brothers Holdings, Inc. ("Lehman Brothers"), American International Group, Inc. ("AIG"), Federal National Mortgage Association ("Fannie Mae"), and Federal Home Loan Mortgage Corporation ("Freddie Mac") is considered.

[7] Additionally, neither the RSFI report nor the release calculates the unique economic or competitive impact of the proposal on variable contract separate accounts with underlying money market mutual funds. The same analytical omission exists in the release's Paperwork Reduction Act calculations at Section IV.

[8] *Source:* National Association of Insurance Commissioners (NAIC) data, used by permission, tabulated by ACLI Research Department.

because the problems that the initiative seeks to rectify do not apply to these money market funds, which did not experience heavy redemptions and thus did not suffer from a liquidity crisis. Accordingly, they did not contribute to market "contagion" and associated collateral problems during the market stresses. In contrast to publicly available money market funds that may be used as a substitute for bank-like cash accounts and thus subject to fluctuations during periods of market stress, money market funds underlying variable contract separate accounts are not historically prone to fluctuations due to the long-term nature and purpose of variable life insurance and variable annuities. Variable contract owners do not typically use underlying money market funds as a short-term cash alternative.

Pursuant to many states' insurance laws and regulations, variable life insurance contracts and variable annuity contracts do not allow the imposition of redemption fees and the suspension of redemptions in an underlying fund to a variable contract separate account under a "fees and gates" approach. Accordingly, existing annuity contracts and life insurance policies do not allow for the imposition of fees or gates, and state insurance authorities will not approve new contracts or policies that would allow for such restrictions on redemptions. For example, the Texas Insurance Department has interpreted Section 3.705(3)(ii)of the Texas Insurance Code to be more restrictive that Section 22(e) of the Investment Company Act, and has advised some life insurers that they could not have any deferral on variable contract withdrawals that did not fit within the Texas insurance law.

Similarly, the NY Department of Financial Services *Product Outline for Individual Fixed and/or Variable Deferred Annuities* highlights provisions similar to the Texas restrictions.[9] Many other jurisdictions have parallel prohibitions to these.[10] The SEC should, therefore, provide an exclusion from the proposed money market fund reform initiative for the money market funds underlying registered separate accounts in view of state insurance laws and regulations that do not allow a "fees and gates" approach to money market funds.

III. Solution

We recommend that the proposed money market reforms provide an exclusion for money market funds underlying registered variable contracts from the two alternative approaches under consideration under Rule 2a-7 because these money market funds did not suffer the mass redemptions experienced by publicly available money market funds, and did not share the causal factors identified in the RSFI report. Contract holders' use of money market funds within registered separate accounts is quite different from investors' use of publicly available money market funds.

Such an exclusion is sensible and warranted based on the differences in historic data regarding redemptions between publicly available money market funds and those within registered separate accounts. Congress and the SEC have recognized how variable contracts are different from publicly available mutual funds and have provided appropriate adjustments to reflect these differences in

[9] Section III.D.9 of the New York product outline (page 25) parallels the Texas constraints discussed above. Section III.E.12 (page 30) precludes charges in the event of cash surrender. Section III.G.5 (page 54) provides that any restrictions or limitations on transfers between investment options in a separate account must be described in the contract.

[10] *See, e.g.*, Ariz. Rev. Stat. Ann. § 20-2636 (2012); 3 Colo. Code Regs. 702-4:4-1-1 (2012); 02-031 Code of Maine Rules Ch. 310, Art. VI (2012); N.M. Admin Code 13.9.3 (2012).

the 1940 Act, rules thereunder, and interpretive or no-action positions.[11] The same practice should apply in the money market reform initiative.

The SEC has long recognized the "hybrid" insurance and securities characteristics of variable contracts, and has respected the authority of state insurance regulation over the insurance features of variable contracts.[12] In its review of the 1940 Act on the statute's 50th anniversary, the SEC noted that

> [w]ith the enactment of the McCarran-Ferguson Act in 1945, Congress determined that regulation of the insurance industry was the exclusive prerogative of the states. Primarily for this reason, the Commission seeks to focus its regulatory efforts exclusively on the securities elements of variable insurance products and to avoid regulation of the insurance elements.[13]

The SEC staff also observed in its Investment Company Act Study that

> The regulation of variable annuities and variable life insurance under the Investment Company Act presents questions of application and interpretation that defy easy analysis. *In many ways, the regulation of these products under the Act is a historical anomaly.* The Investment Company Act naturally presents a statutory framework for the products and services that existed in 1940. Variable insurance products did not exist then in any form, and Congress did not anticipate their creation. *Though Investment Company Act regulation of these products is appropriate, the differences these products present from more traditional investment company products are significant enough that the Act is the proverbial "round hole" into which the "square peg" of insurance products is forced*.[14] (Emphasis added)

The "fees and gates" alternative would inflict an unnecessary and ill-fitting consequence on money market funds underlying registered separate accounts. As noted above, already-issued annuity contracts and life insurance policies, as well as many jurisdictions' insurance laws and regulations, preclude restrictions on redemption and the imposition of ad hoc fees that are not described in the contract or policy. An exclusion from the money market reform alternatives is warranted and rational in light of the state insurance law conflicts and the lack of a nexus to the problems identified in the RSFI report. This is an instance where the SEC should follow its commendable practices in rulemaking which recognize that variable contract separate accounts are different from publicly available mutual funds and are subject to state insurance laws that may conflict with federal securities laws or regulations.

If the SEC cannot resolve to provide a blanket exclusion for money market funds in registered separate accounts for the reasons stated above, then ACLI would only support the floating net asset value alternative, and would strongly oppose the "fees and gates" alternative if it would apply to money market funds in registered separate accounts.

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[11] *See* note 3 *supra*.
[12] *See Protecting Investors: A Half Century of Investment Company Regulation* (1992) at 376. http://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf
[13] *Id.* at 377.
[14] *Id.* at 372.

IV. Conclusion

ACLI supports sensible reform of money market funds. The proposal, however, is too broad in its application to money market funds underlying registered separate accounts funding variable life insurance and variable annuities. The problems that the initiative seeks to rectify do not apply to money market funds in variable contract separate accounts. They did not experience mass redemptions during the 2007-2008 market crisis that is the focus of the proposed revisions. Indeed, unlike publicly available money market funds, assets in variable contract money market funds remained stable and increased slightly during this period of market stress. Accordingly, they did not contribute to market "contagion" and associated collateral problems during the market stresses.

In contrast to publicly available money market funds that may be used as a substitute for bank-like cash accounts and thus subject to fluctuations during periods of market stress, money market funds underlying variable contract separate accounts are not historically prone to similar fluctuations, due to the long-term nature and purpose of variable life insurance and variable annuities. Variable contract owners do not typically use underlying money market funds as a short-term cash vehicle.

Additionally, many state insurance laws and regulations do not permit life insurers to impose a unilateral liquidity fee or suspend redemptions on variable contracts, as envisioned under the "fees and gates" alternative, and already-issued annuity contracts and life insurance policies reflect those state law restrictions. In the 1940 Act, in the rules thereunder, and in interpretive positions, Congress and the SEC have historically recognized the hybrid insurance-security characteristics of variable life insurance and variable annuities, and have respected state insurance laws.

An exception from the money market reform initiative is warranted because money market funds within variable contract separate accounts did not contribute to the problems sought to be addressed, and because the "fees and gates" alternative directly conflicts with state insurance laws and regulations. This solution is consistent with investor protection and appropriate in the public interest.

If the SEC declines to provide a reasonable exclusion from the money market reform initiative, we strongly oppose the application of the "fees and gates" alternative to money market funds in variable contracts due to its conflict with state insurance laws and regulations and existing contracts and policies, and would only support the first alternative that would require money market funds to sell and redeem shares based on the current market-based value of the securities in their underlying portfolios, rounded to the fourth decimal place (e.g., $1.0000), as a ''floating'' net asset value per share (''NAV''). To be clear, a blanket exclusion from the money market reform initiative for money market funds in variable contract separate accounts is a more sensible and preferable approach in keeping with the SEC's recognition of the differences between publicly available mutual funds and money market funds underlying variable contract separate accounts.

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We greatly appreciate your attention to our views. If any questions develop, please let me know.

Sincerely,

Carl B. Wilkerson

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