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Charlotte, NC 28277

February 13, 2023

VIA ELECTRONIC SUBMISSION

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (File No. S7-26-22)
Release Nos. 33-11130; IC-34746 (the "Proposal")1

Dear Ms. Countryman:

Brighthouse Financial, Inc. ("Brighthouse," the "Company," "we," "our," or "us") is a major provider of annuities and life insurance in the United States. Our product offerings include variable annuity contracts and variable life insurance policies ("variable contracts" or "variable products") among many other insurance products. We are also the sponsor of a large complex of proprietary insurance-dedicated mutual funds, which are offered as underlying investment options in our variable products. Our proprietary mutual funds are managed by our subsidiary investment adviser, Brighthouse Investment Advisers, LLC. Through our insurance products and asset management services, we offer Americans innovative solutions to help them protect what they've earned and ensure it lasts.

Brighthouse acknowledges the hard work of the Securities and Exchange Commission (the "SEC") and its staff that went into the Proposal, as well as the SEC's admirable goal of minimizing dilution risk for mutual fund investors. While the Proposal contains no substantive discussion regarding variable products, it does invite comments on that topic.2 Unfortunately, the proposed swing pricing-hard close framework is irreconcilable with variable products as NAV-dependent contracts. The proposed framework is so flawed and harmful in the context of variable products that it simply cannot be adopted, at least not without complete exemptions from the proposed framework for insurance companies, their separate accounts, and underlying funds.

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[1] 87 FR 77172.

[2] The SEC asked one question about variable products in the Proposal. *See* Question 114 ("Should we permit conduit funds, which invest all their assets in another fund and must calculate their NAV on the basis of the other fund's NAV, and which include master-feeder funds and insurance company separate accounts, to receive same-day pricing?").

Many of the concerns raised in this letter apply not only to Brighthouse, but to the variable product sector generally. In that regard, Brighthouse supports the industry comment letters submitted by the American Council of Life Insurers and Committee of Annuity Insurers (the "Joint ACLI/CAI Letter"), the Investment Company Institute, and the Insured Retirement Institute. Nevertheless, we have chosen to also file our own letter because we believe the Proposal to be so unnecessary and unworkable, and potentially harmful to our customers and life insurance companies, that we feel compelled to communicate our concerns directly to the SEC.

For the reasons discussed in this letter, we implore the SEC to abandon the proposed swing-pricing hard close framework. If the SEC is to adopt swing pricing-hard close in some form, to avoid extreme and unjustifiable harm to investors and insurance companies, it is absolutely essential that the SEC adopt exemptions that preserve the current regulatory framework for the variable product sector. Specifically, insurance companies and their two-tier separate accounts[3] would need to be excepted from hard close, and underlying mutual funds would need to be excepted from swing pricing.

For decades, the current regulatory framework has helped countless Americans and our customers save for retirement and secure their financial futures. Most importantly, the current framework continues to work today, whereas the proposed swing pricing-hard close framework would make it impossible for variable products to operate as intended. The Proposal is fundamentally flawed, and we see no other choice than for the SEC to abandon the proposed framework entirely or otherwise adopt broad exceptions that would preserve the current regulatory framework for the variable product sector.

Summary of Comments

This letter primarily focuses on our concerns with the proposed swing pricing-hard close framework as it relates to variable products and underlying funds. We believe that to be the most problematic and harmful aspect of the Proposal. In addition to our primary comments, in an appendix following the main body of this letter, we have included additional comments related to the proposed swing pricing rules and the proposed amended rules for liquidity risk management programs.

For the reasons summarized below, and as more fully discussed throughout this letter, the proposed swing pricing-hard close framework as it relates to variable products and underlying funds is unnecessary, unworkable, and severely harmful.

- ***Unnecessary*** – The SEC seeks to justify the Proposal based on market events that occurred in March 2020, but there is no evidence presented that variable product investors experienced significant dilution during that time period. Our data indicates that our contract owner

[3] Any such exception for separate accounts would need to apply to all registered and unregistered two-tier separate accounts that support variable contracts and invest their assets in the shares of one or more underlying mutual funds which are themselves registered open-end investment companies. The vast majority of variable product separate accounts are two-tier separate accounts of that nature, including all of our separate accounts supporting variable products. All references to separate accounts herein refer to two-tier separate accounts that invest in underlying mutual funds. None of our comments relate to one-tier managed separate account structures.

transaction activity in March 2020 was generally within the range of previous and subsequent corresponding periods. We believe our data is likely reflective of the broader variable product market, as variable contract investors tend to have especially long time horizons primarily given the long-term income and/or life insurance protections provided by variable products. In the absence of any evidence to the contrary, it does not appear that the SEC has presented a compelling basis to justify the Proposal, at least with respect to variable products.

- ***Unworkable*** – The Proposal has two core problems that render it completely unworkable for variable products: defective swing pricing and breakage. Like virtually all variable products, our variable contracts are dependent on the net asset values ("NAVs") of underlying funds. Because our products are NAV-dependent contracts, even if the SEC adopts hard close, we would have to continue transmitting our share orders on behalf of our separate accounts to the underlying funds after they disseminate their NAVs (which will be after 4 p.m. Eastern Time).[4] This is not a matter of costs or system changes – it is due to the order of operations that is inherent to how our variable products are designed and embedded in policy forms, as issued by us and approved by state insurance departments. And yet, the inability to transmit orders prior to 4 p.m. will result in unavoidable and harmful consequences for our variable product customers and life insurance companies.

  The following summarizes the defective swing pricing and breakage problems arising under the Proposal:

  - ***Defective Swing Pricing –*** The SEC will not achieve its overarching goal of passing transaction costs onto the investors whose transaction activity actually generated those costs. Same as today, in a hard close framework, insurance-dedicated funds would continue to receive all orders from insurance companies after 4 p.m., such that each underlying fund would always be swing pricing "today" based on "yesterday's" contract owner transaction activity. In turn, contract owners who transact "today" would always end up bearing the transaction costs generated by contract owners who transacted "yesterday." This would be an unfair and illogical result and would be completely counter to the premise of swing pricing.

  - ***Breakage –*** The Proposal would expose our variable product separate accounts—the vehicles that support our customers' investments—to significant breakage risk. In a hard close regime, because we would still transmit share orders on behalf of our separate accounts after 4 p.m. (same as we do today), we would stand to lose same-day pricing on all of our fund orders. If we were to lose same-day pricing on those orders, our separate accounts would be subject to daily breakage, an extreme financial risk that neither state law, federal law, nor our policy forms contemplate. Separate account breakage would arise because our contracts provide for "same-day pricing" for purposes of striking unit values and processing unit transactions, but we would get

[4] All references to times of day in this letter are Eastern Time. For simplicity, this letter assumes that underlying funds strike their NAVs as of 4 p.m. Please note, the problems with the Proposal exist no matter which time of day an underlying fund selects as its pricing time. The root issue is that we cannot begin our separate account valuation and processing procedures until *after* we have NAVs for the current business day from the underlying funds. Any framework that presupposes otherwise will be unworkable and lead to the harms discussed herein.

"next day pricing" on the fund orders that reflect unit activity. The daily breakage would equal the difference in the underlying funds NAVs from one day to the next. Indeed, the daily breakage risk would be massive and compounding: it would exist within every subaccount of every separate account on every business day.

The breakage risk would place our life insurance companies in an impossible predicament. On one hand, if the separate accounts were to bear the breakage without general account support, the separate accounts may not be able to support account values and redemption obligations, which would give rise to significant contractual and legal risks/questions. On the other hand, if our insurance companies were seen as being contractually or legally obligated to provide substantial and ongoing financial support to the separate accounts to offset breakage, such financial support would expose our insurance companies to untenable financial and legal risks/questions. In any event, the breakage would ultimately come to harm our customers as the financial burdens associated with breakage would inevitably fall upon investors in some form, making it more difficult for them to save for retirement and otherwise achieve their financial goals.

- ***Harmful*** – We cannot emphasize strongly enough how harmful the proposed swing pricing-hard close framework would be to our customers and our life insurance companies. Defective swing pricing would unfairly burden our contract owners with transaction costs that are unrelated to their transaction activity, and cause transacting contract owners to realize swing factors that are not reflective of daily unit flows. Breakage would expose our separate accounts and seemingly, in turn, our customers and life insurance companies to an indeterminable, overwhelming, and intolerable financial risk, a risk that was never intended for variable contract investors or issuers. **We urge the SEC to carefully weigh these harms, as we believe the potential harms of the proposed swing pricing-hard close framework far outweigh the benefits (if any) and would produce far more harm than the dilution problem that the SEC seeks to address.**

Given the unnecessary, unworkable, and harmful nature of the proposed swing pricing-hard close framework, the SEC should preserve the current regulatory framework for the variable product sector. If the swing pricing-hard close framework is to proceed to a final rulemaking in some form, we see no other choice than for the SEC to adopt exceptions necessary to completely carve out the entire variable product sector, including insurance companies, separate accounts (registered and unregistered), and underlying funds.[5]

[5] When the SEC originally proposed hard close in 2003, that proposal included a 'conduit fund' exception that would have permitted insurance company separate accounts (among others) to act as conduits for transmitting transaction orders from their contract owners to underlying funds. Commenters on that proposal explained why the conduit fund exception was necessary for the variable product sector. Indeed, avoidance of separate account breakage was the primary reason why a conduit fund exception was essential under the 2003 proposal. *See* Comment Letter of the CAI on Amendments to Rules Governing Pricing of Mutual Fund Shares, Investment Company Act Release No. 26288 (Feb. 6, 2004). We believe a broad exception for variable products is no less necessary under the Proposal than the conduit fund exception was in 2003.

I. Our Variable Product Business and Separate Account Operations

a. Our Variable Product Business

Brighthouse has a rich history that dates back to 1863 as part of MetLife, Inc.'s former U.S. retail annuity and life insurance business. In 2017, Brighthouse separated from MetLife, Inc. into an independent publicly-traded company. Our size and long-standing market presence position us prominently within the annuity and life insurance industry.

A substantial portion of our overall insurance business is variable products, including variable annuities and variable life insurance policies. Brighthouse has three life insurance company subsidiaries that support our variable product business: Brighthouse Life Insurance Company ("BLIC"), Brighthouse Life Insurance Company of NY ("BLNY"), and New England Life Insurance Company ("NELICO"). Our variable products are distributed through Brighthouse's subsidiary broker-dealer, Brighthouse Securities, LLC, and 414 independent distribution partners.

We have 205 variable product lines, of which 15 are actively selling and 190 are closed to new customers.[6] With respect to our in-force variable product business, we have over 800,000 contracts outstanding, including individual contracts and individual certificates under group contracts. Most of our variable products are registered as securities under the Securities Act of 1933 (the "1933 Act"), and almost all are issued through two-tier separate accounts. Ten of our 16 separate accounts are registered as unit investment trusts under the Investment Company Act of 1940 (the "1940 Act").[7] Currently, our separate accounts have a total of 42 registration statements under the 1933 Act.

Because all of our separate accounts have two-tier structures and support multiple variable investment options, they are all divided into accounting subdivisions called "subaccounts." Each subaccount represents a variable investment option with a single underlying mutual fund, often more simply called an "underlying fund." Across our variable product offerings, our products include 73 proprietary underlying funds and 152 non-proprietary underlying funds. The non-proprietary funds are offered by 41 different mutual fund families.

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[6] Our "actively selling" products include group contracts that are no longer sold to new plans but are accepting new participants.

[7] The six other separate accounts are not registered under the 1940 Act pursuant to exclusionary provisions thereunder. For example, one such unregistered separate account relies on the exemption set forth in Section 3(c)(11) of the 1940 Act for separate accounts that derive their assets solely from certain qualified or governmental benefit plans. The unregistered separate accounts are generally structured and operate in a manner identical to the registered separate accounts. As such, the same issues related to defective swing pricing and breakage, as discussed in this letter, apply equally to our registered and unregistered separate accounts, so the necessary exemptions for variable products from the swing pricing-hard close framework must extend to both registered and unregistered separate accounts.

As part of our overall variable product business, we sponsor insurance-dedicated mutual funds. The Brighthouse funds are series of two fund trusts, Brighthouse Funds Trust I and Brighthouse Funds Trust II. The funds are offered through our variable products, as well as variable products issued by certain formerly affiliated insurance companies of MetLife, Inc. Our subsidiary investment adviser, Brighthouse Investment Advisers, LLC, serves as the investment adviser to the Brighthouse funds. Many of the Brighthouse funds are sub-advised by unaffiliated investment advisers. As of December 31, 2022, the Brighthouse funds had approximately $102 billion in net assets.

b. Our Separate Account Pricing and Processing Operations

Each business day, we receive orders from our contract owners until close of business, which is the close of regular trading on the New York Stock Exchange ("NYSE"). We deem any customer order received from 4:00 p.m. on the prior business day through close on the current business day to be received on the current business day. Orders may be submitted via our website, telephone, email, fax, or regular mail. We receive orders directly from contract owners and through financial intermediaries such as broker-dealers, investment advisers, and third-party administrators. As we receive orders, they are entered into our workflow system.

Depending on the nature of the transaction, the orders we receive may be submitted on the basis of dollars, units, or percentages. Customer orders may be for new premiums, withdrawals/surrenders, transfers, annuitizations, death benefits, and any other transactions performed pursuant to our customers' contracts (*e.g.*, rebalancing, loans, exercise of optional benefits). The complexity of the orders range significantly. By way of example, a "simple" request may be to surrender the contract, while a "complicated" request may involve several interrelated transactions. In addition to customer orders for which we receive specific requests, many contract owner transactions on a given business day are automated, such as fee deductions, automatic withdrawals, dollar cost averaging, periodic rebalancing, etc.

Importantly, all orders relating to a separate account are unit transactions at the separate account level – they are not direct orders to buy or sell underlying fund shares. A contract owner's interest in a separate account is based on the subaccount units that are attributable to their contract. In that regard, the value of a contract owner's investment in a separate account will be driven by two factors: (1) the number of subaccount units attributable to their contract and (2) the value of those units (which fluctuates up or down daily based on the underlying funds' NAVs as discussed further below). The number of units attributable to a customer's contract depends on the transactions performed under their contract. All separate account transactions are performed by crediting or debiting some number of accumulation units in the applicable subaccounts. Nevertheless, as reflected below, the unit transactions on a given business day will result in orders to the underlying funds to buy or sell fund shares. Those orders are calculated based on the net unit flows within the separate accounts and are intended to keep the separate accounts' liabilities (*i.e.*, unit redemption obligations) and assets (*i.e.*, underlying fund shares) in sync.

Upon close of business each business day, our separate account pricing and processing operations begin. The daily order of operations is as follows:

- *Step One: Dissemination of Underlying Fund NAVs (NAV Dissemination)* – Like virtually all other variable products, our variable products are NAV-dependent contracts. Upon close of business, our pricing/processing systems must remain idle until the underlying funds have disseminated their NAVs. We receive hundreds of NAVs each night. Our underlying funds' NAVs are universally calculated as of 4:00 p.m. This means, of course, that we receive the NAVs at some time after 4:00 p.m. The NAVs are provided to us typically between 5:30 p.m. and 8:00 p.m. On some occasions, the underlying funds disseminate their NAVs even later than 8:00 p.m. Once the NAVs are made available, they are uploaded into our central pricing and processing system.

- *Step Two: Striking of Unit Values (Unit Valuation)* – Once the NAVs have been uploaded into the central system, we strike an "accumulation unit value" (or "AUV") for each subaccount of each separate account. We use AUVs to calculate account values and process customer orders for that same business day. Because variable products pass through the performance of their underlying funds, each subaccount's AUV is tied to the NAV of its underlying fund. More specifically, to calculate the AUV for a given subaccount, we use a net investment factor approach that uses the underlying fund's NAV for that business day and then adjusts for a contract's stated asset-based charges, also known as "separate account charges" (*e.g.*, mortality and expense risk charges, cost of insurance charges, certain administrative charges, certain optional benefit charges), as well as applicable dividends, capital gains, and taxes. The resulting value is the AUV for that subaccount for that same business day.

  As of February 2, 2023, we strike approximately 63,975 AUVs each business day.[8] We aim to have all AUVs calculated between 6:30 p.m. and 8:00 p.m. However, if the underlying funds were late in disseminating their NAVs, this process sometimes does not finish until as late as 10:00 p.m. Once the AUVs are struck, the AUV files are sent from the central system to 14 different systems for unit trading.

- *Step Three: Processing of Unit Transactions (Unit Trading)* – After we strike the subaccount AUVs, we then (and only then) calculate account values, process customer orders, and perform any other unit transactions under the contracts (such as deductions for "contract charges" that are not embedded in the AUVs and systematic transactions). All of these calculations and transactions are performed consistently with the forward pricing requirements set forth in Rule 22c-1. As previously noted, while customer orders may be submitted on the basis of dollars, units, or percentages, all separate account transactions are ultimately performed by issuing or redeeming subaccount units. As such, we cannot process any separate account transactions for a given business day unless and until we have AUVs for that day.

[8] The number of AUVs is far greater than the number of underlying funds primarily for three reasons. First, a single subaccount often has many different AUVs to reflect different combinations of applicable separate account charges (*i.e.*, different price points). Second, many underlying funds are offered through more than one separate account. Third, underlying funds are offered through more than one variable product, and each product generally has its own subaccounts.

As noted, we have 14 different systems for unit trading. We aim to begin our systems' batch cycles by 8:00 p.m., subject to any delays in the previous steps due to late dissemination of the underlying funds' NAVs. Depending on the system and the amount of transaction activity, the cycles finish running anywhere from 12:00 a.m. to 6:00 a.m. on the following day.

- *Step Four: Orders to the Underlying Funds (Fund Orders)* – After we process all unit transactions, we calculate and transmit net orders to the underlying funds on behalf of the separate accounts. Like all variable product separate accounts, our separate accounts are designed to be self-supporting, meaning that they generally operate without any financial support from our life insurance companies' general accounts. In order to be self-supporting, a separate account's assets (*i.e.*, the total value of the shares held in the separate account) must align with its liabilities (*i.e.*, the total value of its outstanding accumulation units). To achieve that alignment, when a subaccount issues units, there must be a corresponding purchase of fund shares. Conversely, when a subaccount redeems units, there must be a corresponding redemption of fund shares. However, like all other insurers, we do not transmit an individual fund order for every single unit transaction. Rather, we submit omnibus orders to purchase or redeem an amount of underlying fund shares reflecting the net unit transaction activity for that business day.

  Going back to our specific systems, after the unit transaction system batch cycles are complete, the unit transaction files feed back into the central system, which generates a net purchase/redemption order for each underlying fund. These orders are generated and delivered to the underlying funds between 12:00 a.m. and 6:00 a.m.

Under the current regulatory framework, even though the share orders in step four are transmitted to the underlying funds after 4 p.m., our separate accounts are still entitled to same-day pricing from the underlying funds.[9] This is critically important to the proper function of our separate accounts. Each subaccount remains self-supporting so long as the same NAV is used to (i) strike the AUV (in step two) and (ii) price the share order (in step four). If a different NAV were to apply to step two and step four, then the subaccount's liabilities and assets would fall out of sync as the underlying fund's NAV changes from day to day. That potential disconnection between separate account liabilities and assets is the "breakage" that we discuss in this letter and that renders the Proposal unworkable.

The logistical challenge we face every business day is processing the massive amount of information necessary to perform our separate account operations. But we have the systems and procedures in place to perform them. The key to it all—the essential element that allows our separate accounts to operate as intended—is same-day pricing for both unit valuation (step two) and fund orders (step four).

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[9] Under the current regulatory framework, the separate accounts are entitled to same-day pricing for step four because Brighthouse effectively functions as an agent for the underlying funds with respect to the receipt of customer orders, such that receipt by Brighthouse is deemed to be receipt by the underlying fund. This is, of course, not unique to Brighthouse but is standard industry practice in accordance with longstanding SEC staff no-action relief. *See New York Life Fund, Inc.* (pub. avail. May 6, 1971).

Despite the importance of same-day pricing in step four, we would not be able to change the order of operations to preserve same-day pricing under the proposed regulatory framework. The order of operations is inherent to our variable products as NAV-dependent contracts. We cannot submit orders to the underlying funds until after we process the unit transactions, we cannot process the unit transactions until we strike AUVs, and we cannot strike AUVs until the underlying funds have sent us their NAVs. Therefore, we cannot submit orders to the underlying funds until after they have disseminated their NAVs. And, because the underlying funds disseminate their NAVs no earlier than 4:00 p.m., we cannot submit orders to the underlying funds before 4:00 p.m. as required to preserve same-day pricing under hard close. Thus, we would lose same-day pricing under the Proposal. To be clear: the order of operations is not a matter of Brighthouse enhancing or changing its systems. The order of operations is fundamental to our variable product designs, and we are bound to it in the contracts issued to our customers (as further explained in the next section). We just cannot perform step four before step one as the SEC envisions for hard close.

c. Contractual Provisions and Prospectus Disclosures Related to Our Separate Account Operations

A major difference between variable products and mutual funds is that variable products are written contracts between insurers and their customers. Each variable product has a written, detailed policy form that specifically describes the various rights and benefits of the contract owner (the customer) and the obligations of the insurer (the issuer). The insurer must satisfy its contractual obligations or otherwise be in breach of contract and in violation of state insurance law. Accordingly, Brighthouse is contractually and legally obligated to adhere to the terms of nearly one million outstanding contracts and any contracts it issues in the future, and Brighthouse has no authority to deprive contract owners of their contractual rights or unilaterally amend inforce policy forms to the detriment of contract owners.

As discussed, our separate account pricing and processing operations are not only inherent to our variable product designs, they are also embodied in our contracts issued to our customers. For example, a fairly representative BLIC variable annuity policy form[10] contains specific provisions regarding our receipt of customer orders, pricing of units, and processing of unit transactions, such as the following:

- <u>Business Day</u> is defined as each day that the NYSE is open for business, and each Business Day ends as of the close of regular trading on the NYSE.
- On each Business Day, the policy form guarantees:
  - The <u>Separate Account</u> will be valued (*i.e.*, <u>Accumulation Unit Values</u> will be struck for each <u>Subaccount</u> of the Separate Account).
  - The <u>Account Value</u> will be calculated. Account Value will equal the sum of the contract owner's interests in the <u>Subaccounts</u>. Account Value in a Subaccount is

[10] *See* Exhibit (d)(i) to the Form N-4 Registration Statement for Brighthouse Separate Account A, File Nos. 333-209055, 811-03365.

determined by multiplying the number of Accumulation Units allocated to the contract for the Subaccount by the Accumulation Unit Value.

  - BLIC will deem any Notice (including customer transaction order) to be effective as of the Business Day on which it is received, and that any such Notice will be effective if received in good order prior to the end of a Business Day.
  - All Separate Account transactions effective as of a Business Day will be processed based on the Accumulation Unit Values for that Business Day.

- With respect to the calculation of Accumulation Unit Values each Business Day, the policy form provides that:
  - Accumulation Unit Values for each Subaccount are determined by multiplying the Accumulation Unit Value for the immediately preceding Business Day by the Net Investment Factor of the Subaccount for the current Business Day.
  - The Net Investment Factor for each Subaccount is determined by dividing A by B and multiplying by (1-C) where:
    - A is (i) the net asset value per share of the [underlying fund] held by the Subaccount at the end of the current Business Day; plus (ii) any dividend or capital gains per share declared on behalf of such [underlying fund] that has an ex-dividend date as of the current Business Day;
    - B is the net asset value per share of the [underlying fund] held by the Subaccount for the immediately preceding Business Day; and
    - C is (i) the Separate Account Product Charges which are shown on the Contract Schedule for each day since the last Business Day. The daily charge is equal to the annual Separate Account Product Charges divided by 365; plus (ii) a charge factor, if any, for any taxes or any tax reserve established as a result of the operation of the Subaccount.

Collectively, these contractual provisions give customers the right, each business day, to submit orders to Brighthouse and get "same-day pricing" on any order we receive prior to the close of trading on the NYSE (normally 4 p.m.). These provisions also provide for "same-day valuation" each business day for purposes of processing unit transactions and valuing contracts. And through the use of the prescribed net investment factor, when calculating the AUV(s) for a subaccount on any given business day, the contract provides that the AUV will be struck based on the underlying fund's NAV for the same business day.[11] These contractual provisions directly align with our separate account operations as described in the previous section and longstanding principles under state law and federal law, including Rule 22c-1.

[11] These provisions are not unique to Brighthouse. They are typical of variable annuity contracts throughout the industry. They are based on the National Association of Insurance Commissioner's Model Variable Annuity Regulation and longstanding requirements of Rule 22c-1 under the 1940 Act.

Beyond the policy forms themselves, our separate account operations are also disclosed throughout the prospectuses for our variable products. For example, the current prospectus for a fairly representative variable annuity contract includes the following excerpts:[12]

- "A Business Day closes at the close of normal trading on the New York Stock Exchange, usually 4:00 p.m. Eastern"
- "Every Business Day as of the close of the New York Stock Exchange (generally 4:00 p.m. Eastern Time) we determine the value of an Accumulation Unit for each of the Investment Portfolios . . . ."
- "[W]e determine the value of an Accumulation Unit for each of the Investment Portfolios by multiplying the Accumulation Unit value for the immediately preceding Business Day by a factor for the current Business Day. . . . The net investment factor for each Investment Portfolio is determined by dividing A by B and multiplying by (1-C) where: [description tracks policy form]"
- "Purchase Payments and transfer [and withdrawal] requests are credited to a contract on the basis of the Accumulation Unit value next determined after receipt of [the] request. . . . [R]equests received <u>before</u> the close of the New York Stock Exchange will be [priced as of] that day . . . . [R]equests received <u>after</u> the close of the New York Stock Exchange, or on a day when the New York Stock Exchange is not open, will be treated [as received] on the next day the New York Stock Exchange is open (the next Business Day)."

It is important to understand that our customers' contractual rights to receive same-day pricing and same day valuation as described in the policy form and prospectus does not contractually depend on whether Brighthouse gets same-day pricing on the share orders it transmits to the underlying funds on behalf of the separate accounts. In other words, under the terms of the contracts, the subaccount AUVs are formulaically derivative of the corresponding underlying fund NAVs for the same business day, regardless of whether Brighthouse is able to purchase or sell the underlying fund shares based on those NAVs. Yet, in order for a separate account to be self-supporting as intended by state and federal law, we must be able to purchase and sell the underlying fund shares (in step four) based on the same NAVs that we used to strike AUVs (in step two). The current regulatory framework allows us to get same-day pricing in step four – the proposed framework would not. For that very reason, the proposed framework is fundamentally incompatible with how our variable products and separate accounts are designed to operate.

II. The Proposed Swing Pricing-Hard Close Framework is Unnecessary, Unworkable, and Harmful

In the context of variable products, the swing pricing-hard close framework is unnecessary, would be completely unworkable, and would be tremendously harmful to both investors and life insurance companies. We therefore urge the SEC to preserve the current regulatory framework for variable products. If the SEC were to proceed with the Proposal, then to ensure that variable products and separate accounts can function as intended and to protect investors and insurers

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[12] *See* Post-Effective Amendment No. 13 to the Form N-4 Registration Statement for Brighthouse Separate Account A, File Nos. 333-209055, 811-03365, filed on April 13, 2022 pursuant to Rule 485(b) under the 1933 Act.

from harm, it would be absolutely essential for the SEC to exempt life insurance companies and separate accounts from hard close and underlying mutual funds from swing pricing.

a. The Swing Pricing-Hard Close Framework is Unnecessary

Given the absence of any specific evidence or discussion regarding dilution or late trading in the variable product market, the Proposal reads as if it is creating solutions in search of a problem. There is no compelling reason to upend decades of established regulatory practices for variable products, especially when doing so would result in significant harm to investors and life insurance companies. Furthermore, given that the Proposal does not discuss how the swing pricing-hard close framework would impact variable products, we are left to assume that the SEC did not evaluate such harms or try to balance them against the perceived benefits.

i. The March 2020 Market Events

The Proposal relies heavily on the market events that occurred in March 2020—market events that occurred directly in response to unprecedented widespread fear and uncertainty surrounding the COVID-19 pandemic—as the basis for eschewing the longstanding and proven current regulatory framework in favor of an untested swing pricing-hard close framework. The Proposal discusses those market events and their impact on U.S. mutual funds in general and unconvincing terms. In fact, the SEC admits that it "[does] not have specific data about the dilution fund shareholders experienced" in March 2020.[13] However, most relevant to this letter, the Proposal contains absolutely no discussion about the variable product sector. It does not explain whether or how those market events impacted variable products or their underlying funds. Nor does it contain any evidence that variable products and their underlying funds are subject to the same degree of dilution and liquidity risk that the SEC seems to associate with retail mutual funds.

Due to the absence of any data in the Proposal related to variable products and underlying funds, Brighthouse proceeded to analyze its own data. Based on our analysis, we do not believe that our products experienced the dilution and liquidity issues that the SEC claims to have occurred in March 2020. Furthermore, we have no reason to believe that our data is not fairly representative of the larger variable product sector.

For example, the SEC claims that the market events in March 2020 gave rise to outlier investor redemption activity that resulted in significant dilution for investors and liquidity crunches for funds. Brighthouse did not experience any of those problems in connection with its variable products. Our contract owner redemption activity did not spike in March 2020. Looking back at contract owner unit transaction activity in March for the past four years, our aggregate net daily order flow to the underlying funds was as follows:[14]

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[13] *See* 87 FR 77172, p. 178, fn. 40 of the Proposal.

[14] Please note, our unit flows are normally in net redemptions, primarily due to two factors: (1) many of our variable products are closed to new business and (2) the deduction of contract-level charges results in large unit redemptions daily.

- March 2019: Average daily net redemption of $28,631,409
- March 2020: Average daily net redemption of $25,267,461
- March 2021: Average daily net redemption of $25,559,347
- March 2022: Average daily net redemption of $33,330,265

We are not surprised by our data, as we do not believe that the variable product sector can simply be lumped into the general U.S. mutual fund sector with respect to liquidity and dilution risk. Variable product investors have especially long time horizons – they seek tax-deferred asset accumulation for retirement savings, guaranteed income, and life insurance protection. In addition, variable product investors can be subject to large surrender charges and tax penalties if they take early withdrawals from their contracts. With that in mind, we believe that redemption activity for variable products tends to be less driven by market events than for retail funds. That has been our experience and is reflected in our data.

As the SEC considers whether to adopt a swing pricing-hard close framework for the variable product sector, the SEC must consider these issues with more analytical rigor. In that regard, the SEC should produce market evidence that the events in March 2020 actually and acutely impacted variable products or their underlying funds, or that there are pervasive dilution and liquidity risks in the variable product market. In the absence of any such evidence, it is difficult to see how the SEC could justifiably adopt rules that upend the regulatory framework and operational intricacies for variable products.

ii. Late Trading

The Proposal also presents late trading as a secondary justification for hard close. To the best of our knowledge, late trading has not been a problem for many years, and the Proposal presents no evidence to show that late trading is actually a problem today. It is noteworthy that the most recent enforcement action cited by the SEC was brought in 2005, nearly 20 years ago.[15]

In any event, the variable product market effectively already has a hard close at the separate account level. Speaking for Brighthouse, our procedures require orders to be received by us prior to 4:00 p.m. in order to get same-day pricing, as currently required by and in compliance with Rule 22c-1. Therefore, late trading by investors in variable products is not permitted as a result of a de-facto hard close. Adding an additional hard close at the underlying fund level would do nothing to further prevent late trading.

b. The Swing Pricing-Hard Close Framework is Unworkable

The proposed swing pricing-hard close framework is unworkable because it is irreconcilable with variable products as NAV-dependent contracts. As discussed further below, if the SEC were to adopt the proposed framework and apply it to the variable product sector, there would be at least two unintended and extremely harmful consequences:

[15] *See* 87 FR 77172, p. 209, fn. 226 of the Proposal.

- First, the SEC would fail to achieve the purpose of swing pricing. Swing pricing would not pass the costs stemming from contract owner purchase and redemption activity onto the contract owners who actually engaged in that activity. Instead, contract owners who transact "today" would always bear the transaction costs generated by contract owners who transacted "yesterday."
- Second, the SEC would cause variable product separate accounts to incur a significant daily financial risk called "breakage." Breakage exists when a separate account has an asset-liability mismatch. Hard close would create breakage within separate accounts due to the loss of same-day pricing on the net share orders that insurers transmit to underlying funds on behalf of their separate accounts.

Given these serious issues with the Proposal as it relates to variable products, Brighthouse does not see how the proposed swing pricing-hard close framework could be adopted. Consequently, we believe that the SEC must either abandon the proposed framework entirely or adopt broad exceptions that exempt life insurance companies and separate accounts from hard close and underlying mutual funds from swing pricing.

i. Defective Swing Pricing: Swing Pricing will Pass Transaction Costs onto the Wrong Contract Owners

In the context of variable products, swing pricing does not work.[16] The purpose of swing pricing is "to pass on costs stemming from shareholder purchase or redemption activity to shareholders engaged in that activity."[17] If applied to the variable product sector, swing pricing would not accomplish that goal. Rather, contract owners who transact on the current business day would always bear the transaction costs of the contract owners who transacted on the prior business day. This would be an illogical and yet unavoidable result of the swing pricing-hard close framework.

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[16] We do not comment on the general merits of swing pricing as an anti-dilution tool in the retail fund space. Yet, in the context of insurance, the Proposal implicates public policy issues that the SEC seemingly has not considered, such as:

- Swing pricing would not be solely reflective of contract owner transaction activity. For example, swing pricing would be heavily influenced by unit activity stemming from contract fee deductions and other systematic transactions.
- Swing pricing would impact non-transacting contract owners in many ways. For example, contract owners with optional benefits could realize swing factors through automatic reset features.
- When insurance guarantees become payable under a contract (*e.g.*, death benefits), swing pricing could cause contract owners or beneficiaries to receive a smaller payout, which would be harmful to them.

With that in mind, in addition to the specific concerns raised in this letter, we urge the SEC to consider the broader public policy implications of swing pricing in the insurance context and address those public policy issues as part of any final rulemaking.

[17] *See* 87 FR 77172, pp. 172, 215 of the Proposal.

Given the NAV-dependent operation of our variable contracts and separate accounts, even if the SEC adopts hard close, we would not be able to transmit net orders to the underlying funds prior to 4 p.m. Referring back to the discussion in Section I.b., "Our Separate Account Pricing and Processing Operations," we cannot perform step four (fund orders) before step one (NAV dissemination), and we believe the same would apply to other life insurance companies that issue variable products. Accordingly, even if the SEC were to adopt hard close, insurance-dedicated underlying mutual funds would generally receive all of their orders after 4 p.m. each business day and none between 9 a.m. and 4 p.m., same as they do under the current framework. This fact would have a profound impact on how underlying funds would swing price under the Proposal, and how swing pricing would impact contract owners.

Under the Proposal, if an underlying fund were to receive all of its orders after 4 p.m. each business day as we expect, swing pricing seems to break down entirely. Each business day, the underlying fund would be determining whether to swing price and would be calculating a swing factor based on one or more orders that trace back to contract owner transaction activity on the previous business day. In essence, swing factors would always be on a one-day lag. Consequently, any contract owner who transacts "today" would indirectly realize an NAV that was adjusted to reflect transaction costs arising out of unit activity that occurred "yesterday."

The following further illustrates this point in the context of our operations. For simplicity, the following assumes a single subaccount and underlying fund in which we are the sole insurance company shareholder:

- On Business Day 1:
  - We receive customer unit orders from 9:00 a.m. to 3:59 p.m.; then
  - After 4:00 p.m., the underlying fund disseminates its NAV for Day 1; then
  - Using the NAV for Day 1, we strike the subaccount AUV for Day 1; then
  - We use the Day 1 AUV to process all unit transactions for Day 1; and then
  - We transmit an order reflecting the net unit activity to the underlying fund.
- On Business Day 2:
  - The underlying fund receives our order prior to 9:00 a.m. The order is deemed to be received on Day 2 due to hard close. The underlying fund receives no additional orders from 9:00 a.m. to 4:00 p.m.; then
  - After 4:00 p.m., the underlying fund decides whether and how to swing price when striking its NAV. To swing price, the underlying fund will consider its order flow for Day 2, *i.e.*, our order that traces back to the Day 1 unit activity; then
  - The underlying fund swing prices using the order that traces back to the Day 1 unit activity. The stale swing factor becomes embedded in the Day 2 NAV; then
  - After 4:00 p.m., the underlying fund disseminates its Day 2 NAV; then
  - Using the Day 2 NAV, we strike the subaccount AUV for Day 2; and then
  - We use the Day 2 AUV to process unit transactions for Day 2.

- As a result, any contract owner who transacts on Day 2 will realize an AUV that reflects the Day 2 NAV, but that Day 2 NAV will be calculated based on Day 1 unit activity. Thus, any contract owner who transacts on Day 2 will indirectly bear the underlying fund transaction costs generated by the contract owners who transacted on Day 1.

Of course, this result is clearly at odds with the policy goals espoused in the Proposal. Yet, it appears to be an unavoidable flaw in swing pricing due to the NAV-dependent nature of variable contracts. This flaw in swing pricing would be extraordinarily unfair to contract owners. The stale swing factors realized would be unrepresentative of unit flows for the current day – they could even be opposite to unit flows. Furthermore, the theoretical "first-mover advantage" that the SEC hopes to eliminate[18] would still exist, as contract owners would be theoretically motivated (perhaps more so than ever) to transact first in order to avoid transaction costs generated by other contract owners. Please see Section II.c., "The Proposal will do Severe Harm to our Customers and our Life Companies" for further discussion regarding the substantial harms associated with defective swing pricing that the SEC should carefully consider and weigh.

ii. Breakage: Hard Close will Result in Significant and Unacceptable Financial Risk for Variable Product Separate Accounts

Should the SEC adopt a hard close framework that causes variable contract separate accounts to lose same-day pricing on their underlying fund orders, there would be significant separate account "breakage." Such breakage would be entirely inconsistent with the legal requirements for separate accounts, and would impose unacceptable risk and harm on variable product investors and issuers, including our customers and life insurance companies.

Under state and federal law, variable contract separate accounts are required to maintain assets with a value that shall at least equal the reserves and other contract liabilities of the separate account.[19] Separate account assets generally refers to the value of the underlying fund shares held in the separate account, whereas separate account liabilities generally refers to the redemption value of the separate account's outstanding units. For two-tier separate accounts with multiple subaccounts, this requirement to align assets and liabilities applies on a subaccount-by-subaccount basis. Furthermore, under state and federal law, variable contract separate accounts are required to be insulated from the insurance company's general account, where all income, gains, and losses of the separate account are credited to the separate account without regard to the income, gains, and losses of the insurer.[20] The very concept of insulation necessitates that variable contract separate accounts will be able to maintain matching assets and liabilities without financial support from the insurer's general account. Indeed, substantial financial

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[18] *See* 87 FR 77172, p. 199 of the Proposal.

[19] *See* National Association of Insurance Commissioners' Variable Annuity Model Regulation 250. *See also* Section 2(a)(37) of the 1940 Act and Rule 0-1(e) thereunder. For example, the definition of "separate account" under Rule 0-1(e) requires that "the separate account shall be legally segregated, the assets of the separate account shall . . . have a value at least equal to the reserves and other contract liabilities with respect to such account, and at all other times, shall have a value approximately equal to or in excess of such reserves and liabilities; and that portion of such assets having a value equal to, or approximately equal to, such reserves and contract liabilities shall not be chargeable with liabilities arising out of any other business which the insurance company may conduct."

[20] *See id.*

support could be seen as fundamentally inconsistent with the entire legal framework for variable contract separate accounts.

As explained in Section I of this letter, we keep our separate account assets and liabilities in sync through a four-step process that is inherent to our products as NAV-dependent contracts and embedded in our policy forms. The key to keeping the assets and liabilities in sync: units are valued (in step two) and fund orders are priced (in step four) using the same underlying fund NAV. The current framework makes that possible because fund orders transmitted after 4 p.m. still get same-day pricing.

Breakage exists when separate account assets and liabilities fall out of sync. Because we have two-tier separate accounts with multiple subaccounts, any breakage would arise (if at all) within our individual subaccounts. If a subaccount were to experience breakage—where its liabilities were to exceed its assets (negative breakage)—the separate account may not be able to support its account values or redemption obligations, and it is possible that our life insurance companies could be viewed as legally and contractually obligated to absorb breakage by providing financial support to the separate accounts. If our insurers were obligated to bear that breakage, the financial support would be provided by the applicable company's general account, where the general account would provide cash to true-up the broken subaccount's assets or otherwise support the subaccount's redemption obligations. The relevant insurer might be seen as legally and contractually obligated to provide such financial support because the insurer's contracts and disclosures generally dictate how the insurer will value units and process unit transactions.

Under the proposed framework, breakage risk will exist for every subaccount of every separate account on every business day. Once again referring back to the order of operations described in Section I.b. of this letter, breakage will arise because unit valuation (step two) and fund orders (step four) will become disconnected due to the loss of same-day pricing for the fund orders transmitted after 4 p.m. Each subaccount's units will be valued based on the underlying fund's NAV for the current business day, but the fund order reflecting the unit activity in that subaccount will get the underlying fund's NAV for the next business day. The breakage within the subaccount will be the percentage difference in the underlying fund's NAV between the current business day and the next business day. More specifically:

- If the subaccount had net inflows for the current business day, and the underlying fund's NAV for the next business day is higher than the current business day, there will be negative breakage. The potential future liability generated by the net inflows will be greater than the value of the shares that could be acquired using those net inflows.
- Also, if the subaccount had net outflows for the current business day, and the underlying fund's NAV for the next business day is lower, there will be negative breakage. The separate account's payment obligations will be greater than the proceeds generated by the redemption of underlying fund shares.

The following example illustrates how the current regulatory framework allows us to avoid breakage and how the proposed regulatory framework creates breakage. For purposes of this example, assume a single subaccount and underlying fund.

	Current Regulatory Framework	Proposed Hard Close Framework
Business Day 1		
Assumed Underlying Fund NAV	$5.00 per share	$5.00 per share
Assumed Subaccount AUV	$4.00 per unit	$4.00 per unit
Assumed Net Unit Flows	Net inflow – net issuance of 100,000 units, resulting in net inflows of $400,000	Net inflow – net issuance of 100,000 units, resulting in net inflows of $400,000
Net Fund Order from Brighthouse to Underlying Fund	Purchase of $400,000 in fund shares	Purchase of $400,000 in fund shares
Underlying Fund NAV Applicable to Fund Order	***$5.00 per share***	***Unknown***
Business Day 2		
Assumed Underlying Fund NAV	$5.05 per share (an increase of 1% relative to Day 1)	$5.05 per share (an increase of 1% relative to Day 1)
Subaccount AUV	$4.04 per unit (a corresponding increase of 1% relative to Day 1)	$4.04 per unit (a corresponding increase of 1% relative to Day 1)
Total Value of the Units Issued on Day 1 as of Day 2	***$404,000***	***$404,000***
Total Value of the Shares Purchased as of Day 2	***$404,000***	***$400,000***
Subaccount Breakage Between Day 1 and Day 2	***$0 0%***	***($4,000) (1%)***

The example is somewhat oversimplified (*e.g.*, it does not reflect how adjustments for dividends or distributions could impact the net investment factor used to value units, and it uses conservative assumptions), but nevertheless it is a fair representation of how hard close would result in breakage. The loss of same-day pricing on the fund order transmitted after 4 p.m. on Day 1 caused unit valuation (step one) and the fund order (step four) to become disconnected. The breakage arose on Day 2 as the underlying fund's NAV increased by 1%, causing the separate account to have incurred a liability that was 1% greater than the value of the shares it purchased. In this example, the 1% breakage would exist unless and until the insurer's general account purchases additional fund shares to offset the breakage.

Critically—and this point cannot be overemphasized—the full scope of the breakage problem would be far more vast and overwhelming. Breakage risk would exist within every subaccount of every separate account on every business day. Every subaccount would immediately come to have an asset-liability mismatch and those mismatches would seemingly compound day-after-day in the absence of ongoing and significant financial support from our life insurance companies' general accounts.[21] However, separate accounts are not structured to depend on daily backing by general accounts, and such substantial general account support could be seen as entirely inconsistent with how separate accounts are supposed to legally operate. Even the mere potential for immense breakage risk would present serious problems for separate accounts and general accounts.

Ultimately, the harms arising from breakage would be severe for both investors and insurers. As discussed more fully in Section II.c., "The Proposal will do Severe Harm to our Customers and our Life Companies," in the face of extreme breakage, we would be placed in an impossible predicament. The separate accounts cannot absorb massive breakage risk because the separate accounts may not be able to support their account values and redemption obligations, and breakage within the separate accounts could be viewed as impermissible under applicable state and federal law. However, nor can our life insurance companies absorb massive amounts of separate account breakage by providing substantial and ongoing financial support to the separate accounts: our products are not priced to account for that risk, such general account support would raise serious questions under applicable law, and we cannot bear extreme breakage as a responsible business entity subject to strict solvency regulation. At our own behest or at the behest of our state regulators, we would have no other choice than to explore all ways to mitigate the associated financial and regulatory risks. It is difficult to see any other way to mitigate those risks other than redirecting the financial risk to our customers. As such, it is reasonable to presume that the extreme breakage risk would, one way or another, come to fall upon American investors, making it more difficult for them to save for retirement and realize their financial goals.

iii. The Defective Swing Pricing and Breakage Problems would be Unavoidable under the Proposal

1. Not a Matter of Cost

The SEC, in discussing the challenges that retirement plans would face under the Proposal, boils those challenges down to money and resources. We assure the SEC that isn't the case for variable products. The Proposal is fundamentally irreconcilable with the design of our variable products and the contractual obligations to which we are subject. Of course, if we were required to build entirely new systems as a result of the Proposal, the costs would be astronomical and completely unjustified. Yet, avoiding a "big spend" is not the reason we are submitting this letter. We are submitting this letter because the proposed swing pricing-hard close framework is completely unworkable and would result in serious harm to our customers and our life companies.

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[21] It is true that as underlying fund NAVs fluctuate from day to day, the breakage within any single subaccount could cut in either direction, meaning that there would be days where the change in NAV causes a subaccount's assets to exceed liabilities. However, the proper operation of separate account operations cannot be gambled on day-to-day market fluctuations.

2. Contract Modification is Not a Feasible Option

The SEC should not assume that we can amend our inforce contracts to somehow facilitate the Proposal. First, even if we could modify our contracts, it is not at all clear how we would need to amend them. It would seem that we would have to somehow completely reinvent how variable products and separate accounts work, all within the confines of state and federal law. Second, and more practically, we cannot deviate from the terms of our inforce contracts. We cannot violate the terms of our inforce contracts and we have no unilateral power to amend them in any way that is disadvantageous to the customer.

While there is a process for modifying inforce contracts by endorsement or rider, a wide-scale overhaul of our inforce contracts would be practically impossible, particularly if the amendment would be disadvantageous to customers. First, we would need to obtain approval from the insurance regulatory department in each state. The process is costly and time consuming. Furthermore, the outcome on a state-by-state basis would be entirely unpredictable. In terms of separate account operations, uniformity among all contracts would be essential, but there is no guarantee that every state would take a uniform position on any amendment.

Even if we could somehow obtain universal state approval, state law or state regulators may require us to obtain contract owner consent, especially because any amendment would most likely be disadvantageous to contract owners. To the extent that contract owner consent is necessary, it is extremely unlikely that we would be able to obtain universal assent. And, even if contract owner consent is not required in a given state, it's reasonable to expect that we would become subject to private litigation as contract owners (or plaintiff firms) bring lawsuits for breach of contract. In that regard, courts could force us to honor the terms of our original contracts with customers.

Even if we successfully navigate the state approval process, obtain all necessary customer consents, and avoid orders from courts that require us to honor the terms of our original contracts, our ability to make modifications to the contracts would need to comply with state insurance law and the 1940 Act. That would be a significant challenge given that those laws reflect traditional regulatory principles (*e.g.*, forward pricing under Rule 22c-1).

3. Early Cut-Offs Will Not Work

In the Proposal, the SEC expects the widespread use of "early cut-offs" to help facilitate swing pricing and still get same-day pricing. The idea is that intermediaries would cut off receipt of investor transactions before 4 p.m. in order to give themselves time to transmit orders to mutual funds prior to the 4:00 p.m. hard close. While this may be an option for broker-dealers or investment advisers, early cut-offs are not an option for Brighthouse, as they would not address the core problems with the Proposal and would violate the terms of our contracts.

Early cut-offs would not fix the core problems with the Proposal because they would not change the fact that our variable products are NAV-dependent contracts. As explained earlier, even in a hard close framework, the underlying funds would still calculate their NAVs as of 4:00 p.m. and transmit those NAVs to us some time after 4:00 p.m. Only then could we begin the process of calculating AUVs, processing unit transactions, and transmitting orders to the underlying funds, same as today. In other words, transmitting orders to funds is our *last* step in the process; we cannot make it the *first step*. Regardless of the cut-off time (2:00 p.m., 12:00 a.m., 9:01 a.m., etc.), our pricing and processing cannot start until we have NAVs from the underlying funds for the current business day, and we still would not have those NAVs until after 4:00 p.m. Thus, even if we imposed an early cut-off, we would not be able to transmit fund orders until after 4:00 p.m., we would still lose same-day pricing, and the defective swing pricing and breakage problems under the Proposal would still exist. Indeed, the only thing that would change is that many of our customers—especially those on the west coast[22]—would lose same-day pricing due to an arbitrary cut-off. In short, early cut-offs would have no discernable benefit and would do harm to our customers, so there is no clear reason why we would use them at all.

Also of note, even if we wanted to impose early cut-offs—which, again, there is no clear reason to do—an early cut-off would violate the terms of our in-force contracts.[23] As illustrated in Section I.c., "Contractual Provisions and Prospectus Disclosures Related to Our Separate Account Operations," our contracts give contract owners the right to receive same-day pricing on any transaction orders that we receive prior to the close of the NYSE (normally 4 p.m.) We are contractually prohibited from imposing an early cut-off on our customers. Furthermore, the prospectus disclosures that our customers relied upon guarantees them same-day pricing on orders that we receive prior to 4 p.m. As such, our customers are entitled to and reasonably expect a 4 p.m. cut-off, and we have every intent to continue meeting their rights and expectations.

On this point, we lastly wish to express our strong support for the views in the ACLI/CAI Joint Letter about why widespread early cut-offs would be bad public policy for American investors. The implementation of widespread early cut-offs would be entirely impractical, unfathomably costly, discriminative, and anticompetitive.

c. The Proposal will do Severe Harm to our Customers and our Life Companies

In this section, we reemphasize and further explain the severe harms that would come to our customers and our life insurance companies should the SEC adopt the proposed swing pricing-hard close framework. We implore the SEC to carefully consider and weigh these harms against any perceived benefits. We believe the harms vastly outweigh any such benefits, and so we believe that the SEC should preserve the current regulatory framework for variable products. The SEC should not do away with a longstanding and trusted framework for an anti-dilution tool that our customers did not ask for, will not understand, and will ultimately make it harder for them to secure their financial future.

[22] For example, as practical matter, customers in Hawaii would likely stand to lose same day pricing entirely.

[23] For our registered separate accounts, an early cut-off would also be in violation of Rule 22c-1 in its current form or as proposed, as the rule does not permit registered investment companies to impose early cut-offs.

i. Defective Swing Pricing will Harm our Customers and Variable Product Investing

Defective swing pricing will pass transaction costs onto the wrong customers and fail to remove first-mover advantage. As further discussed in Section II.b.i of this letter, if the SEC were to adopt swing pricing-hard close as proposed, contract owners who transact "today" would always end up bearing the transaction costs generated by the contract owners who transacted "yesterday." In that regard, in the context of variable products, swing pricing would entirely fail to "pass on costs stemming from shareholder purchase or redemption activity to shareholders engaged in that activity" as the SEC envisions.

Defective swing pricing would directly harm our customers by impacting the value of their investments. As the direction and degree of unit flows change every day, underlying funds' swing pricing would always be one day behind, producing flawed NAVs every business day. The flawed NAVs would get passed through to contract owners, impacting their daily account values, benefit values, and contract transactions. While the precise day-to-day impact of defective swing pricing would vary, it would inevitably cause many of our customers to lose money.

Defective swing pricing would also indirectly harm our customers and variable product investing by undermining the investor experience. Customers on the wrong end of defective swing pricing will be completely flummoxed to learn that swing pricing has cost them money for no logical or justifiable reason. The confusion will inevitably beget dissatisfaction and distrust with the regulatory framework, and investors will come to avoid variable products for that reason. We believe that variable products offer real retirement and life insurance solutions to Americans, but investors will find elsewhere to put their money if they distrust the regulatory framework.

Defective swing pricing alone should be fatal to the Proposal, at least as it relates to variable products. We do not see how the SEC could justifiably adopt a swing pricing framework that would produce results that are antithetical to the objectives of swing pricing and cause harm to investors and variable product investing.

ii. Separate Account Breakage will Harm our Customers and our Life Companies

Breakage will result in systemic financial risk and legal risk for our separate accounts and life insurance companies and would inevitably harm our customers. As further discussed in Section II.b.ii of this letter, if the SEC were to adopt hard close, the loss of same-day pricing on our fund orders would result in significant and compounding asset-liability mismatches in our separate accounts. This breakage would occur within every subaccount of every separate account on every business day as the NAVs of the underlying funds fluctuate from day to day.

The scope and magnitude of the potential separate account breakage would be extreme and would place us in an impossible predicament. On one hand, if the breakage were to be borne by our separate accounts (the vehicles that support our customers' contracts), the separate accounts may not be able to support their account values and redemption obligations, which would raise significant contractual, state law, and federal law risks/questions. On the other hand, if the breakage were to be borne by our life insurance companies, there would likewise be significant financial and legal risks/questions. Neither is an acceptable result.

In no event should the burdens associated with separate account breakage fall upon insurance companies. Our life companies unequivocally should not bear the massive and indeterminable breakage that would be created by the Proposal. This is for several reasons:

- Our products are not priced to account for breakage risk, meaning the contractual fees and charges to which we are bound in our policies do not contemplate any breakage risk, let alone extreme breakage risk. After all, variable products are "securities" precisely because they are designed to shift all investment risk from the insurer to the investor.[24]
- The potential future breakage would represent an indeterminable liability for our life companies – the companies that our customers trust and rely upon for financial security.
- Breakage would expose us to regulatory risk and uncertainty. Substantial and ongoing general account support for variable product separate accounts could be seen as in violation of state and federal laws that contemplate the existence of insulated separate accounts that can support their own financial obligations. In addition, general account support for separate accounts used in connection with retirement plans could be seen as raising issues under the Employee Retirement Income Security Act of 1974 (ERISA). For a more fulsome description of these legal considerations, we reference the SEC to the Joint ACLI/CAI Letter.
- It is reasonable to presume that the Delaware Department of Insurance, the New York Department of Financial Services, and the Massachusetts Division of Insurance, the domiciliary state insurance regulators of BLIC, BLNY, and NELICO, respectively, as well as their other state insurance regulators, would not tolerate the breakage risk and would look unfavorably upon the Proposal for that reason. These domiciliary state regulators establish statutory capital reserve and solvency standards for our life companies. They will be alarmed by the extreme breakage risk that could stand to disrupt separate account operations, burden life companies' general accounts, and/or harm life insurance customers. They may require that actions be taken to reduce or mitigate the financial risks associated with breakage.

In any event, however, it would be the investors who suffer. If the separate accounts bear the breakage, investors may not realize the benefits of their contracts. If the general accounts bear the breakage, then in the face of substantial financial and legal risks arising from daily separate account breakage, insurers would have no choice but to explore all possible avenues for mitigating or eliminating that risk, either at our their own behest or the behest of state insurance regulators. For example, among the avenues that would need to be explored:

- For existing contracts, increasing fees and charges on in-force contracts to the maximums permitted by the contractual provisions and prospectus disclosures;

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[24] Variable products are securities, and are not eligible for the Section 3(a)(8) exclusion from the 1933 Act for annuity or life insurance products, precisely because they shift investment risk from the insurer to the contract owner. *See* SEC v. Variable Annuity Life Ins. Co. of Am., 359 U.S. 65 (1959).

- For existing contracts, limiting or refusing new premiums and transfers on in-force contracts to the extent permitted by the contractual provisions and prospectus disclosures;
- For new contracts, setting substantially higher current and maximum charges;
- For new contracts, potentially adding some form of breakage charge or account value true-up mechanism that passes through breakage to contract owners; and
- Slowing or entirely stopping sales of new variable products, impeding product innovation and making fewer insurance solutions available to investors.

None of these options are choices that Brighthouse would make lightly, as they would all negatively impact our customers and the community we aim to serve. We believe that Americans are best served by an affordable and competitive variable product market. Yet, if massive breakage risk were to fall upon insurers, the Proposal would inevitably result in more expensive products and less choice. This is not the future we want for our customers and other Americans who look to annuities and life insurance for financial solutions.

III. Conclusion: The SEC Must Preserve the Current Regulatory Framework for the Variable Product Sector, including Insurance Companies, Separate Accounts, and Underlying Funds

For the reasons discussed throughout this letter, the proposed swing pricing-hard close framework as it relates to variable products and underlying funds is unnecessary, unworkable, and severely harmful for both insurers and consumers. The proposed framework is unnecessary as there is no compelling evidence that a dilution, liquidity, or late trading problem exists within the variable product sector. The proposed framework is unworkable because it will unavoidably result in defective swing pricing and extreme separate account breakage. And the proposed framework is harmful as defective swing pricing would undermine variable product investing, and separate account breakage would create an untenable financial risk that would ultimately get passed onto investors.

In light of these fundamental flaws with the Proposal, we urge the SEC to abandon the proposed swing-pricing hard close framework. If the SEC is to adopt swing pricing-hard close in some form, to avoid extreme and unjustifiable harm to investors and life companies, it is imperative that the SEC adopt full exemptions for the variable product sector that preserve the current regulatory framework for insurance companies, separate accounts, and underlying funds. Insurance companies and their separate accounts must not be subject to hard close, and underlying funds must not be subject to swing pricing.

Brighthouse stands ready to assist the SEC and SEC staff in fully considering the serious issues that we have raised in this letter. We are open to exploring potential alternatives to the swing pricing-hard close framework with the SEC and SEC staff, although in the absence of a proposed alternative or any substantive discussion in the Proposal about variable products, we unfortunately have no basis to offer comments on potential alternatives at this time.

We once again ask the SEC to carefully consider our comments, as well as the elemental differences between the variable product sector and the mutual fund sector, as it decides whether to proceed with the rulemaking. We firmly believe that the proposed framework is irreconcilable with variable products as NAV-dependent contracts, and that the potential harms far outweigh the potential benefits. We respectfully submit that, in the context of variable products, we see no other choice than for the SEC to abandon the swing pricing-hard close framework entirely or adopt exemptions that would preserve the current regulatory framework.

Respectfully submitted,

Brighthouse Financial, Inc.

By: ____________________

Allie Lin
Executive Vice President and General Counsel

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
Mr. William A. Birdthistle, Director, Division of Investment Management

APPENDIX

ADDITIONAL COMMENTS RELATED TO THE SWING PRICING AND LIQUIDITY RISK MANAGEMENT PROPOSALS

The main body of our comment letter focuses on our concerns with the proposed swing pricing-hard close framework as it relates to variable products and underlying funds. This appendix includes additional comments related to the Proposal, specifically comments on the proposed new rules on swing pricing and the proposed amended rules for liquidity risk management programs.

Additional Comments Related to Swing Pricing

- **Financial Statements for Separate Accounts.** In the 2016 release adopting optional swing pricing for mutual funds,[25] the SEC clarified how funds using swing pricing should prepare financial statements and performance reports. More specifically, as part of the release, the SEC clarified that funds utilizing swing pricing would (i) continue to prepare their statements of assets and liabilities using the "GAAP NAVs" rather than the "Swung NAVs"; (ii) prepare their statements of changes in net assets based on the Swung NAVs; (iii) prepare financial highlights using both GAAP NAVs and Swung NAVs; and (iv) calculate total return within financial highlights and performance information based on the GAAP NAV.

  If the SEC adopts swing pricing as proposed, the SEC's adopting release should include guidance on how swing pricing by the underlying funds may impact the financial statements and performance reporting for variable contract separate accounts that have a two-tier structure. Separate account financial statements and performance reports generally do not include information about the underlying funds' NAVs, but the underlying funds' NAVs are reflected in the unit values for each subaccount. Assuming that the separate accounts would be purchasing and redeeming shares based on the underlying funds' Swung NAVs, all separate account financial statements and performance reports would be derived from Swung NAVs as opposed to GAAP NAVs. Given the 2016 guidance which designated the use of GAAP NAVs and Swung NAVs for different purposes, we believe the SEC should specifically address whether separate account financial statements and performance reports should be based solely on Swung NAVs and, if not, how such financial statements and performance reports should be prepared.

- **Dilution for Funds of Funds.** The Proposal acknowledges that an upper-tier fund in a fund of funds structure may not submit its purchase or redemption orders for lower-tier fund shares until after 4 p.m., and that under hard close, an upper-tier fund would have to submit such order before the lower-tier fund's designated pricing time in order to receive same-day pricing.[26]

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[25] *See* Investment Company Swing Pricing, Release No. IC-32316 (Oct. 13, 2016).

[26] *See* 87 FR 77172, p. 213 of the Proposal.

We are concerned about the dilutive impact that hard close could have for funds of funds, especially in master-feeder structures, and how the Proposal includes virtually no discussion about this issue. In a fund of fund structure, the upper-tier fund calculates its NAV using the lower-tier fund's NAV, and the upper-tier fund uses its NAV for transacting in the upper-tier fund's shares (*i.e.*, pricing purchase and redemption orders). To the extent that the upper-tier fund submits an order to the lower-tier fund, and that order is priced using a lower-tier fund NAV that differs from the lower-tier fund NAV that the upper-tier fund used for valuation, there could be dilutive impacts on the upper-tier fund's portfolio. Hard close would seem to exacerbate that dilution risk.

The SEC should consider the dilutive impacts that hard close could have on funds of funds. The SEC should also consider how any dilution risk created by hard close compares to the dilution risk that the SEC hopes to mitigate through swing pricing. Furthermore, should the SEC proceed to a final rulemaking, the adopting release should include specific discussion about the potential dilutive impacts on funds of funds and whether they are outweighed by the perceived benefits of swing pricing.

<u>Additional Comments on Liquidity Risk Management</u>

- **Treatment of Bank Loans and Floating Rate Loans as Illiquid Assets.** We oppose the SEC's proposal to remove the less liquid asset category and urge the SEC to reconsider. Alternatively, we ask that the SEC adopt a pragmatic standard or guidance that would provide a path for treating most bank loans and floating rate loans within the amended definition of "moderately liquid" investment, particularly if the related strategies are used by insurance-dedicated funds.

  As part of the SEC's proposed overhaul of liquidity risk management programs, the SEC proposes to remove the less liquid investment category and, in turn, treat all investments that were categorized as "less liquid" assets as "illiquid" assets. Currently, the less liquid category consists of investments that could be sold within seven calendar days but with sale reasonably expected to settle in more than seven days. The Proposal discusses how the removal of the less liquid category would primarily impact funds that hold bank loans, as bank loans are the most common type of investment in the less liquid category. While the Proposal does not specifically address floating rate loans, we note that like bank loans, floating rate loans are often categorized today as "less liquid."

  We do not believe that the Proposal should make it practically impossible to manage a responsible bank loan (or floating rate loan) strategy. As reflected in the Proposal, there is evidence that these strategies can be just as resilient with respect to liquidity as more traditional fixed income strategies,[27] and not all bank loan funds have exhibited the elevated dilution and liquidity risks that the SEC generally associates with bank loan strategies, including during the market events that occurred in March 2020. In addition, we believe that the SEC should consider the different liquidity pressures that may face retail funds versus insurance-dedicated mutual funds. As discussed in the main body of

[27] *See* 87 FR 77172, p. 252 of the Proposal.

our letter, variable product investors tend to have especially long time horizons. We believe that fact reduces liquidity and dilution pressures for underlying portfolio management strategies relative to similar retail fund strategies.

The SEC should not render responsible bank loan (and floating rate loan) strategies obsolete, as eliminating these strategies would be harmful to investors. Many investors have specifically chosen to invest in funds using these strategies, and these strategies play important roles in larger asset allocation strategies. We therefore ask the SEC to reconsider this aspect of the Proposal or adopt a more pragmatic approach to the liquidity categories that makes responsible bank loan (and floating rate loan) strategies possible for mutual funds generally or insurance-dedicated mutual funds specifically.

- **Monthly Form N-PORT Reporting.** We oppose the SEC's proposal to change the publication frequency of Form N-PORT reports from quarterly to monthly, as well as the proposed requirement to present complete portfolio holdings in accordance with Regulation S-X on Part F of Form N-PORT ten times per year rather than twice per year. The SEC is proposing these requirements because it believes that a monthly reporting regime will substantially increase the amount of information made available to investors on Form N-PORT.[28] However, a substantial increase in data comes with a corresponding increase in costs to be borne by shareholders. A monthly reporting regime will dramatically increase the costs associated with the preparation, review, and filing of Form N-PORT reports. Funds and their advisers will need to expand their vendor engagements, increase human resources, dedicate substantially more time to Form N-PORT reports, and develop new systems, processes, and procedures. All of these increased expenses will be passed along to shareholders.

  We encourage the SEC to closely scrutinize and consider the aggregate costs of this wide reaching rulemaking proposal, as the costs to be passed along to investors could far outweigh the dilution risk that the SEC seeks to address. In that regard, we urge the SEC to find ways to reduce overall costs as part of this rulemaking. We believe that a monthly Form N-PORT reporting regime—particularly the proposed requirement to file reports monthly and include complete portfolio holdings in Part F—to be an unnecessary cost for shareholders. Generally, we do not believe that variable product investors rely heavily on Form N-PORT to make investment decisions, and that quarterly Form N-PORT filings and current Part F portfolio holding disclosures are sufficient and meet the needs of investors. We do not believe that the benefit of a monthly reporting regime is commensurate with the additional cost of monthly reports.

[28] *See, e.g.,* 87 FR 77172, p. 227 of the Proposal.