

MEMORANDUM

TO: File No. S7-01-21

FROM: Angela Mokodean, Branch Chief, Division of Investment Management


RE: Teleconference with Representatives of Federated Hermes

DATE: July 7, 2021

On June 30, 2021, staff of the SEC participated in a teleconference with representatives of Federated Hermes. SEC staff on the call included—from the Division of Investment Management—Sarah ten Siethoff, Brian Johnson, Thoreau Bartmann, Viktoria Baklanova, Angela Mokodean, Adam Lovell, James Maclean, Penelope Saltzman, and Keri Riemer, and—from the Division of Economic and Risk Analysis—Diana Knyazeva. Federated Hermes representatives on the call included:

- Chris Donahue, President and CEO;
- Michael Granito, Chief Risk Officer;
- Peter Germain, EVP and Chief Legal Officer;
- Greg Dulski, General Counsel and Head of International Government Affairs;
- Deborah Cunningham, EVP and Chief Investment Officer of Global Liquidity Markets; and
- Karishma Page, Partner, K&L Gates.

The participants discussed, among other things, the Commission's request for comment titled "Request for Comment on Potential Money Market Fund Reform Measures in President's Working Group Report" (File No. S7-01-21) and the attached slide deck.



Federated Hermes, Inc.
*The Impact of a Global Pandemic on Money Market Funds and the
U.S. Short-Term Capital Markets.*

Presented to
The Securities and Exchange Commission

Presented by

- Peter Germain
- Debbie Cunningham
- Greg Dulski
- Michael Granito

June 2021

Federated Hermes, Inc.

The Impact of a Global Pandemic on Money Market Funds and the U.S. Short-Term Capital Markets.

I. Our Global Experience in the Short-Term Capital Markets: March/April 2020

Peter Germain, Chief Legal Officer

Debbie Cunningham, CFA, Global Liquidity Chief Investment Officer

II. Rule 2a-7 & The Short-Term Capital Markets: Amendments, Structural Review & Enhancements

Peter Germain, Chief Legal Officer

Michael Granito, Chief Risk Officer

III. A European Perspective

Greg Dulski, Head of International Government Affairs

IV. Conclusion: Follow the Data

Peter Germain, Chief Legal Officer

Federated Hermes, Inc.

Money Market Funds Play a Critical Role in the U.S. Short-Term Capital Markets

FEDERATED HERMES OFFERS LIQUIDITY MANAGEMENT SOLUTIONS TO ITS INVESTORS AROUND THE WORLD

US Institutional Prime FNAV MMFs
(2a-7)

US Government CNAV MMFs (2a-7)

US Municipal Security FNAV MMFs
(2a-7)

US State Government Liquidity Pools

US Private Liquidity Products

EU Low Volatility NAV Prime MMFs

EU Public Debt CNAV MMFs

UK Low Volatility NAV Prime MMFs

UK Short-Term VNAV Prime MMFs

Offshore MMFs

WHO WE ARE AND WHY OUR PERSPECTIVE MATTERS

Federated Hermes, Inc. (“Federated Hermes”) is uniquely positioned to provide a global perspective on the performance of money market funds (“MMFs”) and the interplay of MMFs on global markets and in particular the short-term capital markets. We manage over \$430 billion in money market assets, including \$230 billion in MMFs. We are not only one of the largest managers of U.S. Government Debt MMFs, we are also one of the largest users of REPO in the market, and we have been a leader in liquidity management for over 50 years.

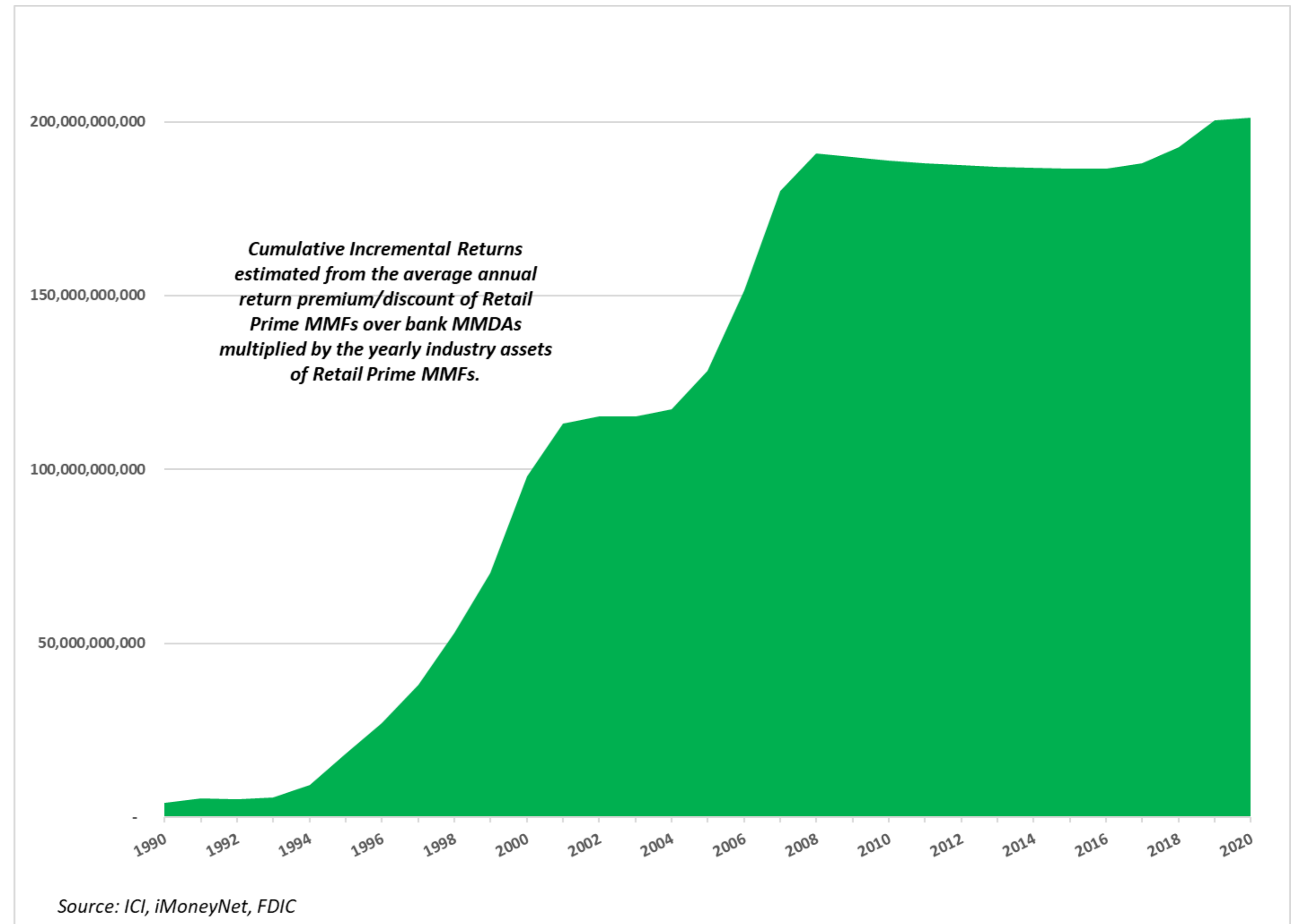
We have one of the longest tenured institutional MMFs in the United States, we were the first to establish liquidity products in Ireland in the 1990s, and we were the first to offer UK domiciled MMFs in the 2000s. We are not bank sponsored. Our growth and success stems directly from the stringent credit review process on issuers employed by our experienced team of MMF professionals. We know our customers and they know us, and we are committed to defending our stakeholders. Experience matters.

We understand and support a need for meaningful review of the liquidity crisis of March 2020 resulting from the unprecedented decisions of global leaders to shut down the world’s economy. We engage on a regular basis on the operations of the short-term capital markets with regulators and policy makers in the United States, the United Kingdom, and the European Union. We are committed to improving regulation in the short-term capital markets when it is supported by the data.

Federated Hermes, Inc.

Money Market Funds Benefit the Real Economy: Funding U.S. Issuers & Providing Market Returns for U.S. Investors

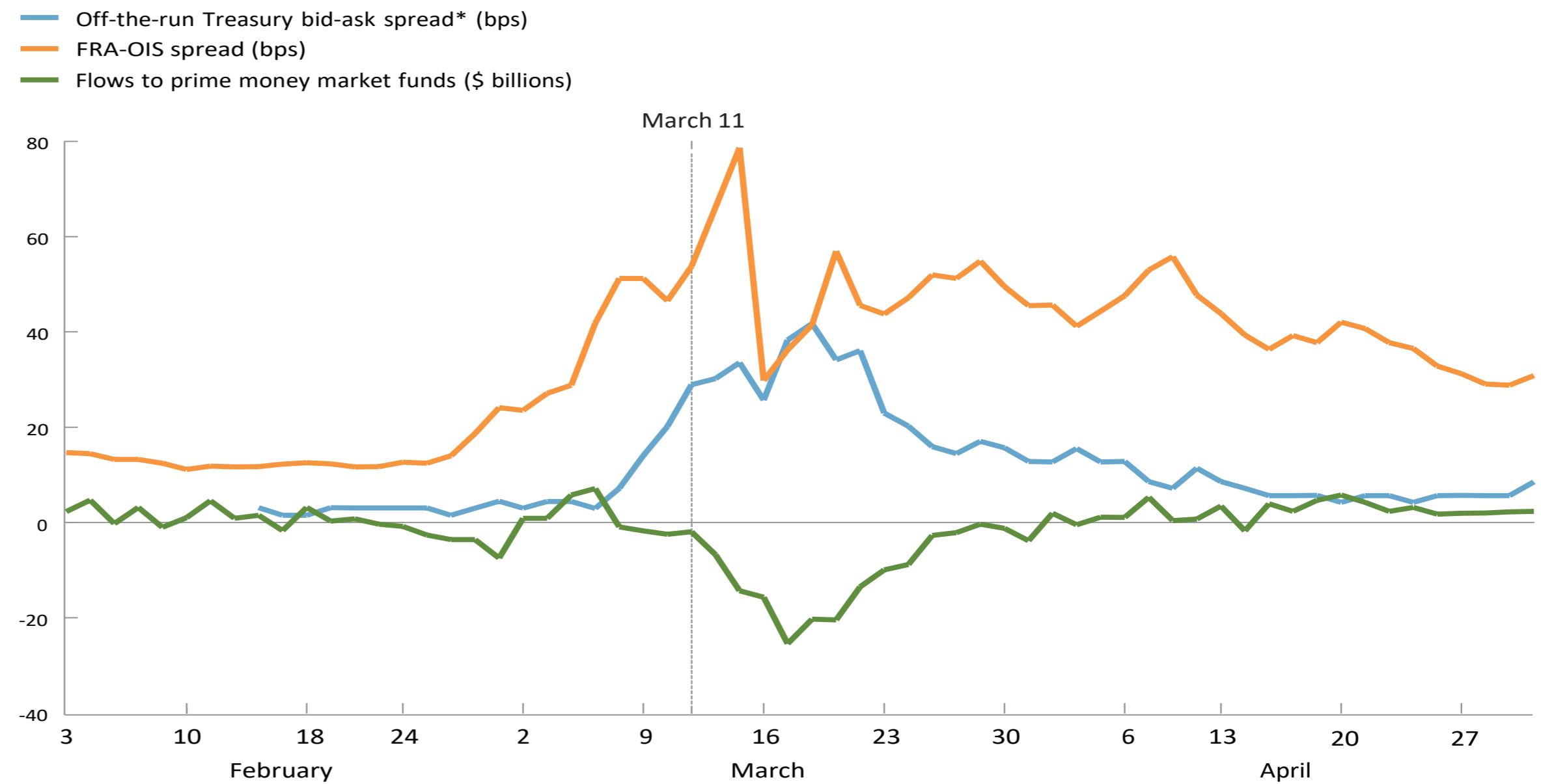
MMFs are one of the greatest investment product innovations enabled by SEC Exemptive Authority and Rulemaking, and they are incredibly important to our stakeholders. MMFs enhance capital formation and market efficiency for US issuers and provide market rates of return for liquidity cash management that was not previously available. MMFs have saved US issuers billions of dollars over other means of financing, and as depicted in this chart, since 1990, MMFs have provided over \$200B in estimated cumulative incremental returns to retail prime investors over bank MMDAs.



Federated Hermes, Inc.

MMFs were one of the last market participants to be impacted by the Liquidity Crisis

The FRA-OIS spread is viewed as a proxy for turmoil/risk in the interbank lending markets as it represents the spread between the rate at which central banks lend and the average rate at which banks lend to one another. The widening of FRA-OIS spreads was widely noted in early March 2020 (before outflows from MMF commenced) and was attributed to market concerns over the COVID-19 pandemic. As evidenced by the early March FRA-OIS spreads and the timeline below, MMFs neither caused nor enhanced the Liquidity Crisis. Playing a role in the markets and reacting to market stresses should not be confused with causing such stresses.



*The off-the-run Treasury spread is calculated using the bid and offer prices on the next most recently issued 10-year US Treasury note.
 Note: The off-the-run bid-ask spread on 10-year US Treasury note and the FRA-OIS spread are both shown on the left scale in basis points (bps). Flows to prime money market funds are also shown on the left scale, but in billions of dollars.
 Sources: Bloomberg (FRA-OIS spread), iMoneyNet (flows to prime money market funds), and ICI calculations of Bloomberg data (bid-ask spread on off-the-run 10-year US Treasury note)

December 31, 2019	January 21, 2020	February 20, 2020	March 2-6, 2020	March 9, 2020	March 11, 2020	March 12, 2020	March 13, 2020	March 15/16, 2020	March 17/18, 2020
<ul style="list-style-type: none"> China reports cluster of COVID-19 cases in Wuhan 	<ul style="list-style-type: none"> CDC Confirms First US Coronavirus Case 	<ul style="list-style-type: none"> Global Equity Markets Drop 	<ul style="list-style-type: none"> Turmoil Impacts U.S. Government Securities 	<ul style="list-style-type: none"> Dow Drops 2,000 Points, Period of Extreme Volatility in Bond Markets Begin & Further U.S. Government Securities Volatility – Impacting Credit Markets 	<ul style="list-style-type: none"> WHO Declares COVID-19 a Pandemic & US infections jump and restrictions begin 	<ul style="list-style-type: none"> Major Declines in Global Equity Markets & Redemptions in MMFs commenced 	<ul style="list-style-type: none"> COVID-19 is declared a National Emergency and bans Non-US Citizens Traveling From Europe 	<ul style="list-style-type: none"> Major Declines in Global Equity Markets & CP Market & Other High-Quality Short-Term Markets Impacted 	<ul style="list-style-type: none"> MMF Outflows Peak MMLF Established

Federated Hermes, Inc.

US Prime MMFs: In Context

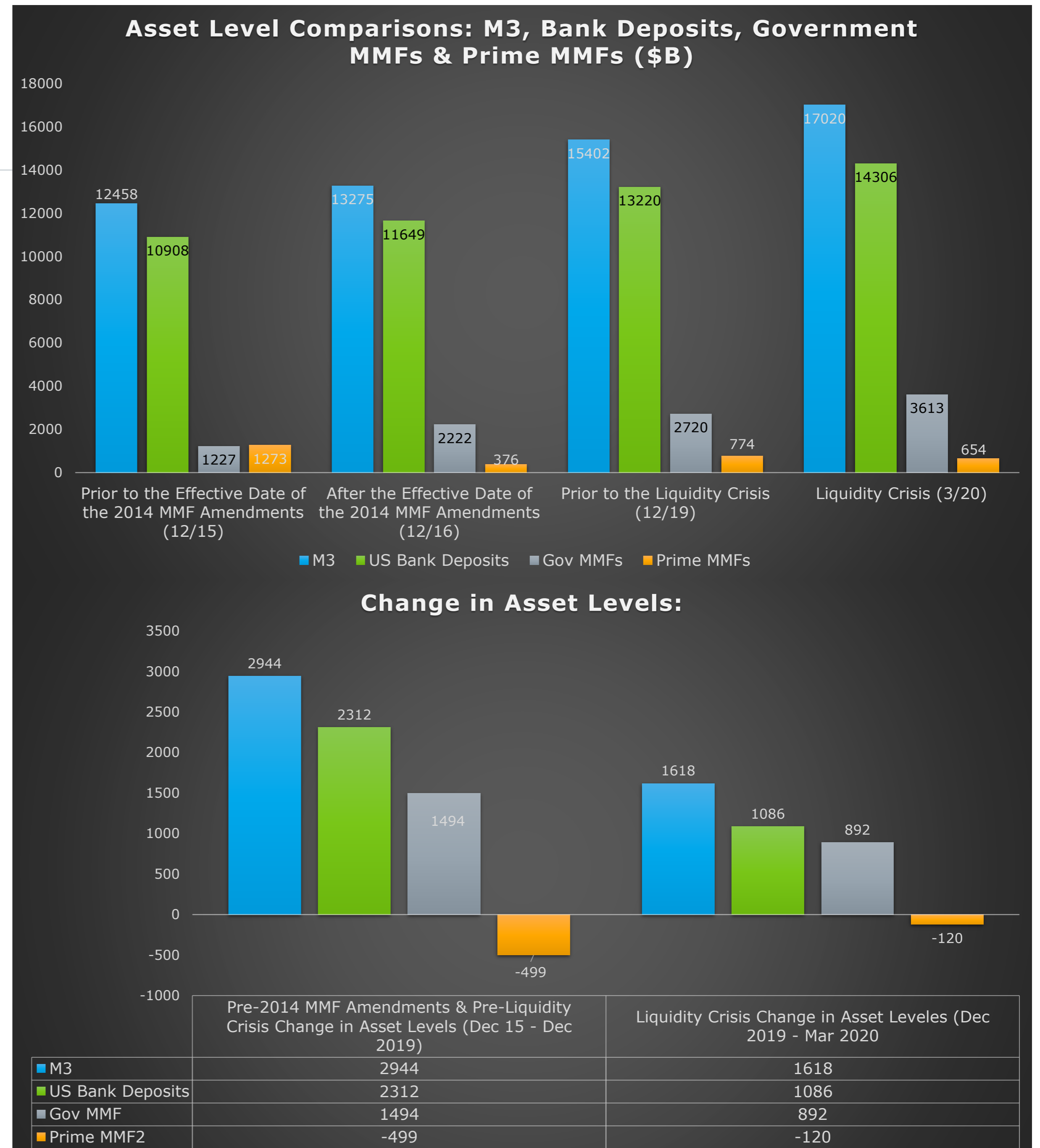
As a result of the 2014 Amendments, between 2015 and 2019 US Prime MMFs were reduced in size by over \$499 Billion, leading to a significant shift in funding, away from US businesses and state and local governments, with funds moving to Bank Deposits and US Government MMFS.

In 2016, US Prime MMF assets were 10.2% of M3, the institutional measure of U.S. money supply. At the beginning of 2020, before the onset of the pandemic, US Prime MMFs made up only 5% of the liquidity market.

In comparison, the reduction in size in the US Prime MMFs resulting from the Liquidity Crisis was only \$120 billion, while at the same time deposits into US Banks increased \$1.086 Trillion and assets in US Government Funds increased by a further \$892 billion (increases that clearly did not come from Prime MMFs).

Prime MMFs liquidation of CP in the Liquidity Crisis represented only 3% of the total CP outstanding.

The MMLF support utilized by Prime MMFs amounted to 1% of the total crisis support that the Fed provided to other money market participants.



Federated Hermes, Inc.

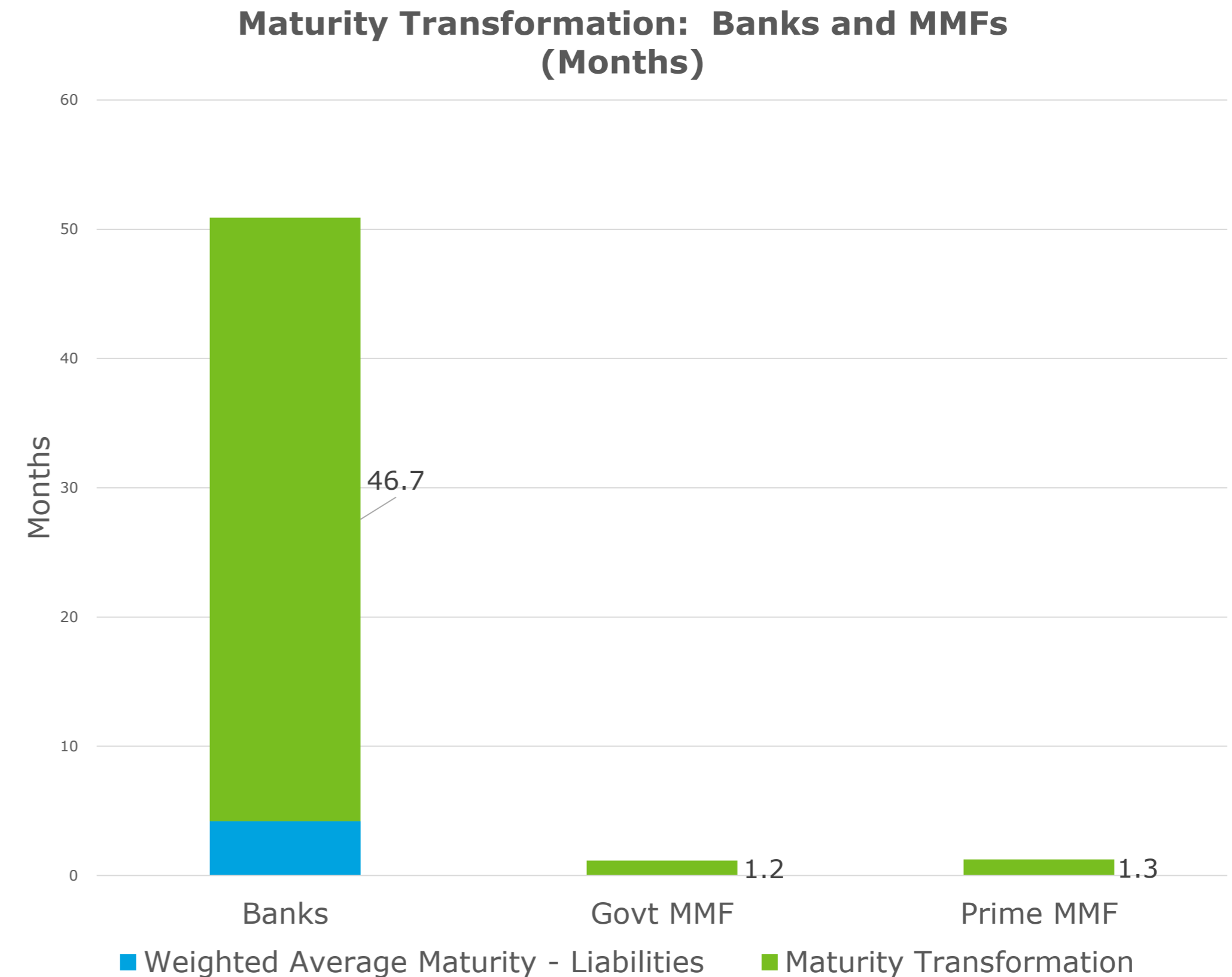
Maturity Transformation – Banks v MMFs

Maturity transformation is a red herring. MMFs have a maximum portfolio WAM and WAL of 60 and 120 days and can only purchase securities with a maximum maturity up to 397 days. As of June 14, 2021, the WAM for institutional Prime and Government MMF assets were 37 and 34 days.¹ In contrast, bank portfolio duration is opaque, over 4 years, and can only be estimated¹ and includes exposure to mortgages in excess of 30 years.

Financial institutions create value by investing in assets with maturities that are longer than their underlying liabilities. A premium is earned for investing in longer maturity assets, accompanied by interest rate risk.

Risk is a function of the gap between the average maturity of assets vs. liabilities. Studies published by SF Fed (2020)² and NYU Stern School (2017)³ approximate the WAM for bank assets at 4.25 years and for liabilities at 0.35 years, resulting in a gap of 3.9 years.

The so-called MMF put is really a right to redeem at a fund's net asset value.



Source: The Carfang Group

¹ Crane Data

² Banks, Maturity Transformation, and Monetary Policy 9/2020, Pascal Paul, Federal Reserve Bank of San Francisco

³ Banking on Deposits: Maturity Transformation without Interest Rate Risk, Itamar Drechsler, Alexi Savov, and Philipp Schnabl September 2017, New York University Stern School of Business

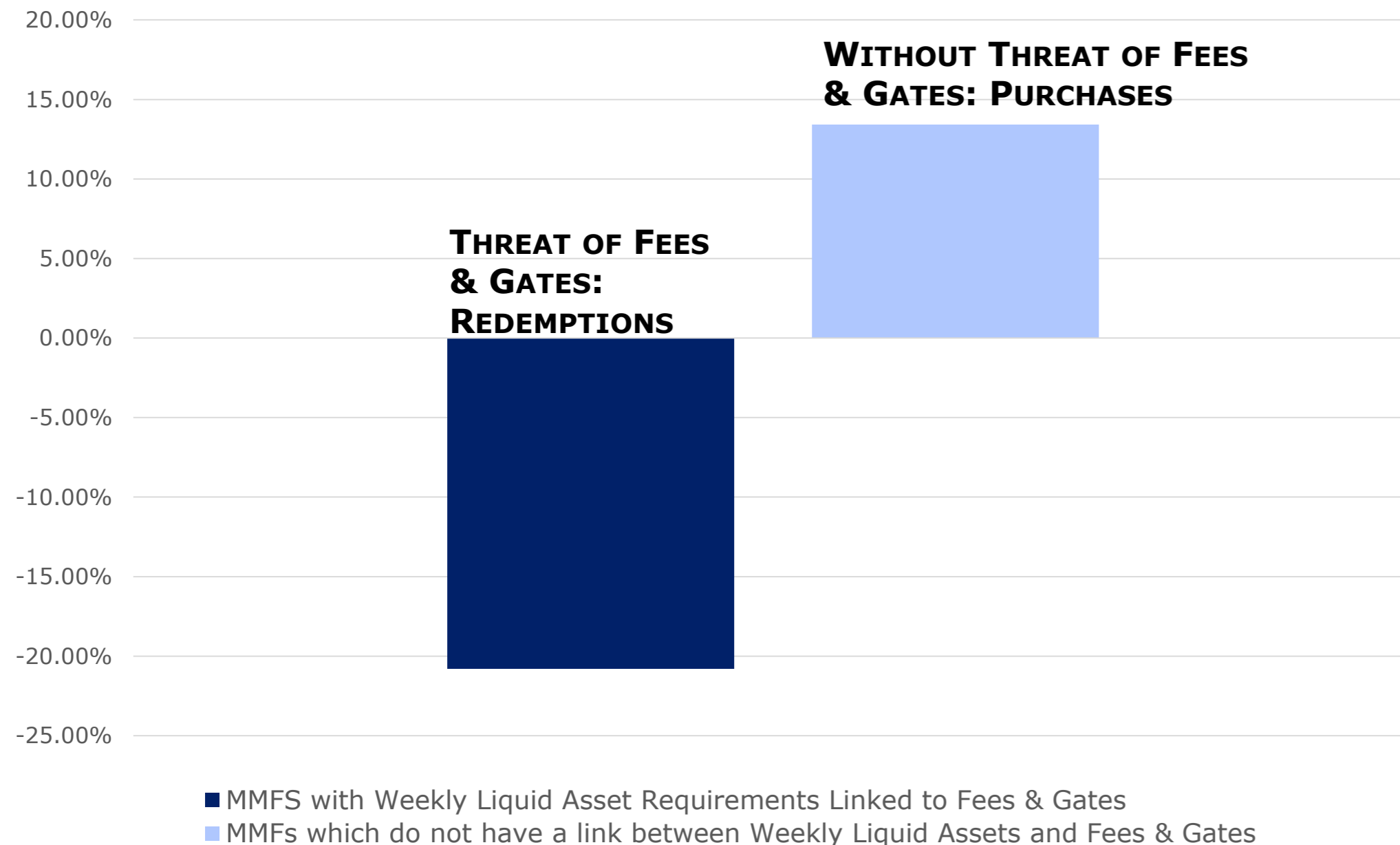
Federated Hermes, Inc.

Artificially High Redemptions were Caused by Linking Weekly Liquid Assets and the Potential Imposition of Fees & Gates

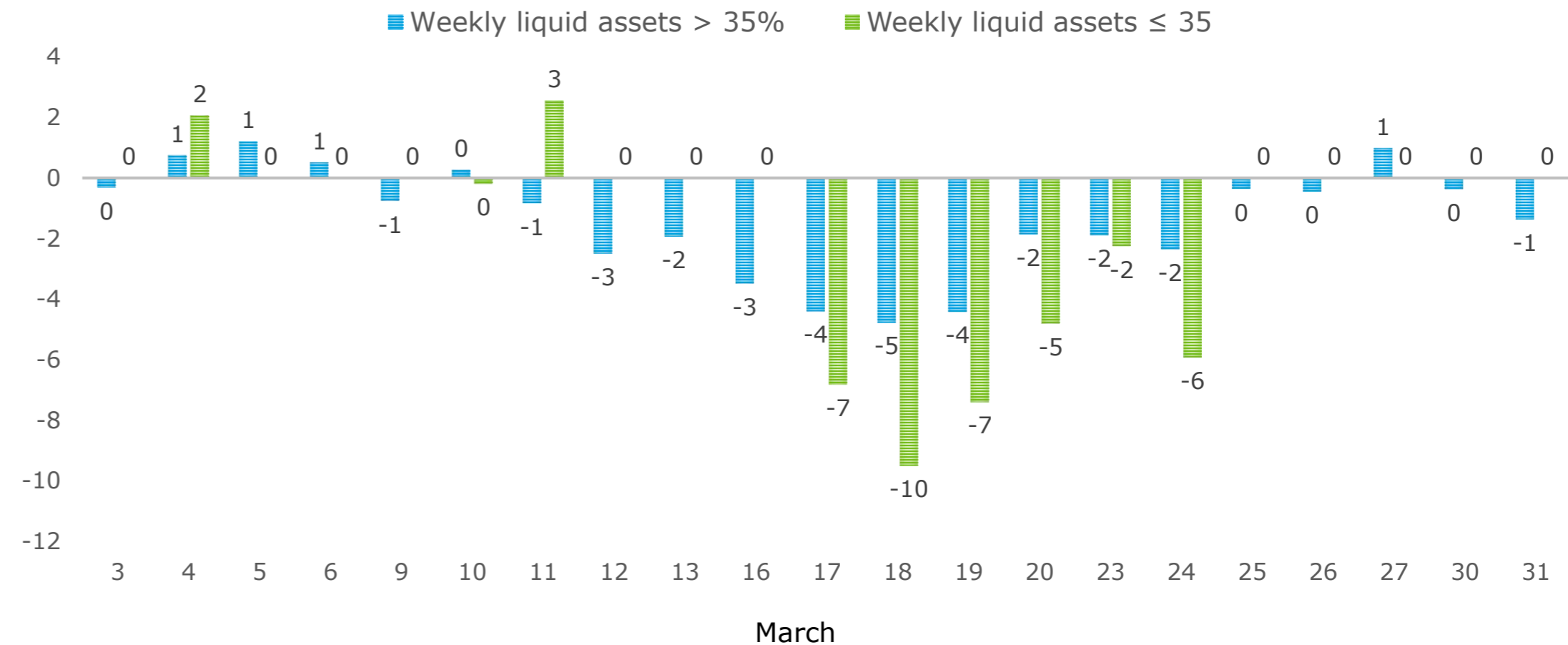
Our Experience: March 2020

Throughout the Liquidity Crisis, increases and decreases in our Prime MMF assets under management were strongly correlated to the requirement that a MMF consider the imposition of fees and gates if weekly liquid assets fell below 30%.

FEDERATED HERMES
PRIME MMF % ASSET CHANGES
FEBRUARY 28, 2020 – MARCH 31, 2020



As Weekly Liquid Assets Dropped Below 35%, Institutional Prime Money Market Funds Had Larger Outflows
Average percentage change in assets of institutional prime funds, daily, March 3-March 31, 2020



Industry Experience: March 2020

Our experience is consistent with that of the industry, where the correlation between increased redemptions and MMFs whose weekly liquid assets fell below 35% (merely approaching the 30% weekly liquid asset threshold) is reflected in the ICI chart above.

Federated Hermes, Inc.

The PWG Report: Missing the Mark

Our Experience: PWG Report

The PWG Report mainly presented previously analyzed, discussed and rejected reform proposals, many of which would lead to the elimination of MMFs as viable products. The report also failed to address the larger short-term capital market structural reforms which are necessary.

Prior to the 2014 Amendments, US MMFs were able to use their internal liquidity, as needed, without creating any artificial incentive for investors to redeem. The 2014 Amendments took what was once an internal 30% liquidity buffer and, by linking it with the potential imposition of liquidity fees and gates, converted it to a hard floor. *Only the consideration of delinking the 30% weekly liquid asset requirement from the potential imposition of fees and gates would have made a difference during the Liquidity Crisis.* This is the only reform measure clearly supported by the data.

Significant regulatory enhancements to MMFs were implemented after the Financial Crisis, including (i) new daily and weekly liquidity requirements, (ii) know your customer rules, (iii) tighter WAM and WAL limitations, and (iv) enhanced transparency and reporting requirements (among others). These enhancements, and the true narrative of the performance of the U.S. Short-Term Capital Markets as a whole, and the role of MMFs in those markets, has been largely ignored or misconstrued by those who would like to reclassify MMFs from investment products subject to SEC oversight, to bank-like guaranteed products which should be under the supervision of the Fed.

Before the Effective Date of the 2014 Reforms, Over Two-Thirds of Prime Funds Dipped Below 30 Percent Weekly Liquid Assets At Least Once

Number of funds with at least one week with weekly liquid assets below 30 percent

Time period	Prime		Tax-exempt	
	Number	Percent of total	Number	Percent of total
June 2, 2010 - October 11, 2016	162	68%	21	10%
October 19, 2016 - February 25, 2020	0	0%	0	0%

Number of weeks in which at least one fund had weekly liquid assets below 30 percent

Time period	Prime		Tax-exempt	
	Number	Percent of total	Number	Percent of total
June 2, 2010 - October 11, 2016	323	97%	60	18%
October 19, 2016 - February 25, 2020	0	0%	0	0%

Sources: ICI calculations of iMoneyNet and SEC form N-MFP data

Federated Hermes, Inc.

Money Market Fund and U.S. Short-Term Capital Market Recommendations

Our Experience Informs Our Recommendations

The U.S. Securities and Exchange Commission (“SEC”):

The SEC is likely to be pressured by both the Fed and FSOC to go further and adopt more reforms that are not supported by the data. The SEC should, however, stay true to its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. We recommend the following:

- amending Rule 2a-7 to remove the link between a fund’s 30% weekly liquid asset requirement and the potential imposition of a fee and gate, a recommendation supported by the data; and
- the SEC’s Division of Trading and Markets should undertake a thorough review of the U.S. Short-Term Capital Markets to identify additional means of improving liquidity during stressed market periods, in undertaking this review, the Division of Trading and Markets could play a leadership role in promoting improvements in the U.S. Short-Term Capital Markets – a central mandate of the SEC.

The Federal Reserve (“Fed”):

We also recommend that the Fed explore structural reforms that address the root causes of the pressures experienced in critical funding markets in March 2020, including:

- Improving Liquidity and Market-Making in Stressed Environments; and
- U.S. Short Term Market Structure Reforms.

Federated Hermes, Inc.

Avoiding a Rush to Judgment: Perspective & False Narratives

In considering our recommendations it is important to reject false narratives and avoid a rush to judgment. Consider the following:

- One of the Fed's primary roles is to provide liquidity in a crisis, particularly a government-induced crisis that caused unprecedented market shocks.
- The MMLF was not a bail-out. It was necessary action, consistent with the Dodd-Frank Act, to restore liquidity in the markets.
- The MMLF was minuscule in comparison to other Fed action. The Fed's balance sheet expanded by over \$3 trillion during 2020 to accommodate the financing facilities (which totaled over \$2.3 trillion at their peak) and other actions taken by the Fed. The Cares Act and PPP programs (which were essentially grants to small business and targeted industries) totaled an additional \$1.2 trillion. In contrast, the MMLF was the second smallest of the 2020 Federal Reserve financing facilities (\$53 billion at its peak) and the CPFF was even smaller, and both were quickly paid off in full (with interest) at no loss to US taxpayers.
- MMFs are investment products, not insured deposits –they are in fact 100% capitalized.
- Only in last few years have banks had any rules and measures regarding required liquidity, while MMFs are required to maintain at least 10% daily liquid assets and 30% weekly liquid assets, plus additional liquid assets based on knowledge of investor time horizons.
- The only structural vulnerability in MMFs today (the linkage of the 30% weekly liquid asset requirement and fees/gates) was created by the 2014 MMF Amendments.

Federated Hermes, Inc.

Amending Rule 2a-7

Assets in prime institutional MMFs declined dramatically after the 2014 reforms. Shareholders were concerned that if weekly liquid assets fell below 30% that fund boards would consider the imposition of a liquidity fee or redemption gate. As a practical matter, for assets that remained in prime MMFs, the 30% weekly liquid asset test became a trigger that instigated redemptions, and what was supposed to be a liquidity buffer became a hard floor. The Fed predicted that the 30% weekly liquidity asset test would lead to artificially high redemptions – and it did.

- Although funds generally held weekly liquid assets well in excess of 30% of AUM, such liquidity could not be used to meet the artificially high redemptions, or even greater redemptions would have ensued. The liquidity buffer thus became a hard floor.
- Total redemptions from prime institutional funds were approximately \$100 billion (or 16.4% of prime institutional funds assets)¹. These funds only used \$53 billion of the MMLF – clearly indicating that there was adequate liquidity to meet redemptions in March 2020, if weekly liquid assets could have been used. This poses the question. How low would the redemptions have been without the improper linkage of the 30% weekly liquid asset requirement with the potential imposition of fees and gates?

The only reform necessary for prime institutional and tax-exempt MMFs is to remove the linkage of the 30% weekly liquid asset test. Fund boards should have the ability and obligation to apply a fee or gate when it is in the best interest of shareholders.

¹. Institutional Prime assets as of 2/29/20 were more than \$608B. Source: Crane Data 6/10/21

Federated Hermes, Inc.

Recommended Fed Actions to Improve Liquidity and Market-Making in Stressed Environments

Following the 2008 Financial Crisis, the Fed introduced a broad array of capital, leverage and liquidity constraints on banks that have curtailed their ability to fulfill market-making objectives in stressed conditions, *impairing liquidity when it is most needed*.

- In future stressed market conditions, such as March 2020, the Fed should make a timely designation of a “Liquidity Event” (as defined in the DFA Section 1105). Such action should:
 - Encourage banks to make use of the discount window to acquire high-quality short-term paper (“HQST”) to generally support the U.S. Short-Term Capital Markets;
 - Temporarily allow any discount window eligible paper in high quality liquid assets (“HQLA”); and
 - Temporarily relax the Supplementary Leverage Ratio (“SLR”) requirement to allow HQST paper and US Treasuries to be excluded from the SLR denominator.
- The March 15, 2020 modifications to the conditions to access the discount window should be permanent.
- A thorough review of regulations adopted post-crisis which negatively impact market-making should be undertaken.

These steps will support funding markets generally and should limit the need for ad hoc emergency lending facilities.

Federated Hermes, Inc.

Reforms to the U.S. Short-Term Capital Market Structure

The commercial paper market is unnecessarily fragmented, with non-financial CP trading on electronic platforms, while Bank CP is generally limited to market-making by the issuing bank.

- Regulators should convene a working group of private market stakeholders to arrive at a model that provides greater transparency and liquidity in periods of market stress. This could include:
 - Expansion and coordination of electronic trading platforms such as BOOM and Tradeweb
 - Central repository of credit information on all issuers for participants to review and use
 - Allowing for buyers and sellers to directly interact, not just through brokered transactions
- The Fed should encourage banks to make markets in all bank CP, not just their own issues.
- A platform (like REPO) that allows investors, issuers and dealers to view bids and offers of all market participants would improve the functioning and liquidity in the Short-Term Capital Markets, particularly in stressed conditions.

The SEC's Division of Trading and Markets could play a leadership role in promoting improvements in the U.S. Short-Term Capital Markets— a central mandate of the SEC.

Federated Hermes, Inc.

Balancing the SEC's Capital Market Mandate with the Fed's Focus on Financial Stability

The SEC describes its commitment to its mission in the “What We Do” section of its website, highlighting that “[f]or more than 85 years since our founding at the height of the Great Depression, we have stayed true to our mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.”

Since its inception in 1913, the Fed's ultimate mission is lender of last resort to quickly supply liquidity to markets and institutions in order to avert panics. Yet it is only now addressing the fact that it must act promptly in crisis conditions. As in 2013, the SEC will be pressured to adopt a financial stability mandate that would ultimately come at the expense of its statutory mandate of investor protection, efficiency and capital formation.

- The SEC should remain true to its mission, which has established the foundation of financial stability in the U.S. capital markets.
- Liquidity is the intersection of the SEC's mandate and financial stability. The SEC, working with the Fed, should focus greater attention on regulations that can enhance liquidity in Short-Term Capital Markets in crisis periods.
- The SEC's Division of Trading and Markets should undertake a thorough review of the U.S. Short-Term Capital Markets to identify additional means of improving liquidity during stressed market periods.

The SEC should not compromise its own mission of investor protection, capital formation and market efficiency to accommodate the Fed's unrealistic goal of avoiding having to provide market liquidity in another crisis.

Federated Hermes, Inc.

The PWG Report and International Work-Streams: US and EU MMFs are NOT a Like for Like Comparison

ESMA, IOSCO and the FSB have centered their review of short-term capital markets and MMFs on the reform options identified in the PWG Report. However, the US and EU Short-Term Capital Markets and MMFs are very different, and one needs to understand the differences to put into context certain European MMF positions.

European Prime MMFs, regardless of their structure, experienced redemption pressure. The experience of Prime Low-Volatility MMFs in Europe, was like that of Floating NAV MMFs in the US, as redemptions were artificially high because of the linkage of the 30% weekly asset requirement and the potential imposition of fees and gates.

The same explanation does not hold true for European Floating NAV MMFs. Unlike US Floating NAV MMFs, European Floating NAV MMFs are not subject to fees and gates; however their redemption pressure can be attributed to other provisions in the EU MMF regulations, specifically, European Floating NAV MMFs:

- Are only required to hold 7.5% daily and 15% weekly liquid assets (half of what is required for US Floating NAV MMFs); and
- Are permitted to self-designate any security in their portfolio as being liquid and thus eligible for inclusion in their WLA.

Retaining these light touch requirements on Floating NAV MMFs impacts comments provided by the EU Floating NAV industry. It is also important to note that in the European Union, Member State Regulators retain discretion in their supervision of EU MMFs, which also leads to differing views on various options identified in the PWG Report.

Examples of Potential Divergence: Swing Pricing and Liquidity Fees as Macroprudential Tools

Examples of Member State Discretion: Diversification Requirements

Federated Hermes, Inc.

Conclusion: Follow the Data

Following the data is a theme that we believe is critical to ensuring that a proper regulatory review is undertaken. There should be no rush to judgment, no acceptance of false narratives, and no deference to regulators who should not be supervising investment products and usurping the authority of the SEC.

The events of March 2020 have confirmed the resilience of U.S. MMFs and the data does not support a broad call to action by the SEC. The data also confirms that there is no “structural vulnerability” in MMFs, except as noted below. The Federal and State government decisions to abruptly shut down our economy, in reaction to a global pandemic, is simply not something markets were designed to, nor should be expected to, absorb, without some level of Fed intervention to stabilize markets.

Work needs to be done to better understand how the U.S. Short-Term Capital Markets can be improved.

Significant reform enhancements were adopted post-Financial Crisis, at least one of which negatively impacted market liquidity in the pandemic, and that was the linkage of WLA to Fees/Gates and should be straight-forward to resolve. This is supported by the data.

We very much appreciate your time, and direct you to our two responses to the PWG Report which can be found by clicking on the following links:

<https://www.sec.gov/comments/s7-01-21/s70121-8662821-235311.pdf>

<https://www.sec.gov/comments/s7-01-21/s70121-8861709-240107.pdf>

Federated Hermes, Inc.

Appendix: Understanding the True Narrative of MMFs and Banks to US Taxpayers

Support Provided to MMFs v. Banks Since 1971 and MMF Incidents v. Bank Failures

Since the first MMFs were offered in the US in the early 1970s, only two have “broken a buck.” In one case shareholders recovered 96 cents on the dollar and in the other they recovered over 99 cents on the dollar, and US taxpayers bore none of the loss. By comparison, there have been more than 3600 bank failures since 1971 at a cost to the Federal government of over \$180 billion. Since 2010, when the SEC’s 2010 MMF rule amendments were adopted, 371 banks have failed at a cost to the U.S. government of over \$28 billion. Source: FDIC.

Fed Profited from Various MMF Facilities

Rather than providing a bailout, the Fed and U.S. Treasury made significant profits on both the 2008 and 2020 CP and MMF financing facilities, as documented for the annual reports of the Federal Reserve System for the years 2008 and 2020. In 2020, the Fed earned \$43 million in net profits on the CPFF, an additional \$180 million in interest and \$130 million in financing facilities fees on the MMLF. See notes to Combined Financial Statements for Federal Reserve Banks for the year 2020, at p 22; Federal Reserve, CPP Funding Facility II LLC, Financial Statements for the year 2020 at p 4. The Fed earned \$543 million on its 2008 AMLF program. The U.S. Treasury received \$1.2 billion in premiums for its 2008 MMF share guarantee program and paid no claims.