Federated Hermes

Federated Hermes, Inc.
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September 13, 2021

U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Re: Comment Letter of Federated Hermes on President's Working Group Report on Money Market Mutual Funds ("MMFs") (SEC File No. S7-01-21)

Dear Ladies and Gentlemen:

INTRODUCTION

We are writing on behalf of Federated Hermes, Inc. and its subsidiaries ("Federated Hermes"), to provide additional comments in response to the Report of the President's Working Group on Financial Markets, Overview of Recent Events and Potential Reform Options Report on Money Market Funds (the "PWG MMF Report") which was issued in December 2020. Federated Hermes has also previously provided two detailed comment letters responding to the specific policy options identified in the PWG MMF Report (the "Federated Hermes Comment Letters")[1] and each are incorporated and restated herein by reference.

In this comment letter, Federated Hermes elaborates on previously discussed regulatory reforms and provides further regulatory reforms for your consideration relating to (i) the operation of liquidity fees and gates after the linkage between liquidity fees and potential imposition of fees and gates is removed, (ii) specific commentary on swing pricing, and (iii) recommendations on enhancing MMFs' ability to know their customers, via application of Rule 22c-2(a)(2) under the Investment Company Act of 1940 (as amended) (hereinafter the "Act ") to MMFs. Federated Hermes believes that the combination of delinking the potential imposition of fees and gates with a MMF's weekly liquid asset requirements, adoption of Liquidity Fee Procedures, and enhancements to a MMF's ability to "Know Their Customer" via an amendment to Rule 22c-2, when combined with consideration of and improvements in the short-term markets generally, address the concerns identified in the PWG MMF Report without adversely impacting the viability of MMFs and their benefits to investors, issuers and capital formation.

[1] 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 has been in the investment management business since 1955 and has more than 45 years of experience managing MMFs. Federated Hermes has participated actively in the development and evolution of MMFs beginning in the 1970s and to this day. Federated Hermes currently manages over $400 billion in money market assets including registered domestic and offshore funds, private funds and state government-sponsored local government investment pools ("LGIPs") that invest in money market instruments. MMFs managed by Federated Hermes in the United States include U.S. government MMFs, municipal MMFs and prime MMFs. Federated Hermes also manages MMFs and other investment funds and accounts in Canada, Europe and Asia. In addition to MMFs, Federated Hermes manages accounts for institutional customers that invest in money market instruments. Federated Hermes also manages mutual funds and accounts that invest in equity securities, bonds and other longer-term fixed income instruments. The equity and fixed income funds and accounts managed by Federated Hermes cover a variety of styles, including ESG and impact funds.

I. CLARIFYING & ENHANCING TOOLS (LIQUIDITY FEES AND REDEMPTION GATES) AVAILABLE TO FUND BOARDS

In our previous comment letters we have advocated that once the link between a MMF's weekly liquid asset requirements and the potential imposition of liquidity fees and gates is removed, a MMF's board should be given the discretion, upon exercise of its fiduciary duty and in the best interests of shareholders, to implement liquidity fees and gates. A MMF's board is singularly best placed to decide on the appropriateness of a fee or gate based on all the information related to the fund, as each fund is subject to its own unique facts and circumstances.

After discussions earlier this year with the Commissioners of the SEC and its Staff, we further considered how the application of such tools would work moving forward after the linkage is removed and upon further consideration of the necessity and merits of applying fees and gates to MMFs, we note the following enhancements to our previous submissions.

A. LIQUIDITY FEES

Once the link between a MMF's daily and weekly liquid assets and the potential imposition of fees is removed, the MMF's board should retain the ability to impose a reasonable liquidity fee, in accordance with a revised provision relating to liquidity fees as set forth herein. We have attached as Appendix A to this letter a suggested form of amendment to Rule 2a-7 which provides for the implementation of temporary liquidity fees and sets forth key elements which should be incorporated into a MMFs new Liquidity Management Procedure for your consideration. Our proposed amendments include not only the identification of key elements for boards to consider as part of new Liquidity Management Procedures, but also a reporting requirement under which MMF boards would be required to report the basis for applying liquidity fees or imposing temporary suspensions. The requirement for MMFs and their boards to evaluate the need for liquidity fees and temporary suspensions not only as part of their exercise of their fiduciary duty and in the best interest of shareholders, but also in accordance with specific mandated procedures (which would be subject to SEC review) should insure that all MMF boards will have the information necessary to not only consider, but implement, liquidity fees as, when and if appropriate. Importantly, the consideration and implementation of such fees will not be tied to any specific metric or threshold associated with fund management or the markets and should, therefore, not create a new "signal" incentivising investors to redeem shares; rather, the amended rule would identify information which the board should evaluate in determining whether to impose such fees to prevent material dilution or other unfair results.

The retention of discretionary liquidity fees, subject to specific procedures, addresses the regulatory concern to direct the cost of liquidity in times of extreme market stress to redeeming shareholders, and does so in a manner that does not adversely impact the utility of MMFs since liquidity fees could be assessed consistent with same day settlement (see our discussion on swing pricing below).

B. REDEMPTION GATES

A Temporary Redemption Gate could prove to be a useful tool for MMF Boards in circumstances where the Board determines that the imposition of a Liquidity Fee would not be adequate. While such circumstances may be difficult to imagine, one need only look back to the Reserve Primary Fund situation where the timely imposition of a Redemption Gate might have afforded the board with an opportunity to evaluate other solutions to their predicament. It is also important to note that no Liquidity Fees or Redemption Gates were imposed by any MMFs during the crisis in March of 2020. Thus, the imposition of either is likely to be an extremely rare occurrence. It is also notable that no MMF made use of the ability under the Act to take up to seven days to meet redemptions as one large MMF did during the Financial crisis in 2008.[2] Although a number of MMFs did make use of the Money Market Mutual Fund Liquidity Facility and incurred expenses related thereto, we are unaware of any adverse impact to the funds or shareholders resulting from such participation.[3] Likewise, a Liquidity Fee, properly calibrated to ensure the redeeming shareholders bear the costs of liquidity in times of severe market stress, should not adversely impact the fund or remaining shareholders. A Temporary Redemption Gate, while highly unlikely to be used, would necessarily require a substantial level of shareholder communication as to the nature and anticipated duration of the redemption pause, and would likely be viewed as more disruptive to shareholders in a market crisis. It is, nonetheless, an additional, potentially useful, tool for MMF boards to consider in a future crisis.

II. SWING PRICING

Once the link between daily and weekly liquid assets and liquidity fees and gates is removed, if a board

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[2] See https://www.sec.gov/comments/s7-03-13/s70313-130.pdf for a thorough discussion of a successfully imposed temporary suspension of the Putnam Prime Money Market Fund.

[3] As the Federal Reserve set a rate of 1.25% for utilizing the MMLF, there was no adverse impact on MMFs because paper placed with the MMLF had higher yields and were able to be sold at a premium.

retains the ability to apply a liquidity fee (i) in its discretion, (ii) in the exercise of its fiduciary duty, (iii) in the best interests of shareholders, and (iv) in accordance with mandated Liquidity Fee Procedures (as noted above), then we believe swing pricing becomes entirely redundant since the liquidity fee charged is meant to assess redeeming shareholders a fee that approximates the costs of providing liquidity in stressed market conditions. An analysis of the potential application of swing pricing to MMFs should start by considering the following questions:

1. Is swing pricing necessary if a MMF's board has the ability to charge a liquidity fee?
2. Is swing pricing necessary to prevent dilution to shareholders?
3. Is swing pricing necessary to eliminate or mitigate so-called "first mover advantage"?
4. Would the potential application of swing pricing effectively serve as another regulatory induced incentive for investors to redeem earlier in times of severe market stress?
5. Would swing pricing effectively eliminate the utility of MMFs to investors, notably the key features of same day and intra-day settlement?

While swing pricing has been used in some open-end funds in Europe, it has not been applied to any MMFs. Moreover, while swing pricing has been permitted in the US, it has not been implemented for even non-MMF open-ended funds. Same day settlement, which is critical to investors in MMFs, would make the implementation of swing pricing even more challenging and would not provide enough time for price discovery within the timeframe of end of day NAV calculation for transaction purposes prior to the close of the Fed wire. Additionally, the timing problem is magnified further for MMFs that strike a NAV multiple times a day (to allow for same day and intra-day purchase and redemption of shares) as there would not be enough time to implement a swing factor between NAV cut-offs. Swing pricing is simply not a feasible option for MMFs. Alternatively, liquidity fees are already operationally feasible in MMFs and provide the same effect of directing costs to redeeming shareholders. ***There are no tangible benefits to employing swing pricing as a tool for MMFs that serve the PWG's overarching goals for reform.***

Investors simply will not invest in a MMF with swing pricing, as this would eliminate the fund's ability to provide intra-day and same-day settlement. As a result, the "dash for cash" or credit crisis would not be mitigated – but rather shifted to unregulated and less transparent vehicles or worse, uninsured bank deposits. Regulating MMFs out of existence via swing pricing is entirely unnecessary and would be incredibly harmful for our stakeholders (investors, issuers, and short-term markets).

1. Is swing pricing necessary if a MMF's board has the ability to implement a liquidity fee?

Swing pricing is not necessary for MMFs because they already have the ability to impose liquidity fees, which serve a similar purpose and are a more appropriate tool for MMFs. As previously concluded by the SEC, swing pricing is not appropriate for MMFs given the other liquidity management tools at their disposal. In 2016, the SEC amended Rule 22c-1 under the Investment Company Act to permit, but not require, open-ended mutual funds to implement swing pricing. The SEC intentionally excluded MMFs from using swing pricing, explaining that MMFs already have extensive tools at their disposal that could accomplish comparable goals to swing pricing, such as liquidity requirements that are more extensive than those imposed on other funds and the possibility of imposing liquidity fees on redemptions.[4] The SEC explained that "money market fund liquidity fees allocate at least some of the costs of providing liquidity to redeeming rather than non-transacting shareholders, and generate additional liquidity to meet redemption requests." The SEC concluded that the liquidity fee regime under Rule 2a-7 serves a similar purpose to swing pricing and "is a more appropriate tool for money market funds to manage the allocation of liquidity costs than swing pricing."

2. *Is swing pricing necessary to prevent dilution to shareholders?*

No, swing pricing is not required to prevent dilution to shareholders. MMFs are required to process all purchases and redemptions using forward pricing. By requiring all transactions to be processed with forward pricing, the impact of any cost to the fund to obtain liquidity is already reflected in the Fund's NAV. Moreover, if the intention is to create a disincentive for investors to redeem in times of severe market stress, the application of an operationally feasible liquidity fee would accomplish the goal.

3. *Is swing pricing necessary to eliminate or mitigate so-called "first mover advantage"?*

No, swing pricing is not necessary to eliminate any so-called "first mover advantage" in MMFs, because forward pricing, properly applied, negates the risk that someone can "game the system" to avoid a loss. Of course, if by "first mover advantage" we mean any investor who redeems to avoid a future loss, then nothing can be done to prevent an investor from correctly predicting a future market event, nor should we endeavour to do so. First, we do not believe that a first mover advantage exists today, or in the past, with respect to MMFs. For FNAV MMFs, shareholders can only redeem at the NAV next determined. Shadow NAV pricing on stable NAV retail funds also vitiates meaningful first mover advantage. Second, notwithstanding our position of the non-existence of first mover advantage, it was already addressed by the SEC in the MMF reforms adopted post Financial Crisis when institutional MMFs were required to operate with a floating NAV. Moreover, if one continues to believe a first mover advantage remains, then the requirement to impose a swing price would not only increase any potential advantage but, as noted below, could incentive investors to redeem early in times of market stress.

4. *Would the potential application of swing pricing effectively serve as another regulatory induced incentive for investors to redeem earlier in times of severe market stress?*

As observed during the Liquidity Crisis, the linkage of the potential liquidity fees and gates to a MMF's weekly liquid asset requirements served as a regulatory induced incentive for investors to redeem and led to artificially high levels of redemptions. Similarly, the potential imposition of mandated swing pricing could serve as the next regulatory induced incentive for investors to redeem.

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[4] See Investment Company Swing Pricing, SEC Release No. IC-32316 (October 13, 2016), available at www.sec.gov/rules/final/2016/33-10234.pdf, at 24-25. 32 Id. at 24-25.

5. ***Would swing pricing effectively eliminate the utility of MMFs to investors, notably the key features of same day and intra-day settlement?***

Swing pricing would eliminate important MMF features. Swing pricing would effectively eliminate a MMF's ability to strike a NAV multiple times per day and provide same-day (T+0) settlement. These are essential features which allow MMF shareholders to sell shares and receive the proceeds from their redemptions on the same day, often within hours. Specifically, these features are critical for corporations, government entities, not-for-profits, and other institutional investors to effectively and efficiently manage their day-to-day operating cash, meet payroll and other liabilities, and maintain appropriate levels of liquidity on a daily basis.

In its submission to the PWG, the ICI[5] provided an excellent summary of the operational processes currently involved in pricing and redeeming MMF shares, noting that:

> Rule 22c-1(a) under the Investment Company Act requires funds and dealers in fund shares to transact fund shares at the NAV next computed after receipt of an order to buy or redeem (forward pricing). In calculating a fund's NAV, the fund manager follows established, board-approved valuation policies and procedures. In practice, long-term funds, which typically settle T+1, commonly cut off orders, value all portfolio investments, and price their shares as of 4:00 pm (ET). Many MMFs (including institutional prime floating NAV money market funds), however, perform this process multiple times a day and offer T+0 settlement to help their institutional investors with their daily cash management needs. T+0 settlement requires a fund to compute its NAV, receive and process redemptions, and complete Fedwire instructions after the fund's closing time (typically 4:00 pm ET) but before the Federal Reserve's 6:45 pm ET Fedwire cut-off time. Before each NAV strike, the fund accountant (which can be the fund manager or a different service provider) transmits a file listing the fund's portfolio investments to a pricing vendor. The vendor inserts the current market price for each investment into the file and transmits it to the fund accountant. The fund accountant then applies a series of controls to validate the prices received. After researching and resolving any exceptions. The fund accountant uses the reviewed prices (and fair values, as necessary) to value the fund's investments and calculate its NAV. The NAV is then disseminated through a variety of methods to the fund's transfer agent, intermediary distribution partners, media outlets, and shareholders. Money market funds would face even more daunting challenges. Because receipt of shareholder flow information is fundamental to determining first whether the threshold has been crossed and then to swing the NAV on any given day, it is unlikely a money market fund could gather this information before the NAV calculation process and still have sufficient time to calculate, apply, and potentially correct the application of a swing pricing mechanism multiple times a day and/or still accommodate same day settlement and meet the Federal Reserve's current cut-off time to provide Fedwire instructions for the

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[5] https://www.sec.gov/comments/s7-01-21/s70121-8662926-235321.pdf

> transmittal of redemption proceeds to institutional investors. The process is further complicated and meaningfully delayed if intermediaries generate any of the funds' order volume and fund flow activity as the funds would need to depend on these intermediaries to deliver the information in a timely and reliable manner.[6]

Even a cursory review of the above, noting the number of steps involved, the complexity and importance of the pricing reviews, and the operational challenges associated with meeting intra-day and end of day liquidity needs, make it clear that any required use of swing pricing would effectively eliminate the utility of MMFs.

III. ENHANCING THE KNOW YOUR CUSTOMER REQUIREMENTS

In the US, Rule 22c-2(a)(2) under the Investment Company Act of 1940[7] does not apply to MMFs. A potential regulatory enhancement could include amending Rule 22c-2 to require MMFs to enter into agreements with intermediaries to provide shareholder information. This would equip MMFs even better to plan for sufficient portfolio liquidity to meet anticipated redemptions above and beyond the 10% daily and 30% weekly liquid asset minimums. Understanding the size and nature of underlying accounts would give portfolio managers useful insight in determining necessary levels of liquidity to maintain under various market conditions. Certain institutional shareholders, for example, may exhibit trading patterns over time which reflect cyclical cash flow patterns relating to receipt of revenue, payment of taxes and capital expenditures which would be helpful in anticipating liquidity needs. Inside an omnibus account, all of this activity is opaque to the portfolio manager. Providing sufficient transparency to allow better assessment of liquidity needs would enhance substantially liquidity management in institutional MMFs.

IV. CONCLUSION

We thank you again for the opportunity to provide further comments on the PWG MMF Report. We set forth in this letter enhancements to our previous submissions which reflect how the application of liquidity fees and gates could work after the improper linkage with a MMF's weekly liquid assets is removed. With these enhancements, Federated Hermes believes that the combination of (i) delinking the potential imposition of fees and gates with a MMF's weekly liquid asset requirements, (ii) adoption of Liquidity Fee Procedures, and (iii) enhancements to a MMF's ability to "Know Their Customer" via 22c-2 amendments, when combined with improvements in the short-term markets generally, addresses the

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[6] See also: For a discussion regarding how the industry distribution model and the use of intermediaries complicates the use of swing pricing, see Investment Company Institute, "Evaluating Swing Pricing: Operational Considerations," (November 2016) (2016 ICI Swing Pricing Paper), available at www.ici.org/pdf/ppr_16_evaluating_swing_pricing.pdf.

[7] 17 C.F.R. at § 270.22c-2. See: https://www.sec.gov/rules/final/1968/34-8429.pdf

concerns identified in the PWG MMF Report without adversely impacting the viability of MMFs and their benefits to investors, issuers and capital formation.

We look forward to an opportunity to discuss this important subject further with you and would be happy to respond to any questions you might have.

Sincerely,

/s/ Deborah Cunningham Deborah Cunningham, CFA Executive Vice President, Chief Investment Officer of Global Liquidity Markets and Senior Portfolio Manager	/s/ Peter Germain Peter Germain Chief Legal Officer Federated Hermes, Inc.

APPENDIX A: Discretionary Fee & Temporary Suspension Provision

Delete current Rule 2a-7(c)(2)(i)(A)(B) and replace with the following:

(i) *Discretionary liquidity fees and temporary suspension of redemptions.* The board of **directors** of the fund, including a majority of directors who are not interested directors of the fund, may impose a discretionary liquidity fee (in an amount not to exceed two percent of the value of shares redeemed) or suspend the right of redemption temporarily, subject to paragraphs (c)(2)(i)(A), (B), and (C) of this section if it determines that such action is in the best interest of the **fund** and fund shareholders and is necessary to prevent material dilution or other unfair results.

In determining whether to impose either a discretionary fee or a gate, the board of **directors** has a duty to request and the adviser has a duty to provide such information as it deems reasonably necessary to make its decision including, but not limited to:

(a) current and expected market conditions;
(b) current market-based net asset **value** per share calculation;
(c) capital stock activity (gross and net purchases and redemptions);
(d) review of shareholder information relative to expected purchases and redemptions ("Know Your Customer");
(e) **Daily** and **Weekly Liquid Asset** levels;
(f) information about current credit quality of portfolio holdings;
(g) credit spreads and liquidity conditions prevailing in relevant markets, including estimated transaction costs;
(h) results of recent **Stress Testing** required under this rule; and
(i) the availability and costs of alternative liquidity sources.

The **fund** shall adopt policies and procedures reasonably designed to comply with this section and to keep records of any determinations made hereunder for the period specified in paragraph (h)(1) of this section.

(A) Application and duration of discretionary liquidity fee. Once imposed, a liquidity fee must be applied to all shares and must remain in effect until the board of **directors**, including a majority of the directors who are not interested **persons** of the fund, determines that imposing the liquidity fee is no longer required to prevent material dilution or other unfair results and is no longer in the best interests of the **fund**.
Duration of Temporary Suspension.

(B) *Application and duration of temporary suspension of redemptions.* In the event the board of directors of a money market fund determines that the imposition of a Liquidity Fee would not prevent material dilution or other unfair results, or is otherwise not in the best interests of the fund and fund shareholders, the Board may impose a temporary suspension of redemptions in accordance with the provisions of this section. The temporary suspension of redemptions must apply to all shares and must remain in effect until the fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines that the temporary suspension of redemptions is no longer in the best interests of the fund. Provided, however, that the fund must restore the right of redemption on the beginning of the next business day following ten business days after suspending redemptions. The money market fund may not suspend the right of redemption pursuant to this section for more than ten business days in any rolling ninety calendar day period.

(C) *Reporting of actions taken pursuant to this subsection.* The board of directors of the fund shall file a report summarizing the basis for its decision to impose either a discretionary liquidity fee or a temporary suspension to the Security and Exchange Commission within 5 business days of making such decision.