Federated Hermes

Federated Hermes, Inc.
1001 Liberty Avenue
Pittsburgh, PA 15222-3779

April 11, 2022

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

Re: Comment Letter of Federated Hermes, Inc. on the U.S. Securities and Exchange Commission's Proposed Rules Regarding Money Market Funds (SEC File No. S7-22-21)

Dear Ladies and Gentlemen:

I. INTRODUCTION

This letter ("Federated Hermes Comment Letter I") presents the comments of Federated Hermes, Inc., and its subsidiaries ("Federated Hermes"), in response to the rules regarding money market funds ("MMFs") proposed by the Securities and Exchange Commission (the "Commission" or "SEC") on February 8, 2022 (the "Proposal").[1] We have also submitted a separate comment letter focused on the Proposal's swing pricing requirements.[2] We would also like to state, up-front, our endorsement of the comment letter submitted by the Investment Company Institute ("ICI") on the Proposal,[3] with only minor differences regarding (i) the application of liquidity fees, (ii) availability of discretionary gates, and (iii) increases to the required daily and weekly liquidity requirements. We fully support the ICI's opposition to swing pricing and their support of a reverse distribution mechanism ("RDM"), as the most appropriate means to manage MMFs in a negative rate environment. As the ICI so rightly points out, MMFs are critically important for (i) over 50 million retail investors, as well as corporations, municipalities, and other institutional investors, who rely on the $5 trillion MMF industry as a low cost, efficient, transparent, cash management investment vehicle that offers market-based rates of return, and (ii) governments (federal, state and local), businesses, and financial institutions who utilize MMFs as an important source of financing.

Federated Hermes has managed MMFs since their inception and remains a leader in the management and distribution of MMFs around the globe. We take our position as an industry leader very seriously, not only because of our history successfully managing MMFs for over 45 years, but because of the critical role MMFs have played for stakeholders, including shareholders, issuers, and those that benefit from the activities of both the public and private sector entities that access the short-term funding markets. We have worked tirelessly over the years to defend and support MMFs, one of the SEC's greatest innovations and

---

[1] SEC, Proposed Rule, Money Market Fund Reforms, 87 Fed. Reg. 7248 (Feb. 8, 2022) (although the Commission met to approve the issuance of the public notice on December 15, 2021, it was not published in the Federal Register until 2022, and we therefore refer to the notice accompanying the Proposal as the "2022 MMF Release" to distinguish it from prior SEC MMF releases, or simply as the "Release").

[2] *See* Comment Letter of Federated Hermes, Inc. on the U.S. Securities and Exchange Commission's Proposed Amendment to Rule 2a-7 Requiring the Use of Swing Pricing in Institutional Prime and Tax Exempt Money Market Funds (SEC File No. S7-22-21) (Apr. 11, 2022) ("Federated Hermes Comment Letter II").

[3] *See* Comment Letter of Investment Company Institute Re: Money Market Fund Reforms (Apr. 11, 2022).

one of the best products ever created, against repeated challenges by regulators who seek to control all aspects of the short-term funding markets. It is in this light that we provide our response to the Proposal, as failure to adopt a measured response to the unprecedented events of March 2020 will have unnecessary and catastrophic consequences for stakeholders, including the short-term funding markets, and the overall economy.

Federated Hermes appreciates the tremendous pressure being applied on the Commission with respect to MMFs. Central banks are once again singularly focused on eliminating the utility of MMFs and thereby regulating them out of existence. Former Federal Reserve ("Fed") Bank President Rosengren, a long-standing critic of MMFs, stated "my personal preference would be not to have prime money market funds."[4] Ignoring not only the lack of any data supporting assertions that MMFs played a role in the events of March 2020, but also the dramatic reduction in size of the prime MMF universe after the SEC's 2014 amendments to Rule 2a-7 (the "2014 Amendments"), central banks continue to push a false narrative as to the role MMFs have in short-term funding markets and, specifically, the impact MMFs had on the market turmoil experienced in the Spring of 2020, resulting from the COVID-19 pandemic and government reactions to it (the "Liquidity Crisis").

While global regulators have acknowledged that the Liquidity Crisis has placed a spotlight on the critical need to reform and enhance the resilience of short-term funding markets,[5] such important market reforms have taken a backseat to the reform of MMFs, which "reform" paradoxically would harm short-term markets by reducing liquidity and increasing costs to issuers relying on these markets for funding. Improving short-term funding markets, of which MMFs are but a very small participant, and addressing the root causes of the Liquidity Crisis, should be the priority, and any reform to MMFs, without consideration of the impact of changes to the short-term funding market, would be counterproductive.

The Liquidity Crisis was a great stress test for the MMF reforms adopted by the SEC in the 2010 amendments to Rule 2a-7 (the "2010 Amendments") and the 2014 Amendments. While many of those reforms enhanced the safety and resilience of MMFs, one in particular did not.[6] The linkage of liquidity

---

[4] Eric Rosengren, President, Federal Reserve Bank of Boston, Financial Stability Factors and the Severity of the Current Recession, Robert Glauber Lecture, Harvard Kennedy School Institute of Politics, at minute 101:08-104:40 (Nov. 10, 2020), available at https://iop.harvard.edu/forum/financial-stability-factors-and-severity-current-recession.

[5] *See* Financial Stability Board, *Policy Proposals to Enhance Money Market Fund Resilience Final Report*, at 37 (Oct. 11, 2021) ("FSB 2021 Policy Report"), available at https://www.fsb.org/wp-content/uploads/P111021-2.pdf, , and The Board of the International Organization of Securities Commissions, *Money Market Funds during the March-April Episode Thematic Note*, at 4 (Nov. 2020), available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD666.pdf.

[6] We also note that the requirement to force institutional prime and tax-exempt MMFs to float their share prices by pricing shares to the fourth decimal point that was included in the 2014 Amendments and implemented in October 2016, caused turmoil in the short-term credit markets, decimated the institutional prime MMF business, and has failed to provide any benefits to shareholders, issuers or markets. Sweep program intermediaries and others whose system requirements mandated a stable NAV or that could not accommodate a four-decimal point price for MMF shares were forced to redeem in the weeks leading up to the October 2016 implementation date and this artificial floating share price was a major factor in the redemption of the bulk of institutional prime MMF shares at that time. Query whether markets would have been better served by leaving MMF reform at the 2010 Amendments and addressing any remaining systemic risk concerns at the firm level.

fees and gates to a MMF's liquidity requirements (adopted over the objection of numerous commenters and then-SEC Commissioner Kara Stein)[7] served as a bright line that incentivized investors to redeem prematurely, leading to artificially high levels of redemptions, and transformed what should have been useable liquidity for MMFs into a hard floor. This improper linkage caused a regulatory "hit" for MMFs on both sides of the balance sheet, both restricting a fund's ability to utilize its internal liquidity and creating an improper incentive leading to artificially high levels of investor redemptions. Put simply, the SEC made a fundamental mistake in crafting the 2014 Amendments and should acknowledge the error, remove the linkage, and focus on improving short-term funding markets.

The need to eliminate this improper linkage is clear and has been since the onset of the Liquidity Crisis. The Commission correctly calls for the immediate termination of the improper linkage upon finalization of the Proposal. However, the Proposal fails to reflect the ensuing benefits removing the improper linkage will have on other key aspects of the Proposal, such as the need for higher liquidity levels or the effectiveness of a liquidity fee unrestrained by the improper linkage. Importantly, eliminating the improper linkage in no way necessitates the elimination of discretionary liquidity fees and redemption gates, tools which we believe, once unencumbered, could be invaluable to MMFs in future stressed markets.

Each of the proposed reforms included in the Proposal should be analyzed with the understanding that the improper linkage has been removed. Looking at additional reforms in this light, rather than in a vacuum, provides a more fulsome picture of the positive impacts delinking will have across the spectrum of reform proposals and will avoid the damaging consequences of adopting inappropriate, unnecessary, and factually unsupported reforms. One example is the Proposal's stated preference of swing pricing over the use of a liquidity fee as a means of applying the cost of liquidity to redeeming shareholders. The Proposal bases this preference on the failure of liquidity fees to work (or even be used) during the Liquidity Crisis, however this position ignores the regulatory requirements as they exist today, specifically that the imposition of liquidity fees is not permissible under Rule 2a-7 unless a fund's weekly liquid assets fall below 30%. Given the improper linkage, a manager or board would have needed to make an affirmative decision to permit its liquidity to fall below the 30% (effectively accepting increased redemptions caused by the improper linking). Any manager or board making such a determination would have been subjected to intense criticism for allowing a fund's liquidity to be intentionally reduced below regulatory minimums in times of market stress just to obtain the ability to impose a liquidity fee. This would have clearly led to fundamental fairness issues, and we are very glad no manager or board took this approach.

In determining not to apply swing pricing to MMFs in 2016, the SEC confirmed that a liquidity fee was the Commission's preferred approach for MMFs. That determination was correct in 2016 and remains correct today. Swing pricing eliminates a key tenet of MMFs; the ability to transact intraday and same day. Swing pricing would also encourage some investors to market time MMFs not only in stressed conditions, but at any regular interval where a MMF would ordinarily expect to have net redemptions (month-end, quarter-

---

[7] *See, e.g.*, M. Cipriani, A. Martin, P. McCabe, & B. M. Parigi, *Gates, Fees, and Preemptive Runs*, FRBNY Staff Report No. 670 at 1 (Apr. 2014), available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr670.pdf; *see also* Statement of Hon. Kara M. Stein, July 23, 2014, available at https://www.sec.gov/news/public-statement/2014-07-23-open-meeting-statement-kms ("Ultimately, despite the rule's efforts to mitigate the risks posed by gates, I believe the incentives to avoid them will remain powerful. I fear these incentives may result in a greater chance of fire sales during times of stress, and a spread of the panic to other parts of our financial system, while also denying both investors and issuers access to capital.").

end, year-end, tax days, etc.) in excess of the Proposal's "impact threshold" of 4% of a MMF's total assets that would trigger imposition of swing pricing, which according to the Commission's Notice accompanying the Proposal, occurs on approximately 5% of trading days.[8] This is slightly more often than once per month, hardly a rare event, nor one that would be difficult for market timers to game. For funds with multiple strikes, a reduced threshold which may increase the frequency of application will apply. This increased frequency may not necessarily correspond with redemptions in excess of the 4% market threshold, and we note that higher redemptions are typically observed earlier in the day. Besides creating new market timing opportunities, swing pricing would also serve as another "bright line" for investors and would accelerate redemption requests in times of stress as some investors may look to game the system, utilizing sophisticated algorithms to redeem before a swing price is implemented.

Investors in MMFs, whether purchasing or redeeming, believe that having an accurate net asset value ("NAV") is a key tenet of U.S. mutual funds and an element of fundamental fairness. Swing pricing calls that into question, introducing unnecessary uncertainty as to the accuracy of the NAV and potentially exacerbating redemptions in times of stress. Notwithstanding the sanctity of the NAV, it has always been true that advisors and fund boards have been responsible for trying to reduce material dilution or any other unfair results.

Certainly a properly calibrated, unencumbered, targeted liquidity fee remains a more appropriate liquidity management tool ("LMT") for MMFs as opposed to swing pricing which will encourage unnecessarily early redemptions, greatly diminish the already dramatically reduced size of the prime MMF market (if not eliminating it entirely), increase the risk of shareholders being treated unfairly (as the Proposal would permit a fund manager to utilize purchase and redemption assumptions in determining whether a swing pricing should be applied) and create new opportunities for market timing. We should not replace one improper bright line trigger with another.

Replacing one improper bright line trigger with another is exactly what some managers are proposing with respect to a mandatory liquidity fee. Mandatory liquidity fees, which include triggers (either single or double triggers), one of which is a fund's liquidity levels, will lead to increased redemptions, and once again convert usable liquidity into a floor. Moreover, those managers advocating for mandatory liquidity fees are also proposing a fixed liquidity fee or fees. A discretionary liquidity fee, with discretion in both the timing of implementation and amount, will (i) not serve as a trigger for redemptions, (ii) not impair a fund's ability to utilize its liquidity as intended, and (iii) prevent the imposition of a punitive fee. A discretionary model empowers a board, consistent with its fiduciary duty and in the best interest of the fund and the fund's shareholders, to implement, in instances involving material dilution, a liquidity fee which best approximates the cost of obtaining the actual liquidity in specific market circumstances.

Since the conclusion of the Liquidity Crisis and the publication of the President's Working Group Report on Money Market Mutual Funds (the "PWG Report") (SEC File No. S7-01-21)[9], securities regulators have consistently stated that more than delinking is necessary to alleviate the pressure being applied by central banks. The problem, however, is that other than delinking, the other proposals, including increasing required liquidity or implementing a highly destructive mandatory swing pricing mechanism (when less cataclysmic options are available), are not supported by the data or the Proposal's cost benefit analysis.

[8] 2022 MMF Release, 87 Fed. Reg. at 7263.

[9] The PWG Report is available online at https://home.treasury.gov/system/files/136/PWG-MMF-report-final-Dec-2020.pdf.

Moreover, the main empirical study on which the Proposal relies to establish that swing pricing would deter redemptions in a crisis acknowledges that prior empirical studies have concluded that swing pricing simply does not deter redemptions.[10] There is no evidence which supports the proposition that swing pricing would have reduced or avoided the problems of March 2020.

The study then goes on to dissect data from U.K. bond mutual fund redemptions in the market crises of 2018 and 2020 and concludes that swing pricing only deters redemptions in mutual funds that mix retail and institutional investors.[11] So, swing pricing, according to the SEC's favored study, may only have deterred redemptions in a context that has not existed with prime U.S. MMFs since October 2016. Furthermore, the 2022 MMF Release repeatedly implies (without actually stating) that swing pricing is currently used by European MMFs.[12] That is not true. European MMFs do not and have not used swing pricing.[13] Further, the SEC concedes that they have no data on whether or not swing pricing might actually trigger redemptions.[14] Any new MMF reform must be supported by data, backed-up by a proper cost benefit analysis and reflect the positive impacts that delinking will have on MMFs, which go well beyond simply removing the incentive for investors to redeem and the conversion of useable liquidity into a floor.

We very much appreciate that the Proposal has rejected, once again, many of the old, disproven, and discarded reform ideas which were tabled as part of the PWG Report. However, the need for "more" or a "package", so to speak, has resulted in a current Proposal which (i) introduces new ways to market time funds and treat investors unfairly, (ii) includes proposals which are neither supported by data nor the Commission's cost benefit analysis, (iii) is based upon a number of incorrect assumptions, (iv) ignores less onerous alternatives which would preserve, not eliminate, the utility of MMFs for investors and issuers, and (v) unjustifiably calls into question the integrity of the U.S. mutual fund governance system.

The Proposal then goes beyond the events of the Liquidity Crisis and, as a matter of first impression, simultaneously introduces a prohibition on the use of a RDM to address a negative yield environment, putting at risk the four trillion dollars invested in U.S. Government MMFs. Notwithstanding that the interest rate environment continues an upward trajectory, and notwithstanding the repeated statements of the Fed on its intention not to introduce negative interest rates in the U.S., the proposed prohibition on the use of RDM and the requirement for financial intermediaries to confirm that they are capable to transact using a four-digit NAV would effectively kill off U.S. Government MMFs immediately – even if a negative rate environment is never experienced. The Proposal cites only a concern that investors will not understand

---

[10] 2022 MMF Release, 87 Fed Reg. at 7303 n.354 (citing D. Jin, M. Kacperczyk, B. Kahraman & F. Suntheim, S*wing Pricing and Fragility in Open-End Mutual Funds* (Jan. 2021), REV. OF FIN. STUD. (forthcoming 2022) available at http://dx.doi.org/10.2139/ssrn.3280890. The final version of that study has since been published. *See* D. Jin, M. Kacperczyk, B. Kahraman & F. Suntheim, 35 REV. FIN. STUD. 1 (2022), available at https://academic.oup.com/rfs/article/35/1/1/6162183?login=true. We will cite to the now-published version in later references to this study.

[11] D. Jin, M. Kacperczyk, B. Kahraman & F. Suntheim, 35 REV. FIN. STUD. 1 (2022).

[12] *See, e.g.*, 2022 MMF Release, 87 Fed. Reg. at 7265 n.144, 7269, 7303 n.355.

[13] Comment Letter of European Fund and Asset Management Association (EFAMA) (Mar. 23, 2022), available at https://www.sec.gov/comments/s7-22-21/s72221-20121032-273211.pdf.

[14] *See* 2022 MMF Release 87 Fed. Reg. at 7265 n.144; *see also* Jin et al., *supra* note 10, at 8 (an empirical study did "not find any stabilizing flow effect during stress periods" at mutual funds using swing pricing), and 28-35 (effects of swing pricing in reducing redemptions in stress periods not significant at purely institutional funds and instead "are pronounced for funds with higher retail ownership, [but] it is not driven by the retail investors that sell more in these funds, rather it is the institutional investors facing the presence of retail investors.").

how RDM would operate – ignoring the fact that the U.S. is a disclosure-based regulatory jurisdiction. Concerns regarding shareholder confusion can and should be addressed with the use of clear and concise, plain English disclosure. In a negative rate environment, investors will experience negative returns in their bank accounts or any other liquidity management product. Retaining the availability to invest in U.S. Government MMFs in a negative rate environment is critically important to investors.

Federated Hermes supports a data-driven approach to regulation which will enhance the safety and resilience of MMFs. Such an approach must include a full analysis of the short-term funding markets, not just MMFs, to ensure that the Proposal addresses the root causes of the Liquidity Crisis. Other than removing the improper linkage, the data simply does not support the Proposal. The underlying assumptions, the introduction of new market timing / arbitrage opportunities, the lack of credible supporting data, the disregard of more appropriate LMTs, and the implication that fund boards will fail to discharge their fiduciary duty are alarming.

In this letter, we have endeavored to answer the questions set forth by the Commission and we remain eager to discuss any questions or comments which may arise. Ensuring that any final rules adopted (i) are supported by data and a fact-based cost benefit analysis, (ii) properly consider less onerous and equally effective alternatives, and (iii) enhance the safety and resilience of MMFs, is our top priority and a commitment we have made to our stakeholders.

Table of Contents

II. EXECUTIVE SUMMARY

As the dust settled on the worst days of the Liquidity Crisis, competing narratives emerged as to what caused the Liquidity Crisis and what could have been done to prevent it. Inexplicably, MMFs are once again front and center in the regulatory spotlight based, in large part, on a false narrative that they were somehow a cause of, or exacerbated the impact of, market pressures experienced during the Liquidity Crisis. This is simply not true. Consideration of every aspect of the Proposal must be undertaken with a proper contextual reference as to how the Liquidity Crisis unfolded and the impact the Liquidity Crisis had on both short-term funding markets and MMFs.

A closer, fact-based inspection of the timeline and events, as set forth in detail immediately below, confirms that MMFs did not cause or exacerbate market turmoil in the Spring of 2020. Unlike the 2007-2009 Financial Crisis, the Liquidity Crisis did not originate in the financial sector. Rather, the Liquidity Crisis had its origins in the government response to the COVID-19 pandemic. Market reaction to the COVID-19 pandemic and the response to it ignited a flight to safety not seen in recent U.S. history. While action taken by the Fed and Treasury to calm the markets was ultimately effective, significant market stress could have been avoided if action had been taken earlier.

On Monday, March 9, 2020, the stock markets experienced their largest single day drop since 2008 with the Dow index dropping 2,000 points. At this point the volatility expanded into the bond market, which entered a period of extreme volatility starting on March 9, 2020, due in part to margin calls and unwinding of leveraged positions.[15] The equity markets only deteriorated from there, with further major declines in global equity markets on Thursday, March 12, and on Monday, March 16, global equity markets took a one-day decline of 12-13%, the largest one-day drop of the period. The equity market decline continued through April 7, 2020. The turmoil also impacted the market for U.S. government securities in the first week of March, which became volatile by early in the second week of March 2020, before the impact was felt in other credit markets or the commercial paper market.

By the end of the second week of March 2020, the SEC and federal bank regulators had shifted into crisis response mode with temporary relief for businesses affected by the COVID-19 pandemic. The turmoil in the commercial paper market and other high-quality short-term markets and its impact on MMFs did not begin until mid-March 2020, weeks after the equity and oil markets had begun to plummet and at least a week after the bond market entered its turbulent period. Blaming these conditions or the expansion of investor panic in the short-term funding market on MMFs is disingenuous at best, as events in the real world and in other segments of the financial markets occurred before MMFs experienced significant outflows. The FRA-OIS spread, which is viewed as a proxy for turmoil or risk in the interbank lending markets because it represents the spread between the rate at which the central bank lends and the average rate at which banks lend to one another, widened in early March 2020 (well before outflows from MMF commenced) and was attributed to market concerns over the COVID-19 pandemic.[16]

---

[15] Andreas Schrimpf et al., Bank for International Settlements, Leverage and Margin Spirals in Fixed Income Markets During the Covid-19 Crisis, Bulletin No. 2 (Apr. 2, 2020), https://www.bis.org/publ/bisbull02.pdf.

[16] *See* Alex Harris, *Why It Matters That the FRA-OIS Spread Is Widening*, BLOOMBERG, Mar. 9, 2020, https://www.bloomberg.com/news/articles/2020-03-09/why-it-matters-that-the-fra-ois-spread-is-widening-quicktake; *see also* PWG Report, *supra note* 9, at 13, cht. 3; Federal Reserve Bank of St. Louis, *Timeline of Events Related to the COVID-19 Pandemic*, FRASER, https://fraser.stlouisfed.org/timeline/covid-19-pandemic (last visited

We note that while MMFs advised by global systemically important banks ("GSIBs") only represented approximately 28% of prime MMF assets, they were responsible for 56% of net redemptions from prime institutional MMFs, during March and April 2020.[17] At the precise moment when those same GSIBs needed deposits to fund their balance sheet growth to cover record-breaking commercial borrower draw-downs on lines of credit, their institutional cash management clients shifted approximately $56 billion out of prime MMFs, and the GSIBs received the large inflows of deposits they needed.[18] This looks less like an investor run than GSIBs working with their cash management clients to strategically shift accounts to meet the their balance sheet funding needs.

Acknowledging that the data confirms that MMFs were impacted by, and not the cause or amplifier of the Liquidity Crisis, is important as it establishes the predicate for what level of regulatory response should be considered.[19] MMFs, despite both significant regulatory hindrances on their use of their internal liquidity and regulatory induced artificially high levels of redemptions, successfully managed throughout the Liquidity Crisis notwithstanding the complete freezing of the short-term funding markets.[20]

In considering the events of the Liquidity Crisis, global securities regulators have identified and agreed on two critical points:

1. The linkage between a MMFs liquidity requirements and the potential imposition of fees and gates is improper and should be removed; and

---

Apr.. 5, 2022). For a more fulsome analysis of the timing of the events which occurred during the Liquidity Crisis, see Comment Letter of Federated Hermes on President's Working Group Report on Money Market Funds (Apr. 12, 2021) (the "First Federated Hermes Comment Letter"), available at https://www.sec.gov/comments/s7-01-21/s70121-8662821-235311.pdf.

[17] 2020 MMF Release, 87 Fed. Reg. 7248, 7255, n.52.

[18] *Id*.; *see also* D. Glancy, M. Gross & F. Ionescu, *How Did Banks Fund C&I Drawdowns at the Onset of the COVID-19 Crisis?*, FEDS NOTES (Jul. 31, 2020), available at https://doi.org/10.17016/2380-7172.2601.

[19] *See* Office of Financial Research, 2020 Annual Report to Congress, at 4, 11-13 ("OFR Annual Report 2020"), available at https://www.financialresearch.gov/annual-reports/files/OFR-Annual-Report-2020.pdf.

[20] As of year-end 2021, U.S. Prime MMFs held only 24.9% of total outstanding commercial paper, and U.S. Prime Institutional MMFs hold roughly 75% of prime MMF portfolio assets. SEC Division of Investment Management Analytics Office, Money Market Funds Statistics, Form N-MFP Data, Period Ending December 31, 2021 (Jan. 14, 2022) at 4 tbl. 11, https://www.sec.gov/files/mmf-statistics-2021-12.pdf ("SEC MMF Data") (prime MMFs hold a total of $270 billion in commercial paper); Federal Reserve, Commercial Paper Rates and Outstanding Summary (Apr. 5, 2022) (showing $1,065.7 billion in commercial paper outstanding at December 31, 2021), https://www.federalreserve.gov/releases/cp/default.htm; *see also* V. Baklanova, I. Kuznits & T.Tatum, SEC Division of Investment Management Analytics Office, *Primer: Money Market Funds and the Commercial Paper Market,* at 1-2 (Nov. 9, 2020), available at https://www.sec.gov/files/primer-money-market-funds-commercial-paper-market.pdf ("SEC MMF Primer"); Investment Company Institute (ICI), Report of the COVID-19 Market Impact Working Group, *Experiences of US Money Market Funds During the COVID-19 Crisis*, at 7, fig. 3.3 (Nov. 2020), https://www.ici.org/pdf/20_rpt_covid3.pdf ("ICI Report"). Commercial paper represents approximately 29% of portfolio assets of U.S. prime MMFs and generally is not used to as the main asset to meet DLA requirements. V. Baklanova, I. Kuznits & T. Tatum, SEC Division of Investment Management Analytics Office, *How Do MMFs Manage Their Liquidity Buffers*, at 3-4 (Jul. 21, 2021), available at https://www.sec.gov/files/how-do-prime-mmfs-manage-liquidity-buffers.pdf.

2. Short-term funding markets, which were completely frozen in the Liquidity Crisis, need to be improved.[21]

These are the two actions that must be taken. Upon removal of the improper linkage, retention of unencumbered liquidity fees and gates and enhancements to improve the functioning of the short-term funding markets, no further reforms to MMF regulation are necessary or supported by the data.

We have set forth in this comment letter specific background and data points surrounding each aspect of the Proposal. Moreover, in addition to responding to the Commission's questions, we highlight several critical themes which should be further considered before any aspect of the Proposal, other than delinking, moves forward.

A. Liquidity Fees & Redemption Gates

1. Remove the Linkage – We fully support the Commission's proposal to immediately eliminate the link between the imposition of fees and gates and a MMF's liquidity requirements ("Delinking"). This improper linkage led to both artificially high levels of redemptions and converted 30% of weekly liquidity into an unusable floor.

2. Appreciate the Benefits of Delinking – Delinking does more than simply eliminate an artificial incentive for investors to redeem. Delinking frees up an additional 30% of liquidity that has been otherwise unavailable to MMFs since 2016, and an amount which would have been sufficient to cover nearly all liquidity demands experienced during the Liquidity Crisis.

3. Retain Unencumbered Discretionary Liquidity Fees & Gates – Although liquidity fees and gates were not used during the Liquidity Crisis, that does not mean they will not be valuable tools for a fund board to consider in a future crisis. One cannot say that liquidity fees and gates did not work simply because they were not used. First, because of their structure, liquidity fees could not even be considered as options until a MMF's liquidity fell below 30%, which would have brought an onslaught of unnecessary redemptions. Moreover, as a positive result of the 2010 Amendments and 2014 Amendments, directors and funds were better prepared with both higher levels of liquidity entering the Liquidity Crisis and the benefit of the Know Your Customer ("KYC") requirements. As government intervention to reopen completely frozen short-term markets began to work, the implementation of liquidity fees was not necessary. That said, retaining a board's ability to implement either a liquidity fee or gate, unencumbered by an improper linkage, in its discretion, would provide directors with additional tools for consideration in times of market stress. Suggesting directors wouldn't use the tools unfairly, undermines the fiduciary role of independent directors upon which the SEC has for so long relied to moderate potential conflicts between the adviser and the funds. Unlike the Proposal, global and international policymakers favor the retention of liquidity fees as appropriate LMTs for a MMF board

[21] FSB 2021 Policy Report, *supra* note 5, at 38-39.

to consider.[22] Finally, discretionary liquidity fees are clearly a less onerous alternative to swing pricing.

B. Swing Pricing[23]

1. The proposal to require mandatory omnipresent swing pricing is wholly unworkable and appears to have been proffered with no regard for the future viability of MMFs or the utility MMFs provide to investors, issuers, and markets. The swing pricing proposal:

- effectively transforms prime and tax-exempt MMFs into complicated, separately managed accounts, instead of "mutual funds" in which investors, particularly institutional investors, understand that there is by definition a mutualization of the investment experience;
- potentially penalizes investors with redemption charges in normal market conditions, where neither material dilution nor corresponding transactions to effect redemptions arise;
- introduces fundamental fairness issues and market timing / arbitrage opportunities;
- will cause investors to further flee prime MMFs (which assets were reduced by over 75% following the 2014 Amendments)[24] and move to less transparent, unregulated vehicles;
- could serve as a new redemption trigger in stressed markets, exacerbating redemptions;
- will be incredibly costly and time consuming and will provide no benefit to any remaining investors. MMFs experience routine, anticipated regular net redemptions at various times during the year (month-end, quarter-end, year-end, tax days, etc.) which are often in excess of the proposed market impact threshold. As a result, MMFs will have to engage in complex, expensive, and time-consuming calculations to render a swing factor of zero;
- discourages transparency between investors and managers which can be critical for funds to ensure they have sufficient liquidity in accordance with their KYC requirements; and
- Requires daily calculations which provide no underlying benefit. Prices, under the proposed swing pricing mechanism, will likely only swing in periods of profound

---

[22] FSB 2021 Policy Report, *supra* note 5, at 27; European Systemic Risk Board (ESRB), Recommendation of the European Systemic Risk Board of 2 December 2021 on reform of money market funds, at 11-12 (ESRB/2021/9), available at https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation220125_on_reform_of_money_market_funds~30936c5629.en.pdf?26a37498f9b2917912eb6bd1dc5824d7; ESMA, *Final Report: ESMA Opinion on the Review of the Money Market Fund Regulation*, at 20 (Feb. 14, 2022), available at https://www.esma.europa.eu/file/122874/download?token=MkpZcI2J; M. Grill et al., *Mind the liquidity gap: a discussion of money market fund reform proposals*, ECB Macroprudential Bulletin No. 16 (Jan. 2022), available at https://www.ecb.europa.eu/pub/financial-stability/macroprudential-bulletin/html/ecb.mpbu202201_1~218b65d720.en.html.

[23] A detailed analysis on the Proposal's swing pricing requirements, including an extensive cost-benefit analysis is set forth in a separate comment letter. *See* Federated Hermes Comment Letter II, *supra* note 2. .

[24] Source: iMoneyNet Analyzer March 3, 2022.

volatility. This high cost no benefit approach will only serve to force users and sponsors to cease investing in MMFs.

2. The proposal to require a mandatory, omnipresent swing price has been predicated upon several false assumptions:

- False Assumption 1 - *Liquidity fees did not work* – Liquidity fees, once the improper linkage is removed, can be a valuable tool for a fund board to use in future times of stress. Liquidity fees independent of liquidity requirements and liquidity fees burdened by the improper linkage are not the same. The Proposal takes the simple view that liquidity fees do not work, basing that position on the experience of liquidity fees burdened by the improper linkage included in the 2014 Amendments. We agree that the liquidity fee provision as crafted by the 2014 Amendments did not work, however, liquidity fees, unburdened by an improper linkage, remain far more appropriate for MMFs than a swing price and unencumbered liquidity fees achieve, in a targeted and efficient manner, the same regulatory objective – application of the cost of liquidity in times of stress to redeeming shareholders.

- False Assumption 2 - *Directors will not implement a liquidity fee* – The repeated concerns included in the Proposal that directors would not, in accordance with their fiduciary duty, implement a liquidity fee if doing so was in the best interest of the fund and its shareholders not only calls into question the U.S. fund governance model but is incredibly offensive to boards that discharged their duties faithfully and spent countless hours working with MMF advisors to ensure that U.S. MMFs successfully maneuvered through the Liquidity Crisis. Contrary to this assumption, there is documented evidence that boards are not loathe to implement temporary fees and gates when doing so is in the best interest of a MMF and its shareholders.[25] Moreover, any discussion about why liquidity fees were or were not used must also reflect the market reality that as a result of the 2010 Amendments and 2014 Amendments, MMFs were not only better prepared entering the Liquidity Crisis, but fund boards had more information available to them. Any so-called "first mover advantage" was addressed by the mandate of a floating NAV and given the ultimate intervention by the Fed, the need to impose a liquidity fee did not arise. Moreover, a fund board would not, under the current rules, have been permitted to implement a liquidity fee in the Liquidity Crisis until its weekly liquidity fell below 30%, something that, given the improper linkage, would have led to even more artificially high levels of redemptions.

- False Assumption 3 - *Swing pricing will NOT eliminate a key tenet of MMFs* –Swing pricing, as proposed by the Commission, will eliminate both intraday and same day liquidity. The provision of both intraday and same day liquidity is critical to MMF investors. This is why swing pricing has not been used in ANY jurisdiction for MMFs.

[25] *See, e.g.*, Diana B. Henriques, "Professional Money Fund is Closed by Putnam," NY TIMES (Sep. 18, 2008), available at https://www.nytimes.com/2008/09/19/business/19money.html; *see also* Comment Letter of Federated Investors, Inc. (May 14, 2014), available at https://www.sec.gov/comments/s7-03-13/s70313-360.pdf.

References to the use of swing pricing in Europe or any other jurisdiction do not apply to MMFs.

- False Assumption 4 – *Swing pricing is utilized by MMFs in other jurisdictions* - The Proposal strongly implies that Europe and other jurisdictions have applied swing pricing requirements to MMFs.[26] This suggestion is simply false.[27] No MMF domiciled in either the EU or the UK has utilized swing pricing.

- False Assumption 5 - *Use of estimates in 2022 is more appropriate now than it was in 2016* – This is false. The use of estimates introduces fundamental fairness issues and arbitrage opportunities which can be exploited by investors. In its prior rulemaking under rule 22(c) the SEC determined that swing pricing was not appropriate for MMFs. In adopting the swing pricing provisions of rule 22c-1 in 2016, the SEC determined not to impose swing pricing on MMFs because MMFs already have unique portfolio liquidity requirements not found in other types of mutual funds, and other LMTs such as the ability to impose liquidity gates and fees if needed.[28] The SEC also noted the processing costs and fundamental fairness issues associated with using swing pricing to address dilution issues at less liquid funds and that liquidity fees may be a simpler and fairer alternative for some funds,[29] and chose not to apply swing pricing to MMFs which address dilution considerations associated with redemptions more directly through portfolio liquidity requirements and the ability to impose liquidity fees. These determinations remain true today. Swing pricing is not appropriate for MMFs.

- False Assumption 6 – *Floating NAV ("FNAV") MMFs remain subject to first mover advantage which would be mitigated by swing pricing* - By definition FNAV MMFs are designed to eliminate first mover advantage. The pricing of FNAV MMFs to the fourth decimal, combined with the requirement for forward pricing, ensures that all shareholders, whether redeeming or not, are receiving a properly calculated forward price reflective of market conditions. There is no first mover advantage which necessitates the implementation of a mandatory omnipresent swing price. This is particularly true for MMFs that price portfolio assets at the bid price.

- False Assumption 7 - *That any data suggests further reforms are necessary for retail or government funds.* – U.S. Government MMFs and retail MMFs should not be subject to any further regulatory reforms.

---

[26] 2022 MMF Proposal, 87 Fed. Reg. at 7265 n.144 ("We are not aware of any evidence that use of swing pricing in other jurisdictions . . . . "), 7269 ("Some commenters asserted that swing pricing works better in Europe.…"), 7303 ("In other jurisdictions swing pricing is used . . . .") (citing European data at footnote 355).
[27] Comment Letter of European Fund and Asset Management Association (EFAMA) (March 23, 2022), available at https://www.sec.gov/comments/s7-22-21/s72221-20121032-273211.pdf.
[28] 17 C.F.R. 270.22c-1(a)(3); *see also* SEC, Investment Company Swing Pricing, Final Rule, 81 Fed. Reg 82084, 82090-82091 (Nov. 18, 2016), available at https://www.federalregister.gov/documents/2016/11/18/2016-25347/investment-company-swing-pricing.
[29] 81 Fed. Reg. at 82094-82096, 82118, 82120, 82128-82129.

- <u>False Assumption 8</u> - *That institutional prime and tax-exempt MMFs triggered mass redemptions in March 2020* - There was a "dash for cash" across all categories of financial products in February, March and April 2020,[30] without regard to form or structure as institutions sought to maximize their access to liquidity to weather the storm. For example, there was a massive "run" on bank lines of credit which saw borrowers draw down and max out their bank lines in an aggregate amount of more than $450 billion, more than four times the net redemptions from prime MMFs, disrupting bank balance sheets and access by smaller borrowers to credit.[31] Government MMFs saw net inflows in excess of $1.1 trillion and aggregate bank deposits surged by over $800 billion during the same period.[32] Most of that money came from somewhere other than the proceeds of redemptions from prime MMFs.

- <u>False Assumption 9</u> - *That securities market transactions operate in a vacuum to cause securities prices to move artificially* - Securities transactions reflect decisions made by investors in reaction to new information. The transactions are a mechanism by which the information gets reflected in market prices. Bad news is bad news no matter what barriers the FSOC seeks to impose on its transmission to the markets. A global pandemic is bad news. As the Office of Financial Research put it: "This time, the trigger was exogenous to the financial system — a new, virulent virus that rapidly became a global pandemic, resulting in growing infections; deaths; great public fear; and disruptions to families, businesses, and lives worldwide."[33]

It is important to note that in the European Union, the European Systemic Risk Board ("ESRB") has recommended to the European Commission that all MMFs should have available one LMT but does not seek to "impose" swing pricing. The ESRB leaves the determination as to what LMT is appropriate for a bund board to consider. Similarly, the European Securities Markets Authority ("ESMA") suggests to the European Commission that each MMF put in place at least one type of LMT. Such LMTs could be, in particular, anti-dilution levies ("ADL"), liquidity fees, and could also include swing pricing.

---

[30] OFR Annual Report 2020, *supra* note 19, at 11-12 ("This year's disruptions reconfirm that no financial system, however structured, can avoid instability when large numbers of financial actors all try to move into cash at once… with no asset class left untouched . . . . ").

[31] D. Glancy et al., *supra* note 18 ("C&I loans increased by nearly $480 billion in March [2020] -- the largest monthly increase in the history of this [Federal Reserve data] series, surpassing the nearly $90 billion increase in C&I loans in the six weeks following Leman Brothers' collapse in 2008"); C. Minoiu & T. Kapan, *The corporate "dash for cash" and banks' pullback from risk-taking*, WORLD BANK ALL ABOUT FINANCE BLOG (Apr. 12, 2021), https://blogs.worldbank.org/allaboutfinance/corporate-dash-cash-and-banks-pullback-risk-taking; J. Bosshardt & A. Kakhbod, *Why Did Firms Draw Down their Credit Lines during the COVID-19 Shutdown?* (working paper draft Apr. 27, 2021); D. Greenwald, J. Krainer & P. Paul, *The Credit Line Channel*, Federal Reserve Bank of San Francisco Working Paper Series 2020-26 (Nov. 2021), available at https://www.frbsf.org/economic-research/wp-content/uploads/sites/4/wp2020-26.pdf.

[32] 2022 MMF Release, 87 Fed. Reg. at 7252 n.28 (government MMFs had record inflows of $838 billion in March and $347 billion in April 2020); D. Glancy et al., *supra* note 18) (bank deposits surged by over $800 billion in March 2020).

[33] OFR Annual Report 2020, *supra* note 19, at 11.

C. Liquidity Requirements

1. Acknowledge the current rule - After reading the sections of the Proposal relating to liquidity requirements, one could reasonably assume the requirements for liquidity start and end at 10% daily and 30% weekly. There is little to no mention of the very important KYC overlay which requires MMFs to treat the 10% daily and 30% weekly requirements as floors.[34] Discussions surrounding an increase to 25% daily and 50% weekly liquidity requirements appear to suggest that by removing the linkage managers will be able to operate at significantly lower liquidity levels, effectively ignoring KYC requirements. The studies cited by the SEC in the Proposal, document that MMFs maintain higher liquidity based on their shareholders' propensity to redeem.[35] Experience also shows that MMFs, in anticipation of market stress, will hold liquidity far in excess of any minimum regulatory requirements to ensure that they are in the best position possible to manage in times of stress. MMFs manage and have managed to higher levels of redemptions on both a routine (month-end, quarter-end, year-end, tax days, etc.) and extraordinary basis (including the European debt crisis, the U.S. debt-ceiling issues of 2011, 2013, and 2018, the 2013 and 2021/2022 "Taper Tantrum" increases in interest rates associated with the Fed tapering off its policy of "quantitative easing," and the massive redemptions experienced in 2016 as a result of the implementation of the SEC's 2014 Amendments).

2. Acknowledge the de facto 30+% increase in useable liquidity upon removal of the improper linkage - By eliminating the linkage, the Proposal will increase the available liquidity by 30+% of the fund's assets from what is effectively available today – an amount which, for most funds, exceeds the level of redemptions experienced during the worst weeks of the Liquidity Crisis.

3. Managing to the rules which were applicable should not be interpreted negatively - The Proposal implies that the selling of longer dated paper or infusions of sponsor support were negatives in the Liquidity Crisis. Both are permissible (although we firmly oppose sponsor support) and as all U.S. MMFs were able to meet investor redemptions throughout the Liquidity Crisis, managers should be praised and not persecuted for their efforts. Moreover, not using a liquidity fee, which could not have been used unless and until a fund's liquidity were to fall below 30%, should also not carry a negative inference.

4. Selling Longer-Term Paper is Not Inappropriate. There is a suggestion in Section II-C of the Release that it is inappropriate for a MMF manager to sell any portfolio assets other than WLA to obtain cash to meet redemptions. MMF managers receive a management fee to ensure that investors receive a highly liquid diversified portfolio that reflects both market conditions and the needs of its shareholder base. Contrary to the innuendo of Section II-C, MMF managers should be able to use their discretion to determine what securities should be purchased and sold to maximize the benefit to all shareholders, as managers are best

[34] 17 C.F.R. 270.2a-7(d)(4).

[35] For example, see L. Casavecchia, C. Ge, C.W. Li & A. Tiwari, *Prime Time for Prime Funds: Floating NAV, Intraday Redemptions and Liquidity Risk During Crises*, at 21, 25 (working paper, Nov. 3, 2021), available at: https://doi.org/10.2139/ssrn.3671972, which was cited in the 2022 MMF Release, 87 Fed. Reg. at 7305 n.361.

positioned to determine which securities should be sold to minimize adverse impact on the fund and fund shareholders. Creating a regulatory presumption that MMF managers should only sell short-dated paper or only utilize assets categorized as daily or weekly liquid assets to meet redemptions is not appropriate and fails to appreciate the varied factors a manager is charged with considering. Particularly where MMF portfolios are priced at the bid, how is the determination of what security should be sold an appropriate topic for regulatory intervention? Does the SEC really want to substitute its judgment on the steps to take in managing liquidity in dynamic markets over experienced portfolio managers who have been specifically chosen by investors for their market expertise? In March 2020, managers, in making determinations on what securities to sell, likely did factor in investor perceptions based upon the inappropriate linkage in Rule 2a-7 between WLA levels and potential redemption fees and gates. In the future, they will also likely factor in any market variable or regulatory requirement that could impact the fund in a negative fashion. The mistakes of the 2014 Amendments should give pause for reflection on taking regulatory action without proper support by the underlying data.

5. <u>Proposed increases in liquidity requirements are arbitrary and unsupported</u> - The proposed increase in liquidity requirements is entirely arbitrary, not supported by the data and essentially deemed immaterial by the Proposal's own terms, as breaches of nearly 50% of the increased levels under the Proposal do not even merit disclosure to the Commission or a fund's board, nor should they. This is because all of the data shows that the current 10% and 30% floors required by subsections (d)(4)(ii) and (iii) of Rule 2a-7, supplemented by KYC procedures required by subsection (d)(4) of Rule 2a-7, are, once unencumbered by improper linkages, more than adequate to manage MMFs' liquidity in both normal and stressed conditions.

6. <u>Higher liquidity requirements will negatively impact capital formation and efficient markets</u> – A further increase in required liquidity would decrease the yield spread of prime MMFs versus government MMFs making prime funds unattractive to investors, thereby severely injuring the products to the detriment of capital formation and efficient markets. Reviewing recent data on MMF liquidity holdings, which have been intentionally high to maneuver through difficult market conditions, is not enough to justify mandating higher levels of liquidity moving forward. Such an effort penalizes managers for being prepared for stressed market conditions.

7. <u>Past performance is no guarantee of future results</u> – The Proposal presupposes that because MMFs have been able to operate with higher levels of liquidity for an extended period of time in the recent past, that they should do so permanently. This presumption fails to consider the basis for why funds have been operating with exceptionally high levels of liquidity (unprecedented period of low interest rates, maneuvering through periods of massive redemptions in response to previous SEC MMF reforms, and significant market turbulence observed because of various debt crisis, political uncertainty, and a global health pandemic) and why, up to this point, investors have been willing to accept lower yields. The high levels of liquidity maintained in recent times by funds is a positive reflection of the impact that both daily and weekly liquidity requirements and the KYC overlay have on

MMFs. They also reflect the uncertainty that markets, and investors have experienced in recent times and managers willingness to ensure that MMFs hold sufficient levels of liquidity. This experience, however, does not mean that investors will continue to accept low spreads between government and prime MMFs in normal market conditions, as a market yield is required to compensate investors for investing in the real economy.

D. Negative Interest Rate Environment, Reverse Distribution Mechanism ("RDM") & Impact on Financial Intermediaries

We have set forth below our views on the importance of RDM in a negative rate environment and the negative impact of the Proposal on financial intermediaries. We note that this is a matter of first impression, as consideration of the appropriateness of RDM (or the impact prohibiting RDM would have on financial intermediaries) was not a matter for discussion or consultation under the PWG Report and the proposal set forth by the SEC does not reflect any formal industry feedback. First and foremost the issue of how MMFs should operate in negative rate environments is neither ripe for consideration nor properly considered by the Proposal, and as such we do not believe any final rule should be adopted with respect to how MMFs should operate in a negative rate environment. Nevertheless, we highlight the following critical points for further consideration.

1. Notwithstanding the current interest rate environment and the repeated confirmation by the Fed that they have no intention to implement negative interest rates in the U.S., the Proposal includes, as a matter of first impression, a targeted prohibition on the use of RDM in a negative interest rate environment, something wholly unrelated to the events surrounding the Liquidity Crisis and a prohibition that puts in immediate jeopardy $4 Trillion invested in U.S. Government MMFs.

2. For nearly fifty years, MMFs have distributed the income accrual arising from investing in securities with positive interest rates to shareholders through a dividend. Shareholders can choose to receive this dividend in cash, or reinvest the dividend in the fund, thereby increasing the number of shares held in the fund. In an environment where interest rates are below zero, the dividend accrued by shareholders would be negative. In this instance, the use of an RDM is simply the inverse of the transaction where there is a positive accrual – because it is unlikely that shareholders would choose to wire in cash to cover the negative accrual – the number of shares held by the shareholder would be reduced by the amount of the negative dividend. Despite the Commission's concerns, this transaction should be clearer to shareholders than a conversion to a FNAV structure, where the value of each share is uncertain.

3. In a negative rate environment, the retention of a stable NAV and the use of RDM is not only the clear investor preference, but the only option that will retain the benefits of MMFs for most investors. The focus should be on both investor communication and the adoption of clear and concise disclosure. The U.S. is, after all, a disclosure regime.

4. Prohibiting the use of RDM and mandating the requirements set forth in the Proposal will eliminate the use of government MMFs as a sweep investment, and lead to the potential outflows of nearly $4 trillion from U.S. Government MMFs into banks (which will be effectively operating using RDM) or other less transparent products. This is because financial intermediaries for cash sweep arrangements, if forced to modify their systems to accommodate nonstable pricing of U.S. government and retail MMFs, will likely drop all MMFs from their sweep platforms rather than spend the time, money and effort to redesign their systems, especially in the absence of any realistic chance of negative interest rates in the near future. This will result in a shift in cash to either banks (who will not want the cash and whose receipt will only increase their systemic relevance and the systemic risk to the financial system) or to less transparent unregulated vehicles. This, of course, runs directly counter to the SEC's legislative mandate and will substantially increase systemic risk.

5. The use of RDM will preserve an important investment product for all stakeholders as MMFs will continue to be able to provide same and intra-day liquidity and, with respect to stable NAV funds, maintain a stable value in periods of negative rates just as they do in a positive rate environment. The use of RDM supports the SEC's stated goal of preserving the benefit of stable NAV funds for investors and the short-term credit markets.[36] Not employing RDM risks a material shift in assets to less transparent, unregulated products such as crypto-assets and stablecoins.

6. Prohibiting RDM based on potential investor confusion ignores clear evidence to the contrary, overstates the risk of confusion and underestimates the effectiveness of disclosure. Banks have always used RDM effectively in negative interest rate scenarios and, until the implementation of the Money Market Fund Regulation ("MMFR") in Europe, RDM was successfully used in Europe for years without issue. For banks, on repayment of a deposit where the rate has been negative, the amount repaid to the client is the original principal less the negative interest applicable. The client therefore receives a lower amount of currency – but the value of each unit of currency is unchanged. For example, a client places a one-year deposit of $100 at a negative rate of 1%. The interest is therefore (-$1.00). At maturity, the client receives $99 – his new principal amount, with each $1.00 still being worth $1.00. The shareholders will be provided proper disclosure and their experience with their own checking and savings accounts will reinforce what negative rates mean for the value of their principal.

---

[36] *See* U.S. Securities and Exchange Commission (SEC), final rule, *Money Market Fund Reform; Amendments to Form PF* at 47783-47784 ("2014 MMF Reform Release"), available at https://www.federalregister.gov/documents/2014/08/14/2014-17747/money-market-fund-reform-amendments-to-form-pf ("We therefore believe that eliminating amortized cost valuation in the context of stable NAV funds would be contrary to a primary goal of our rulemaking—to preserve to the extent feasible, while protecting investors and the markets, the benefits of money market funds for investors and the short-term funding markets by retaining a stable NAV alternative.").

E. Delinking Impacts Liquidity, Liquidity Fees & Swing Pricing

The removal of the improper linkage between liquidity fees and gates and a fund's mandated liquidity requirements has been universally accepted as a necessary next step. Policy makers, fund boards, investment managers and investors are all in agreement that the improper linkage unnecessarily exacerbated the experience of MMFs during the Liquidity Crisis. It is with the removal of the improper linkage in mind that all additional reforms should be considered as each of the critical elements of the proposal are intertwined with the ramifications of Delinking.

1. <u>Delinking & Liquidity Requirements</u> - Required liquidity levels are the obvious example, as the removal of the improper linkage immediately frees up over 30% of weekly liquid assets previously unavailable to fund managers and removes an artificial incentive for investors to redeem.

2. <u>Delinking & Liquidity Fees</u> - Removing the linkage also frees up a fund board to consider the implementation of a liquidity fee, unencumbered by the current regulatory requirements which only permit a board to consider implementing a liquidity fee if weekly liquid assets fall below 30%. This linkage rendered a board's ability to implement a liquidity fee effectively moot, as a board, even if it wanted to implement a liquidity fee in the Liquidity Crisis, would have been forced to sit back and watch investors redeem unnecessarily out of the funds as liquidity fell. Delinking frees up a board to implement a liquidity fee when and if appropriate in its discretion in accordance with the exercise of the board's fiduciary duty to try to address material dilution.

3. <u>Delinking & Swing Pricing</u> – The fund board should be free to utilize the most appropriate LMT in stressed markets, and for MMFs the preferred LMT will likely be a liquidity fee. A MMF which has, in normal times, weekly liquid assets of 30% or more is unlikely to need to sell any securities to meet redemptions targeted at a 4% factor. A need to sell is even more unlikely if considered against the Proposal's intention to require an even higher percentage of daily liquidity. The proposal to require a mandatory omnipresent swing price is rendered moot if MMFs are permitted to apply a liquidity fee.

F. Short-Term Market Structural Issues Must Be Addressed

In addition to agreeing that the improper linkage of the potential imposition of fees and gates and a funds' mandated liquidity levels should be removed, global regulators also recognize that there is a critical need to improve the functioning of the short-term funding markets. These markets froze during the Liquidity Crisis and the resulting market stresses would have occurred with or without the existence of MMFs. We underline the FSB's recommendation[37] to adopt complementary measures that aim at improving the functioning of underlying short-term funding markets. We agree with the findings of the FSB, largely under IOSCO recommendation, and believe work on improving the functioning of the short-term funding markets is critical to avoiding any repeat of the events of 2020.

---

[37] See Section 3.2 of the FSB's October 2021 final report suggesting adopting complementary measures on risk monitoring and short-term funding markets. Financial Stability Board, Promoting Global Financial Stability: 2021 FSB Annual Report 11 (Oct. 21, 2021), available at https://www.fsb.org/wp-content/uploads/P271021.pdf.

In its Thematic Note[38] dated November 2020, IOSCO stated that the observed lack of asset liquidity may have been due to the severe disruption of the short-term funding markets. IOSCO recognized that MMFs are an important, but not the only, investor in the commercial paper market, prompting the need for an analysis and understanding of the broader market ecosystem. Then, in its Work Program[39] 2021-2022, IOSCO poses, as one of the top priorities, to focus on the FSB policy work relating to MMFs and the underlying short-term funding markets.

The Commission should recognize that the disruption in the commercial paper market was far less severe in the Liquidity Crisis than the Financial Crisis, did not come from or spread to the financial sector, and was not caused by MMF redemptions.[40] Moreover, the size of the Fed funding facility for the commercial paper markets was dramatically smaller in 2020 ($4.3 billion maximum drawn down) than it was in 2008 ($350 billion) even though the 2020 facility was broader based in terms of eligible paper and counterparties.[41] However, the events of 2020 underscore the importance of readiness to address liquidity issues in the short-term funding markets.

Consequently, we maintain that a fully-fledged reform of the short-term funding markets is warranted and should be considered as part of the Commission's work to address the root causes of the Liquidity Crisis. Any consideration of the impact potential reforms would have on MMFs without consideration of necessary improvements to the short-term funding markets is incomplete. Notwithstanding the tremendous benefits of Delinking, none of the reforms within the Proposal would have prevented the Liquidity Crisis or the need for the Fed to intervene, as the markets were effectively frozen.[42] Why the markets froze is the critical question. They did not freeze because of MMF redemptions which make up only a small fraction of the market. They froze because of two principal factors:

1. The reforms stemming from the Financial Crisis of 2008 effectively made it too expensive for many traditional market participants to take commercial paper into their inventory even though highly rated and not at risk of default; and

2. The government response to the COVID-19 pandemic, in shutting down the economy, caused the much cited "dash for cash".

G. Consideration of Reforms Should Reflect an Accurate Narrative of the Liquidity Crisis

The market turmoil in the Spring of 2020 was created by a global health pandemic and the resulting government lockdown of the economy. This shutdown caused a sharp economic downturn as unemployment surged and sales and income tax revenues to state and local governments dropped

[38] *See* OICU-IOSCU, Thematic Note, *Money Market Funds during the March-April Episode* (Nov. 2020), available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD666.pdf.
[39] *See* OICU-IOSCU, *IOSCO Board Priorities - Work Program 2021-2022*, available athttps://www.iosco.org/library/pubdocs/pdf/IOSCOPD673.pdf.
[40] *See* N. Boyarchenko, R. Crump, A. Kovner & D. Leonard, *The Commercial Paper Funding Facility*, Federal Reserve Bank of New York Staff Report No. 982 (Sept. 2021), available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr982.pdf.
[41] *Id.* at 6-10, 12.
[42] *See* Comment Letter of Federated Hermes, Inc. on Structural Reforms to Mitigate Systemic Risk and the Root Causes of the Liquidity Crisis of March 2020 at https://www.sec.gov/comments/s7-01-21/s70121-8861709-240107.pdf.

drastically. The panic in the real economy led to investors seeking the safety of cash to prepare for uncertainty. The financial markets turmoil began in the equity markets weeks before impacting the markets in U.S. treasury securities and corporate bonds and continued to impact the markets for bonds and repurchase agreements days before affecting the commercial paper markets. This all transpired well before outflows started from MMFs. MMFs are a useful and efficient capital markets and investment management tool and are not a threat to the financial system. A measured response to the Liquidity Crisis is necessary given that MMFs were not the cause of the problem. Such a response should include, as noted above, market structure reforms.[43]

The narrative surrounding the Liquidity Crisis has been heavily influenced by central banks, many of which have long sought to eliminate MMFs as an investment product. The claims of government bailouts and taxpayers being put at risk have proven false. Very simply, the programs adopted to assist the short-term credit markets, in which MMFs are no longer a dominant player,[44] precluded the use of defaulted securities and were miniscule compared to other actions taken by the Fed. The Money Market Fund Liquidity Facility ("MMLF") took on no appreciable risk and made millions of dollars for taxpayers.[45] The Fed's 2020 Commercial Paper Funding Facility ("CPFF") was even smaller, with a peak drawdown of only $4.3 billion (compared to $350 billion in 2008) and was promptly paid off in full with nearly $50 million in profits to the U.S. Treasury and the Federal Reserve Bank of New York.[46]

In response to the Liquidity Crisis, the Fed exercised its statutory powers to open emergency credit facilities to provide liquidity to the markets to help reduce the turmoil.[47] These emergency credit facilities included the Primary Dealer Credit Facility ("PDCF"), the Primary Market Corporate Credit Facility ("PMCCF"), the Secondary Market Corporate Credit Facility ("SMCCF"), the Paycheck Protection Program Liquidity Facility ("PPPLF"), the CPFF, the MMLF and the Term Asset-Backed Securities Loan Facility ("TALF"). The total of these facilities was approximately $2.3 trillion. Had the Fed announced its intent to take measures to avoid a panic earlier, query whether the Liquidity Crisis would have materialized. Also, had MMFs been permitted to utilize their 30% WLA without signalling the potential imposition of gates and fees, would other actions even have been necessary?

The smallest of these was the CPFF. The next smallest was the MMLF, which at its peak reached only $51 billion. Neither of these programs lent to MMFs. The CPFF provided financing to issuers of commercial paper, while the MMLF provided financing to banks that purchased commercial paper

---

[43] *See* First Federated Hermes Comment Letter, *supra* note 16.

[44] Investments by U.S. Institutional Prime MMFs only represent approximately 18% of the commercial paper market. *Supra* note 20 (prime MMFs held just under 25% of commercial paper as of year-end 2021).

[45] Federal Reserve Board, *Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act*, at 3 (Mar. 10, 2021), available at https://www.federalreserve.gov/publications/files/pdcf-mmlf-cpff-pmccf-smccf-talf-mlf-ppplf-msnlf-mself-msplf-nonlf-noelf-03-11-21.pdf; *see* letter from Janet L. Yellen, Chair, Federal Reserve, to Sen. Elizabeth Warren (Nov. 30, 2015) at 1, https://www.federalreserve.gov/foia/files/warren-letter-20151130.pdf ("Yellen Letter") (noting that providing central bank liquidity to markets during times of unusual financial stress prevents or mitigates extraordinary pressures in financial markets that would otherwise have severe adverse consequences for American households and businesses and the U.S. economy).

[46] Boyarchenko et al., *supra* note 41, at 3.

[47] *See, e.g.*, Tim Sablik, Federal Reserve Bank of Richmond, *The Fed's Emergency Lending Evolves*, Econ Focus, Second/Third Quarter 2020, https://www.richmondfed.org/publications/research/econ_focus/2020/q2-3/federal_reserve ("Fed Emergency Lending Paper").

from MMFs. These facilities provided liquidity to the commercial paper market and issuers of commercial paper, rather than directly to MMFs or other investors in commercial paper. The MMLF was expanded by the Fed to cover purchases of bank CDs and certain municipal securities when demand for the facility proved to be less than anticipated.[48] At year-end 2020, the outstanding loans under the MMLF stood at $3.7 billion[49] and has since been fully repaid. In comparison, at year-end 2019, the Federal Reserve Banks' aggregate balance sheet totalled approximately $4.2 trillion and grew to approximately $7.4 trillion by year-end 2020.[50]

The size of the MMLF during the Liquidity Crisis was approximately a third of the size of the analogous Fed credit facility deployed in the Financial Crisis.[51] This facility was consistent with a primary purpose of the Fed, namely, to provide liquidity to the commercial paper market through banks by purchasing commercial paper from the banks at the "discount window."[52] Notably, the Fed used that authority during the Spanish flu pandemic of 1918-1919 to provide liquidity to banks to allow them to continue lending during that crisis.[53]

The Fed could have pre-empted much of the market disruption by simply doing a month earlier what they were created to do when the Federal Reserve Act was adopted in 1913 and has been a major part of its statutory role ever since, which is to take necessary action to prevent a panic in the short-term funding markets.[54] Or, as the Federal Reserve Bank of New York Staff Report observed, a key lesson from 2020 is "the importance of operational readiness in setting up the facility and the importance of a quick and comprehensive response."[55] What ensued, as a result of initial Fed inaction, was a bona fide panic, triggered by government action to stem the market disruption caused by the COVID-19 pandemic, which only abated when the Fed finally took the action it should have taken in February 2020.

The truth is that the Fed would have had to take action to promote liquidity in March of 2020 whether or not MMFs existed. The fact that the Fed could address the illiquidity in the short-term markets so efficiently through programs like the MMLF is a testament to the vital role MMFs played in helping to resolve the panic.

The word "mutual" in mutual funds means what it says. Assets, profits, losses and expenses are a joint enterprise that are shared *pro rata* among all of the investors. MMFs are and should be no different.

---

[48] *See* SEC MMF Primer, *supra* note 20, at 3.

[49] Federal Reserve Board, *Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act*, at 3 (Jan. 9, 2021), available at https://www.federalreserve.gov/publications/files/pdcf-mmlf-cpff-pmccf-smccf-talf-mlf-ppplf-msnlf-mself-msplf-nonlf-noelf-01-11-21.pdf.

[50] Federal Reserve Banks Combined Financial Statements, As of and for the Years Ended December 31, 2020 and 2019 and Independent Auditors' Report at 3, available at https://www.federalreserve.gov/aboutthefed/files/combinedfinstmt2020.pdf ("FRB Financial Statements").

[51] ICI Report, *supra* note 20, at 25.

[52] *See, e.g.*, Fed Emergency Lending Paper, *supra* note 48, at 14.

[53] *Id.* at 17.

[54] Pub. L. No. 63-43, 63rd Cong., (1913), An Act to Provide for the Establishment of Federal Reserve Banks, to Furnish an Elastic Currency, to Afford Means of Rediscounting Commercial Paper, to Establish More Effective Supervision of Banking in the United States, and For Other Purposes, at Sections 13, 15, codified as amended at 12 U.S.C. §§ 343-347, 353-358, 372.

[55] Boyarchenko et al., *supra* note 41, at 12.

Investors in MMFs are choosing this approach to managing their short-term balances. They have chosen not to manage their cash in individually managed accounts, or to deposit it in a bank. Changes to MMF rules that would differentially allocate transactions costs and price changes among MMF shareholders is fundamentally at odds with the concept of mutual funds. MMF investors are seeking to retain access to liquidity. They are not chasing the highest net return. As part of that, investors accept that they collectively bear the cost of preserving that liquidity by holding large amounts of liquid assets in the portfolio and allowing investors to redeem at NAV when they want to access their money for some other use. Attempting to differentially allocate among MMF shareholders the costs of redemptions by estimating a NAV for that purpose through swing pricing is fundamentally at odds with the mutual nature of MMFs and not consistent with investor expectations.

Moreover, it is unnecessary to demutualize MMFs if gates and fees are delinked from a funds WLA levels. Delinking would allow MMFs to use liquidity to redeem shareholders and unlock a large, counter-cyclical pool of cash for this purpose (not just the 30% minimum, but also the substantial extra amounts held pursuant to their additional KYC liquidity levels) without worrying that it will signal to investors that the gates are about to drop. MMFs would, of course, still be required to reinvest any and all new cash into liquid assets and meet liquidity requirements before investing in less liquid assets. Had Delinking been in place in 2020, we doubt that the MMLF would have been required.

H. Cost Benefit Analysis.

The SEC is required, in any rulemaking under the Investment Company Act, to engage in a rigorous cost benefit analysis as part of its decision-making process in deciding whether to regulate to address an issue involving MMFs and in adopting or amending the terms of the rule.[56] An initial question in any cost benefit analysis is whether the proposed rule change accomplishes the intended result. In other words, will the expected benefit be realized at all? The unsupported assertions and sheer speculation upon which the Proposal is based are inadequate and fail to justify its adoption.

If a rule will not achieve its intended purpose, there is no benefit. By any measure the sufficiency of the cost benefit analysis in support of the Proposal does not pass muster. Four trillion dollars in U.S. Government MMFs and over six hundred billion dollars[57] in institutional prime and municipal MMF assets are put at risk by the terms of the Proposal. The cost benefit analysis of any proposal which comes with such significant costs to the markets and investors must be performed to a higher standard. The data used to justify the Proposal is incomplete and puts the cart before the horse by requesting more data by which a final rule can be justified – leading to conclusions drawn not based on the terms of the Proposal but on responses provided to the Proposal which will not be subject to further non-judicial scrutiny.

---

[56] *See Michigan v. Environmental Protection Agency*, 576 U.S. 743 (2015) (Clean Act and APA require rigorous cost/benefit analysis); *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (Securities Exchange Act and APA require rigorous cost/benefit analysis). Note the specific requirement to take into account the economic impact in rulemakings in Investment Company Act 2(c), 15 U.S.C. 80a-2(c) ("[T]he Commission shall also consider whether the action will promote efficiency, competition, and capital formation"), with the more ambiguous Clean Air Act language at issue in *Michigan v. Environmental Protection Agency*, 42 USC 7412(n)(1)(A) (whether such action is "appropriate and necessary").

[57] Including $281 billion in public institutional prime and $346 billion in non-public institutional prime. SEC Division of Investment Management Analytics Office, Money Market Fund Statistics, Form M-NFP Data Period ending February 2022, at 1, available https://www.sec.gov/files/mmf-statistics-2022-02_1.pdf.

> Notwithstanding the incompleteness of the cost benefit analysis performed, or the reliance on unsupported assumptions instead of data, given the alternative reform proposals available and the hugely beneficial removal of the improper linkage, other than Delinking and working to improve the functioning of the short-term funding markets, no further reforms are justified. Actions taken in reliance on inaccurate data or fallacious assumptions are arbitrary and capricious.[58]

III. AMENDMENT TO REMOVE LIQUIDITY FEES AND REDEMPTION GATES

We fully support delinking the potential imposition of liquidity fees and gates with required minimum liquidity levels ("Delinking"). This is a part of the 2014 Amendments that should never have been implemented and unnecessarily amplified the stresses experienced by MMFs during the Liquidity Crisis. Commissioner Stein was right in her objection to the 2014 Amendments:

> [A]fter careful study, I am concerned that gates are the wrong tool to address this risk. As the chance that a gate will be imposed increases, investors will have a strong incentive to rush to redeem ahead of others to avoid the uncertainty of losing access to their capital….
>
> Ultimately, despite the rule's efforts to mitigate the risks posed by gates, I believe the incentives to avoid them will remain powerful. I fear these incentives may result in a greater chance of fire sales during times of stress, and a spread of the panic to other parts of our financial system, while also denying both investors and issuers access to capital. I am, therefore, in the unfortunate position of not being able to support the rule that the staff recommends adopting today, despite some of its well-considered and thoughtful components.[59]

However, while there is general agreement that Delinking should be eliminated,[60] the impact of Delinking gates and fees from liquidity requirements, rather than eliminating gates/fees authority, has not been properly considered in evaluating other aspects of the Proposal.

---

[58] *See* 5 U.S.C. § 706(2)(A) (2018) (requiring courts to set aside agency action found to be arbitrary or capricious); *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (holding that "an agency rule would be arbitrary and capricious if the agency has . . . entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise").

[59] Hon. Kara M. Stein, July 23, 2014, available at https://www.sec.gov/news/public-statement/2014-07-23-open-meeting-statement-kms.

[60] 2022 MMF Release 87 Fed. Reg. at 7252-7256; L. Li, Y. Li, M. Machiavelli & X. Zhou, Federal Reserve Board Division of Research and Statistics, *Liquidity Restrictions, Runs and Central Bank Interventions: Evidence from Money Market Funds*, at 32 (May 24, 2021), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3607593 (data indicates redemptions driven by *linkage* of potential gates and fees to WLA compliance). Notably, the study found that DLA levels did not drive redemptions, and did not find that either liquidity requirements or gating/redemption fee authority drive redemptions, but instead that the linkage of WLA levels to gating/redemption fee authority "might have exacerbated" redemptions.

A. The Impact of Delinking Must be Properly Considered

Delinking would have allowed MMFs to access over 30% more liquidity held within MMFs during the Liquidity Crisis, an amount of liquidity greater than redemptions experienced.[61] Delinking will also eliminate one of the major incentives for redemptions that IOSCO and other policymakers observed in March 2020. This is supported by the data. In the U.S., the SEC itself has found that "[s]taff outreach to market participants indicate that prime fund outflows accelerated as WLAs [weekly liquid assets]fell close to 30 percent."[62]

Notably, private institutional prime MMFs, which are not subject to a required linkage between liquid asset thresholds and imposition of gates and fees, saw only a 6% net drawdown from March 9 through March 20, 2020, as compared to registered prime institutional MMFs which saw a 30% net drawdown over that same period.[63]

If there is no regulatory link between the level of liquidity buffers and the potential imposition of fees or gates, MMF managers will be able to use weekly liquid assets in a countercyclical way. Federated Hermes supports the existing MMF daily and weekly liquid asset requirements of 10% and 30%, respectively. We note that these requirements are further enhanced by a KYC overlay and if a MMF's liquidity falls below these requirements at any time, it is limited to purchasing daily and weekly liquid assets. These daily and weekly liquidity requirements, once unencumbered, should be retained and applied to all MMFs. The positive impact of Delinking cannot be overestimated.

B. Discretionary Liquidity Fees & Gates Should Remain Tools for Directors' Consideration

While we appreciate the SEC's acceptance that the 2014 Amendments improperly linked the imposition of gates and fees to a fund's liquidity levels, we do not agree with the proposed response to remove both the potential imposition of fees and gates from the directors' toolkit. The problem with the 2014 Amendments was the linkage, not the potential imposition by a fund board, in its discretion, of a liquidity fee or gate. Liquidity fees and gates remain viable options that should be available to fund boards, particularly the use of properly calibrated liquidity fees which provide a targeted and efficient way to allocate the cost of providing liquidity to redeeming investors in times of stress, without causing material dilution.

The Commission notes in its proposal that

> Fees and gates were intended to serve as redemption restrictions that would provide a "cooling off" period to temper the effects of a short-term investor panic and preserve liquidity levels in times of market stress, as well as better allocate the costs of providing liquidity to redeeming investors. However, these provisions did not achieve these objectives during the period of market stress in March 2020.

This conclusion is false. It was not the fees and gates that failed to achieve the stated objectives, but rather the linkage of such tools to liquidity levels. Moreover, it was not only that funds were hesitant to dip below

---

[61] *See* 2022 MMF Release, 87 Fed. Reg. at 7252-7254.

[62] *See* U.S. Securities and Exchange Commission Division of Economic and Risk Analysis, *U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock*, at 5 (Oct. 2020), available at https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf.

[63] 2020 MMF Release, 87 Fed. Reg. at 7252.

(or even get close to) the 30% WLA threshold for fear of triggering further redemption, but also that the markets were effectively frozen. No bids were available, underscoring both the depth of investor panic as well as the initial miscalculation by the Fed and Treasury that something needed to be done to avert an economic meltdown. Accordingly, there is a need to focus on market reform, rather than adopting dangerous and uncalled for reforms to MMFs. Simply put, the short-term funding markets failed and, because of the improper linkage embedded in the 2014 Amendments, MMFs could not access their own internal liquidity.

In the Proposal, the SEC expresses its belief that investors are less sensitive to the possibility of a liquidity fee than a redemption gate and goes on to note that a tool to cause redeeming investors to bear the costs of liquidity should be available. The Proposal further states that the current liquidity fee provisions in Rule 2a-7 did not achieve this goal and recognizes that such failure "is due to the design of the current rule."[64] We fully agree.

The SEC then references several proposals to enhance the liquidity rules to ensure that such rules are effective in times of stress. However, the SEC dismisses these enhancements, citing their concern regarding timing:

> We are not proposing any of these approaches because we do not believe they would result in timely decisions to impose liquidity fees on days when the fund has net outflows that, due to associated costs to meet those redemptions, will dilute the value of the fund for remaining shareholders.

Rule 2a-7 has always relied upon timely action by boards and continuing to do so remains entirely appropriate.[65] Concerns regarding timing can be addressed in several ways. A decision to simply abandon the use of liquidity fees and turn to a more burdensome and costly alternative which eliminates a key tenet of MMFs is not supported by the data.

Enhancing procedures surrounding the monitoring of a fund's liquidity and the consideration of potential implementation of liquidity fees can ensure that a board's determination is timely. In a previous comment letter, Federated Hermes suggested a form of amendment to Rule 2a-7 which provides for the implementation of liquidity fees and sets forth key elements which should be incorporated into a new liquidity management procedure. The enhanced procedure would require a fund's board to evaluate the need for liquidity fees and/or temporary gates as part of its fiduciary duty and in serving the best interest of shareholders as well as to report to the SEC the basis for applying liquidity fees and imposing temporary suspensions.[66] Procedures to ensure prompt consideration of liquidity fees and/or temporary gates by MMF boards should ensure that in times of stress Fund Boards have readily available to them information on:

- current and expected market conditions;
- current market-based net asset value per share calculation;
- capital stock activity (gross and net purchases and redemptions);

[64] *See* 2022 MMF Release, 87 Fed. Reg. at 7258-7259.
[65] See for example Rule 2a-7(g)(1)(i)(B) Prompt Consideration of Derogation
[66] *See* Federated Hermes comment letter dated September 13, 2021 ("Third Federated Hermes Comment Letter") at https://www.sec.gov/comments/s7-01-21/s70121-9232417-250529.pdf

- review of shareholder information relative to expected purchases and redemptions (KYC);
- Daily and Weekly Liquid Asset levels;
- information about current credit quality of portfolio holdings;
- credit spreads and liquidity conditions prevailing in relevant markets, including estimated transaction costs;
- results of recent stress testing required under this rule; and
- the availability and costs of alternative liquidity sources.

Furthermore, dismissing liquidity fees as a future tool because liquidity fees were not utilized during the Liquidity Crisis would be incredibly premature, as we cannot separate the regulations as they existed during the Liquidity Crisis with an inappropriate linkage to a fund's liquidity levels and gating and the board's determination not to utilize any one tool. Under the current regulations, a fund's weekly liquidity would have needed to fall below 30% before such a tool could have been used, and data showed that as funds' liquidity dipped below 35%, redemptions, albeit unnecessarily, increased given investors' fear of gates – so the use of liquidity fees, or lack thereof, during the Liquidity Crisis cannot be considered in isolation and was dramatically impacted by the inappropriate linkage.

We note that banks have been authorized to impose discretionary redemption penalties and 7-day restrictions/prior notice requirements (and by Fed Regulation D required to reserve the contractual right to do so) on withdrawals of deposits other than "demand deposit accounts."[67] These discretionary bank deposit fees and gates have never been linked to a regulatory liquidity requirement. Indeed, most U.S. banks have never been subject to specific federal liquid asset requirements and only recently have the very largest U.S. banks been subject to specific liquidity requirements.[68] We are not aware of any suggestion that the Fed requirement for discretionary redemption fees and gates on bank deposits, not linked to any specific trigger, has induced bank runs.

We also note that the study cited by the 2022 MMF Release document found that redemptions are not driven by investor focus on MMF daily liquid asset levels - the portfolio assets that are actually used to make redemptions - but instead by investor focus on weekly liquid asset levels because of the regulatory linkage in Rule 2a-7 of compliance with regulatorily required weekly liquid asset levels to potentially triggering liquidity gates and fees.[69] These two facts demonstrate further that it is not the possibility of a gate or fee that accelerates redemption propensity, it is the specific trigger in Rule 2a-7 that links weekly liquid asset compliance with potential gates and fees that create the accelerant. By delinking liquidity from fees and gates, the trigger for accelerated redemptions is removed. The studies do not show that unlinked gating or redemption fee authority at the discretion of a MMF board would cause or accelerate redemptions.

---

[67] 12 C.F.R. Pt. 204.

[68] 12 C.F.R. 50, 249, 329; OCC, Federal Reserve, FDIC, Final Rule, *Net Stable Funding Ratio: Liquidity Measurement Standards and Disclosure Requirements*, 86 Fed. Reg. 9120 (Feb. 11, 2021) (liquidity requirements in form of liquidity coverage ratios and net stable funding ratios adopted in 2014 and 2021 and apply only to very large banks).

[69] L. Li et al., *supra* note 60, at 19, which was cited in the 2022 MMF Proposal, 87 Fed. Reg. at 7252 n.31.

Finally, we note at the global level that, in its final report[70] dated October 2021, the FSB does not propose to eliminate discretionary liquidity fees. It only suggests the removal of ties between regulatory thresholds and imposition of fees and gates but stresses that "MMFs would be able to activate fees and gates irrespective of their liquidity levels." Moreover, in the European Systemic Risk Board's Recommendation[71] on reform of MMFs, it does not advocate for dismissing liquidity fees and does not seek to impose swing pricing on MMFs. The ESRB concludes that the determination on the application of the appropriate LMT (liquidity fees, gates or swing pricing) should be left to the fund board. ECB has echoed this recommendation by stating[72] that "to keep fund managers' incentives aligned with prudent liquidity risk management, authorities should not have a role in requiring the use of liquidity management tools [LMTs]." In the same vein, in its opinion[73] on the review of the Money Market Fund Regulation, ESMA clearly states that "[t]hese LMTs should be activated by the manager of the MMF, and not by the authorities since there is a risk that when the authorities decide to activate a tool it would actually trigger the very contagion it intended to contain."

Federated Hermes supports the retention of a fund board's ability to impose either a liquidity fee or a redemption gate, in its discretion and in accordance with its fiduciary duty, when doing so is in the best interest of the fund and its shareholders, without reference to any specific level of liquidity. These are important tools that should remain.

The SEC should not overshoot this mark of what needs to be done, as it did in 2014. Rather, the SEC should calibrate enhanced reforms that are supported by the data. The SEC should not take unnecessary action simply to appear forceful to other government agencies.

C. SEC Redemption Gate and Liquidity Fee questions 1-12

SEC PROPOSAL QUESTION 1 AND FEDERATED HERMES RESPONSES

Should we, as proposed, no longer allow money market funds to impose redemption gates under Rule 2a-7?

No. The Commission should, for the reasons noted above, allow money market funds to impose redemption gates under Rule 2a-7, provided however that such imposition is left to the board's discretion to act in the best interests of the fund and its shareholders. Providing a board with more tools for consideration in times of market stress is a positive. We do not accept that a board would be paralyzed by having to consider what circumstance would justify the use of a gate, and instead believe that a board will appreciate having many options on the table as it considers actions necessary to discharge its fiduciary duty and ensure that all shareholders are treated equally. We also do not believe that a board's ability to implement a gate, which is not encumbered by an automatic trigger, would lead to increased or accelerated redemptions.

---

[70] *See* FSB 2021 Policy Report, *supra* note 5.

[71] *See* European Systemic Risk Board (ESRB), *Recommendation of the European Systemic Risk Board 2 December 2021 on reform of money market funds* (ESRB/2021/9), available at https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation220125_on_reform_of_money_market_funds~30936c5629.en.pdf?26a37498f9b2917912eb6bd1dc5824d7.

[72] *See* M. Grill et al., *supra* note 22.

[73] *See* ESMA, *Final Report*: *ESMA opinion on the review of the Money Market Fund Regulation*, *supra* note 22.

Are there circumstances, beyond those covered by rule 22e-3, in which the ability of a money market fund to impose a gate or suspend redemptions would provide benefits to money market funds and short-term markets?

While the provisions of rule 22e-3 remain appropriate for situations involving a fund closure, it is impossible to predict future scenarios where a fund could benefit from the imposition of a short-term gate, which, unencumbered by linkage to liquidity levels, might stem preemptive redemptions. Therefore, retaining the potential usage of a gate by a board in its discretion remains appropriate, provided such imposition is no longer tied to a particular metric.

SEC PROPOSAL QUESTION 2 AND FEDERATED HERMES RESPONSES

Instead of removing the ability to impose gates from Rule 2a-7, should we retain gates as an available tool for money market funds?

Yes. 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. A temporary redemption gate could serve as a potentially useful tool for MMF boards to consider in a future crisis.

If so, should we modify the current provision to remove the tie between gate determinations and liquidity thresholds?

Yes. Imposition of a redemption gate should not be tied to any specific fund metric and any determination to implement a gate should be made at the discretion of the board in exercise of its fiduciary duty.

Should a fund board be able to impose a gate any time it determines that doing so is in the best interest of the fund?

Yes.

If so, should a fund have to opt in ex ante to having gates as a potential tool?

No. While the potential use of a gate to manage a MMF in a time of stress should not be mandatory, all fund boards should have the option to consider the use of a gate in the best interest of the fund and fund shareholders.

In what circumstances would it likely be in the fund's best interests to impose a gate?

While it is impossible to predict future scenarios where a fund could benefit from the imposition of a short-term gate, which, unencumbered by linkage to liquidity levels, would not lead to preemptive redemptions, it may be envisioned that such tool could be utilized to prevent material dilution or other unfair results depending on the specific circumstances impacting a fund. One need only look back to the different approaches taken by the boards of the Reserve Primary Fund and the Putnam Prime Money Market Fund (the "Putnam Prime Fund"). In Putnam's case, the board did press "pause" on redemptions and implemented a gate as it sought out a resolution to address its redemption pressure and in doing so managed to treat all shareholders fairly; resulting in a positive outcome for all of its shareholders – both those looking to redeem and those who were happy to remain invested. Contrast that to the action, or inaction, taken by board of the Reserve Primary Fund. The timely imposition of a redemption gate might have afforded the Reserve Primary Fund's board with an opportunity to evaluate other options to their predicament.

As each fund's situation is unique, discretion to utilize a gate by a board is imperative. Moreover, consideration of appropriate LMTs by fund boards, without such tools being improperly linked to any identifiable metric, would also void any potential "gaming" by investors.

Would a board impose a gate in practice and, if so, what are the practical consequences of any such decisions?

If application of a gate is determined by the board to be the best response in a stressed market condition to ensure that all shareholders are treated equally, we believe boards would impose gates, even if such determination results in a fund being liquidated. The Putnam Prime Fund is a perfect example. The Putnam Prime Fund held $17.4 billion on September 12, 2008 but experienced a decline in assets over September 15 and 16 (the day of and following the Lehman Brothers bankruptcy) of more than $5 billion. On September 17, the fund's board voted to suspend redemptions and liquidate the fund.[74] The fund's board took prudent and timely action which prevented the Putnam Prime Fund from experiencing the uncontrolled redemptions suffered by the Reserve Primary Fund and provided the Putnam Prime Fund with sufficient time to negotiate a solution that restored liquidity on terms that were equitable to all shareholders. Specifically, on September 25, the Putnam Prime Fund exchanged $12.3 billion of assets in-kind for shares of Federated's Prime Obligations Fund. The Putnam Prime Fund immediately liquidated by distributing the Prime Obligations Fund shares to its shareholders. Prime Obligations Fund then honored another $5 billion of outstanding redemptions from former Putnam Prime Fund shares at $1 per share.[75]

The Putnam example is definitive proof that a board, in exercise of its fiduciary duty, will consider the tools available to it and make difficult decisions when necessary. Even if the action would ultimately result in the fund liquidating. The benefit of the temporary gate would be that the portfolio continues to march to maturity and more cash becomes available to meet redemptions, all while ensuring shareholders are treated equally.

Gates, unencumbered by an improper tie to liquidity, remain appropriate tools for boards to consider. However, if the concerns expressed in the Proposal remain, that a board would not exercise its fiduciary duty accordingly and implement the most appropriate LMT, the Commission could require all fund boards to appoint independent legal counsel to further ensure that boards are cognizant of, and discharge as appropriate, their fiduciary responsibilities.

Would it be effective to require a fund to adopt board-approved policies and procedures that identify the circumstances in which the fund would impose a gate?

No. A board should be left to consider the potential imposition of a gate in its discretion as it would consider the potential usage of any other LMT. Boards should, however, be required to adopt specific policies and procedures relating to consideration of key data points as part of any analysis on whether to impose a LMT.

If so, what factors should those policies and procedures consider for purposes of when to impose a gate?

---

[74] *See* Henriques, *supra* note 25.
[75] *See* Comment Letter of Federated Investors, Inc. (Sept. 16, 2013), available at https://www.sec.gov/comments/s7-03-13/s70313-130.pdf.

While the determination on the potential imposition of a gate is best left for a board's consideration as it discharges its fiduciary duty, we have provided a recommended set of procedures which could be used by fund boards to ensure that all appropriate data is considered. These key data points should include:

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

How would this approach affect investor and fund behavior? For example, would investors be likely to redeem preemptively in terms of stress out of concern that a fund may impose a gate, or would investors view a redemption gate as unlikely under this approach?

We do not believe a completely discretionary gate would materially alter an investor's behavior, as a fund would retain the right to impose a gate in the event of liquidation at all times under rule 22e-3. Moreover, retention of a time-limiting provision to ten days would provide further certainty to investors that, should a gate need to be in place for longer than ten days, then the fund would need liquidate. The ability to utilize a gate, however, should be de facto available to all funds. If fund boards were required to "elect" into this option, then we do believe such a requirement would inappropriately impact investor fund selection.

SEC PROPOSAL QUESTION 3 AND FEDERATED HERMES RESPONSES

If we retain the connection between redemption gates and liquidity thresholds, what liquidity threshold should we use to permit a board to impose a redemption gate? For example, should the liquidity threshold remain at 30% weekly liquid assets, increase to 50% weekly liquid assets in connection with our proposal to increase liquidity requirements, or be lower than the current 30% threshold (e.g., 10% or 15% weekly liquid assets)?

There should be no connection between redemption gates and liquidity thresholds. Imposition of gates should be in a board's discretion in connection with its exercise of its fiduciary duty to avoid material dilution or other unfair results.

Should the board's ability to impose a redemption gate instead be tied to a daily liquid asset threshold, such as the current 10% threshold, the proposed 25% threshold discussed below, or a lower threshold, such as 5%?

No. The potential imposition of a gate (or liquidity fee) should not be tied to any liquidity level.

How would these changes affect investor and fund behavior?

If the potential imposition of a gate remains tied to any liquidity level, then investor behavior will remain as observed in the Liquidity Crisis and gates will continue to serve as a trigger for artificially high investor redemptions. If, however, a board's ability to impose a gate is not tied to any specific metric, then having such tool at its disposal would not incentive investors to redeem.

Are there other ways we should modify provisions related to redemption gates to make them less likely to incentivize preemptive redemptions in times of stress?

Imposition of gates should be left to a board's discretion in connection with its exercise of its fiduciary duty and should continue to be limited to ten days for any fund intending to gate outside of liquidation.

SEC PROPOSAL QUESTION 4 AND FEDERATED HERMES RESPONSES

Should we allow certain types of money market funds to impose redemption gates, but not others? For example, are retail investors less sensitive to the potential imposition of gates, such that allowing retail funds to impose gates is less likely to contribute to incentives to redeem preemptively? Alternatively, should we only allow institutional funds to impose gates given that these funds historically have experienced higher levels of redemptions in times of stress?

All boards, regardless of shareholder base, should have the ability to consider the potential use of a gate (or liquidity fee) in times of stress as part of a board's exercise of its fiduciary duty.

SEC PROPOSAL QUESTION 5 AND FEDERATED HERMES RESPONSE

If we retain a redemption gate provision in Rule 2a-7, would the board's ability to impose a redemption gate reduce the need for, or otherwise affect, other regulatory provisions we are proposing (e.g. the swing pricing requirement for institutional prime and institutional tax-exempt money market funds, increased liquidity requirements for all money market funds)?

Yes. We believe the retention of a board's ability to impose a gate and a liquidity fee would be an additional tool at a board's disposal to be considered as part of its exercise of its fiduciary duty in times of stress which would be considered to prevent any material dilution or other unfair results, obviating the need for swing pricing.

SEC PROPOSAL QUESTION 6 AND FEDERATED HERMES RESPONSE

Should we remove the liquidity fee provisions from Rule 2a-7, as proposed?

No. Liquidity fees should remain a viable option for a fund board to implement in times of stress unencumbered by an inappropriate linkage to liquidity levels. Timely determinations and properly calibrated liquidity fees address the concerns noted by the SEC. 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. 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 investor to redeem shares. 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, contrary to swing pricing, can be assessed consistent with same day settlement.

To what extend did the possibility of liquidity fees motivate investors' redemption decisions in March 2020?

We believe that the primary regulatory driver for redemptions experienced during the Liquidity Crisis was the inappropriate linkage in Rule 2a-7 between mandatory liquidity levels and the requirement to consider imposing a gate. After discussions with our investor base, we believe a properly calibrated liquidity fee intended to address the cost of liquidity resulting from redemptions in times of stress would not motivate, or would disincentivize, investors to redeem in times of stress. We also believe that the potential imposition of a liquidity fee should not be tied to any specific liquidity threshold to ensure that no shareholders attempt to game the system.

If liquidity fees are less of a concern for investors than redemption gates, would liquidity fee provisions, on their own, be less likely to contribute to preemptive redemptions in future stress periods? If so, are there advantages to retaining the current liquidity fee provisions and their connection to weekly liquid asset thresholds?

Provided liquidity fees are no longer tied to specific liquidity thresholds, we do not believe that they will lead to preemptive redemptions in future periods of stress. The imposition of a liquidity fee should be at the board's discretion, subject to their fiduciary duty, and decisions to implement should be based on the totality of a fund's circumstances. Specific and auditable procedures should be required to ensure proper and timely consideration of liquidity fees.

If we retain the connection between liquidity fees and liquidity thresholds, what liquidity threshold should we use to permit a board to impose a liquidity fee (e.g., the current 30% weekly liquid asset threshold or 10% daily liquid asset threshold, the 50% weekly liquid asset threshold or 25% daily liquid asset threshold we propose to use for purposes of funds' minimum liquidity requirements, or a lower threshold, such as 10% or 15% weekly liquid assets or 5% daily liquid assets)?

No connection between liquidity fees and liquidity thresholds should remain.

How would changes to the liquidity threshold that allows a fund board to consider liquidity fees affect investor and fund behavior?

Investors would be aware that in times of stress the cost of accessing liquidity may be borne by redeeming shareholders and that such determination will be in the hands of the fund's board subject to their fiduciary duty to ensure all shareholders are treated equally.

SEC PROPOSAL QUESTION 7 AND FEDERATED HERMES RESPONSE

Rather than remove the current liquidity fee provisions, should we modify the circumstances in which a money market fund may impose liquidity fees?

Yes. Liquidity fees should be implemented by a fund's board, in its discretion, when it determines that the fees are in the best interests of the fund and fund shareholders to avoid material dilution or other unfair results. Requiring fund boards to adopt specific procedures relating to the potential imposition of liquidity fees will ensure both proper and timely consideration and provide an auditable record for the Commission on any action, taken by a board in times of stress. MMFs are mutual funds. Part of the statutory concept and investment thesis of mutual funds is that revenues and expenses are shared *pro rata* among all shareholders. *Pro rata* allocation of ordinary transaction costs associated with redemptions is not unfair, but is simply a part of being an investor in a mutual fund that is designed for investors seeking ready access to their cash to use when needed for other purposes.

Should we permit a fund's board to impose liquidity fees when it determines that fees are in the best interests of the fund?

Yes.

Would a board use this tool in practice?

Yes. Unencumbered by an inappropriate linkage, and available as a tool for a board to consider in times of stress and in the best interest of the fund, a liquidity fee would be an appropriate tool for a board to use.

What would be the impediments (if any) of the board making this determination?

In times of market stress, and in accordance with enhanced procedures setting forth key considerations, we believe a board would not hesitate to use a liquidity fee if it is determined to be the most appropriate tool to utilize in the best interest of a fund in times of stress.

Would the board be able to act quickly enough to impose a fee so that redeeming investors bear the costs associated with their redemptions and do not have a first mover advantage?

Yes. Rule 2a-7 operates today based in no small part on a reliance that a fund board has the ability to act quickly to ensure that all shareholders are treated fairly. The imposition of a liquidity fee should be guided by new enhanced policies which would include appropriate escalation procedures ensuring timely consideration of the potential imposition of liquidity fees in times of stress. If the Commission believes additional safeguards are required to ensure that fund boards properly consider the potential imposition of LMTs, a new requirement for all MMF boards to have independent legal counsel should be considered.

Any so-called first mover advantage in institutional MMFs was addressed by the Commission in 2014, as these funds now operate on a fluctuating forward price basis. The NAV redeeming investors receive reflects any price movements and costs which occur after the redemption order is placed as calculated using a forward price. Historically, the term "first mover advantage" has been used to refer to investors looking to redeem out of a stable priced MMF before a fund were to experience a break-the-buck scenario. That is no longer the case. The term should NOT be used to refer to a shareholder who is simply looking to redeem at a forward price if they are fearful of future market activity – that is typical investor behavior.

Are there other ways we could achieve these goals through a liquidity fee framework? For example, would it be effective to require a fund to adopt board-approved policies and procedures that identify the circumstances in which the fund would impose a liquidity fee and how the fund would calculate the amount of the fee, without requiring in-the-moment board decisions or action? If so, what factors should those policies and procedures consider for purposes of when to impose a liquidity fee (e.g., size of redemptions, liquidity of the fund's portfolio, market conditions, and transaction costs)?

Enhanced procedures surrounding the potential imposition of liquidity fees are appropriate, and such procedures could set forth circumstances for imposition, however such procedures would not eliminate the need for a board to meet to consider in times of extreme market stress as a board will need to consider all options available to it during times of stress.

While the determination on the potential imposition of a liquidity fee is best left for a board's consideration as it discharges its fiduciary duty, we have provided a recommended set of procedures which could be used by fund boards to ensure that all appropriate data is considered. These key data points should include:

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

As another alternative, should we require a fund to adopt board-approved policies and procedures that result in a fund determining its liquidity costs each day it has net redemptions and applying those costs through a fee?

No. We do not believe that a requirement to determine liquidity costs on a daily basis is appropriate. The mere occurrence of net redemptions does not equate to material dilution. These are mutual funds and not separate accounts. There is, by the nature of the product, a mutualization of the performance and expense experience. Liquidity fees and other tools are appropriate for consideration in times of stress and provided a fund's board has in place policies and procedures to be implemented in times of stress, daily calculations should not be required.

Under either of these approaches, how should funds calculate the amount of a liquidity fee? Should this calculation method be the same as or similar to the calculation of a swing factor for purposes of our proposed swing pricing requirement or the Commission's current swing pricing rule applicable to other mutual funds?

While the determination on the potential imposition of a liquidity fee is best left for a board's consideration as it discharges its fiduciary duty, we have provided a recommended set of procedures which could be used by fund boards to ensure that all appropriate data is considered. The goal in such a situation should be to avoid any instances of material dilution. Subject to retention of a 2% cap, which would reflect the extremely rare high end of any possible liquidity fee but which would in turn provide some level of certainty for investors, the following data points should be considered:

- current and expected market conditions;
- current market-based net asset value per share calculation;
- capital stock activity (gross and net purchases and redemptions);

- review of shareholder information relative to expected purchases and redemptions (KYC);
- Daily and Weekly Liquid Asset levels;
- information about current credit quality of portfolio holdings;
- credit spreads and liquidity conditions prevailing in relevant markets, including estimated transaction costs;
- results of recent Stress Testing required under this rule; and
- the availability and costs of alternative liquidity sources.

Should the calculation account for factors that boards may consider in determining the level of a liquidity fee under the current rule, such as changes in spreads for portfolio securities (whether based on actual sales, dealer quotes, pricing vendor mark-to-model or matrix pricing, or otherwise); the maturity of the fund's portfolio securities; or changes in the liquidity profile of the fund in response to redemptions and expectations regarding that profile in the immediate future?

Yes. A fund's board should consider these factors, and any others that are relevant at the time, to ensure that the liquidity fee implemented most accurately estimates the actual material cost of a fund's liquidity. If those are not material and are what MMF investors would expect to be a normal ongoing expense feature of investing in a fund whose purpose is maintaining ready access for all investors to their cash, at some point attempting to assign these costs to redeeming investors, but only some of the time when an arbitrary net redemption threshold is triggered, is unnecessary.

Although materiality is measured by its significance to investors and takes into account not just absolute numbers and percentages but also what these signify to investors.[76] The actual costs to a MMF and its investors of net redemptions and related portfolio transactions for a MMF with strong liquidity levels and portfolio assets valued at the bid price may often not be material by any realistic measure. MMFs prior to the 2014 Amendments employed a half-cent measure of materiality on share prices. The materiality threshold for disclosures of bank deposit interest rates is one twentieth of one percent (0.05%),[77] and for disclosures of interest rates on consumer loans is one eighth of one percent.[78] Prime institutional MMFs currently are required to be priced to the fourth decimal place. If the portfolio costs of processing a net redemption does not move MMF share prices, they cannot realistically be viewed as material to any MMF investor and should not be assessed.

Should the liquidity fee take into account the market impact of selling the fund's securities to meet redemptions?

Possibly, if the market impact of selling the fund's securities would result in material dilution. This is a determination that should be made by a fund's board as part of its analysis.

[76] *See* SEC Staff Accounting Bulletin 99 (Aug. 12, 1999).
[77] 12 C.F.R. 1030.3(f).
[78] 12 C.F.R. 1026.14(a).

Should the liquidity fee be based on an assumption that the fund meets redemptions with its most liquid securities, a pro rata amount of each security in its portfolio, or only the securities the fund intends to use to meet redemptions?

No. The liquidity fee must be determined based on the facts and circumstances of the fund at the appropriate time in consideration of the liquidity strategy employed by the fund's manager. The board will need to consider a variety of factors, including market rates at the time and requirements to not only maintain liquidity but also weighted average maturity ("WAM") and weighted average life ("WAL") which will impact which securities are sold at any particular time. The rule should not try to substitute prescriptive dictates for the judgment of investment professionals. MMFs must remain flexible to successfully maneuver in times of stress and fund boards must be equipped with tools that allow them to consider the specific facts and circumstances of their funds in times of stress and select the best tools, if any, to be utilized in a specific situation.

Should the liquidity fee be a set amount, such as 0.5%, 1%, or 2% of the value of the shares redeemed? Instead of a uniform fee amount, should the rule establish a default fee that funds could adjust upward or downward, as appropriate?

A fund board should have the discretion to implement an appropriate liquidity fee which best approximates the cost of achieving such liquidity in times of market stress, provided however that a cap of 2% should be included in the requirements.

SEC PROPOSAL QUESTION 8 AND FEDERATED HERMES RESPONSE

If we maintain a liquidity fee provision in the rule, should it apply only to institutional prime and tax-exempt funds, or should retail or government funds also be subject to the provision?

Purely discretionary liquidity fees should be a tool for directors to utilize regardless of fund or investor type.

What are the key distinguishing characteristics of the funds that would lead to differing approaches?

A fund board's determination to implement a liquidity fee will be impacted by each board's consideration and assessment of the particular fund, market activity generally, future liquidity demands, knowledge of a fund's investor base, including anticipated future redemptions and concentration levels, views surrounding ease in obtaining additional liquidity, and anticipated fund flows, amongst many other potential variables, all of which could lead boards to make different, but entirely appropriate, determinations on the best LMTs to use in times of stress.

SEC PROPOSAL QUESTION 9 AND FEDERATED HERMES RESPONSE

If we allowed or required funds to impose liquidity fees, are there other changes we should make to the current framework? For example, should we continue to limit the size of the liquidity fee to no more than 2% of the value of the shares redeemed?

As previously noted, the current framework should be revised to provide for discretionary liquidity fee implementation supported by a required enhanced procedural environment to ensure both proper and timely consideration of the implementation of liquidity fees. The imposition of a fee should not be required. While the calculation of such fees should be at the discretion of the fund's board and should approximate the actual cost of the liquidity, we believe including a 2% cap remains appropriate. Such a cap would provide investors with confidence that such a fee would not exceed a specific threshold and given the nature of the securities held, and the history of price movements within a fund, it is difficult to imagine any scenario where the cost of liquidity would exceed 2%.

Are there circumstances in which the liquidity costs associated with meeting redemptions may exceed 2% of the value of the shares redeemed, such that increasing or removing the limit would better mitigate dilution?

This would be incredibly unlikely and, as such, retaining a 2% liquidity fee cap remains appropriate. We reiterate that such a cap would provide investors with confidence that such a fee would not exceed a specific threshold and given the nature of the securities held, and the history of price movements within a fund, it is difficult to imagine any scenario where the cost of liquidity would exceed 2%, however inclusion of such a cap would provide investors with some certainty on the maximum impact of any such fee.

SEC PROPOSAL QUESTION 10 AND FEDERATED HERMES RESPONSE

If we adopted a modified liquidity fee framework that required funds to apply liquidity fees more frequently than is contemplated by the current rule, are there operational issues we would need to consider? For example, are intermediaries able to apply liquidity fees on a dynamic basis (e.g., where liquidity fees vary in size and may apply more frequently than during periods of stress)?

First, rule enhancements should not be designed to implement liquidity fees more frequently. Rather they should be designed to ensure that, when appropriate, such fees are timely considered and, if implemented, the calculated fees best approximate the actual cost of liquidity. Second, yes there will be operational issues to consider, however as liquidity fees are an option today, such preparation to utilize in the future should not be material.

SEC PROPOSAL QUESTION 11 AND FEDERATED HERMES RESPONSE

Should we require money market funds to implement practices to mitigate investor dilution but permit money market funds to choose between imposing liquidity fees or imposing the proposed swing pricing approach as the method for doing so?

Retaining the ability to use a timely and properly considered and calculated liquidity fee eliminates any reason to mandate swing pricing. That said, should the Commission insist on consideration of swing pricing as an optional LMT, if a board elects to utilize a liquidity fee approach, then such board should be able to disapply any swing pricing requirement. Providing the board with additional tools to address different stressed environments is a far better option than mandatory omnipresent swing pricing requirement.

The materiality of the actual costs incurred should also be considered. If they are not material and are what MMF investors would expect to be a normal ongoing expense feature of investing in a fund whose purpose is maintaining ready access for all investors to their cash, at some point attempting to assign these costs to redeeming investors, but only some of the time when an arbitrary net redemption threshold is triggered, is simply splitting hairs for no real purpose. Materiality is measured by its significance to investors and takes into account not just absolute numbers and percentages but also what these signify to investors.[79] The actual costs to a MMF and its investors of net redemptions and related portfolio transactions for a MMF with strong liquidity levels and portfolio assets valued at the bid price may often not be material by any realistic

[79] *See* SEC Staff Accounting Bulletin 99 (Aug. 12, 1999).

measure. If the portfolio costs of processing a net redemption do not move MMF share prices, they cannot realistically be viewed as material to any MMF investor and should not be assessed.

Should we allow money market funds to choose other unspecified options for mitigating investor dilution? What are the advantages and disadvantages of these approaches?

We believe liquidity fees, subject to enhanced procedural requirements, are a critical tool which should be available for a fund board to consider in times of stress.

What factors would influence a fund's decision of whether to implement swing pricing, a liquidity fee framework, or another method of mitigating dilution?

As swing pricing would eliminate a key tenet of MMFs, and as the use of a properly calibrated and timely implemented liquidity fee accomplishes the same regulatory objective, of passing on the cost of liquidity, we would anticipate that a fund board would elect to implement liquidity fees in the best interest of its shareholders. That said, we would expect any MMF board to properly consider the facts and circumstances surrounding each particular fund and the market conditions/events which triggered the discussion and then elect to put in place the best LMT available to address the particular situation.

SEC PROPOSAL QUESTION 12 AND FEDERATED HERMES RESPONSE

Do money market funds view rule 22c-2 as a viable way to implement liquidity fees, if the board approves the use of such fees?

Whether via 22c-2 or as part of Rule 2a-7 a liquidity fee is an effective liquidity management tool that should be available to all boards. We believe the most appropriate place for the provisions regarding a MMFs use of liquidity fees to be within the rubric of Rule 2a-7. Rule 22c-2 was designed to deter market timing, and its history indicates it was not meant for MMFs. The proposed swing pricing requirement would apply to both purchase and redemption pricing and introduces opportunities for market timing/arbitrage of MMFs that currently do not exist and that are not present with liquidity fees. The market timing/arbitrage opportunity is greatest under the SEC proposal to use a vertical slice of the MMF portfolio to determine the swing price, because the net redemptions will normally be paid out of daily liquidity and there will be no meaningful cost or true NAV impact to the net redemption, but purchasers against the flow of the net redemption in excess of the trigger amount of 4% outflows will get a discounted price for their shares. If anything, the swing pricing proposal is directly contrary to the requirements and purposes of rule 22c-2.

Should we modify any of the requirements of rule 22c-2 or Form N-1A that relate to redemption fees for these funds? For example, should we specify that, like a liquidity fee under Rule 2a-7, a money market fund redemption fee under rule 22c-2 does not need to be disclosed in the prospectus fee table?

No further amendments are necessary. The implementation of liquidity fees should be within the rubric of Rule 2a-7. Rule 22c-2 was designed to deter market timing.

Would retail prime or retail tax-exempt funds opt to rely on rule 22c-2?

Whether via 22c-2 or as part of Rule 2a-7, retail prime and tax-exempt funds should be able to avail themselves of the benefits of a liquidity fee. We believe the most appropriate place for the provisions regarding a MMFs use of liquidity fees to be within the rubric of Rule 2a-7. Rule 22c-2 was designed to deter market timing, and its history indicates it was not meant for MMFs.

Would institutional prime or institutional tax-exempt funds ever use rule 22c-2 in addition to the proposed swing pricing requirement and, if so, why?

Perhaps. If a swing pricing requirement is codified it is highly unlikely that any significant institutional prime or institutional tax-exempt funds will exist. Shareholders' opposition to swing pricing is clear and investors in these funds require a fund's ability to provide intraday and same day liquidity. However, if swing pricing is the only liquidity management tool available consideration may be given to preserve the NAV on purchases and eliminate any arbitrage opportunities.

IV. SWING PRICING

A. The case for mandated, omnipresent swing pricing has not been made.

Federated Hermes firmly opposes any proposal which mandates the use of swing pricing, as swing pricing is simply not compatible with MMFs. In 2016, the SEC determined that a liquidity fee, not swing pricing, was the more appropriate LMT for MMFs. In adopting the swing pricing provisions of Rule 22c-1, the SEC determined not to impose swing pricing on MMFs because MMFs already have unique portfolio liquidity requirements not found in other types of mutual funds, and other LMTs such as the ability to impose liquidity gates and fees if needed.[80] The SEC also noted at that time the processing costs and fundamental shareholder fairness issues associated with using swing pricing to address dilution issues at less liquid funds and that liquidity fees may be a simpler and fairer alternative for some funds,[81] and chose not to apply the requirement to MMFs which addressed dilution considerations associated with redemptions more directly through portfolio liquidity requirements and the ability to impose redemption fees.

That rule requires a fund to conduct a four factor review as to whether to impose swing pricing and what "swing factor" to use, based on (1) the size, frequency and volatility of net purchases and redemptions in stressed periods; (2) the fund's investment strategy and liquidity of the asset class held in portfolio (referencing emerging markets funds, illiquid bond funds and alternative strategies funds as examples of illiquid portfolios with large market impacts and transactions costs);[82] (3) cash and liquidity on hand; and (4) transactions costs for portfolio sales. Rule 22c-1 caps the swing factor at no more than 2% even for mutual funds with relatively illiquid portfolios and requires that the swing factor be no more than is reasonable in relation to portfolio transaction costs.[83] These factors weigh very strongly against use of swing pricing in MMFs, which invest exclusively in short-term highly liquid money market instruments for which transaction costs are very low (particularly for MMFs that price at the bid – which should be required), and which are required to maintain very large DLA and WLA positions. Similarly, MMFs are "excepted funds" not subject to Rule 22c-2 requirements to consider redemption fees of up to 2% to deter and recoup the shareholder dilution and portfolio transactions costs of market timing and short-term trading.[84] Swing

---

[80] 17 C.F.R. 270.22c-1(a)(3), SEC, Investment Company Swing Pricing, Final Rule, 81 Fed. Reg 82084, 82090-82091 (Nov. 18, 2016).
[81] SEC, Investment Company Swing Pricing, Final Rule, 81 Fed. Reg 82084, 82094-82096, 82118, 82120, 82128-82129 (Nov. 18, 2016).
[82] 81 Fed. Reg at 82095-82096.
[83] 81 Fed Reg. at 82122.
[84] SEC, *Mutual Fund Redemption Fees*, Final Rule, 70 Fed. Reg. 13328, 13330 n.26 (Mar. 18, 2005); SEC, *Mandatory Redemption Fees for Redeemable Fund Securities*, Proposed Rule, 69 Fed. Reg. 11762, 11767 (Mar. 11, 2004) (MMFs are liquid and not subject to harms from frequent and short-term trading).

pricing and mandatory redemption fees are the wrong tool for MMFs. That determination remains true today despite the proposed mandatory application of swing pricing to MMFs in the Proposal. The SEC's apparent change in in preferred approach is based on several flawed and/or incorrect positions.

1. <u>Liquidity Fees, unencumbered by misguided linkages, remain a valuable tool for MMFs and boards to deal with material dilution or other unfair results.</u>

The Commission repeatedly asserts that the liquidity fee requirements set forth in the 2014 Amendments did not work. In an attempt to evidence that they did not work, the Commission cites that no MMFs implemented liquidity fees during the Liquidity Crisis. This conclusion ignores the elephant in the room, which is the improper linkage between a MMF's liquidity levels and the potential imposition of gates and fees. Under the 2014 Amendments, a liquidity fee can only be implemented once a MMF's liquidity falls below 30%; however, if a MMF were to let its liquidity fall below 30%, such fund would have experienced artificially high levels of redemptions as investors would have redeemed out of the MMF to avoid a potential gate. The 2014 Amendments not only incentivized artificially high levels of redemptions, but also created an environment where a MMF board could not properly consider the imposition of a liquidity fee without first sparking investor redemptions based on potential gating, creating a downward spiral.

The improper linkage was not just the linking of liquidity requirements to gates and fees, but also the linkage of gates and fees themselves. One could not be considered without the other and, as a result, the experience of the Liquidity Crisis does not accurately reflect what the experience would have been if a liquidity fee was an option independent of both liquidity levels and gating. Moreover, fund boards benefitted from key elements of the 2010 Amendments and 2014 Amendments heading into the Liquidity Crisis, including greater transparency and higher levels of liquidity entering the crisis (both through mandated levels of daily and weekly liquidity and the KYC overlay), which when combined with both permissible usage of sponsor support, a managers ability to use its discretion to determine what securities (including longer dated securities) should be sold at any given point in time, and government intervention to unfreeze a completely frozen short-term funding markets system, boards simply did not need to implement liquidity fees.

2. <u>MMF Boards will properly exercise their fiduciary duty and implement the best LMT, if required, in times of market stress.</u>

The Commission repeatedly asserts that having a mandatory, omnipresent swing price eliminates the concern that a board would not implement a liquidity fee when necessary, thus removing the decision from the board. This position goes against the entire fund governance model and calls into question the position of the Commission with respect to fund boards, and particularly to the role of independent directors. Does the Commission really believe that a MMF board, including independent directors, would not act in the best interest of a fund and its shareholders in times of stress to put in place the most appropriate LMT available for a particular situation?

How can the Commission reconcile a position that places confidence that a fund board will do the right thing when it comes to certain issues (e.g., proper utilization of amortized cost accounting and a fund's valuation) but not with respect to which LMT should be used in times of stress? The Commission goes on to reference the board's exercise of its fiduciary duty in Section II D of the Proposal on "Amendments Related to Potential Negative Interest Rates", noting that "Rule 2a-7 imposes on the board of a money market fund a duty to consider appropriate action whenever the board believes the extent of any deviation may result in material dilution or other unfair results to investors or current shareholders." If the

Commission is accepting that a board will dutifully fulfill its fiduciary duties with respect to actions in a negative rate environment, why wouldn't the Commission take the same approach when it comes to adopting a liquidity fee if and when appropriate?

The implication of this position goes beyond that of just MMFs and casts a negative light on the governance of all U.S. registered funds. Perhaps the Commission should consider requiring all fund boards to have independent legal counsel to provide further comfort, albeit unjustified, that boards will be advised of their requirements and their options as they discharge their fiduciary duty.

3. Investors monitor and redeem based on liquidity levels when a reduction in liquidity levels by regulation could trigger imposition of a liquidity fee or gate.

The Commission notes that institutional investors are more likely to observe a fund's liquidity levels and redeem as they are reduced, thereby necessitating the adoption of mandatory, omnipresent swing pricing. The Commission references data observed during the Liquidity Crisis where institutional investors redeemed as liquidity levels were reduced. This conclusion, however, once again ignores that the motivation behind monitoring of the liquidity levels and any subsequent redemptions are both directly linked to the potential imposition of fees and gates. Removing the linkage would remove the incentive to act based on a fund's liquidity levels.

A MMF publishes its WAM and WAL on a daily basis and we do not expect shareholders to redeem (nor do they) should a MMF approach the outside limits of either WAM or WAL. That is because the consequence of breaching a WAM or WAL requirement is not punitive on a shareholder, but rather to manage the MMF back into compliance should the WAM and WAL move outside of the regulatory requirements. Moreover, the study referenced in the Proposal evidences that investor redemptions are not triggered by changes in a fund's daily liquid asset levels -- the portfolio assets that are used to make redemptions -- but instead by weekly liquid asset levels, due to their serving as a regulatory trigger to a MMF board considering the imposition of gates and fees.[85] Once the linkage is removed, so too is the incentive to monitor and act based on liquidity levels.

4. The best approach to ensuring the cost of liquidity is applied to redeeming investors, in times of stress, when the potential for material dilution or other unfair results exist, is the use of an unencumbered, discretionary, liquidity fee.

Federated Hermes believes that discretionary liquidity fees properly calibrated and timely implemented, evidenced and auditable by new enhanced procedures, will serve as a key LMT for MMF boards in times of market stress. Federated Hermes believes in the existing fund governance model and believes that fund boards will act in the best interest of the funds and their respective shareholders in accordance with their fiduciary duty and impose the most appropriate LMT available when required. Finally, Federated Hermes believes that if the incentive to redeem (the linkage) is removed, then putting into place a mandatory omnipresent swing price is not only unnecessary but entirely inappropriate.

Notwithstanding that the stated premise for the imposition of a swing price regime is inherently flawed, Federated Hermes, and the investment community generally, continues to support the regulatory intention to apply the cost of liquidity, which might result in material dilution to remaining shareholders, in times of stress. However, for MMFs, the best approach to apply the cost of liquidity to redeeming shareholders in

[85] L. Li et al., *supra* note 60.

times of stress is through the use of a targeted liquidity fee, not an omnipresent swing price. As noted by the SEC in 2016, swing pricing is not compatible with MMFs and would serve to eliminate a key tenet MMFs provide to investors.[86] This remains true.

The implementation of swing pricing by a MMF may result in the enrichment of one shareholder to the detriment of another. For example, for subscribing investors, when there are net redemptions that are above the swing threshold, the subscriber will receive shares at the downward-adjusted NAV. These outcomes may be contrary to the objectives of investor protection and the perceptions of market fairness.[87]

Moreover, if a MMF were to attempt to retain a structure which provides for intraday transactions, such a provision will create an environment which is both imbalanced and one that may create inappropriate market timing/arbitrage opportunities for the most sophisticated investors. Redemption and subscription activity do not, as a general matter, occur at the same times throughout the day. Typically, redemptions are placed first thing in the morning (or the evening before for forward settlement) and investments generally occur throughout the day. Under the swing pricing methodology as proposed, it is more than likely that potential swings will occur for the first part of the day and then not later in the day. This creates opportunities for investors which subscribe early in the day and receive a NAV which has been lowered by a swing factor and then redeem later that same day using a NAV which is unencumbered, both in situations where a properly managed MMF in normal times has made no actual transactions to accommodate any of the trades. The securities remain, in both instances, valued exactly the same, despite a swing price potentially being charged, resulting in shareholders paying or receiving a NAV based on charges that were never incurred.

Providing intraday and daily liquidity to investors is vitally important for all stakeholders. This feature will be lost should swing pricing be mandated. The elimination of intraday settlement also forces more money movement to the end of the day, thereby increasing the systemic risk associated with having trillions of dollars settling at the end of a day, as opposed to balancing out the flow of funds in the financial system throughout the day. Liquidity fees remain a more appropriate alternative and implementation of swing pricing to MMFs will not work for investors.

Even with only end-of-day share pricing, swing pricing would introduce opportunities for investors to engage in market timing of MMFs. Those opportunities currently do not exist (which is why the swing pricing provisions of rule 22c-1 do not currently apply to MMFs). There are a number of highly predictable cash flows into and out of MMFs (and banks and other less regulated holding points for cash balances) that MMF managers take into account in setting portfolio liquidity levels because these events tend to cause net purchases or net redemptions of MMF shares. These include such things as payroll cycles, quarterly tax payments, corporate transfers to 401(k) plans, and bond coupon payments. Other large flows are more specific to large investors cash movements but nonetheless knowable and predicable, such as capital calls into large private equity funds. Yet others can be identified and exploited by market timers using computer analysis, algorithms, and artificial intelligence programs to identify market signals and other predictors of net movements of cash into and out of cash equivalents such as MMFs.

---

[86] 17 C.F.R. 270.22c-1(a)(3); SEC, *Investment Company Swing Pricing*, Final Rule, 81 Fed. Reg 82084, 82090-82091 (Nov. 18, 2016).

[87] For instance, this could result in arbitrary and unexpected results for investors purchasing or redeeming through automated programs such as 401(k) contributions or periodic withdrawal programs.

The Proposal states that on average there are outflows from a prime MMF in excess of 4% of the fund's assets on approximately 5% of trading days,[88] or a little more often than once per month. If a market timer can identify those market timing opportunities using computer algorithms, knowledge of the standard calendar timing of large commercial and government cash flows, and signals of market stress such as VIX index of expected market volatility (sometimes referred to the "fear index"), the Merrill Lynch Option Volatility Estimate ("MOVE Index"), the Average True Range Indicator ("ATR"), Bollinger Bands, whatever replaces the TED Spread and OIS Spread measures post-LIBOR, or other market and economic indicators that are predictive of large money movements into and out of prime MMFs, it can earn a very strong return on a low risk investment in prime institutional MMFs by moving into an out of MMFs at the appropriate times.

The proposed swing pricing requirement would apply to both purchase and redemption pricing. A market timer may be able to reliably predict net inflows and outflows from MMFs and trade against the flow to purchase shares at an artificially discounted price based on the mechanics of the swing pricing requirement, and then redeem during periods of net inflows at a full true NAV.

Liquidity fees only apply to redemptions and do not create market timing opportunities. The market timing/arbitrage opportunity would be largest under the Proposal to use a vertical slice of the MMF portfolio to determine the swing price, because the net redemptions will normally be paid out of daily liquidity and there will be no meaningful market impact, transactions cost or true NAV impact to the net redemptions, but purchasers against the flow of the net redemption will get a discounted price for their shares. In the ensuing several days after the large redemption, the MMF portfolio is rebalanced to its target maturity and liquidity structure. In this process, the MMF never incurs the cost of selling a "vertical slice" in the "pricing period" or in "current market conditions." Furthermore, large unanticipated redemptions are likely to be accompanied by market events that would imply new adjustments to portfolio holdings or maturity structure. The "vertical slice" approach embodies a flawed baseline assumption for what the adviser would actually trade. Imposing a swing pricing requirement based on net redemptions from MMFs would be directly contrary to the requirements and purposes of SEC 22(c) of the Investment Company Act and rules 22c-1 and 22c-2 to combat market timing and dilution of shareholder value.[89]

If the Commission's Division of Economic Research and Analysis needs assistance in analyzing the market timing opportunity that would be created by the swing pricing aspects of the Proposal, it may be useful to consult with the Fed, where the staff and leadership appear to have two decades of analytic and practical experience with mutual fund market timing strategies.[90]

---

[88] 2022 MMF Proposal, 87 Fed. Reg. at 7263.

[89] *See* SEC, Final Rule, *Investment Company Swing Pricing*, 81 Fed. Reg. 82084 (Nov. 18, 2016).

[90] *See, e.g.*, P. Shen, *Market Timing Strategies That Worked*, Federal Reserve Bank of Kansas City Research Working Paper 02-01 (May 2002), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=445920; P. McCabe, *The Economics of the Mutual Fund Trading Scandal*, Federal Reserve Economics Discussion Series 09-06 (Dec. 9, 2008), https://www.federalreserve.gov/pubs/feds/2009/200906/200906pap.pdf; Federal Retirement Thrift Investment Board, Final Rule, *Participants Choices of TSP*, 73 Fed. Reg. 22049 (Apr. 24, 2008) (amendments to self-directed retirement account rules to prevent further market timing of mutual funds by federal employees); and Federal Retirement Thrift Investment Board, Proposed Rule, *Participants Choices of TSP*, 73 Fed. Reg. 12665 (Mar. 10, 2008) (explaining the shenanigans in more detail); A. Rayner, *Fed Admits That Employees Made Market Timing Trades*, THE TIMES, Dec. 10, 2003, https://www.thetimes.co.uk/article/fed-admits-that-employees-made-market-

Swing pricing, while applicable to non-MMF funds, has never been applied to a MMF (whether in the U.S., EU, UK, or any other jurisdiction), and any requirement to implement would be a de facto elimination of MMFs as a viable product for investors. This is a result that would not be justified by any cost benefit analysis given the less onerous alternative of liquidity fees. Federated Hermes does not accept that the operational problems can be easily remedied by reducing availability of intraday price points, moving closing times up, and putting in place fees to investors based on best guess "estimates."

Investors have been clear that they will not invest in a MMF with swing pricing, as this would eliminate the fund's ability to provide intraday and same-day settlement. As a result, any future "dash for cash" or credit crisis would not be mitigated – but rather shifted to unregulated and less transparent vehicles. If any investors were to remain in MMFs, then the mere prospect of the application of a swing price would serve as yet another bright line incentive for an investor to redeem earlier (just like the result from linking liquidity to the imposition of fees and gates).

The SEC's decision in 2016 to exclude MMFs from rule 22c-1's requirement to implement swing pricing was the right determination and should be reaffirmed. The basis behind the SEC's conclusion remains sound and should not be disregarded because of the improper linkage of a liquidity fee with liquidity levels in the 2014 Amendments.

B. Operational Challenges & Increased Market Risk

The Proposal greatly discounts the operational challenges of implementing a mandatory, omnipresent swing price mechanism and massively underestimates the impact such operational changes will have on investors' desire to use MMFs. Notwithstanding the time and cost to implement the swing pricing proposal as crafted and notwithstanding that after such imposition there would likely be no shareholders left, the impact on being able to provide both intraday and same day liquidity should not be misunderstood. Both intraday and same day liquidity in any meaningful way will be eliminated and these are critical to investors.

Investors need both intraday and same day liquidity for a variety of reasons. Intraday liquidity provides investors with flexibility to use MMFs as a cash management tool knowing that they will have ready access to their funds at various points throughout the day. Similarly, the provision of same day liquidity is a fundamental tenet of the product for investors. The earlier cut-off time imposed on MMFs by a swing pricing requirement imposes operational limits that may preclude their use as a store of same-day liquidity for such features as check-writing linked to a brokage or bank account or other payment features.

---

timing-trades-925d30v5nrn; Federal Reserve Press Release, *FOMC formally adopts comprehensive new rules for trading and investment activity* (Feb. 18, 2022), https://www.federalreserve.gov/newsevents/pressreleases/monetary20220218a.htm; N. Timiraos, *The Stock Trading Scandals at the Federal Reserve*, WALL STREET JOURNAL PODCAST (Jan. 14, 2022); J. Smialek, *A Fed Official's 2020 Trade Drew Outcry. It Went Further than First Disclosed*, N.Y. TIMES (Jan. 6, 2022), https://www.nytimes.com/2022/01/06/business/economy/richard-clarida-fed-stock-fund.html; B. Cheung, *A Timeline of the Federal Reserve's Trading Scandal*, Yahoo!Finance (Jan. 10, 2022), https://news.yahoo.com/a-timeline-of-the-federal-reserves-trading-scandal-104415556.html?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAANqwIeecYU-1y3qG0xUyjl4AcsJCKBm2LhWROQmjJiVymXiVdWxLJy27Kgs1f51o1MATVk9f6roW-[_]CO1jH_mWrMeMSJQU2XYudrkvf1gHmBr___L9Bu9F2k_Gg0V1n4Kig5N7zc-1N0J4h5cb.

The requirement to add swing pricing makes both unworkable. First, for intraday liquidity there are several critical issues, including:

1. Timing of Investor Purchases & Redemptions Will Lead to Market Timing/Arbitrage Opportunities & Unequal Shareholder Treatments; and
2. Operationally estimates would need to be utilized to facilitate intraday payments, increasing the risk of unfair treatment of investors.

Similarly, for same day liquidity, investors need to have the ability to transact throughout the day and obtain redemptions in time to utilize the funds. A move to close funds earlier in the day to accommodate all of the operational hurdles associated with a mandatory omnipresent swing pricing mechanism make these funds unusable for any investors who live outside of the east coast. Investors on the west coast simply will not know their cash needs early enough in the day to participate.

C. LMTs Should be Implemented at the Discretion of the Board in Periods of Stress.

Liquidity management tools ("LMTs") should be used at the discretion of a MMF board in periods of stress to ensure that all shareholders are treated fairly. These tools should not be intended to be used on a daily basis, as in normal times, management of a MMF's liquidity is a key aspect of a manager's daily duties (and part of a board's oversight) and something that an investor is paying a management fee for. Moreover, in normal market conditions there is simply no additional costs associated with obtaining liquidity that should be passed on to investors. Daily management of liquid assets in normal market conditions has never been an issue. MMF managers make investment purchase and sale determinations based on the shareholder base, anticipated shareholder activity and market events. The ability to manage one's portfolio consistent with the regulations and tailored to one's investor base is a key distinguishing factor amongst funds.

One positive result of the 2010 Amendments was the adoption of the KYC requirements, which put in place a specific mandate to ensure that managers are managing their portfolios in a manner which reflects the current shareholder base. Funds with proper KYC procedures increase liquidity when the shareholder base becomes more concentrated and may reduce liquidity for more diverse investor bases. Additionally, greater emphasis on communication between managers and large investors at the time of investment is critical. Once again, this permits managers to ensure that, should additional liquidity be necessary, the portfolio managers can adjust accordingly. Increased investor communication stemming from the KYC procedures also ensures that large redemptions may be discussed and planned with investors at the time of investment. Mandatory, omnipresent swing pricing will drastically reduce the incentive for investors to communicate their cash needs with managers.

Federated Hermes employs a team of Trade Liaisons who are tasked with tracking and reporting to the portfolio managers and traders, large trades and their anticipated trade dates. As part of their role, the Trade Liaisons are a key point of contact with all large institutional clients. When accounts are established for new institutional or intermediary clients, the team works to understand the typical flow patterns of the client and provides the clients with a list of the dollar thresholds for each of the funds in which they invest, above which a notification call should be placed to our Trade Liaison team. These thresholds are set well below the amount that we believe would impact the performance of the fund in order to allow for multiple clients trading at that amount. We generally request advance notice for large trades, if possible. For purchases which equal or exceed the amounts identified, we request advance notice of the trade.

Notwithstanding our firm belief that swing pricing is inappropriate for a MMF and the use of a properly calibrated and timely implemented liquidity fee is the best way for a MMF board to ensure that the cost of liquidity in times of stress are passed on to redeeming investors, we would accept that an optional swing pricing mechanism, to be implemented at the Board's discretion (not omnipresent) and one that would be tailored by a fund board to reflect fund specific facts and circumstances would be the "least worst" option.

D. SEC swing pricing questions 13-65

SEC PROPOSAL QUESTION 13 AND FEDERATED HERMES RESPONSE

As proposed, should we require any money market fund that is not a government money market fund or a retail money market fund to implement swing pricing?

No. No money market fund, government, retail or institutional, should be subject to mandatory omnipresent swing pricing.

Should we permit, but not require, these funds to implement swing pricing?

Notwithstanding that the mandatory use of swing pricing is not appropriate for any MMF, Federated Hermes is generally supportive of providing fund boards with a variety of tools to utilize in times of market stress. Provided a fund board can elect to implement a properly calibrated and considered liquidity fee, we would not object to the inclusion of swing pricing as an optional tool to be implemented solely at the discretion of a fund board as part of its exercise of its fiduciary duty.

If swing pricing were an optional tool, would money market funds use it?

In times of market stress, we believe fund boards will consider and implement the best tools to ensure that the fund is being managed to treat all shareholders equally. If swing pricing is optional, while we do not believe it will be elected as the most appropriate tool given its elimination of a key tenet of MMFs, it would indeed be given proper consideration along with any other LMT.

Would they be more likely to use optional swing pricing or optional liquidity fees, such as those which Rule 2a-7 currently contemplates?

To clarify a key aspect of the question, Rule 2a-7 does not currently contemplate an optional liquidity fee as such fee can only be implemented should a fund's WLA fall below 30%. For MMFs, liquidity fees (unencumbered by an improper linkage) are the most appropriate LMT to efficiently allocate the cost of liquidity to redeeming shareholders in times of stress. As such, we believe that fund boards will likely elect a liquidity fee over a swing price in times of stress. However, providing a fund board with additional tools which can be individually assessed based on the facts and circumstances of both the fund and the nature of the period of stress is always beneficial, and we do not oppose the inclusion of both liquidity fees and swing pricing, if optional.

SEC PROPOSAL QUESTION 14 AND FEDERATED HERMES RESPONSE

Should we adopt a framework that requires a fund to adjust its NAV for spread, other transaction costs, or market impacts only when net redemptions exceed a certain percentage of a money market fund's net assets? If so, should swing pricing apply only when a fund's net redemptions exceed the market impact threshold under the proposed rule?

The primary driver behind consideration of either a swing price or a liquidity fee should be to pass on to redeeming shareholders, in times of stress, the cost of liquidity if the board of a MMF determines such fee to be in the best interest of the fund and shareholders to avoid any material dilution. For MMFs, only the use of liquidity fees will accomplish this objective and preserve MMFs for their stakeholders. Determination as to when and in what amount any liquidity fee should apply is best considered by a MMF board only when there is material dilution. It is, after all, a mutual fund and not a separate account.

With proper management and adherence to KYC liquidity requirements, floating NAV MMFs can and do regularly experience redemptions well in excess of 4%, without diluting remaining *or* redeeming shareholders. With a properly-managed MMF, the pricing is already correct for the overall portfolio regardless of whether the asset is held or sold. When sales need to occur in a portfolio to accommodate an unusually large redemption, the realizable price is already part of the NAV calculation, just now reclassified from unrealized to realized gain or loss. If the redemption is met by DLA being reduced, the NAV may change marginally based on a lower percentage in DLA, but the share price impact is not material. There is no evidence of dilution to shareholders from the impact of redeeming shareholders, nor any need for swing pricing.

Should funds be able to set their own threshold?

The board of a MMF should have the discretion to determine an appropriate liquidity fee in its exercise of its fiduciary duty and in consideration of the specific facts and circumstances of the fund.

SEC PROPOSAL QUESTION 15 AND FEDERATED HERMES RESPONSE

Should we permit a money market fund to reasonably estimate whether it has net redemptions and the amount of net redemptions, as proposed, or should we require a fund to determine the actual amount of net redemptions during a pricing period? Are there operational complexities to this approach?

Rather than acknowledging that swing pricing is simply not appropriate for MMFs which settle on a T+0 basis, the Commission has offered up the use of estimates in an attempt to speed up the valuation process. The use of estimates equates to attempting to fit a square peg into a round hole. Estimates are not required for funds which transact on a T+1 (or more basis) as the actual data is available. This is one reason why swing pricing has never been applied to MMFs.

MMFs transact on a T+0 basis and as such the operational challenges imposed by swing pricing make the use of estimates necessary. At the same time, however, the use of estimates as a factor in determining swing pricing increases the risk that shareholders will receive an inaccurate price. The use of estimates significantly increases the risks prices are simply wrong. For example, if a good faith estimate is used which determines a swing price is required and a late subscription is received, shareholders redeeming into the fund would have been charged an inappropriate fee and investors into the fund would have obtained a reduced NAV. The inverse is also true for late day redemptions. The timing of transactions will play a critical role as to whether "estimates" lead to inaccurate pricing and would likely require disclosure to investors that "pricing may not be accurate based upon use of good faith estimates." Clearly any such disclosure would only further discourage investors from using MMFs or highlight to those looking to game the system opportunities for market timing/arbitrage. However, concerns regarding the use of "good faith" estimates by managers and boards would likely lead to just such disclosure.

<u>**SEC PROPOSAL QUESTION 16 AND FEDERATED HERMES RESPONSE**</u>

As proposed, should money market funds that strike NAV multiple times per day be required to determine whether the fund has net redemptions and, if so, the swing factor to apply for each NAV strike (i.e., for each pricing period)? Are there alternative approaches we should consider? If so, how could such an approach ensure that investors are treated fairly?

MMFs that strike their NAV multiple times per day are doing so utilizing forward pricing. Any methodology that would treat one strike differently from the next would be inappropriate. That said, new opportunities to "game" the system and obtain intra-day market timing/arbitrage for funds which retain multiple intra-day NAV strikes will exist, benefitting only those investors looking to game the system and creating a new type of "material non-public information" ("MNPI") – information surrounding investor activity. This MNPI will be the intent of investors to redeem. There will be significant compliance cost across the industry to protect this information from abuse by market timers. Swing pricing is simply not appropriate for MMFs and the regulatory objectives can be achieved in a less intrusive means via the adoption of new unencumbered and discretionary liquidity fee requirements.

Multi-strike funds will require complex adjustments to daily operations. These will entail significant changes in the accounting practices for funds, the times that NAVs can be struck and the times that wires for same day settlement can be sent. There is substantial doubt that vendors to funds will be willing to undertake these changes on behalf of the relatively small number of affected funds, or that investors will accept potentially significant delays in receiving redemption proceeds. Queuing theory and the law of large numbers suggest that the swing threshold will be triggered more often in smaller MMFs (because 4% is a smaller absolute number for a smaller MMF but investor transactions may be the same absolute size at large and small MMFs) and multi-strike MMFs (because the swing threshold is 2% on a twice-daily strike MMF and 1.33% for a thrice-daily strike MMF) than at larger, single-strike MMFs.

The greater frequency of swing pricing will likely drive investors away from smaller MMFs and multi-strike MMFs and into larger single-strike MMFs to reduce the probability of being hit with an unexpected haircut on a redemption due to swing pricing. Greater concentration of assets into fewer, much larger MMFs would reduce competition and potentially add to systemic risk. Moreover, multi-strike MMFs hold a greater percentage of liquid assets and attract investors that are willing to accept a slightly lower yield in exchange for greater liquidity, thereby collecting like-minded investors in a MMF where the increased costs of frequent transactions is sought out and willingly borne by all, and removing these investors who value the ability to move money quickly from other MMFs comprised of investors who value modestly higher yields over ability to transact faster and more frequently. Causing the frequent traders to move their assets from multi-strike MMFs into larger single strike MMFs will shift the burden of transaction costs and added portfolio liquidity needs to a broader base of MMF investors who have until now been avoiding some of those costs through the separation of investors by their liquidity priorities into single strike and multi-strike MMFs.[91]

<u>**SEC PROPOSAL QUESTION 17 AND FEDERATED HERMES RESPONSE**</u>

Should we require swing pricing for both net redemptions and net subscriptions, or only for net redemptions, as proposed?

---

[91] Casavecchia et al., *supra* note 35.

Swing pricing should not be required in any event. However, LMTs should be available in times of either net subscriptions or redemptions.

If we require swing pricing for both net redemptions and net subscriptions, what additional operational complexities or other considerations might arise?

Notwithstanding that the requirement to use swing pricing will effectively eliminate the viability of MMFs, the operational challenges, with no corresponding cost benefit upside and given the more appropriate alternative of liquidity fees, and the use of estimates, should make it clear that swing pricing is not a viable option for MMFs.

If we required swing pricing for net subscriptions, should we require funds to assume the purchase of a vertical slice of the fund's portfolio and to value portfolio holdings at ask prices to reflect spread costs?

No. Advisers pay for redemptions primarily out of daily and weekly liquidity and do not incur market impact costs. Then in the several days after a major redemption, the MMF portfolio is rebalanced to its target liquidity and maturity structure. In this process, the fund never incurs the cost of selling a "vertical slice" in the "pricing period" or in "current market conditions." Thus, a "vertical slice" is in concept a flawed baseline assumption for what the MMF would actually transact to address large redemptions.

SEC PROPOSAL QUESTION 18 AND FEDERATED HERMES RESPONSE

As proposed, should we require the swing factor to account for spread costs and other transaction costs if a fund's net redemptions are at or below the market impact threshold?

Swing pricing should not be required in any event. However, LMTs should be implemented, and costs determined by the fund board based on the specific facts and circumstances leading to such consideration.

What effect would this proposed requirement have on institutional funds that already use bid prices when striking their NAVs? Should we instead require an institutional fund to apply swing pricing when net redemptions are at or below the market impact threshold only if the fund does not price at the bid? What are the reasons a money market fund may not price at the bid currently?

Federated Hermes prices all of its FNAV MMFs at bid (other than portfolio assets with a put right such as variable rate demand notes ("VRDNs") which are priced at the put price, and portfolio assets with a remaining term under 60 days which are priced at amortized cost) and we believe doing so is industry best practice. We support mandating all FNAV MMFs use bid prices (other than those with a put right or that are valued at amortized cost under the current rule) to reduce any potential NAV impact of net redemptions.

Do pricing services that money market funds use currently provide the option for funds to receive either mid or bid prices (or both)?

Yes.

Are there any impediments to a fund's ability to determine a bid price for each portfolio security?

No. All MMFs should be required to use bid prices (other than as noted in response to Question 18).

Should we remove or revise any of the cost categories that would apply when net redemptions are at or below the market impact threshold?

LMTs should be implemented, and costs determined by the fund board based on the specific facts and circumstances leading to such consideration.

SEC PROPOSAL QUESTION 19 AND FEDERATED HERMES RESPONSE

Should we require the swing factor to account for spread costs, other transaction costs, and market impacts if the amount of net redemptions exceeds the market impact threshold, as proposed? Should we remove or revise any of these cost categories? Do funds need additional guidance on any of these categories, such as application of the market impact factor? Would it be sufficient for funds experiencing net redemptions to apply a swing factor that accounts for spread costs and other transaction costs, but not market impacts?

Swing pricing should not be required. However, LMTs should be implemented, and costs determined by the fund board based on the specific facts and circumstances leading to such consideration.

How effective would this approach be in achieving the objectives of swing pricing discussed throughout this release, including the goal of fairly allocating the costs stemming from net redemptions and preventing those costs from giving rise to a first-mover advantage or dilution?

If the goal of the Proposal is to "fairly" allocate the costs stemming from net redemptions, then the use of a liquidity fee is the most appropriate tool, rather than a mandatory omnipresent swing price which will potentially charge fees to investors which are never incurred by the fund and introduce new ways for investors to market time a MMF and benefit at the detriment of investors remaining in the funds.

SEC PROPOSAL QUESTION 20 AND FEDERATED HERMES RESPONSE

Do some or all institutional funds already estimate market impact factors, or perform similar analyses, to inform trading decisions? If so, would these funds' prior experience smooth the transition to making a good faith estimate of the market impact factor under the proposal?

No. We do not rely on estimates.

What difficulties might funds experience in developing a framework to analyze market impact factors and in producing good faith estimates of market impact factors for purposes of the proposed swing pricing requirement? Are there ways we could reduce those difficulties, while still requiring redeeming investors to bear costs that reasonably represent the costs they would otherwise impose on the fund and its remaining shareholders?

Using a market impact price is either a guess or the MMF has to wait to see the reported actual impact on market prices, which come too late to be useful for pricing and settling MMF purchase and redemption transactions and reporting to intermediaries and investors on transactions and share prices. In the context of the types of events for which this proposal was designed - March 2020 and September 2008 - the underlying secondary markets for short-term portfolio instruments were frozen. It is not clear how the "market impact" in that context could be determined to establish the swing price. Outside of that context, where the secondary markets are not frozen, it is not clear that there is any purpose, theoretical or otherwise, served by the swing pricing proposal.

SEC PROPOSAL QUESTION 21 AND FEDERATED HERMES RESPONSE

Should we define the market impact threshold as an amount of net redemptions for a pricing period that is the value of 4% of the fund's net asset value divided by the number of pricing periods, as proposed?

Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, any consideration of a market impact threshold cannot simply be a percentage based figure as it must take into account the size of the fund and the materiality of the movement and the liquidity within a particular fund. One should also assess the impact such factors will have not only on motivating investor trading activity, but the negative incentive for investor transparency on cash needs and the portfolio management of MMFs today through regular and irregular redemption intervals. Moreover, any consideration surrounding an impact threshold should factor in anticipated periods of redemptions (month-end, quarter-end, year-end, etc.) where portfolio managers are already managing the fund to address these historically consistent redemption patterns.

Should the threshold at which a fund must include market impacts in its swing factor be higher or lower than proposed?

If LMTs are implemented, the costs and thresholds (if applicable), should be determined by the fund board based on the specific facts and circumstances leading to such consideration.

In establishing the threshold amount, should we consider factors other than historical flows?

Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, other factors should be considered, including fund size, whether redemptions were known, anticipated, or unknown and what the levels of the liquidity in the fund are at any particular point in time.

Should the Commission periodically reexamine and adjust the market impact threshold to account for possible changes to redemption patterns and market behavior over time? If so, how often?

No. If LMTs are implemented, the costs and thresholds (if applicable), should be determined by the fund board based on the specific facts and circumstances leading to such consideration.

Does identification of a specific threshold in Rule 2a-7 raise gaming or other concerns?

Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, identification of a specific threshold would raise gaming concerns and would also, as noted above, lead to unfair market timing/arbitrage opportunities for the savviest investors.

SEC PROPOSAL QUESTION 22 AND FEDERATED HERMES RESPONSE

Rather than a set percentage of net redemptions, as proposed, should we define the market impact threshold on a fund-by-fund basis, with reference to a fund's historical flows (i.e., should each fund be required to determine the trading days for which it had its highest flows over a set time period, and set its market impact threshold based on the 5% of trading days with the highest flows)?

Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, if a swing pricing mechanism were optional, then the market threshold should be determined by the fund's board based on the specific facts and circumstance of the MMF.

Should we define the market impact threshold on a fund-by-fund basis with reference to another metric other than net redemptions?

If LMTs are implemented, the threshold (if applicable) should be determined by the fund board based on the specific facts and circumstances leading to such consideration.

SEC PROPOSAL QUESTION 23 AND FEDERATED HERMES RESPONSE

Should we permit the swing pricing administrator to use discretion to establish a smaller market impact threshold, as proposed? Should we prescribe the circumstances in which a smaller market impact threshold would be permitted, the timing of such a determination by the swing pricing administrator (e.g., if a swing pricing administrator must formally establish a smaller market impact threshold that will remain in place for a period of time), disclosure of such a determination to the fund's investors, and recordkeeping requirements in support of the determination? Should we require the fund's board, instead of the swing pricing administrator, to approve use of a smaller market impact threshold? Should the swing pricing administrator or the board have flexibility to establish a larger market impact threshold than proposed? If so, what are the circumstances in which a fund should have flexibility to use a market impact threshold that is larger than 4% of the fund's net asset value divided by the number of pricing periods?

Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, no. If a swing pricing mechanism were optional, such mechanism and the level of the market impact threshold should be set by the fund's board based on the specific facts and circumstances of the MMF.

SEC PROPOSAL QUESTION 24 AND FEDERATED HERMES RESPONSE

Should money market funds be required to take into account other costs in determining their swing factors, beyond those proposed? For example, should we require consideration of borrowing costs that a fund may incur to facilitate shareholder redemptions?

Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, the level of the level of the swing price should be set by the fund's board based on the specific facts and circumstances of the MMF.

SEC PROPOSAL QUESTION 25 AND FEDERATED HERMES RESPONSE

Does our proposed requirement that a fund calculate the swing factor by assuming it would sell a pro rata amount of each security in its portfolio properly account for liquidity costs?

Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, no. The swing price should be set by the fund's board based on the specific facts and circumstances of the MMF and should reflect the market reality of the events in question. It is not appropriate to assume a pro rata amount of each security would be sold. Discretion permitting a MMF manager to manage the fund as they are entrusted to do remains critical.

Are there other considerations related to liquidity costs that the swing pricing framework should take into account, such as shifts in the fund's liquidity management or other repositioning of the fund's portfolio?

Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, a market impact threshold cannot simply be a percentage-based figure as it must take into account the size of the fund and the materiality of the movement and the liquidity withing a particular fund. One should also assess the impact such factors will have not only on motivating investor trading activity, but the negative incentive for investor transparency on cash needs and the regular portfolio management of MMFs today through regular and irregular redemption intervals. Moreover, any consideration surrounding an impact threshold should factor in anticipated periods of redemptions (month-end, quarter-end, year-end, etc.) where portfolio managers are already managing the fund to address these historically consistent redemption patterns.

SEC PROPOSAL QUESTION 26 AND FEDERATED HERMES RESPONSE

Should money market funds calculate the swing factor by estimating the costs of selling only the securities the fund plans to sell to satisfy shareholder redemptions during the pricing period, rather than calculating the swing factor based on the costs the fund would incur if it sold a pro rata amount of each security in its portfolio? If so, what would the operational consequences be?

If LMTs are implemented, the costs should be determined by the fund board based on the specific facts and circumstances leading to such consideration.

SEC PROPOSAL QUESTION 27 AND FEDERATED HERMES RESPONSE

Should the rule permit, rather than require, funds to follow the market impact threshold and swing factor calculations set forth in the rule? If so, what considerations or factors should the rule require a fund to consider when determining market impact thresholds and swing factors if the fund determines not to follow the threshold or calculations set forth in the rule? For example, should the rule identify for these purposes the size, frequency, and volatility of historical net redemptions; the liquidity of the fund's portfolio; or the costs associated with transactions in the markets in which the fund invests?

If LMTs are implemented, the costs and thresholds (if applicable), should be determined by the fund board based on the specific facts and circumstances leading to such consideration.

SEC PROPOSAL QUESTION 28 AND FEDERATED HERMES RESPONSE

Should money market funds be subject to a numerical limit on the size of swing factors? Should the limit instead be bound only by liquidity costs associated with net redemptions for a given pricing period, as proposed?

Any LMT, implemented in times of stress should provide for board discretion and if a LMT is implemented, the costs and thresholds (if applicable), should be determined by the fund board based on the specific facts and circumstances leading to such consideration.

Should we allow a fund to use a set swing factor, such as 2% or 3%, in times of market stress when estimating a swing factor with high confidence may not be possible? How would we define market stress for this purpose? Should a fund's adviser, or a majority of the fund's independent directors, be permitted to determine market conditions were sufficiently stressed such that the fund would apply the set swing factor? Are there other circumstances in which we should permit a fund to use a default swing factor?

No. This would lead to unfair results. Any LMT, implemented in times of stress should provide for board discretion. If LMTs are implemented, the costs and thresholds (if applicable), should be determined by the fund board based on the specific facts and circumstances leading to such consideration. A fund's board should have the discretion, in exercising its fiduciary duty, to determine when a stressed environment exists and whether the use of a LMT is appropriate.

SEC PROPOSAL QUESTION 29 AND FEDERATED HERMES RESPONSE

Should we permit a fund to estimate costs and market impact factors for each type of security with the same or substantially similar characteristics and apply those estimates to all securities of that type in the fund's portfolio, as proposed?

The more instances where estimates are used in the valuation of a funds NAV the likelihood of incorrect and improper results will occur.

Should we define types of securities with the same or substantially similar characteristics?

Yes. Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, securities should be defined based upon the same or substantially similar characteristics.

Should we provide additional guidance to support funds' determinations as to whether securities have the same or substantially similar characteristics?

No. Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, the determination on whether securities have the same or substantially similar characteristics should be left to the MMF manager.

SEC PROPOSAL QUESTION 30 AND FEDERATED HERMES RESPONSE

Is it reasonable to apply a market impact factor of zero to the fund's daily and weekly liquid assets? If not, should funds estimate the market impact factor of such assets in the same way as other assets under the rule, or should we prescribe a different methodology for such assets?

Yes. Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, a market factor of zero is appropriate for a fund's daily and weekly liquidity.

Are there particular circumstances in which it would not be reasonable for a fund to use a market impact factor of zero for daily and weekly liquid assets, such as in stressed market conditions?

Yes. Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, it would not be reasonable in frozen markets/clearing or credit default conditions.

SEC PROPOSAL QUESTION 31 AND FEDERATED HERMES RESPONSE

Instead of specifying swing factor calculations and thresholds in the rule, should we require a fund to adopt policies and procedures that specify how the fund would determine swing pricing thresholds and swing factors based on principles set forth in the rule? If so, should the policies and procedures include the methodologies from the market impact threshold calculation we proposed (i.e., net redemptions that are at or above the 95th percentile of likely fund redemptions, determined based on relevant historical data)? Should the policies and procedures include the swing factor calculation (i.e., the percentage decline in the value of the security, per dollar of the amount of the security that would be sold, multiplied by the dollar amount of the security that would be sold if the fund sold a pro rata amount of each security in its portfolio to meet the net redemptions for the pricing period)? Should the policies and procedures define the market impact threshold with reference to a metric other than net redemptions? If we require policies and procedures, should we specify the market impacts and dilution costs that a fund's swing pricing program must address, rather than specifying specific principles and calculation methodologies?

If there is potential for material dilution and an LMT is implemented, the costs, factors and thresholds (if applicable), should be determined by the fund board based on the specific facts and circumstances leading to such consideration.

SEC PROPOSAL QUESTION 32 AND FEDERATED HERMES RESPONSE

Should we require boards to appoint a swing pricing administrator? What individuals or entities are likely to fulfill the role of swing pricing administrator?

No. We do not believe that a swing pricing administrator should be appointed.

Should we require board involvement in the day-to-day administration of a fund's swing pricing program in addition to its compliance oversight role?

We do not believe that a swing pricing program is advisable, and certainly not one that is applied on a day-to-day basis outside of a discretionary election by a board in stressed market conditions.

How might funds maintain segregation between portfolio management and swing pricing administration?

Notwithstanding that swing pricing is not consistent with the operation of MMFs and will eliminate intraday and same day liquidity despite the Proposal's unsubstantiated position that with some operational changes each can be accommodated, segregation between portfolio management and swing pricing (or the potential imposition of a liquidity fee) should be handled by the Board or a Board approved internal committee (similar to a valuation committee).

Should a fund's chief compliance officer have a designated role in overseeing how the fund applies the proposed swing pricing requirement?

A Fund's chief compliance officer has a critical role in ensuring all of the fund's policies and procedures are adhered to and any new procedures related to the potential imposition of a LMT should be no exception.

SEC PROPOSAL QUESTION 33 AND FEDERATED HERMES RESPONSE

Should we require board review of a swing pricing report more or less frequently than annually? Should we require an evolving level of board review over time (e.g., every quarter for the first year after implementation and then less frequently in following years as the fund gains experience implementing the swing pricing program under various market conditions)? Should we require the fund to disclose any material inaccuracies in the swing pricing calculation to the board (e.g., as they arise, no less frequently than quarterly, or at some other frequency)?

Board review of any swing pricing reports, including any material inaccuracies, should be done quarterly.

SEC PROPOSAL QUESTION 34 AND FEDERATED HERMES RESPONSE

Are there circumstances in which it would not be possible to estimate the market impact factor with a high degree of accuracy? If so, what modifications should we make to the proposal? For example, should we instead adopt a liquidity fee framework that is consistent with the current liquidity fee provision in Rule 2a-7, but without the link to weekly liquid asset thresholds?

In the circumstances for which this proposal was designed, the underlying secondary markets for short-term portfolio instruments were frozen. It is not clear how the "market impact" in that context could be determined with a high degree of accuracy to establish the swing price. Outside of that context, where the secondary markets for the portfolio assets of MMFs are not frozen, it is not clear that there is any purpose, theoretical or otherwise, served by the swing pricing proposal.

Federated Hermes fully supports the adoption of a liquidity fee framework in accordance with the current liquidity fee provision in Rule 2a-7, without the link to WLA thresholds.

SEC PROPOSAL QUESTION 35 AND FEDERATED HERMES RESPONSE

How do the operational implications of swing pricing, as proposed, differ from the operational implications of an economically equivalent dynamic liquidity fee framework?

Implementing the swing pricing proposal will impose on MMFs the high costs of building and running systems for tracking triggers, determining adjustment factors and imposing swing factors on purchases and redemptions of MMF shares. They will also impose investment risks and operating systems costs on institutional users of MMFs. These changes will also create new operational complexities and risks for MMFs, their service providers and investors. Because the triggers and calculations are much more complex and dynamic for swing pricing than for liquidity fees, the costs and operational risks are much higher for implementation and operation of a swing pricing system as contrasted to a liquidity fee system.

In addition, MMFs that employ swing pricing cannot be used by many intermediaries that transmit trade information via the NSCC. A large portion of such trades are received by fund advisors much too late and are too volatile to enable a "good faith" estimate of a net redemption amount; and the associated market impact for calculating a swing factor. Significant and costly infrastructure changes would be required. These are unlikely to be undertaken by the industry, just as they were not undertaken to support swing pricing after rule 22c-1 was promulgated.

What are the operational implications of a requirement for institutional money market funds to impose a liquidity fee that can change in size and that may need to be applied with some frequency?

Federated Hermes does not believe that a liquidity fee would need to be applied with "some frequency" given the historical infrequency of the necessity to impose liquidity fees. Moreover, the operational challenges associated with the imposition of a one-off liquidity fee are significantly more manageable than the operational challenges associated with a mandatory omnipresent swing pricing mechanism.

Are fund intermediaries equipped to apply dynamic fees on a regular basis? Would funds have insight into whether and how intermediaries apply these fees to redeeming investors?

Yes. Some intermediaries sign agreements to collect the liquidity fees and remit them back to the MMF, while others allow the MMF, via the transfer agent, to collect the fee and remit the net proceeds to the intermediary. Both processes allow for varying fee amounts to be charged to the redemptions in order to remit the correct amount back to the MMF.

SEC PROPOSAL QUESTION 36 AND FEDERATED HERMES RESPONSE

If we adopt a liquidity fee framework instead of a swing pricing framework, should a fund be required to apply a liquidity fee under the same circumstances in which a fund would be required to adjust its net asset value under the proposed swing pricing requirement?

No. Imposition of LMTs, and in particular a liquidity fee, should be subject to enhanced and auditable procedures and implemented by the fund's board in the best interest of the fund and its shareholders. The mere occurrence of net redemptions does not equate to material dilution. These are mutual funds designed to provide daily liquidity and not separate accounts.

Should a fund be required to use the same approach to calculating a liquidity fee as the proposed approach to calculating a swing factor?

No. Calculation of a liquidity fee should be designed to accurately reflect the cost of such liquidity and be subject to enhanced and auditable procedures and implemented by the fund's board in its fiduciary duty to serve the best interest of the fund and its shareholders.

Alternatively, should different trigger events or calculation methods determine when a liquidity fee applies and the amount of such fee?

If the events of March 2020 have shown us anything it is that we cannot predict the future nor the best course of action for the next period of market stress. Imposition of LMTs, and in particular a liquidity fee, should be subject to enhanced and auditable procedures and implemented by the fund's board in the best interest of the fund and its shareholders.

SEC PROPOSAL QUESTION 37 AND FEDERATED HERMES RESPONSE

If we adopt a liquidity fee framework instead of a swing pricing framework, should we adopt a simplified fee calculation methodology? If so, should the simplified liquidity fee framework be tied to the level of the fund's net redemptions, the liquidity of its portfolio holdings, or some other input?

The Commission should adopt a liquidity fee framework instead of a swing pricing framework, and the calculation methodology should be subject to enhanced and auditable procedures and designed to reflect the actual cost of liquidity. The fee should be calculated as the cost of providing required liquidity when asset sales are required to satisfy redemptions.

Should the simplified liquidity fee be a set percentage (i.e., a 1% fee), or should the fee increase as redemptions, illiquidity, or other variables increase?

The liquidity fee framework adopted by the Commission should provide for a variable fee determined by a fund's board in accordance with enhanced and auditable procedures designed to reflect the actual cost of liquidity, subject to a cap of 2%.

SEC PROPOSAL QUESTION 38 AND FEDERATED HERMES RESPONSE

Should we permit or require retail or government money market funds to implement swing pricing? Would retail or government money market funds have access to sufficient flow information to apply swing pricing, or would changes to current order processing methods be needed to facilitate access to sufficient flow information?

No. Swing pricing is not appropriate for any MMF, let alone retail or government MMFs.

SEC PROPOSAL QUESTION 39 AND FEDERATED HERMES RESPONSE

Will our proposed swing pricing requirement cause investors to move their assets out of the funds that must implement a swing pricing program to funds that do not, such as government money market funds or short-term bond funds?

Yes. Investors have been clear that they will not invest in a MMF with swing pricing, as this would eliminate the fund's ability to provide intraday and same-day settlement. As a result, any future "dash for cash" or credit crisis would not be mitigated – but rather shifted to unregulated and less transparent vehicles. If any investors were to remain in MMFs, then the potential application of a swing price would serve as yet another bright line incentive for an investor to redeem earlier (just like the result from linking liquidity to the imposition of fees and gates).

In addition, swing pricing would cause investors to move assets out of smaller MMFs and multi-strike MMFs and into larger, single-strike MMFs. Queuing theory and the law of large numbers suggest that the swing threshold will be triggered more often in smaller MMFs (because 4% is a smaller absolute number for a smaller MMF but investor transactions may be the same absolute size at large and small MMFs) and multi-strike MMFs (because the swing threshold is 2% on a twice-daily strike MMF and 1.33% for a thrice-daily strike MMF) than at larger, single-strike MMFs. The greater frequency of swing pricing will likely drive investors away from smaller MMFs and multi-strike MMFs and into larger single-strike MMFs to reduce the probability of being hit with an unexpected haircut on a redemption due to swing pricing.

Greater concentration of assets into fewer, much larger MMFs would reduce competition and potentially add to systemic risk. Moreover, multi-strike MMFs hold a greater percentage of liquid assets and attract investors that are willing to accept a slightly lower yield in exchange for greater liquidity, thereby collecting like-minded investors in a MMF where the increased costs of frequent transactions is sought out and willingly borne by all, and removing these investors who value the ability to move money quickly from other MMFs comprised of investors who value modestly higher yields over ability to transact faster and more frequently. Causing the frequent traders to move their assets from multi-strike MMFs into larger single strike MMFs will shift the burden of transaction costs and added portfolio liquidity needs to a broader base of MMF investors who have until now been avoiding some of those costs through the separation of investors by their liquidity priorities into single strike and multi-strike MMFs.

What are the potential costs and benefits associated with these decisions?

Mandatory omnipresent swing pricing applicable to prime and municipal MMFs would further destroy an important segment that was only recently undermined by the impact of the 2014 Amendments. Further reductions in the prime market will reduce viable options to all stakeholders, investors, issuers, and the markets generally.

SEC PROPOSAL QUESTION 40 AND FEDERATED HERMES RESPONSE

Should we provide any exclusions from the proposed swing pricing requirement for institutional funds? For example, should we provide an exclusion from the swing pricing requirement for affiliated money market funds created by an adviser for the purpose of efficiently managing cash across accounts within its advisory complex and not available to other investors?

All MMFs should be excluded from the imposition of mandatory omnipresent swing pricing.

SEC PROPOSAL QUESTION 41 AND FEDERATED HERMES RESPONSE

Will swing pricing reduce the threshold effects that stem from investors seeking to redeem in advance of a liquidity fee or gate?

No. The removal of the linkage between liquidity and fees and gates will already serve to remove investor incentive to redeem. The adoption of an omnipresent swing pricing mechanism will, unfortunately, replace one bright line redemption trigger with another.

Will swing pricing cause some investors to choose not to redeem because the potential swing factor and price adjustment may be more tangible than the uncertain possibility of potential future losses during periods of market stress?

No. Swing pricing will cause most investors to not invest in institutional prime or municipal MMFs, or to try to figure how to sell before a swing price is implemented. The net result of a mandatory omnipresent swing price requirement is to replace one bright line trigger with another.

SEC PROPOSAL QUESTION 42 AND FEDERATED HERMES RESPONSE

Will swing pricing protect money market fund investors that remain in the fund from dilution when the fund fulfills net shareholder redemptions? Would the increased liquidity requirements that we are proposing provide adequate protection from dilution without swing pricing?

No. MMFs, once unencumbered from the perils of an inappropriate linkage between liquidity levels and fees and gates, have sufficient liquidity levels currently to protect investors from dilution. Mutual funds by their nature have some level of dilution because of the mutualization of the investment in the fund. The goal is to avoid material dilution, otherwise the product is a separate account. As proposed, in most instances there will be no "swing factor", just costs on the fund of implementing a convoluted process that does not reflect the market realities of shareholder activity in normal conditions.

Should we impose additional liquidity requirements for institutional prime and institutional tax-exempt as an alternative to swing pricing?

No. Neither swing pricing nor additional liquidity requirements are necessary. The combination of removing the inappropriate linkage and the ability to impose liquidity fees subject to enhanced procedures provides a fund with not only an additional 30+% of liquidity, but also a LMT that can be tailored to ensure that it is utilized only when necessary and approximates the actual cost of liquidity.

SEC PROPOSAL QUESTION 43 AND FEDERATED HERMES RESPONSE

How might swing pricing affect investor behavior in a period of liquidity stress?

Investors may try to game the system by trying to anticipate and thereby avoid the swing, resulting in replacing one artificial redemption trigger with another.

Will swing pricing increase money market fund resilience by reducing the first mover advantage that some investors may seek during periods of market stress?

No. Any so-called first mover advantage was addressed by the 2014 Amendments requiring institutional funds to float their NAV. Funds transact on a forward price basis so any redemption placed will receive the next calculated NAV. European behavior showed little difference in redemption activity between CNAV and FNAV funds, calling into doubt the forced move in 2014.

Will swing pricing encourage investors to redeem smaller amounts over a longer period of time because investors will not know whether the fund's flows during any given pricing period will trigger swing pricing and, if so, the size of the swing factor for that period?

No. Based on our knowledge of our customers, redemptions experienced during the Liquidity Crisis were influenced by a fear of potential gating. Notwithstanding redemptions triggered by the linkage, investors will make redemption decisions on a case-by-case basis dependent on specific market circumstances and their liquidity needs.

SEC PROPOSAL QUESTION 44 AND FEDERATED HERMES RESPONSE

Based on historical data, how would our swing pricing framework affect money market funds' NAVs under normal market conditions?

The proposed swing pricing framework would increase expenses and decrease interest, if any prime MMF still exist.

SEC PROPOSAL QUESTION 45 AND FEDERATED HERMES RESPONSE

Rather than requiring institutional funds to adopt a swing pricing requirement, should we provide more than one approach to mitigate dilution in Rule 2a-7 and require each institutional fund to determine its own preferred approach? If so, what approaches should the rule provide? Should we, for example, allow a fund either to adopt swing pricing or a liquidity fee? Are there other options that would be appropriate under this approach?

Yes. The SEC should not require swing pricing. We believe liquidity fees are the appropriate approach for MMFs to address the concerns identified by the Commission. Liquidity fees, unencumbered by an inappropriate linkage to liquidity levels, and supported by enhanced procedures, is the best approach. Liquidity fees should be implemented in the discretion of a fund's board in consideration of its fiduciary duty and in the best interest of the fund and its shareholders.

Should non-institutional funds be permitted or required to adopt an anti-dilution approach?

No. Once the link between the potential imposition of fees and gates and a fund's liquidity levels is removed, under current MMF regulations, there is sufficient liquidity in all MMFs to address any material dilution concerns.

Would funds' use of different approaches benefit investors by increasing investor choice or, conversely, would these differences confuse investors or make it more difficult for them to compare money market funds with each other?

Providing fund boards with the ability to utilize different liquidity management tools based on the specific circumstances impacting a given fund benefits investors and will increase investor confidence.

SEC PROPOSAL QUESTION 46 AND FEDERATED HERMES RESPONSE

Are there key operational impediments with the proposed swing pricing approach? Are there key inputs for the swing factor calculation, including the market impact factor, that are operationally and prohibitively difficult to ascertain within the time period needed to calculate the swing factor? Are there key inputs that are not operationally complex to obtain?

As discussed in Section IV. B. of this response and in greater granularity in our submission related solely to swing pricing,[92] there are numerous operational and practical impediments that will inevitably result in the elimination of MMFs as a viable investment option if mandatory omnipresent swing pricing is required.

SEC PROPOSAL QUESTION 47 AND FEDERATED HERMES RESPONSE

Are there instances in which an institutional money market fund permits intermediaries to submit subscription or redemption requests after the fund's cutoff time and to receive the NAV calculated for that cut-off time, as long as the intermediary received the order prior to the fund's cut-off time? If so, when do such instances occur, and how frequently?

Consistent with rule 22c-1, we permit our intermediaries to act as "agent" to the FNAV MMFs which are single strike. These single strike "agent" intermediaries must receive the trade in good order before our funds strike their NAV. Our transfer agent can receive such trades from the "agent" intermediary after the time for the NAV strike. Trades from non-agent intermediaries must be received by the transfer agent before the time of the NAV strike.

SEC PROPOSAL QUESTION 48 AND FEDERATED HERMES RESPONSE

If institutional money market funds do not receive information about subscription or redemption requests early enough to make swing pricing decisions prior to striking NAV, are there rule-based solutions that could improve the timing considerations regarding shareholder flows and swing pricing (e.g., by requiring intermediaries to provide earlier flow information to funds or by requiring specific cut-off times for transaction requests)?

No. While intermediaries who are agents to the MMF could be required to provide estimates of trades to the MMF by the cutoff time of the fund, this again introduces further uncertainty as to the accuracy of the

[92] *See* Federated Hermes Comment Letter II, *supra* note 2.

NAV based on assumptions provided by intermediaries. Intermediaries will be hesitant to provide any estimates given the consequences should such estimates be materially incorrect.

<u>SEC PROPOSAL QUESTION 49 AND FEDERATED HERMES RESPONSE</u>

What proportion of institutional prime and institutional tax-exempt money market funds use mid-market pricing? Would such funds incur greater operational costs than a fund that uses bid pricing to estimate the spread costs the fund would incur to sell a vertical slice of its portfolio?

Federated Hermes prices all of its FNAV MMFs at bid (other than noted in response to Question 18 above) and we believe doing so is industry best practice. We support mandating all FNAV MMFs use bid prices (other than in the contexts noted in response to Question 18) to reduce any potential NAV impact of net redemptions.

<u>SEC PROPOSAL QUESTION 50 AND FEDERATED HERMES RESPONSE</u>

Do commenters agree with our assessment that institutional prime and institutional tax-exempt money market funds could still offer same-day settlement if they are required to implement swing pricing? If not, how would swing pricing affect the ability of institutional money market funds to settle transactions on a T+0 basis?

No. The Commission oversimplifies the complexities involved in providing T+0 settlement with swing pricing. Rather than acknowledging that swing pricing is simply not appropriate for MMFs which settle on a T+0 basis, the Commission has offered up the use of estimates to speed up the valuation process. The use of estimates equates to attempting to fit a square peg into a round hole. Estimates are not required for funds which transact on a T+1 (or more basis) as the actual data is available. This is one reason why swing pricing has never been applied to MMFs. MMFs transact on a T+0 basis and as such the operational challenges imposed by swing pricing make the use of estimates necessary. At the same time, however, the use of estimates as a factor in determining swing pricing increases the risk that shareholders will receive an inaccurate price.

If these funds instead settle transactions on a T+1 basis, how might this affect investors?

It would result in most, if not all investors, moving to government MMFs or other unregulated or less transparent vehicles, thereby eroding the utility of MMFs. Same day and intra-day settlement are critical elements of MMFs.

<u>SEC PROPOSAL QUESTION 51 AND FEDERATED HERMES RESPONSE</u>

How might swing pricing affect the ability of institutional money market funds to offer multiple NAV strikes per day?

It would effectively eliminate the ability of institutional MMFs to offer multiple NAV strikes per day or lead to increased risk for those firms willing to make assumptions on shareholder activity and the potential swing price. As described above in response to Questions 16 and 39, multi-strike MMFs would probably trigger the swing threshold more often than single strike funds because the threshold would be 2% for twice-daily priced funds and 1.33% for thrice daily-priced funds. We anticipate that investors would avoid these funds to reduce the probability of being hit with swing pricing dilution on redemption.

The Federated Hermes multi-strike MMF offers three strike times per business day. Thus, a market impact adjustment would be required for redemptions exceeding 1.333%. in any one strike pricing period. Based on our analysis of our multi-strike MMF, the MMF had net redemptions in excess of 1.333% during a strike pricing period approximately 11% of the days for the period of January 2, 2017 through December 31, 2021. Further, our multi-strike MMF had $12.5 billion in assets as of February 28, 2022, so a 1.333% redemption equates to approximately $167 million, and would not pose any stress to that MMF given the amount of liquid assets held in that MMF, such that a market impact adjustment should not be required to address portfolio transaction costs or outflows. Further, during the same period, that MMF had 18 instances of daily net redemptions exceeding 4%, with the largest percentage redemption of 8.99% on July 31, 2017. There was no impact to the NAV on the day of the 8.99% redemption, evidencing that even a redemption of nearly 9% did not dilute shareholders and that a 1.333% threshold for a multi-strike MMF will cause unnecessary and burdensome processes for MMFs without any corresponding investor benefit.

How many institutional money market funds will reduce the number of times they strike their NAV if we adopt swing pricing as proposed?

It is unclear how many MMFs will remain in existence if swing pricing is adopted as proposed and unclear how many MMF providers will be willing to utilize estimates, risking the integrity of the NAV of the MMF. Our estimation is that the number would be very small and primarily composed of captive investors. An inherent conflict would be created – continuing to operate a MMF with multiple strike points to meet investor demand, while at the same time having to address the risk that investors will have the ability to game the system and take advantage of intraday arbitrage opportunities.

How might investors be affected if these funds are no longer able to offer multiple NAV strikes, or as many NAV strikes, per day?

Investors redeem in and out of MMFs at different times during a day and a fund's ability to provide redemptions earlier in the day is critical to certain investors. The elimination of intraday multiple NAV strikes will lead to investors leaving institutional MMFs. Unlike the massive shift in assets from prime MMFs into government MMFs following the financial crisis, investors in prime products will likely move to less transparent unregulated alternatives. As described above in response to Questions 16 and 39, multi-strike MMFs offer an investor benefit of grouping MMF investors according to the degree to which they value ability to redeem quickly. Multi-strike MMFs typically hold greater portfolio liquidity than single-strike MMFs, to meet the needs of their investors. Those investors that highly value this feature are willing to accept the slightly lower yield associated with more frequent transactions costs and higher portfolio liquidity associated with multi-strike MMFs. Those investors who do not value this feature gravitate to single-strike MMFs with slightly higher net yield. If multi-strike MMF investors were to migrate to single-strike MMFs, all investors would become subject to the same net yield and same timelines to redemption, to the detriment of both categories of investors.

SEC PROPOSAL QUESTION 52 AND FEDERATED HERMES RESPONSE

Should we require all money market funds, including stable NAV money market funds, to adopt a floating NAV and to implement swing pricing?

No. There is no justification to support eliminating stable NAV MMFs. Data confirms that floating NAV MMFs had more redemptions than their stable NAV counterparts and there is no evidence that floating NAVs stop redemptions. It would be far more appropriate, and based on data, to remove floating NAV requirements from institutional prime and tax-exempt MMFs than to impose them on retail funds.

Federated Hermes strongly opposes a floating NAV requirement for retail prime and tax-exempt MMFs because, as the SEC believed in 2014, and as the PWG MMF Report acknowledged, retail MMF investors tend not to redeem their shares in a crisis. By dividing prime and tax-exempt MMFs into separate retail and institutional series, this effect has been even more clearly documented by the data on MMF outflows in the Spring of 2020. Further harming capital formation while harming investors without tangible benefit is certainly contrary to the SEC's mission and inconsistent with the Commission's obligation under the APA. Retail investors largely left their prime and tax-exempt balances in place. In the Spring of 2020, institutional prime MMFs were subject to floating NAVs and this category of MMFs experienced outflows. Retail prime MMFs were not subject to floating NAVs and this category of MMFs did not experience significant outflows. This demonstrates that floating NAVs – which arguably eliminate the theoretical "first mover advantage" – did not stem outflows and retail MMFs did not experience material outflows in a financial crisis. All that floating NAVs for institutional prime and tax-exempt MMFs accomplished was to shrink their size. Why, then, would any rational policymaker amend Rule 2a-7 to impose floating NAVs on retail prime MMFs? It would be an ineffective (and potentially harmful) solution to a non-existent problem.

SEC PROPOSAL QUESTION 53 AND FEDERATED HERMES RESPONSE

Will investors seek alternative cash management investment options that are not subject to fluctuation in value at times of market stress to avoid the additional NAV variability that results from swing pricing? If so, which alternatives are investors most likely to use?

Yes. Investors have been clear that they would not invest in an MMF with swing pricing, as this would eliminate the fund's ability to provide intra-day and same-day settlement. Institutional investors will buy short-term paper directly and/or seek out private funds or stablecoins.[93] The President has noted the unregulated nature, propensity for use in money laundering, and investor and systemic risks associated with digital currencies and stablecoins in particular, and called for coordinated action by Congress and regulators to address the risks.[94] FSOC and Federal Reserve Bank leaders have also noted that stablecoins in particular are a largely unregulated competitive alternative to MMFs that are growing rapidly in investor acceptance and total market capitalization, are subject to investor runs and could disrupt money markets (not in a good

---

[93] For a discussion of stablecoins as an alternative to MMFs and systemic risk considerations concerning stablecoins, see President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, Report on Stablecoins (Nov. 2021), available at https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf; FSOC, 2021 Annual Report, at 123, available at https://home.treasury.gov/system/files/261/FSOC2021AnnualReport.pdf. U.S. dollar stablecoins, as of June 2021 aggregated to approximately $111 billion in assets, with two issuers representing 79% of that total. J. Redman, *Boston Fed President Says 'Exponential Growth' of Stablecoins Could Disrupt Money Markets*, News, BITCOIN.COM(Jun. 27, 2021), https://news.bitcoin.com/boston-fed-president-says-the-exponential-growth-of-stablecoins-could-disrupt-money-markets/.

[94] *See* Executive Order On Ensuring Responsible Development of Digital Assets (Mar. 9, 2022), available at https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/; White House Press Release, President Biden to Sign Executive Order on Ensuring Responsible Development of Digital Assets (Mar. 9, 2022), available https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/09/fact-sheet-president-biden-to-sign-executive-order-on-ensuring-responsible-innovation-in-digital-assets/.

way) in stressed conditions.[95] Retail investors will flood their money into government MMFs or stablecoins, crowding out private investment and related benefit. As a result, the "dash for cash" or credit crisis would not be mitigated – but rather shifted to unregulated and less transparent vehicles. If any investor were to remain, then the potential application of a swing price would serve as another bright line incentive for an investor to redeem earlier (just like the result from linking liquidity to the imposition of gates and fees). As stated above in response to question 52, subjecting institutional prime MMFs to floating NAV was predicted to have a negative impact, and that was demonstrated by 75% of the money flowing out of this type of fund, thereby disrupting financing for issuers and limiting investor choice.

SEC PROPOSAL QUESTION 54 AND FEDERATED HERMES RESPONSE

Are institutional prime and tax-exempt money market funds used in cash sweep arrangements?

Yes, but generally it is a very small percentage (approximately 6% of Federated Hermes clients use FNAV MMFs in sweeps).

SEC PROPOSAL QUESTION 55 AND FEDERATED HERMES RESPONSE

What other operational changes would be required for funds to implement our swing pricing requirement as proposed?

Notwithstanding that we will not have any investors in these funds should the SEC's swing pricing mandate be required, as set forth above, there are numerous operational and practical impediments that will inevitably result in the elimination of MMFs as a viable investment option if mandatory omnipresent swing pricing is required.

SEC PROPOSAL QUESTIONS 56 – 59 AND FEDERATED HERMES RESPONSE

Would swing pricing impose additional complications with respect to the tax treatment of floating NAV money market fund investments? If so, how could we address such complications? Would the implementation of swing pricing for institutional money market funds affect the treatment of shares of such funds as "cash equivalents" for accounting purposes? Would a cap on the swing factor, such as a 2% cap, reduce uncertainty about the treatment of institutional money market fund shares as "cash equivalents"? Should the financial reporting effects of swing pricing differ for money market funds, as opposed to other types of mutual funds? Are there other tax or accounting implications of institutional money market funds using swing pricing that we should address?

The IRS has not yet determined how such gains and losses will be taxed. Although the IRS determined that price fluctuations resulting from a floating NAV would not require burdensome recordkeeping, this determination has not been made for swing pricing.[96] Swing pricing will lead to increased share price volatility in MMFs and unnecessary randomness in both reported price and in realized tax gains and/or losses for investors who seek MMFs for safety of principal. The Commission acknowledges that the IRS may not make a favourable determination:

---

[95] *Id*.

[96] The IRS determined that gains and losses from a floating NAV could be aggregated over time and not individually reported.

> We recognize that if the proposed swing pricing requirement modifies the method of accounting for gains or losses in relevant money market fund shares, or has other tax implications, the tax reporting effects of the proposed swing pricing requirement could increase burdens for investors.[97]

Additional clarification is therefore required to determine:

i. the tax consequences to both MMFs and MMF shareholders with respect to amounts retained by a MMF as a redemption discount for redeeming shareholders, or credited as a purchase price discount to purchasing shareholders as a result of the application of swing pricing,

ii. the impact on the calculation and use of the NAV method of accounting for tax gains and losses, and

iii. any tax issues related to electing in or out of that methodology.

These issues should be addressed by the Treasury Department and the IRS, prior to adopting any additional MMF reforms. Moreover, any cost/benefit analysis is incomplete without consideration of the tax and accounting impact of any proposed regulatory changes.

SEC PROPOSAL QUESTION 60-62 AND FEDERATED HERMES RESPONSE

Are the existing swing pricing-related disclosure obligations on Form N-1A appropriate for money market funds? In addition to the question regarding the swing factor's upper limit, are there other existing obligations that should not be applied to money market funds? Would more information be useful to shareholders or other market participants? If so, what additional information should we require to be disclosed on Form N-1A, Form N-MFP, or elsewhere (e.g., fund websites or other marketing materials)? When should we require such disclosure? Should we require institutional funds to report the number of times the fund applied a swing factor and each swing factor applied, as proposed? Should we require the median, highest, and lowest (non-zero) swing factor applied for each reporting period on Form N-MFP, rather than requiring disclosure of each swing factor applied? Should we require these funds to provide additional information about swing pricing in their monthly reports on Form N-MFP, such as the swing pricing administrator's determination to use a lower market impact threshold (if applicable)? Should we separately require funds to disclose information about market impact factors, such as how many times a market impact factor was included in the swing factor each month and the size of those market impact factors (e.g., either the size of any market impact factor applied, or the median, highest, and lowest (non-zero) amount)?

Swing pricing should never be applied to MMFs, however if any LMT is implemented by the board of any MMF, it should be disclosed to shareholders. However, the specific metrics underlying any such determination to apply a LMT should remain confidential.

SEC PROPOSAL QUESTION 63 AND FEDERATED HERMES RESPONSE

As proposed, should we require an institutional fund to use its adjusted NAV, as applicable, for purposes of current requirements to disclose a fund's NAV on its website and the series- and class-level NAV disclosure requirements on Form NMFP?

[97] 2022 MMF Release, 87 Fed. Reg. at 7270.

Yes. Shareholders and intermediaries will need to know both the adjusted NAV, which includes the swing adjustment, as well as the unadjusted NAV for tax and reporting purposes. We note, however, that reporting the swing prices may contribute to some investors' ability to game and market time the MMF.

Should we require an institutional fund to indicate, for each NAV reported, whether a swing factor was applied (i.e., whether the NAV was "adjusted")?

Yes. Implementation by a fund board of any LMT should be disclosed. Shareholders and intermediaries will need to know both the adjusted NAV, which includes the swing adjustment, as well as the unadjusted NAV for tax and reporting purposes. We note, however, that reporting the swing prices may contribute to some investors' ability to game and market time the MMF.

As an alternative to reporting the adjusted NAV, should we provide that the website and Form N-MFP NAV disclosures should not include a swing factor adjustment? If so, why would the unadjusted NAV be more useful for these purposes? Alternatively, should we require an institutional fund to disclose both its adjusted NAV and its unadjusted NAV on the fund's website or on Form N-MFP? What are the advantages and disadvantages of requiring funds to disclose both figures?

No. Implementation by a fund board of any LMT should be disclosed. Shareholders and intermediaries will need to know both the adjusted NAV, which includes the swing adjustment, as well as the unadjusted NAV for tax and reporting purposes. We note, however, that reporting the swing prices may contribute to some investors' ability to game and market time the MMF.

SEC PROPOSAL QUESTION 64 AND FEDERATED HERMES RESPONSE

Requirements to disclose NAVs per share on fund websites and on Form N-MFP require NAVs per share as of the close of business on a given day, while some funds may have multiple pricing periods and multiple NAVs each day. Should we require a fund to disclose its NAV per share for each pricing period, instead of the end-of-day NAV per share only?

Yes. Although requiring a fund to disclose its NAV per share for each pricing period may incentivize and make it easier for investors to try to "game" the system to try to predict the best NAV calculation at which to purchase and by which to redeem in advance, shareholders and intermediaries will need to know both the adjusted NAV, which includes the swing adjustment, as well as the unadjusted NAV for tax and reporting purposes.

Would this additional transparency be helpful for investors, or would it make NAV disclosure less useful for investors by increasing the number of data points without significantly improving the value of the data?

We believe that such additional disclosure would be helpful to those investors looking to game the system and take advantage of the arbitrage opportunities which will inevitably be created based on the swing pricing proposal set forth. But if the Commission adopts its swing pricing proposal, it would be necessary to disclose the swing factor and pricing to shareholders.

SEC PROPOSAL QUESTION 65 AND FEDERATED HERMES RESPONSE

Will daily website disclosure of fund flows and the adjusted NAV facilitate gaming of swing pricing or preemptive runs by investors that wish to redeem in advance of a fund imposing a swing factor on a particular day? If so, how? Are there changes we should make to reduce the potential for gaming?

Yes. Requiring a fund to disclose its NAV per share for each pricing period may incentivize investors to try to "game" the system and engage in market timing transactions to try to predict the best NAV calculation at which to purchase and by which to redeem in advance. Simply using a discretionary liquidity fee as opposed to an inherently gameable swing price will reduce the potential for gaming and market timing in times of market stress.

V. PORTFOLIO LIQUIDITY REQUIREMENTS

Federated Hermes agrees with the Commission that "it is important for money market funds to have a strong source of available liquidity to meet daily redemption requests, particularly in times of stress, when liquidity in the secondary market can be less reliable for many instruments in which they invest." To that end we believe significant work is necessary to improve secondary market liquidity and we look forward to working with global policy makers to advance this workstream.

However, the need to improve secondary market liquidity in times of stress does not mean that a MMF does not have adequate liquidity at the current regulatory requirements, especially if one properly considers the impact of Delinking. Federated Hermes strongly supports the liquidity requirements adopted as a result of the 2010 Amendments which require MMFs to hold at least 10% daily and 30% weekly liquid assets and the requirement that MMFs have a robust KYC process to assist managers in anticipating investor activity and holding any additional liquid assets, above and beyond the daily and weekly liquid asset thresholds, as required.

The Proposal gives no weight to the current Rule 2a-7 requirements for firms' KYC requirements and the resulting requirement to maintain higher levels of liquidity when appropriate. Knowing one's customer is critical to sound portfolio management for MMFs and should be afforded significant weight in the discussion on what levels of liquidity should be required. MMF managers should not only be prepared with information relating to the make-up of their shareholder base, but also to the greatest extent possible, the intended use of a MMF for the largest investors.

Higher levels of liquidity may be required for funds with a concentrated shareholder base. In situations where our MMFs have had significant shareholder concentration levels we have regularly managed those funds with weekly liquidity in excess of the 30% required minimums. Additionally, when, as a result of our KYC process we become aware of an investors intention to make a large redemption, our portfolio managers will take such information into account and manage the portfolio with higher levels of liquidity. The key point being that each MMF's facts and circumstances needs to be assessed by the MMF manager to determine what amount of liquidity above the regulatory minimum, if any, is sufficient. A liquidity requirement of 10% daily and 30% weekly, unencumbered by an improper linkage to fees and gates, and supplemented by the KYC overlay, gives managers the flexibility to operate at liquidity levels appropriate to the specific facts and circumstances of the MMF. Firms that are not giving proper consideration to their customer base with internal KYC processes and adjusting their liquidity holdings accordingly should be subject to SEC scrutiny. Any such individual firm failures do not mean that the rule, as crafted, is not sufficient.

The daily and weekly liquidity requirements when combined with a properly considered KYC overlay have worked remarkably well since their inception in 2010, with MMF managers successfully maneuvering through multiple crises, including entering the Liquidity Crisis with extremely high levels of liquidity. That said, one aspect of the current regulation which was highlighted in the Liquidity Crisis improperly restricted a MMFs ability to utilize its 30% weekly liquidity and served as an artificial catalyst for redemptions and must be removed. The Proposal arbitrarily calls for higher levels of mandated liquidity, ignoring the market impact of Delinking, freeing up over 30% of additional liquidity for MMFs to use in times of stress and fails to appreciate the importance of KYC. As such, Federated Hermes does not support increasing the existing liquid asset requirements as it is unnecessary and not supported by the data.

The Commission's proposal to require an additional 20% weekly liquid asset requirement, on top of the soon to be unencumbered 30% weekly liquidity requirement would narrow, unnecessarily, the spread in yield amongst prime and government MMFs to less than 10bps. As the SEC staff notes, such a significant increase in liquidity requirements will reduce the spread between prime and government MMFs, thus making prime MMFs less attractive to investors, shrinking the prime MMF industry and increasing the cost of funding to issuers in the prime money markets. This will invariably lead to a shift of more assets out of prime MMFs, reducing funding to private companies and financial institutions. While a tremendous shift of assets out of prime MMFs into government MMFs was observed as a result of the 2014 Amendments, it is unclear if the investors who remained in prime MMFs will now elect to also move to government MMFs, or if they will instead elect to shift into other less transparent unregulated products.

A. The Proposal is supported by a series of self-serving assumptions.

False Assumption 1: Assuming that all redemptions should be met using weekly liquid assets.

The Commission notes that if all redemptions were met using weekly liquid assets there would have been issues:

> Although only one institutional prime fund reported weekly liquid assets below the 30% threshold, it is likely that other funds would have breached daily liquid asset or weekly liquid asset thresholds at the time if they had used daily liquid assets or weekly liquid assets to meet redemptions.

Use of liquidity when liquidity is necessary occurred with regularity before the SEC amended Rule 2a-7 in 2014 to essentially prohibit the use of 30% of a fund's liquid assets. As predicted by then Commissioner Stein, the linkage between a fund's required liquidity levels and the potential imposition of fees and gates became a trigger sparking investor redemptions and the liquidity levels became a hard floor. For some reason the Commission continues to negatively depict the proper management of MMFs throughout the Liquidity Crisis despite MMFs adhering to the requirements as crafted by the Commission. Despite inherent regulatory hurdles, MMF managers successfully managed their portfolios, using their expertise to determine which securities should be purchased or sold as a result of shareholder activity, all while ensuring that MMFs maintained their statutorily required liquidity levels under Rule 2a-7. This, despite the improper linkage which led to artificially high redemptions. The Commission cites managers' decisions to sell longer dated assets and sponsors who chose to inject additional liquidity into a fund as negatives. Both are entirely permissible under the rules (although we firmly oppose sponsor support).

Managers must be afforded the discretion to determine what assets should be purchased or sold in its discretion and no negative inference should be drawn based on what underlying securities (and their maturities) may have been sold by managers who were successfully maneuvering funds in an unprecedented Liquidity Crisis. In addition to managing liquidity, MMF managers also had to ensure that a MMF remained within its WAM and WAL requirements throughout the Liquidity Crisis, so simply looking at portfolio maturities as the single factor for determining what should or should not have been sold could have left portfolios in breach of other, equally important, requirements of Rule 2a-7. Managing a portfolio is not a simple as the Proposal implies.

Similarly, the negative inference on the use of sponsor support – which we fully support the prohibition of – is not appropriate as a basis for increasing required liquidity given that the use of sponsor support was, and is, and appears will continue to be, not only appropriate, but encouraged by the Commission. We continue to believe restricting the use of sponsor support eliminates both moral hazard and the risk of contagion and reinforces to investors that MMFs are investment products. That said, the use of any approved LMT during the Liquidity Crisis to ensure a MMF operated smoothly should not lead to inferences that doing so is somehow inappropriate. Especially when there appears to be no desire to limit or remove the use of said tool in subsequent reforms.

The Commission goes on to assign significant weight to a series of hypothetical portfolios which are then subjected to redemption figures which are only met through the hypothetical portfolios' weekly liquid assets. This hypothetical scenario completely ignores the value of a portfolio manager preparing a fund for times of stress by increasing a fund's liquidity. It completely ignores the requirement that a fund manager comply with KYC requirements and with other portfolio construction requirements (WAM and WAL). It also assumes that there are no inflows into a fund which could be utilized to offset redemptions. Not surprisingly, when one ignores a manager's discretion, ignores KYC requirements, ignores the other requirements of Rule 2a-7, and ignores inflows, it is easy to illustrate how having higher weekly liquidity would serve to meet redemptions with less pressure. This was an entirely self-serving exercise and these assumptions and any conclusions derived from them should carry no weight as they ignore the realities of actively managed funds and the benefits of a manager and its skill which investors rely upon. These are not passive ETFs or robo funds.

The Commission specifically states "Based on this analysis …, we are proposing to increase the minimum liquidity requirements…" The entire premise is a house of cards designed to justify an arbitrary and unnecessary increase in liquidity requirements which is not supported by the data.

False Assumption 2: Managers will not maintain sufficient levels of liquidity if the "incentive" provided by the improper linkage of fees and gates is removed.

The Commission suggests that removing the negative linkage of liquidity fees and gates with liquidity levels, which has now been universally accepted as improper and a catalyst for artificially high redemptions and which should never have been imposed in the first place, could now be interpreted as a negative, stating that the removal of such an incentive increases concern that "funds may subsequently reduce their liquidity levels and not be equipped to handle future stress." The Commission further notes that "the proposed removal of the fee and gate provisions from Rule 2a-7 could have the effect of reducing fund liquidity levels by eliminating such incentives." The referenced incentives include holding liquid assets in excess of the regulatory minimums.

This ignores any ongoing liquidity requirement as well as historical data of managers maintaining high levels of liquidity in advance of stressed markets (see debt ceiling, Brexit, global health pandemic) and ignores the KYC requirement of Rule 2a-7. The removal of the linkage does not remove the incentive of managers to maintain adequate levels of liquidity. The requirement to manage liquidity to one's customer base, KYC, remains and the 10% and 30% levels will continue to serve as a useable floor. However, what changes is the ability of managers to use the liquidity in a fund.

We cite again the ICI data (see chart below) as further evidence that even before the linkage was introduced, funds utilized their weekly liquid assets as necessary and then in accordance with the rule procured only weekly liquid assets until the regulatory thresholds were once again met.

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

	Prime		Tax-exempt	
Time period	**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

	Prime		Tax-exempt	
Time period	**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

False Assumption 3: Average liquidity levels justify permanent increases in required liquidity.

The Commission points to average liquidity levels over the past several years to further justify its proposed higher liquidity levels and ignores the market reality of the data provided and the impact of such enhancements in "normal" conditions. In the "past several years" cited by the Commission, one could argue that managers have effectively managed their funds to not only ensure compliance with regulatory requirements, even while encumbered with an improper linkage to fees and gates, which has meant that levels of liquidity were maintained above regulatory minimums, but also to deal with certain significant market events which could have materially impacted liquidity. These include, but are not limited to, (i) the U.S. Debt Ceiling Crises of 2011, 2013 and 2018 and Taper Tantrums of 2013 and 2021/2022, (ii) the October 2016 implementation of Rule 2a-7 amendments that caused prime MMFs to shed the bulk of their assets in two months, (iii) Brexit, and (iv) a global health pandemic.

The data supports effective liquidity management by MMF managers – increasing liquidity in anticipation of times of stress and managing liquidity at lower required levels in normal conditions. Managing liquidity to confirm compliance with regulations, including regulations which include a misguided linkage, should not be used to justify a demand for arbitrarily higher levels of liquidity. Instead, should serve as evidence that the current regulations are working as intended. The complete freezing of markets does not on its face justify mandating higher liquidity levels.

False Assumption 4: Failure of a single MMF to ensure proper liquidity will lead to a run impacting all MMFs.

The notion that mandatory liquidity levels will be arbitrarily increased, without any non-hypothetically spun data, to ensure that not a single fund will have a liquidity issue, is not appropriate. This approach ignores not only historical precedent proving this is not true but also the important regulatory changes adopted by the Commission in the wake of the Financial Crisis (transparency). Post Financial Crisis, the Reserve Primary Fund broke a buck, the fact pattern leading up to this event remains debated[98] but the fact that such a breaking of the buck did not lead to the downfall of the industry is not disputed – the industry remains.

With the advent of complete transparency if one MMF were to have a liquidity issue, then it would not contaminate all MMFs as there is complete transparency to both regulators and investors on the liquidity within a fund. Another, and perhaps more relevant example of a fund with a liquidity issue not impacting the entire industry is the Putnam example. The Putnam Prime Money Market Fund (the "Putnam Prime Fund") held $17.4 billion on September 12, 2008 but experienced a decline in assets over September 15 and 16 (the day of and following the Lehman Brothers bankruptcy) of more than $5 billion. On September 17, the fund's board voted to suspend redemptions and liquidate the fund.[99] The fund's board took prudent and timely action which prevented the Putnam Prime Fund from experiencing the uncontrolled redemptions suffered by the Reserve Primary Fund and provided the Putnam Prime Fund with sufficient time to negotiate a solution that restored liquidity on terms that were equitable to all shareholders. Specifically, on September 25, the Putnam Prime Fund exchanged $12.3 billion of assets in-kind for shares of Federated's Prime Obligations Fund. The Putnam Prime Fund immediately liquidated by distributing the Prime Obligations Fund shares to its shareholders. Prime Obligations Fund then honored another $5 billion of outstanding redemptions from former Putnam Prime Fund shares at $1 per share.[100] This further illustrates that a liquidity problem in one fund does not equate to the entire industry.

All of the above notwithstanding, the Commission will continue to receive, and analyze, liquidity data and portfolio holdings for the entire MMF industry – providing it with the tools to identify and consult with any outliers.

False Assumption 5: Cannot rely on managers ability to anticipate liquidity needs.

Actively managed funds rely upon a manager's expertise in security selection, portfolio construction, diversification, and liquidity. This is why investors pay a management fee and do not invest in passive products. No investment manager can predict the future, but history is a great indication of the willingness and preparedness of managers to increase liquidity in times of perceived stress. We have just navigated through the worst real life stress test imaginable, or one could say "unimaginable." Nobody could have predicted that in response to a global health pandemic that governments around the world would simply shutter their economies, yet that is what happened. And despite those unprecedented actions, MMF managers reacted, increased liquidity, and navigated through an incredibly stressful and unprecedented time and met all shareholder redemptions. Yes, market support was introduced which indirectly benefited MMF

---

[98] *See* Federated Hermes comment letter dated April 12, 2021, at 7-8, available at https://www.sec.gov/comments/s7-01-21/s70121-8662821-235311.pdf; M. L. Cochran, D. F. Freeman & H. M. Clark, *Money Market Fund Reform: SEC Rulemaking in the FSOC Era*, 2015 COLUM. BUS. L. REV. 861; N. Michel, *The Contagion Concoction, The Truth About Runs and the Great Financial Crisis*, CFMA Working Paper No. 0006 2022 (CATO Institute, forthcoming 2022).

[99] *See* Henriques, *supra* note 25.

[100] See Federated Investors, Inc. comment letter dated September 16, 2013 at https://www.sec.gov/comments/s7-03-13/s70313-130.pdf

managers, but support was provided to all aspects of the global economy and no support was put in place to preserve MMFs – but rather to support the short-term markets generally.

One can go beyond the recent global health pandemic and look at MMFs' preparation in response to each of the European debt crisis, the U.S. debt-ceiling issues of 2011 and 2013, and the massive redemptions experienced in 2016 as a result of the implementation of the 2014 Amendments. All of these are evidence that, with a good foundation of MMF regulation, with a liquidity requirement that is not encumbered with an improper linkage between fees and gates and with good understanding of one's investors base in accordance with KYC requirements, investors and markets can rely upon managers' ability to anticipate liquidity needs.

Notwithstanding that the foundation of the increased liquidity proposal is based upon improper assumptions, it is clear that the Commission does not believe the usage of a fund's liquidity below even current requirements, once the delinking is effective, is material. The Commission has proposed that no notice is warranted to either the Commission or a fund's board until weekly liquidity falls below 25% or daily liquidity falls below 12.5%. This implies that there is no real concern about a fund being able to meet redemptions at those levels of liquidity. On this we fully agree. Moreover, if a fund were to fall below 25% weekly or 12.5% daily, the Commission is proposing that notice within a day and details within 4 days are appropriate. This nonchalant approach to maintaining liquidity above 25% weekly and 12.5% daily is clear evidence that the requirement to hold 50% weekly and 25% daily are entirely arbitrary and not based on data or market concerns. We appreciate that the Commission is under tremendous pressure to put in place a "package" of reforms that go beyond simply removing the improper linkage between fees and gates and liquidity levels, however we urge the Commission not to move forward on further regulatory changes which are arbitrary and not supported by the data.

False Assumption 6: Prime MMFs will continue to exist.

The Commission's proposal to require an additional 20% weekly liquid asset requirement, on top of the soon to be unencumbered 30% weekly liquidity requirement would narrow, unnecessarily, the spread in yield amongst prime and government MMFs to less than 10bps. This will invariably lead to a shift of more assets out of prime MMFs, reducing funding to private companies and financial institutions. While over $1.2 trillion in investments were shifted out of prime MMFs into government MMFs as a result of the implementation of the 2014 Amendments,[101] it is unclear if remaining prime MMF investors will elect to also move to government MMFs, or if they would instead elect to shift into other unregulated less transparent products. Managers, who may attempt to mitigate against the inevitable yield constraint that comes with higher daily and weekly liquid assets may increase their holdings in longer dated paper, thus taking on increased risks.

A. SEC Liquidity Requirement questions 66 - 86

SEC PROPOSAL QUESTION 66 AND FEDERATED HERMES RESPONSE

Would our proposal to increase the minimum liquidity requirements make money market funds more resilient during times of market stress?

---

[101] *See* SEC Division of Investment Management, Money Market Fund Statistics, at 4 (Dec. 31, 2016). https://www.sec.gov/divisions/investment/mmf-statistics/mmf-statistics-2016-12.pdf.

No, the proposal to increase liquidity requirements would not make MMFs more resilient, however the Proposal to remove the improper linkage between fees and gates and liquidity requirements will make MMFs more resilient by freeing-up an additional 30% of liquidity that was effectively unavailable to managers during the Liquidity Crisis. This additional liquidity, combined with prudent investment management and a commitment to KYC rules, will make MMFs more resilient in times of market stress.

Would a lower or higher threshold of daily or weekly liquid assets better allow most money market funds to meet potential redemptions without selling less liquid asset in periods of market stress?

The removal of the improper linkage between fees and gates and liquidity requirements will free-up an additional 30% of liquidity that was effectively unavailable to managers during the Liquidity Crisis and would have alleviated the need to sell longer dated assets. That said, the presumption that the sale of less liquid assets is inappropriate is false. A portfolio manager must be permitted to determine which assets in the portfolio should be purchased, held or sold in their direction at any given time. MMF managers have unique insights into the short-term funding markets and they must be left to make portfolio management decisions unfettered by the dead hand of well-intentioned but misguided prescriptive regulation, subject to proper board and regulatory oversight. A regulatory agenda which looks to prevent managers from selling longer maturing papers does not provide investors with the benefits of the managers expertise and fails to reflect the specific make-up of a particular MMF.

Should we instead propose to raise the minimum daily liquid asset threshold to 20%, 30%, or 35% and/or the minimum weekly liquid asset threshold to 40%, 55%, or 60%, for example? Why or why not?

No. An increase in the daily and weekly liquidity requirements is not necessary and it not supported by the data. The removal of the improper linkage between fees and gates and liquidity requirements will free-up an additional 30% of liquidity that was effectively unavailable to managers during the Liquidity Crisis. Moreover, the Proposal should reflect the proven benefits of the KYC requirements since adoption. Notwithstanding our firm belief that any additional liquidity requirements are both unnecessary and unsubstantiated and would reflect a complete disregard of the benefits of Delinking, should the Commission insist that some level of liquidity requirements be increased, we would suggest the most appropriate, albeit unnecessary, area to increase would be daily liquidity for institutional prime MMFs. Moving daily liquidity to 20% and retaining weekly liquidity at 30%, when combined with both delinking and the current and critically important KYC overlay, will address the Commission's concerns and provide more liquidity to meet daily redemptions. No additional liquidity requirements should be applicable to either retail prime, municipal MMFs or government MMFs as there is little to no data to support the proposition that these funds require further liquidity.

With respect to a potential increase to liquidity levels for institutional prime MMFs it remains critical that these products can obtain a yield spread over that of government MMFs. Without such spread, these funds will be regulated out of existence as all funds will simply move to government MMFs or unregulated less transparent products. This will make short-term markets less liquid, constrain capital formation, and force investors from investing in private sector activities to supporting government MMFs, a bad result for all stakeholders.

We do not think that any increase in current mandatory liquidity levels is justified by the data. If, however, the SEC chooses to ignore the data, the added liquidity levels required to be held under KYC liquidity requirements, and the benefit to liquidity from freeing up WLA for use in redemptions if that measure is delinked from the ability to impose gates and fees, then any increase should be limited to increasing DLA requirements to 15% and WLA requirements to 35% of portfolio assets. This remains a floor, not a ceiling, and based on their KYC obligations, MMFs will continue to hold higher levels based upon their investors' anticipated redemption timelines. Setting unrealistically high minimum DLA and WLA levels essentially treats all prime MMFs the same, regardless of their investors' propensity to redeem and anticipated investment horizons.

SEC PROPOSAL QUESTION 67 AND FEDERATED HERMES RESPONSE

Would our proposal to remove fee and gate provisions from Rule 2a-7 encourage funds to maintain lower levels of liquidity during normal market conditions? If so, do our proposed increased minimum liquidity requirements limit the potential effect on fund liquidity that may otherwise arise from our proposal to remove fee and gate provisions from Rule 2a-7?

No. A manager is required under the KYC rules of Rule 2a-7 to manage a fund with the appropriate level of liquidity for its investor base. The 10% and 30% liquidity levels are minimums. Managers also adjust liquidity levels based on market conditions. The removal of the improper linkage between fees and gates and liquidity requirements will free-up an additional 30% of liquidity that was effectively unavailable to managers during the Liquidity Crisis and a fund's KYC requirements would prohibit a MMF from holding lower levels of liquidity than required.

The most important tenet of a MMF is that it provides investors with a liquid investment in a diversified pool of high-quality assets. MMF managers will not attempt to skirt regulatory minimums and risk operating a portfolio with improper liquidity levels as doing so could jeopardize a particular fund's continued operations. If any regulatory changes should be considered to reduce an incentive to hold lower levels of liquidity it should be the prohibition of sponsor support – as it is the knowledge that if liquidity levels are not managed appropriately that a sponsor can simply step in and provide liquidity that provides a significantly higher encouragement to operate at lower liquidity levels.

Should the proposed minimum liquidity thresholds be higher or lower to accommodate such effect? Why or why not?

The liquidity levels should remain as put in place in under the 2010 Amendments. The removal of the improper linkage between fees and gates and liquidity requirements will free-up an additional 30% of liquidity that was effectively unavailable to managers during the Liquidity Crisis. Daily and weekly liquidity requirements of 10% daily and 30% weekly remain appropriate, each as complimented by Rule 2a-7's KYC requirement which ensures funds maintain higher levels of liquidity as appropriate, consistent with the facts and circumstances of each particular MMF. The prohibition of sponsor support should be considered if the objective is to avoid firms managing toward the lower end of the liquidity requirements.

Notwithstanding our firm belief that any additional liquidity requirements are both unnecessary and unsubstantiated and would reflect a complete disregard of the benefits of Delinking, should the Commission insist that some level of liquidity requirements be increased, we would suggest the most appropriate, albeit unnecessary, area to increase would be daily liquidity for institutional prime MMFs. Moving daily liquidity to 20% and retaining weekly liquidity at 30%, when combined with both Delinking and the current and critically important KYC overlay, will address the Commission's concerns, and provide more liquidity to meet daily redemptions. No additional liquidity requirements should be applicable to either retail prime, municipal MMFs or government MMFs as there is little to no data to support the proposition that these funds require further liquidity.

With respect to a potential increase to liquidity levels for institutional prime MMFs it remains critical that these products have the ability to obtain a yield spread over that of government MMFs. Without such spread, these funds will be "regulated out of existence"[102] as all funds will simply move to government MMFs or unregulated less transparent products. This will make short-term markets less liquid, constrain capital formation, and force investors from investing in private sector activities to supporting government MMFs, a bad result for all stakeholders.

SEC PROPOSAL QUESTION 68 AND FEDERATED HERMES RESPONSE

To what extent would our proposed amendments reduce money market fund liquidity risk?

The removal of the improper linkage between fees and gates and liquidity requirements will free-up an additional 30% of liquidity that was effectively unavailable to managers during the Liquidity Crisis and therefore reduce a MMF's liquidity risk. The Proposal's amendments relating to increasing daily and weekly liquidity requirements will not reduce MMF liquidity risk. This is because a MMF is already operating well above regulatory minimums, when necessary, as part of its regulatory KYC obligations.

SEC PROPOSAL QUESTION 69 AND FEDERATED HERMES RESPONSE

What, if any, impacts would our proposed amendments have on yields of prime money market funds?

The requirement to have 50% weekly and 25% daily would have a negative impact on the yields of prime MMFs. While prime MMFs may maintain liquidity levels near the proposed levels in times of stress, they are not maintained in normal market conditions and investors would receive an unnecessarily lower yield in these times. The Commission's proposal to require an additional 20% weekly liquid asset requirement, on top of the soon to be unencumbered 30% weekly liquidity requirement would narrow, unnecessarily, the spread in yield amongst prime and government MMFs to less than 10bps. This will invariably lead to a shift of more assets out of prime MMFs, reducing funding to private companies and financial institutions.

In our experience, investors have been clear that a spread of at least 10bp is necessary to justify any investment in prime MMFs as compared to government MMFs.

What would be the effect on yields of lower or higher minimum liquidity requirements?

Lower liquidity requirements would have no effect on yields as managers will continue to manage funds based on current liquidity requirements, market conditions and their KYC overlay. Higher levels of liquidity, as noted above, would have a negative impact on yields in normal market conditions, destroying prime MMFs and hurting markets and capital formation for no realizable gain.

Would increased or decreased yields effect the desirability of prime money market funds for retail and/or institutional investors?

---

[102] Z. Pozsar, T. Adrian, A. Ashcroft & H. Boesky, *Shadow Banking*, Federal Reserve Bank of New York Staff Reports No. 458, at 6 (July 2010). As originally published, at page 6 the Staff Report read: "whether shadow banks should have access to official backstops permanently, or be regulated out of existence." Available in its original 2010 form at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr458_July_2010_version.pdf. The Staff Report was subsequently revised in February 2012 to delete this sentence: https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr458.pdf.

Yes. The Commission's proposal to require an additional 20% weekly liquid asset requirement, on top of the soon to be unencumbered 30% weekly liquidity requirement would narrow, unnecessarily, the spread in yield amongst prime and government MMFs to less than 10bps. In our experience, investors have been clear that in normal market conditions a spread of at least 10bp is necessary to justify any investment in prime MMFs as compared to government MMFs. This will invariably lead to a shift of more assets out of prime MMFs, reducing funding to private companies and financial institutions.

Would the proposed amendments decrease the availability of prime money market funds?

Yes. Lower yields in normal market conditions would lead to more investors redeeming out of prime MMFs and moving to either government MMFs or other unregulated and less transparent products, resulting in a further reduction in the number of prime MMFs available to investors. In anticipation of yet another round of Rule 2a-7 amendments, several large fund sponsors reduced or eliminated their prime MMF offerings.[103]

SEC PROPOSAL QUESTION 70 AND FEDERATED HERMES RESPONSE

How would the proposal affect funds' current incentives to maintain liquidity buffers well above the regulatory minimums?

The Proposal would negatively incentivize managers from holding any liquidity buffers over the unnecessarily high regulatory minimums. The Proposal to require an additional 20% of weekly liquid assets, on top of the soon to be unencumbered 30% weekly liquidity requirement, would narrow, unnecessarily, the spread in yield amongst prime and government MMFs to less than 10bps. This will invariably lead to a shift of more assets out of prime MMFs, reducing funding to private companies and financial institutions. Managers, who may attempt to mitigate against the inevitable yield tightening may be forced to purchase longer dated securities, then becoming longer in nature and taking on maturity risk. Additionally, MMF managers would be unlikely to maintain any liquidity above the minimums as the minimums would be set beyond any requirement supported by the data, thus rendering a critically important aspect of current Rule 2a-7, the KYC requirements, moot.

Would funds be more likely to hold daily liquid asset and weekly liquid asset amounts that are closer to the regulatory minimums?

Yes, under the current Proposal any KYC requirement is rendered moot and there would be no incentive to hold above the required minimums, especially as the Commission has indicated going below, even a material amount, is inconsequential. Heightened levels are simply unnecessary and appear to be movement just for the sake of movement with no regard to the market impact. The removal of the improper linkage between fees and gates and liquidity requirements will free-up an additional 30% of liquidity that was effectively unavailable to managers during the Liquidity Crisis. The removal of the penalty for using such liquidity will also lead to increased usage of such liquidity as intended, however fund managers would continue to respect the minimum levels. It is the KYC overlay, however, that ensures that fund managers operate not just at a regulatory minimum, but at a level of liquidity that reflects the specific facts and

[103] Since February 2020, the number of prime MMFs has declined from 62 to 46, a decline of approximately 26% as of April 2022. This continues the anticompetitive trend of declining MMF providers as there were 163 prime MMFs available to investor just over 12 years ago. The reduction in prime funds (78%) and reduction in prime assets (74%) since the adoption of the SEC's 2010 and 2014 Amendments are directly correlated. Source: iMoneyNet Analyzer April 2022.

circumstances on each individual MMF. MMFs who have concentrated shareholders bases or who have been informed of significant redemptions will need to manage their portfolios to reflect that knowledge.

Absent our proposed increase to the minimum liquidity requirements, would the existing requirement for funds to disclose liquidity information on a daily basis on their websites provide sufficient incentive for funds to maintain liquidity buffers well above the current regulatory minimums?

Yes. Funds are properly incentivized to maintain adequate levels of liquidity by both the daily and weekly requirements and the KYC overlay. As an actively managed product, MMF managers receive a fee to provide investors with a diversified and liquid investment product that provides a market yield. Holding appropriate levels of liquidity is already required under Rule 2a-7.

SEC PROPOSAL QUESTION 71 AND FEDERATED HERMES RESPONSE

Would our proposal increase the propensity for prime money market funds to "barbell" or invest in potentially risker and longer-term assets outside of the portion of the fund's portfolio that qualifies as daily liquid assets or weekly liquid assets? Why or why not?

Yes. The Commission's proposal to require an additional 20% weekly liquid asset requirement, on top of the soon to be unencumbered 30% weekly liquidity requirement would narrow, unnecessarily, the spread in yield amongst prime and government MMFs to less than 10bps. This will invariably lead to a shift of more assets out of prime MMFs, reducing funding to private companies and financial institutions.

While the use of barbelling is an entirely appropriate management technique, managers, who may attempt to mitigate against the inevitable yield tightening may look to purchase longer dated securities out of necessity rather than appropriateness, taking on an increase in maturity risk. Notwithstanding a potential increase in "barbelling", portfolio managers will continue to operate funds in accordance with the WAM/WAL requirements which ensure that even a barbelled portfolio is within the maturity limits.

SEC PROPOSAL QUESTION 72 AND FEDERATED HERMES RESPONSE

Should the proposal alter the current framework for which type of money market funds are subject to the minimum liquidity requirements? For example, should the requirements distinguish between prime money market funds and government money market funds?

All MMFs should continue to be subject to the liquidity requirements set forth in the 2010 Amendments. Moreover, for institutional funds, the removal of the improper linkage between fees and gates and liquidity requirements will free-up an additional 30% or more of liquidity that was effectively unavailable to managers during the Liquidity Crisis.

Notwithstanding our firm belief that any additional liquidity requirements are both unnecessary and unsubstantiated and would reflect a complete disregard of the benefits of delinking, should the Commission insist that some level of liquidity requirements be increased, we would suggest the most appropriate, albeit unnecessary, area to increase would be daily liquidity for institutional prime MMFs. Moving daily liquidity to 20% and retaining weekly liquidity at 30%, when combined with both delinking and the current and critically important KYC overlay, will address the Commission's concerns and provide more liquidity to meet daily redemptions. No additional liquidity requirements should be applicable to either retail prime, municipal MMFs or government MMFs as there is little to no data to support the proposition that these funds require further liquidity.

With respect to a potential increase to liquidity levels for institutional prime MMFs it remains critical that these products have the ability to obtain a yield spread over that of government MMFs. Without such spread, these funds will be "regulated out of existence"[104] as all funds will simply move to government MMFs or unregulated less transparent products. This will make short-term markets less liquid, constrain capital formation, and force investors from investing in private sector activities to supporting government MMFs, a bad result for all stakeholders.

Should institutional money market funds and retail money market funds be subject to the same minimum liquidity requirements, as proposed?

All MMFs should continue to be subject to the liquidity requirements set forth in the 2010 Amendments. Moreover, for institutional funds, the removal of the improper linkage between fees and gates and liquidity requirements will free-up an additional 30% or more of liquidity that was effectively unavailable to managers during the Liquidity Crisis.

Does the fact that institutional money market funds experienced more significant outflows than retail money market funds during recent stress events reflect that institutional money market funds should be subject to a different minimum liquidity requirement than retail money market funds? Why or why not?

No. Data supports that while redemptions may have been marginally higher, so too was the level of liquidity held within institutional funds due to managers' understanding of markets and KYC requirements. Moreover, for institutional funds, the removal of the improper linkage between fees and gates and liquidity requirements will free-up an additional 30% or more of liquidity that was effectively unavailable to managers during the Liquidity Crisis and investor incentives to redeem unnecessarily, given the improper linkage between fees and gates and liquidity levels, will also be eliminated.

SEC PROPOSAL QUESTION 73 AND FEDERATED HERMES RESPONSE

Should the proposed minimum liquidity requirements vary based on external market factors? For example, would a countercyclical minimum liquidity threshold, in which the minimum liquidity thresholds decline when net redemptions are large or when the Commission provides temporary relief from the higher liquidity threshold, better incentivize money market funds to use liquidity during times of significant outflows? If so, what specific factors should trigger or inform a countercyclical minimum liquidity threshold?

Minimum liquidity requirements, while remaining above the minimum regulatory level, already vary based on external market factors as a result of the KYC requirements. Countercyclicality cannot be "administrated" by the regulator. This notion of variable buffers is borrowed from the banking regulatory space where it does not prove efficient. In a market-based management of MMFs, liquidity levels beyond the minimum regulatory threshold are dictated by external market factors.

[104] J. Pozar et al., *supra* note 102, at 6.

SEC PROPOSAL QUESTION 74 AND FEDERATED HERMES RESPONSE

Would the increased liquidity thresholds, along with other changes we are proposing, affect investors' interest in monitoring funds' liquidity levels or potential sensitivity to declines below the liquidity thresholds?

Anytime one sets a threshold and attaches any consequences to it and makes it available on a real time basis, it could become a "trigger" for action. The removal of the improper linkage between fees and gates and liquidity requirements will free-up an additional 30% or more of liquidity that was effectively unavailable to managers during the Liquidity Crisis and reduce investor sensitivity to declines in liquidity. Removing the linkage would remove the incentive to act based on a fund's liquidity levels. A MMF publishes its WAM and WAL on a daily basis and we do not expect shareholders to redeem (nor do they) should a MMF approach the outside limits of either WAM or WAL. That is because the consequence of breaching a WAM or WAL requirement is not one of a gate, but rather to manage the MMF back into compliance should the WAM and WAL move outside of the regulatory requirements. Once the linkage is removed, so too is the incentive to act based on liquidity levels.

That said, the monitoring of liquidity will continue if the ill-conceived swing pricing proposal is adopted, as any indicator that would lead to investor redemptions will be a focal point and a trigger for future runs. The adoption of the swing pricing proposal will, without question, serve as the next bright line trigger which will lead to unnecessarily higher levels of redemptions in the next period of market stress.

Are there any changes we should make to reduce potential investor sensitivity to a fund dropping below a liquidity threshold? For example, should we remove, or reduce the frequency of, website liquidity disclosure?

No. Once the link of a potential fee or gate imposition is removed, the incentive for investors to monitor and redeem based on liquidity is mitigated. Similar to a fund's compliance with WAM or WAL, movement outside of parameters is not what triggers redemptions, it's the penalty associated with a particular movement that would lead to redemptions.

SEC PROPOSAL QUESTION 75 AND FEDERATED HERMES RESPONSE

Should the Commission consider revising the definition of daily liquid assets and/or weekly liquid assets in any way? For instance, should we amend the definition of weekly liquid assets to limit the amount of non-government securities that can qualify as weekly liquid assets? Alternatively, would explicitly limiting the amount of investment in commercial paper and certificates of deposit for prime money market funds alleviate stresses in the short-term funding market during market downturns? Why or why not?

No. A weekly liquid asset is a weekly liquid asset and there is no data to suggest that even in frozen markets that commercial paper or certificates of deposits did not pay upon maturity. The Commission's 2010 Amendments provided enhanced requirements surrounding credit quality and there was no issue with respect to credit risk observed in the Liquidity Crisis.

SEC PROPOSAL QUESTION 76 AND FEDERATED HERMES RESPONSE

Should the Commission propose a new category of liquidity requirements to Rule 2a-7?

No.

Would a new category of liquidity requirements with slightly longer maturities than the current requirements (e.g., biweekly liquid assets) significantly enhance funds' near-term portfolio liquidity during periods of stress in the short- term funding markets?

No.

What would be the positive and negative effects of a new category of liquidity requirements with slightly longer maturities?

There is no need to add a new category of liquidity. The current daily and weekly liquidity categories are sufficient, provided they are delinked from the potential imposition of a gate or fee.

SEC PROPOSAL QUESTION 77 AND FEDERATED HERMES RESPONSE

Should the Commission impose penalties on funds or fund sponsors when a fund falls below a required minimum liquidity requirement? For example, should we require funds to "over-correct" to a higher liquidity level after dropping below a minimum requirement? If so, how long should a fund be required to maintain a higher level of liquidity after the over-correction?

No. The potential imposition of a penalty on funds or fund sponsors could once again convert what should otherwise be useable liquidity to a floor, with funds and managers operating to avoid the potential imposition of a penalty. This would be akin to the improper linkage of liquidity fees and gates with liquidity levels.

SEC PROPOSAL QUESTION 78 AND FEDERATED HERMES RESPONSE

Should Rule 2a-7 impose a minimum liquidity maintenance requirement, i.e., require that a money market fund maintain the minimum daily liquid asset and weekly liquid asset thresholds at all times? What are the advantages and disadvantages of this approach?

No. If the liquidity levels are breached, the only requirement is for a MMF to purchase weekly liquid assets until such time as the threshold is once again reached. A rule imposing a limit that cannot temporarily be breached would necessitate maintenance of an additional buffer at all times.

SEC PROPOSAL QUESTION 79 AND FEDERATED HERMES RESPONSE

Are the proposed requirements for the fund to notify its board upon a liquidity threshold event appropriate?

No. There is no need to notify the board unless the event occurs during a period of extreme market volatility.

Would the proposed requirement help boards monitor significant declines in fund liquidity levels?

No.

Do funds currently notify the board when they fall below a certain liquidity level?

Yes. We have procedures in place to ensure that both members of the board and independent legal counsel to the independent directors are notified if liquidity falls below certain levels.

<u>SEC PROPOSAL QUESTION 80 AND FEDERATED HERMES RESPONSE</u>

Should the liquidity levels that trigger a liquidity threshold event be 50% of the minimum liquidity requirements, as proposed? Would a lower or higher percentage be more appropriate (e.g., 10%, 25%, or 75% below the minimum liquidity requirements)? Alternatively, should the rule require funds to notify the board if the fund falls below the minimum liquidity requirements (i.e., below 25% daily liquid assets or 50% weekly liquid assets)?

Boards should be notified of any unexpected events resulting in a funds liquidity level falling materially below required levels.

<u>SEC PROPOSAL QUESTION 81 AND FEDERATED HERMES RESPONSE</u>

Should the rule also require the fund to provide a subsequent notification to its board when the fund's liquidity returns above an identified threshold (e.g., the fund's liquidity is at or above the 25% daily liquid asset requirement and 50% weekly liquid asset requirement)?

An email notification would be provided unless circumstances warrant a telephonic or virtual update meeting.

<u>SEC PROPOSAL QUESTION 82 AND FEDERATED HERMES RESPONSE</u>

Is one business day sufficient time to allow a fund to notify its board following a liquidity threshold event? Is four business days sufficient time to allow a fund to provide its board with a brief description of the facts and circumstances that led to a liquidity threshold event? Should the rule provide more or less time for either or both of these notifications? Should the rule require either or both of these notifications to the fund's board to be written?

Notification should not be required at all unless other issues relating to redemptions and market volatility warrant.

<u>SEC PROPOSAL QUESTION 83 AND FEDERATED HERMES RESPONSE</u>

Are the proposed requirements for the fund to notify the board of the facts and circumstances that led to a liquidity threshold event appropriate? Would the fund provide these details without the rule's requirements (either on its own or after board inquiry)? Should the rule require other specific information in this notification? If so, what information and why? For example, should the rule require a fund to provide a reasonable estimate for when the fund will come back into compliance with the minimum liquidity requirements?

No, unless the fund fell below 50% of required weekly and daily liquidity for more than five business days.

<u>SEC PROPOSAL QUESTION 84 AND FEDERATED HERMES RESPONSE</u>

Should we instead require board notification if a fund has dropped below a particular liquidity level for a specified period (e.g., if the fund has dropped below the minimum liquidity requirements, or some lower amount, for at least 3, 5, or 10 consecutive business days)?

No, unless the fund fell below 50% of required weekly and daily liquidity for more than five business days.

Should a liquidity threshold event for purposes of the board notification requirement align with liquidity threshold events that funds would be required to report on Form N-CR, such that any changes to the scope of the proposed Form N-CR reporting requirement would also apply to the board notification requirement?

No.

SEC PROPOSAL QUESTION 85 AND FEDERATED HERMES RESPONSE

As proposed, should we remove the 10% weekly liquid asset metric from current stress testing requirements and instead require funds to determine the sufficient minimum liquidity level to test?

No.

SEC PROPOSAL QUESTION 86 AND FEDERATED HERMES RESPONSE

Should we instead identify a different liquidity threshold funds must test (e.g., 15%, 20%, or 30% weekly liquid assets)? Under this approach, should we require stress testing to consider both weekly liquid assets and daily liquid assets? If so, what threshold should we use for daily liquid assets (e.g., 5%, 10%, or 15%)?

No.

VI. NEGATIVE INTEREST RATE ENVIRONMENT, REVERSE DISTRIBUTION MECHANISM & IMPACT ON FINANCIAL INTERMEDIARIES

Unrelated to the events of the Liquidity Crisis, the SEC has included a prohibition, in a negative interest rate environment, on the use of a reverse distribution mechanism (or "RDM"). A RDM is a method of distributing negative income to investors in order to maintain a constant NAV in the MMF, an attribute that investors in stable NAV MMFs highly value and is critical for sweep investors.

We are not currently experiencing a negative interest rate environment in the U.S. and given broad-based price pressures and the steps the Fed is taking to raise interest rates to combat inflation, we are unlikely to experience negative rates in the near term. That said, as we may experience negative rates in the more distant future, it may be appropriate at some point to begin a discussion of the potential future use by MMFs of RDM in a negative rate environment. This is a very complex matter of first impression. The appropriateness of RDM was not a matter for discussion or consultation under the PWG Report, prior SEC MMF rulemakings, or ANPRs. The Proposal does not reflect any formal industry feedback. Significantly more analysis and thought needs to be done, and studies conducted as to how RDM and similar mechanisms work in other (non-USD) MMF markets before this topic can be addressed by SEC rulemaking. There simply is not enough known about how these systems would operate, what alternatives are available, how MMF investors will react to negative rates and mechanisms to address them, and what the need will be, to make a binding decision at this time through rulemaking on their use. Adopting a prohibition on RDM is at this point premature, unnecessary, and potentially catastrophic.

The issue of how MMFs should operate in negative rate environments is neither ripe for consideration nor properly a topic for rulemaking under the current proposal. Nevertheless, we highlight the following fundamental issues that should be considered when it is appropriate for the topic to be properly addressed.

The proposal to prohibit RDM and the related proposal to determine that intermediaries can transact at a four-digit NAV puts at immediate risk the $4 trillion currently invested in U.S. Government MMFs today, irrespective of the current interest rate environment (and whether rates ever actually go negative). We note the stated position of the Fed is against the application of negative rates in the U.S. Furthermore, if intermediaries for cash sweep arrangements are forced to prove that their systems will work for nonstable pricing of U.S. government and retail MMFs, they will likely drop all MMFs from their sweep platforms rather than spend the time, money and effort to redesign their systems, especially in the absence of any realistic chance of negative interest rates in the near future.

This will result in a shift in cash to either banks (who may not want the cash and whose receipt will only increase their systemic relevance and the systemic risk to the financial system) or to less transparent unregulated vehicles. It would also reduce investor choice by removing an effective alternative to bank sweep arrangements. The resulting reduction in assets in U.S. Government MMFs would increase systemic risk for the financial markets and create significant disruptions in the markets for Treasuries, U.S. Government agencies, and for repurchase agreements. The operational changes required to move to a floating NAV would significantly impede the intra-day flow of money throughout the financial system. These impacts run directly counter to the SEC's legislative mandate.

The Proposal, to justify a prohibition on the use of RDM, cites only a concern that investors will not understand how RDM would operate – ignoring the fact that the U.S. is a disclosure-based regime. Specifically, the Commission notes that a RDM may "not be intuitive" or that investors "may be misled by such a mechanism and assume that their investment in a fund with a stable share price is holding its value while, in fact, the investment is losing value over time." Concerns regarding shareholder confusion can and should be addressed with the use of clear and concise, plain English disclosure. In a negative rate environment, investors will experience negative returns in their bank accounts or any other liquidity management product. Retaining the availability to invest in U.S. Government MMFs in a negative rate environment is critically important to investors.

A. Shareholder Communication and Clear & Concise Disclosure Address the Proposal's concerns.

Federated Hermes appreciates the points made by the Commission but respectfully suggests that these concerns can be addressed with proper shareholder communication and clear and concise enhanced plain-English disclosures. Moreover, there is no evidence that investors in Europe, who have dealt with negative interest rates and utilized RDM for a number of years, did not understand how RDM worked. They were required to approve the use of RDM upfront and were provided with clear and concise disclosure as to how RDM would operate. More importantly, European investors also experienced, and continue to experience, negative rates on bank deposits and have given no indication that their dwindling balances have caused them any confusion. In a negative rate environment, the MMF balances will behave the same as bank deposits. Investors in MMFs would also see their account balances shrink if the Fed imposes its negative rate policy. That fact, combined with prominent disclosure, significantly reduces the likelihood for confusion.

For nearly fifty years, MMFs have distributed the income accrual arising from investing in securities with positive interest rates to shareholders through a dividend. Shareholders can choose to receive this dividend in cash, or reinvest the dividend in the fund, thereby increasing the number of shares held in the fund. In an environment where interest rates are below zero, the dividend accrued by shareholders would be negative. In this instance, the use of an RDM is simply the inverse of the transaction where there is a positive accrual – because it is unlikely that shareholders would choose to wire in cash to cover the negative accrual, the number of shares held by the shareholder would be reduced by the amount of the negative dividend. Despite the Commission's concerns, this transaction should be clearer to shareholders than a conversion to a FNAV structure, where the value of each share is uncertain. The use of RDM will preserve an important investment product for all stakeholders and supports the SEC's stated goal of preserving the benefit of stable NAV Funds for investors and the short-term credit markets.[105] Forcing a conversation to a floating product for government MMFs would inevitably lead to material redemptions and shift investments into less transparent, unregulated products.

In the Proposal, the Commission correctly identifies that a MMF board may determine that the use of RDM may not be appropriate for a particular MMF.

> [R]ule 2a-7 states that government and retail money market funds may seek to maintain a stable share price by using amortized cost and/or penny-rounding accounting methods. A fund may only take this approach so long as the fund's board of directors believes that the stable share price fairly reflects the fund's market-based net asset value per share. Accordingly, if negative interest rates turn a stable NAV fund's gross yield negative, the board may reasonably believe the stable share price does not fairly reflect the market-based price per share, as the fund would be unable to generate sufficient income to support a stable share price. Under these circumstances, the fund would not be permitted to use amortized cost and/or penny-rounding accounting methods to seek to maintain a stable share price. Instead, the fund would need to convert to a floating share price.

However, the Commission should have noted that a MMF board could also determine that the stable share price fairly reflects the fund's market-based NAV per share and that the use of a RDM is appropriate as (i) maintaining a stable NAV per share is in the long-term best interests of the stable NAV fund and its shareholders; and (ii) shareholders have expressed a clear preference for a stable NAV product. Additionally, because RDM would offset declines to the stable NAV fund's market-based NAV per share with share cancellations, the maintenance of a stable NAV with RDM would effectively result in the same economics as a market-based NAV, thus ensuring that the stable NAV continues to "fairly reflect" the market-based NAV of the stable NAV fund through RDM.

Investors in the U.S., both retail and institutional, are permitted to invest in registered investment products with varied and complex strategies, employing a variety of sophisticated techniques to deliver on their investment objective. The SEC's mission is to ensure that each investor is provided with enough information, in a clear and concise format, to enable investors to make informed decisions. In a negative rate environment, the retention of a stable NAV and the use of RDM is the clear investor preference. The focus should be on both investor communication and the adoption of both clear and concise disclosure. Requiring a four-digit NAV and prohibiting RDM would limit investor choice, make the Fed's job more

[105] *See* 2014 MMF Reform Release, *supra* note 36*,* at 47783-47784.

difficult, and cause damaging disintermediation as intermediaries will simply move away from MMFs and use bank deposits or other investments.

Providing investors with prior notice of the day on which a RDM could potentially take effect would provide any existing shareholders with an opportunity to redeem prior to implementation. Additionally, notice to shareholders upon the use of RDM would serve to provide timely information to investors that the fund was operating in a negative yield environment. These timely notices, supported by enhanced prospectus disclosure, will ensure that shareholders are informed and are not being misled as to the nature of their MMF's investment performance.

B. MMFs Should Not be Required to Determine that Financial Intermediaries Can Transact at a Four-Digit NAV

In accordance with the 2014 Amendments, MMFs and their service providers must be able to accommodate and transact at a four-digit NAV today, for institutional prime MMFs and institutional municipal MMFs, which are required to have a non-stable NAV. Intermediaries that make these categories of MMFs available are able to sell and redeem at non-stable prices and are in fact doing so. If they could not, they would no longer be making these MMF types available on their platforms. The basic technology and systems to transact MMF shares at non-stable prices exist at those intermediaries that have chosen to build it. Requiring it to be applied it to other categories of MMFs would be an incredibly expensive and pointless exercise.

Investors in U.S. government or retail MMFs have never shown a propensity to "run" or engage in mass net redemptions. Not in 2008, not in 2020, not ever. The current rulemaking is supposed to be a response to the Liquidity Crisis. Addressing the theoretical potential for a hypothetical future negative interest rate environment is not related to the Liquidity Crisis, the Financial Crisis, or any other period in U.S. history. The stress-testing conducted by the Commission staff and the industry in the wake of the 2010 Amendments demonstrated that only a combination of a massive net redemption with a sudden unanticipated multi-percentage market interest rate hike or significant portfolio default could cause these MMFs to "break a buck." This is why the Commission chose in its 2014 Amendments to Rule 2a-7 not to force retail or U.S. Government MMFs to calculate NAV to four decimal points or transact at non-stable share prices.

Financial intermediaries for cash sweep arrangements have complex accounting, reporting, and other systems that are different than those used by intermediaries for other mutual funds, and often work on a dollar in/dollar out basis. Most of them dropped institutional prime and municipal MMFs from their sweep platforms after the 2014 Amendments because their sweep systems do not work for a non-stable NAV. If they are forced to prove that their systems work for nonstable pricing of U.S. government and retail MMFs, they will likely drop all MMFs from their sweep platforms rather than spend the time, money and effort to redesign their systems. In the absence of any realistic chance of negative interest rates in the near future, this is an unreasonable cost with no benefit.

To require MMFs to determine that intermediaries can transact at non-stable share prices for U.S. Government MMFs and retail MMFs would, in effect, require intermediaries to build, test, and implement those systems and have them at the ready to transaction at non-stable prices for all retail and U.S. Government MMFs made available on their platforms. That is a very expensive and burdensome requirement to impose on intermediaries to address a situation that no one anticipate will occur and the Fed does not support as a policy tool for the United States.

We anticipate that many intermediaries would choose to cease making U.S. Government MMFs and retail MMFs available through their platforms rather than bear the expenses and administrative burdens of creating and maintaining systems to transact at non-stable share prices in these categories of MMFs to prepare for an economic environment that no one expects will occur soon or possibly ever. This would harm retail investors in MMFs and investors in U.S. Government MMFs, and force them into less attractive, lower-yielding and higher risk alternative investments made available on those platforms. It would harm borrowers from the smaller and fewer retail prime and municipal MMFs that would remain by forcing them to borrow from more expensive sources, like banks loans and issuance of longer-term bonds. It would be anti-competitive and disruptive to the short-term funding markets.

Placing the burden on funds to proactively confirm that intermediaries can accommodate a non-stable NAV is unreasonable given the extremely low likelihood of a negative interest rate environment occurring in a way that would force retail or U.S. Government MMFs to need to transact at non-stable share prices. MMFs should not be severely impacted today based upon a theoretical event that is highly unlikely to occur in the near future, is not proposed or supported by the Fed as a policy tool for the United States and may never occur in the more distant future. If that future ever arrives, it will not be overnight. At such time, if ever, that it becomes a real near-term possibility, MMFs can ask the question of their intermediaries, which can choose to build out their systems to accommodate non-stable NAVs for retail and U.S. Government MMFs, or drop them from their platforms. But there is no purpose served by forcing that choice now.

C. Prohibition of RDM under Commission's Proposal will decimate the U.S. Government MMF sector, forcing nearly $4 Trillion into banks.

Notwithstanding our firm belief that RDM is the best path forward in a negative environment. Should the Commission insist on a potential requirement for all funds to convert to a four-digit NAV in a negative rate environment it should be only upon the occurrence of a negative rate environment and the conversion to a four-digit NAV that any shareholder actions should be required. Certainly, in accordance with the 2014 Amendments MMFs and their transfer agent must be able to accommodate and transact at a four-digit NAV today. That said, placing the burden on funds today to proactively confirm that financial intermediaries can accommodate a four-digit NAV is unreasonable, especially given the low likelihood of a negative rate environment occurring. To ensure that a MMF can continue to operate efficiently in a negative rate environment, however, any financial intermediary upon the occurrence of negative rates and a conversion to a four-digit NAV that cannot accommodate a four-digit NAV should then be required to redeem the holding from the MMF as soon as practicable at a four-digit NAV. This approach ensures that MMFs would not be severely impacted today based upon a potential event that may never occur in the future and would provide a path moving forward on how to treat such investors should, however unlikely, a negative rate environment occur.

D. SEC RDM questions 87-98

<u>SEC PROPOSAL QUESTION 87 AND FEDERATED HERMES RESPONSE</u>

Should the Commission mandate specific disclosure to investors or to the Commission if a fund's gross yield turns negative?

In a negative rate environment, MMF balances will be reduced in the same way that bank deposits are. That fact, combined with prominent disclosure, significantly reduces the likelihood for confusion. The nature of such disclosure should be left to the fund board. However, we note the very positive results observed in

Europe on the use of RDM, where the use of RDM was fully disclosed to investors in the governing documents with advance notice, where possible, before implementation.

SEC PROPOSAL QUESTION 88 AND FEDERATED HERMES RESPONSE

Would a reverse distribution mechanism or similar mechanism mislead or confuse investors?

No. Disclosure and timely shareholder communication will mitigate against investor confusion or fears of investors being misled.

Would such a mechanism benefit investors?

Yes. In a negative rate environment, the retention of a stable NAV and the use of RDM is the clear investor preference.

Would investors more easily understand a decline in share prices (i.e., a floating share price), rather than a decline in the number of stable value shares (i.e., a reverse distribution mechanism), in the event that a fund's gross yield turns negative?

No. With proper disclosure, this would be clear to investors and something they will be experiencing in other areas of economic activity. In a negative rate environment, the retention of a stable NAV and the use of RDM is the clear investor preference. Investors will undoubtedly be aware of the value of their underlying investment and enhanced disclosures surrounding both the negative rate environment and the reduction in value mitigate against any potential confusion.

SEC PROPOSAL QUESTION 89 AND FEDERATED HERMES RESPONSE

Should we permit a stable NAV money market fund to engage in a routine reverse stock split, reverse distribution mechanism, or other mechanism by which the fund maintains a stable share price, despite losing value, by reducing the number of its outstanding shares?

Yes. In a negative rate environment, the retention of a stable NAV and the use of RDM is the clear investor preference

Should we permit only institutional government funds to engage in such a mechanism because institutional investors may be more likely to appreciate that the fund is losing value notwithstanding the lack of a change in the share price? If so, how should we define an institutional government fund for this purpose (e.g., a government fund that does not have policies and procedures reasonably designed to limit all beneficial owners of the fund to natural persons; or a government fund that has policies and procedures reasonably designed to limit all beneficial owners to non-natural persons)?

No. All investors in the U.S., both retail and institutional, are permitted to invest in registered investment products with varied and complex strategies, employing a variety of sophisticated techniques to deliver on their investment objective. The SEC's mission is to ensure that each investor is provided with enough information, in a clear and concise format, to enable investors to make informed decisions. In a negative rate environment, the retention of a stable NAV and the use of RDM is the clear investor preference. The focus should be on both investor communication and the adoption of both clear and concise disclosure.

If we permit the use of such a mechanism, how should a fund be required to communicate its operation to investors?

Providing investors with prior notice, when possible, of the day on which a RDM could potentially take effect would provide any existing shareholders with an opportunity to redeem prior to implementation. Additionally, notice to shareholders upon the use of RDM would serve to provide timely information to investors that the fund was operating in a negative yield environment. These timely notices, supported by enhanced prospectus disclosure, will ensure that shareholders are informed and are not being misled as to the nature of their MMF's investment performance.

Should the fund be required to take steps to make sure existing investors approve of a reverse distribution mechanism before operating such a mechanism? If so, what should those steps be?

Yes. Shareholder approval should be deemed given after proper notice of inclusion in the prospectus. Providing investors with prior notice of the day on which a RDM could potentially take effect would provide any existing shareholders with an opportunity to redeem prior to implementation. Additionally, notice to shareholders upon the use of RDM would serve to provide timely information to investors that the fund was operating in a negative yield environment. These timely notices, supported by enhanced prospectus disclosure, will ensure that shareholders are informed and are not being misled as to the nature of their MMF's investment performance.

SEC PROPOSAL QUESTION 90 AND FEDERATED HERMES RESPONSE

Should all stable NAV money market funds be required to respond to negative interest rates in the same manner (i.e., should all these funds be required to switch to a floating share price, or should each fund be permitted to respond to negative interest rates in a different manner)?

No. As noted above, each MMF board should be left to make its own determination as to whether a stable share price fairly reflects the fund's market-based NAV per share and that the use of a RDM is appropriate.

If the rule permits funds to respond to negative interest rates on an individualized basis, should the rule prescribe specific options that are permissible?

Yes. Federated Hermes fully supports the implementation of RDM as the most appropriate methodology but is not opposed to including other options, such as stock-splits or conversion to a floating NAV for a board's consideration.

Would it be confusing for investors if each money market fund used a different method for absorbing a negative interest rate?

No. It would also enable them to utilize funds that are best suited to the investors' accounting systems.

SEC PROPOSAL QUESTION 91 AND FEDERATED HERMES RESPONSE

Would investors prefer a government or retail money market fund with a negative yield to implement a floating share price or a reverse distribution mechanism? Does the response differ depending on the type of investor? Does the response differ depending on the type of money market fund?

In a negative rate environment, the retention of a stable NAV and the use of RDM is the clear investor preference.

SEC PROPOSAL QUESTION 92 AND FEDERATED HERMES RESPONSE

How likely are investors to remain invested in a money market fund with a negative gross yield?

If RDM is permissible, then we would expect a significant portion of investors to remain invested in a MMF with a negative yield. This is supported by the experience observed in Europe. Investors have remained in Euro-denominated MMFs despite the current negative rate environment. If, however, RDM is not a permissible option and MMFs are forced to float their NAV, then we would anticipate significant redemptions and subsequent investment into unregulated, less transparent products.

If investors redeem shares in a money market fund with a negative gross yield, where might they choose to invest their money instead?

If RDM is not a permissible option and stable NAV MMFs are forced to float their NAV, then we would anticipate significant redemptions and subsequent investment into unregulated, less transparent products or deposits into banks which would reflect lower balances to account for negative yields as well.

SEC PROPOSAL QUESTION 93 AND FEDERATED HERMES RESPONSE

How likely are fund sponsors to continue to operate money market funds in a pervasive negative interest rate environment?

MMF managers will continue to operate MMFs in a negative yield environment if an appropriate methodology, such as RDM, is permissible. MMFs provide investors with a diversified short-term investment option at prevailing market rates. While yield is important, investors will choose to remain in MMFs for diversification. In a negative rate environment, cash placed at banks would be subject to the same negative rates but without the diversification.

Are certain fund sponsors (e.g., bank-affiliated sponsors) more likely than others to continue to operate money market funds in a negative interest rate environment? Are sponsors more likely to continue to operate certain types of money market funds (e.g., prime funds) in a negative interest rate environment?

Provided MMFs are able to utilize RDM, we believe that MMF sponsors will continue to offer, and investors will continue to invest in, all types of MMFs.

SEC PROPOSAL QUESTION 94 AND FEDERATED HERMES RESPONSE

As proposed, should we require a government or retail fund to determine that financial intermediaries in its distribution network can sell and redeem the fund's shares at non-stable prices per share?

No. As discussed above, financial intermediaries for cash sweep arrangements have complex accounting, reporting, and other systems that are different than those used by intermediaries for other mutual funds, and often work on a dollar in/dollar out basis. Most of them dropped institutional prime and municipal MMFs from their sweep platforms after the 2014 Amendments because their sweep systems do not work for a non-stable NAV. If they are forced to prove that their systems work for nonstable pricing of U.S. government and retail MMFs, they will likely drop all MMFs from their sweep platforms rather than spend the time, money and effort to redesign their systems. In the absence of any realistic chance of negative interest rates in the near future, this is an unreasonable cost with no benefit.

To require MMFs to determine that intermediaries can transact at non-stable share prices for U.S. Government MMFs and retail MMFs would, in effect, require intermediaries to build, test, and implement those systems and have them at the ready to transaction at non-stable prices for all retail and U.S. Government MMFs made available on their platforms. That is a very expensive and burdensome requirement to impose on intermediaries to address a situation that no one anticipate will occur and the Fed does not support as a policy tool for the United States.

We anticipate that many intermediaries would choose to cease making U.S. Government MMFs and retail MMFs available through their platforms rather than bear the expenses and administrative burdens of creating and maintaining systems to transact at non-stable share prices in these categories of MMFs. Placing the burden on funds to proactively confirm that intermediaries can accommodate a non-stable NAV is unreasonable given the extremely low likelihood of a negative interest rate environment occurring in a way that would force retail or U.S. Government MMFs to need to transact at non-stable share prices.

Should we, as proposed, require a fund to prohibit a financial intermediary from purchasing the fund's shares in nominee name on behalf of other persons if the fund cannot make such a determination?

No. In accordance with the 2014 Amendments, MMFs and their service providers must be able to accommodate and transact at a four-digit NAV today. That said, placing the burden on funds to proactively confirm that investors can, today, accommodate a four-digit NAV is unreasonable, especially given the low likelihood of a negative rate environment occurring. Accordingly, to ensure that a MMF can continue to operate efficiently in a negative rate environment upon the occurrence of negative rates and a conversion to a four-digit NAV, any shareholder that cannot accommodate a four-digit NAV, at that time, should be promptly redeemed from the MMF. This approach ensures that MMFs, investors, and markets generally, will not be severely impacted today based upon a potential event that may never occur and provides a path to move forward should a negative rate environment occur.

Are there alternative approaches we should take to make sure financial intermediaries are able to handle a fund's potential transition from using a stable NAV to a floating NAV?

Other than permitting RDM, No. See response to Question 94 above.

SEC PROPOSAL QUESTION 95 - 97 AND FEDERATED HERMES RESPONSE

As proposed, should we require a government or retail fund to maintain and keep current records identifying the intermediaries the fund has determined have the capacity to transact at non-stable share prices and the intermediaries for which the fund was unable to make this determination? Are there alternative ways of documenting this information that we should require? Should we require funds to periodically check against these records to make sure they are not using an intermediary that cannot transact at non-stable share prices? Should we mandate or provide additional guidance around how a fund would determine that a financial intermediary can sell and redeem the fund's shares at non-stable prices per share? Should we require a fund to maintain records of these determinations? Should we require a fund to report to its board of directors the basis of its determinations that a financial intermediary has the capacity to redeem and sell securities issued by the fund at a price based on the current net asset value, including prices that do not correspond to a stable price per share? Should we require a fund to disclose the basis of such determinations publicly or to the Commission?

No. See response to Question 94 above.

SEC PROPOSAL QUESTION 98 AND FEDERATED HERMES RESPONSE

Should we require government and retail funds and their financial intermediaries to test their ability to redeem and sell securities issued by the fund at prices that do not correspond to a stable price per share?

No. See response to Question 94 above.

Should we require a fund to report the results of those tests to its board of directors?

If tests are required, the results should be reported to the MMF's board of directors.

Should we require a fund to disclose the results of those tests to the Commission or publicly?

No. The results will form part of a fund's board materials which are available to the Commission upon request.

VII. WAM / WAL

A. Rulemaking with respect to WAM and WAL calculation methodology is unnecessary.

Federated Hermes very much appreciates the consideration by the SEC with respect to the WAM and WAL calculation methodology. As an institution, we currently use securities' market value in calculating WAM and WAL for our floating NAV MMFs and we use amortized cost for our retail and government MMFs. We do not, however, believe there is any material difference in using either methodology and, as such, believe that further rulemaking would not serve to accomplish any meaningful change. The only situation in which the chosen methodology could theoretically materially differ, would be a scenario where there is a credit problem with a security. In that instance, however, all funds would shift to using market value and would not use amortized cost. Given that the methodology will not in any way meaningfully impact a fund's WAM / WAL, we do not believe that necessitating more operational changes is justified by a cost/benefit analysis nor is such a change supported by any data. WAMs and WALs calculated using either format are, for all intents and purposes, equivalent.

B. SEC WAM / WAL questions 99 - 101

SEC PROPOSAL QUESTION 99 AND FEDERATED HERMES RESPONSE

Should we require all money market funds to calculate WAM and WAL based on the percentage of each security's market value in the portfolio, as proposed?

No. The fractional difference between the WAM and WAL calculated with amortized cost versus market value would not change either number calculated in actual days, not fractions of a day. Given that the methodology will not in any way meaningfully impact a fund's WAM / WAL, we do not believe that adding operational changes is justified by a cost/benefit analysis nor is such a change supported by any data.

Should certain types of money market funds be excluded from this requirement or subject to a different requirement? If so, why? For instance, should we require money market funds that maintain a stable NAV to calculate WAM and WAL using the amortized costs of the portfolio?

Federated Hermes calculates WAM and WAL using securities market value for floating NAV MMFs and amortized cost for retail and government MMFs. The only meaningful difference in these methodologies would be if one of the issuers of the portfolio securities had a credit problem, in which case the fund would immediately shift to using market value. Introducing an additional variable for the calculation of WAM and WAL is not supported by the data.

<u>SEC PROPOSAL QUESTION 100 AND FEDERATED HERMES RESPONSE</u>

Are there benefits to calculating WAM and WAL based on amortized cost of the portfolio instead of market value?

No. Federated Hermes calculates WAM and WAL using securities market value for floating NAV MMFs and amortized cost for retail and government MMFs. The only meaningful difference in these methodologies would be if one of the issuers of the portfolio securities had a credit problem, in which case the fund would immediately shift to using market value. Introducing an additional variable for the calculation of WAM and WAL is not supported by the data.

<u>SEC PROPOSAL QUESTION 101 AND FEDERATED HERMES RESPONSE</u>

Are there other changes or additions that would improve the accuracy or consistency of the calculations of WAM or WAL? Should we provide additional guidance related to the proposed amendment?

No. The fractional difference between the WAM and WAL calculated with amortized cost versus market value would not change either number calculated in actual days, not fractions of a day. Given that the methodology will not in any way meaningfully impact a fund's WAM / WAL, we do not believe that necessitating more operational changes is justified by a cost/benefit analysis nor is such a change supported by any data.

VIII. REPORTING REQUIREMENTS

SEC Reporting Requirement questions 102 - 112

<u>SEC PROPOSAL QUESTION 102 AND FEDERATED HERMES RESPONSE</u>

Should we require money market funds to file reports on Form N-CR when they fall more than 50% below a minimum liquidity requirement, as proposed? How might liquidity reporting on Form N-CR affect money market funds' incentives to maintain weekly liquid assets and daily liquid assets above 25% and 12.5%, respectively, of total assets? How might this reporting affect investor behavior?

MMFs are currently required to provide information about the size of daily and weekly liquid assets on their websites. The SEC is proposing the submission of a further report should a liquidity threshold event occur. We do not believe any further information should be required to be reported on Form N-CR. As noted by the ICI, appreciating the SEC's desire to monitor changes in liquidity, we are concerned that public reporting of this information may affect investor behavior. Any such reports should be filed confidentially with the SEC.

<u>SEC PROPOSAL QUESTION 103 AND FEDERATED HERMES RESPONSE</u>

Should a report on Form N-CR when a fund falls more than 50% below a liquidity threshold be filed confidentially with the Commission (e.g., because investors can already see liquidity levels on funds' public websites and Form NCR reporting may increase investor sensitivity to liquidity levels)? Or, in addition to the proposed public reporting when a fund falls more than 50% below a liquidity threshold, should we require funds to file confidential reports at a different level below a minimum liquidity requirement (e.g., 25% below a minimum)? If we require funds to report certain information confidentially on Form N-CR, should that information be publicly available on a delayed basis and, if so, what is an appropriate delay (e.g., 15, 30, or 60 days)?

Reports should be filed confidentially and remain confidential with the SEC.

SEC PROPOSAL QUESTION 104 AND FEDERATED HERMES RESPONSE

Should we use a different daily liquid asset or weekly liquid asset level for determining when a fund must file a report on Form N-CR? If so, what level(s) should we use? For example, would 10%, 25%, or 75% (rather than 50%) below the minimum liquidity requirements be appropriate?

We would suggest a filing upon a fund falling 50% below each of the daily and weekly liquidity requirements for 5 consecutive business days.

SEC PROPOSAL QUESTION 105 AND FEDERATED HERMES RESPONSE

As proposed, should funds be required to report both their current weekly liquid asset and daily liquid asset levels even if only one of those thresholds is crossed?

Yes.

SEC PROPOSAL QUESTION 106 AND FEDERATED HERMES RESPONSE

Should funds be required to report each day they remain below either the 12.5% daily liquid asset threshold or the 25% weekly liquid asset threshold, or is just the initial date of liquidity threshold event sufficient?

An initial notification on the date a threshold is breached is appropriate.

Should funds be required to subsequently report when a fund's liquidity returns above an identified threshold (e.g., to a level at or above the minimum liquidity requirements) or is the daily website disclosure of fund liquidity levels sufficient for this purpose?

No.

SEC PROPOSAL QUESTION 107 AND FEDERATED HERMES RESPONSE

As proposed, should we require funds to report liquidity threshold events within one business day of the relevant event? Is four business days sufficient for funds to file an amended report that includes a brief description of the facts and circumstances leading to the fund falling below either threshold? Should these reporting periods be longer or shorter?

No, only if significantly below for 5 consecutive business days.

SEC PROPOSAL QUESTION 108 AND FEDERATED HERMES RESPONSE

Should any more, less, or other information be required in connection with liquidity threshold events?

Disclosure on the basis for a liquidity threshold event should be fulsome and provide sufficient detail outlying the basis for the event and the response implemented.

SEC PROPOSAL QUESTION 109 – 110 AND FEDERATED HERMES RESPONSE

Should we require, as we are proposing, Form N-CR reports to be filed in an N-CR-specific XML language? Is an N-CR-specific XML language the appropriate type of data language for Form N-CR reports? Why or why not? If another structured data language (e.g., Inline eXtensible Business

Reporting Language), would be more appropriate, which one, and why? Would this proposed requirement yield reported data that is more useful to investors, compared with not requiring Form N-CR to be filed in an N-CR specific XML language, or requiring Form N-CR to be filed in a structured data language other than an N-CR-specific XML language?

No. This is more expensive and not utilized by investors.

SEC PROPOSAL QUESTION 111 AND FEDERATED HERMES RESPONSE

Should any subset of funds be exempt from the proposed structured data reporting requirement? If so, what subset and why?

No.

SEC PROPOSAL QUESTION 112 AND FEDERATED HERMES RESPONSE

What implementation and long-term costs, if any, would be associated with the proposed structured data reporting requirement?

For a thorough discussion of cost benefits under the Proposal, please see Section XII below.

IX. OTHER PROPOSED AMENDMENTS

SEC Other Proposed Amendments questions 113 - 115

SEC PROPOSAL QUESTIONS 113 - 115 AND FEDERATED HERMES RESPONSE

Should we require reporting of registrant name, series name, and LEIs for the registrant and series on Form N-CR, as proposed? Is there other identifying information we should require? Should we make any changes to the definitions we propose to include in Form N-CR? Are there other terms we should define in the form? For the Form N-CR item requiring reporting of financial support, should we require reporting of the date the fund acquired a security, as proposed, if the support involves the purchase of a security from the fund?

No.

X. AMENDMENT TO FORM N-MFP

SEC Amendment to Form N-MFP questions 116 - 140

SEC PROPOSAL QUESTION 116 AND FEDERATED HERMES RESPONSE

Should we require all money market funds to disclose information about shareholder concentration on Form N-MFP, as proposed? Should certain types of funds be excluded and, if so, why?

No. Information on shareholder concentration is considered to be proprietary and therefore should not be required to be disclosed by any type of MMF.

Should the reporting threshold be ownership of at least 5% of a class's shares outstanding, as proposed? Should the threshold be lower or higher, such as 1%, 10%, or 15%? Instead of requiring information about shareholders who hold a certain amount of a class's outstanding shares, should we use a different method of obtaining information about shareholder concentration? For example, should we require

funds to report the amount of net assets held by a specific number of the fund's largest investors, such as the one, five, or ten largest investors?

We agree that 5% would be an appropriate threshold.

SEC PROPOSAL QUESTION 117 AND FEDERATED HERMES RESPONSE

As proposed, should the shareholder concentration item require the name and percentage of ownership for each shareholder who owns of record or beneficially 5% or more? Should we require different information for some or all types of investors? For example, should we not require name information for retail investors or other types of investors?

No. Information on shareholder concentration is considered to be proprietary and therefore should not be required to be disclosed.

As another alternative, should we require funds to report only the number of investors who own of record or beneficially 5% or more, distinguishing between record owners and beneficial owners?

Yes.

Additionally, should this information, as proposed, be reported on a nonconfidential basis? Is there any sensitivity to identifying shareholder information such that it should only be reported to the Commission on a confidential basis?

This information should be kept confidential.

SEC PROPOSAL QUESTION 118 AND FEDERATED HERMES RESPONSE

Do funds currently gather information about shareholder concentration and composition on at least a monthly basis, or would the proposal require more frequent gathering of information than current practices? If more frequent information gathering would be required, what are the associated advantages and disadvantages of assessing shareholder concentration and composition more frequently?

Enhancement to the KYC requirements is necessary to ensure that portals and other intermediaries provide underlying account data. Rule 22c-2(a)(2) under the Investment Company Act of 1940 does not apply to MMFs. A potential regulatory enhancement could include amending rule 22c- to require MMFs to enter into agreements with intermediaries to provide shareholder information.[106]

Should we require funds to report this information on Form N-MFP less frequently than proposed, such as annually, semiannually, or quarterly?

This information should be reported quarterly.

SEC PROPOSAL QUESTION 119 AND FEDERATED HERMES RESPONSE

Should we require institutional prime and tax-exempt money market funds to provide information about the composition of their shareholders by type, as proposed? Are there any changes we should make to the types of shareholders the form would identify? Should certain shareholder categories be added or

[106] *See* Third Federated Hermes Comment Letter, *supra* note 67, at7.

removed? Should we provide additional guidance or definition for any of the categories of shareholders? Should we also require government money market funds to respond to this item? If so, why?

Clear guidance on the categories of shareholders should be provided to ensure consistency on account classification.

SEC PROPOSAL QUESTION 120 AND FEDERATED HERMES RESPONSE

To what extent do money market funds know when an investor beneficially owns 5% or more of a class's outstanding shares when those shares are held through an omnibus account? To what extent do institutional money market funds know the composition of their shareholders by type? Are there any changes we should make to facilitate money market funds' abilities to collect this information, including for investors who invest through an omnibus account? For example, should we preclude a money market fund from selling its securities to a financial intermediary in nominee name on behalf of others unless the intermediary provides certain information about investors in the fund (such as size of holding, type of investor, or other investor characteristics)?

Rule 22c-2(a)(2) under the Investment Company Act of 1940 does not apply to MMFs. A potential regulatory enhancement could include amending rule 22c- to require MMFs to enter into agreements with intermediaries to provide shareholder information.[107]

SEC PROPOSAL QUESTION 121 AND FEDERATED HERMES RESPONSE

Should we require prime funds to disclose aggregate information about the amount of portfolio securities they sold or disposed of during the reporting period for each category of investment, as proposed? Should we instead require details about each instrument sold (e.g., date of sale, price, and identifying information for each holding)? Should we instead consider requiring that prime funds report information about the amount of portfolio securities sold or disposed of on Form N-CR if the amount is above a specific threshold? If so, what amount of selling activity should trigger such reporting?

No.

SEC PROPOSAL QUESTION 122 AND FEDERATED HERMES RESPONSE

Should we require only some money market funds to disclose their selling activity, as proposed? Should we alternatively require all, or a broader subset of, money market funds to disclose this information?

No

SEC PROPOSAL QUESTION 123 AND FEDERATED HERMES RESPONSE

Are there other types of information we should require money market funds to report on Form N-MFP to facilitate monitoring of these funds?

No.

SEC PROPOSAL QUESTION 124 AND FEDERATED HERMES RESPONSE

Is the proposed requirement that funds provide required information separately for the initial acquisition of a security and any subsequent acquisitions of the security appropriate? Why or why not? Should we

---

[107] *See* Third Federated Hermes Comment Letter, *supra* note 67,at 7.

require funds to report the acquisition date and yield as of the acquisition date for each lot, as proposed? Are there better ways for us to assess how long a fund has held a position and its portfolio turnover? If so, how?

No. Given the costs involved to provide such information and the limited utility in doing so, we do not believe the proposed requirement is appropriate.

SEC PROPOSAL QUESTION 125 AND FEDERATED HERMES RESPONSE

Should we, as proposed, require additional information about the counterparty to the repurchase agreement and information about whether a repurchase agreement is centrally cleared or a triparty agreement? Are there other ways we could acquire this information?

No. Given the costs involved to provide such information and the limited utility in doing so, we do not believe requiring additional information regarding repurchase agreements is appropriate.

SEC PROPOSAL QUESTION 126 AND FEDERATED HERMES RESPONSE

As proposed, should we require the CUSIP of the collateral subject to the repurchase agreement and add a category for cash collateral? As proposed, should we remove the provision that allows funds to aggregate information about multiple securities of an issuer that are subject to a repurchase agreement? To what extent do funds currently rely on this provision? What are the potential effects of our proposal to remove this provision? Is there any additional information related to repurchase agreement transactions that we should require?

No. Given the costs involved to provide such information and the limited utility in doing so, we do not believe requiring additional CUSIP information is appropriate.

SEC PROPOSAL QUESTION 127 AND FEDERATED HERMES RESPONSE

Should Form N-MFP require registrants to provide Financial Instrument Global Identifier for securities, if available? Should Form N-MFP permit registrants to report the Financial Instrument Global Identifier in lieu of a CUSIP number on Form N-MFP? Why or why not?

No. Given the costs involved to provide such information and the limited utility in doing so, we do not believe requiring registrants to provide Financial Instrument Global Identifiers is appropriate.

SEC PROPOSAL QUESTION 128 AND FEDERATED HERMES RESPONSE

Are our proposed amendments to consolidate how funds would identify different types of government money market funds effective? Is our proposed approach to identifying funds that should be classified as Treasury funds appropriate?

Yes. We agree that the proposed amendments would reduce confusion and inconsistency in categorizing government MMFs, and believe that the added subsection to identify MMFs that invest in Treasury obligations either directly or through repurchase agreements could aid in identifying different types of government MMFs.

<u>SEC PROPOSAL QUESTION 129 AND FEDERATED HERMES RESPONSE</u>

Is our proposed item to identify money market funds established as cash management vehicles for affiliates or other related entities sufficiently clear? Are there any changes we should make to that item? Is there a more effective way of identifying these funds? Would this question be more appropriate on a different form instead of Form N-MFP, for example, Form N-CEN?

Yes as regards the first of the questions that comprise Question 129.

<u>SEC PROPOSAL QUESTION 130 AND FEDERATED HERMES RESPONSE</u>

Should we simplify disclosure of any fee waiver or expense reimbursement during the reporting period, as proposed? What scope of arrangements do funds currently report as fee waivers or expense reimbursements on Form N-MFP? For example, do they include offsets or credits (e.g., custodian credits)? Do funds need additional clarity or guidance on the types of arrangements to report? Instead of our proposed approach, should we retain information about the person waiving the fee or reimbursing the expense and a description of the fee waiver or expense reimbursement? For example, to better structure the item, should we require filers to identify the type of waiver or reimbursement on Form N-MFP (e.g., management fees, 12b-1 fees)? Why or why not? Should we require filers to provide a reason for the waiver or reimbursement? For instance, should the item require that filers designate whether such actions were taken to maintain a particular expense ratio or a minimum level of yield? Why or why not?

Yes as regards the first of the questions that comprise Question 130. Reporting only the amount of any fee waiver or expense reimbursement during the reporting period is sufficient.

<u>SEC PROPOSAL QUESTION 131 AND FEDERATED HERMES RESPONSE</u>

As proposed, should we require funds to distinguish between U.S. Government agency notes that are coupon-paying and those that are no-coupon discount notes when categorizing their portfolio securities on Form N-MFP? Would this information be helpful for identifying securities that qualify as weekly liquid assets? Should we also require funds to distinguish between these two categories for purposes of disclosing portfolio securities on their websites, as proposed?

Yes, if the Commission would find this information useful.

<u>SEC PROPOSAL QUESTION 132 AND FEDERATED HERMES RESPONSE</u>

Are there other changes or additions that would improve the accuracy and consistency of the required reported information on Form N-MFP?

Yes. Due to the extent of the additional information required to be reported on Form N-MFP, the current filing deadline of no later than the fifth business day of each month should be extended to at least the seventh business day of each month to allow sufficient time for review and verification of the information.

<u>SEC PROPOSAL QUESTION 133 AND FEDERATED HERMES RESPONSE</u>

Should we, as proposed, require liquidity, net asset value, and flow data to be reported as of the close of business on each business day of each month? Would funds incur significantly higher costs than under the current weekly data reporting requirement? Please describe the associated costs.

No. Such requirements would place an undue burden on MMFs and would fail to add value and enhance the MMF space.

SEC PROPOSAL QUESTION 134 AND FEDERATED HERMES RESPONSE

Would our new proposed requirements help us better identify certain risk characteristics that the form currently does not capture?

No.

SEC PROPOSAL QUESTION 135 AND FEDERATED HERMES RESPONSE

Are there other ways to monitor risks and trends in fund liquidity, valuation, and shareholder flow in a more efficient and precise manner without requiring frequent visits to the websites of many different funds?

Yes. The Commission should subscribe to one or more of the private data services where this information is readily available, such as Crane Data.

SEC PROPOSAL QUESTION 136 AND FEDERATED HERMES RESPONSE

When reporting required flow information on Form N-MFP, money market funds must include dividend reinvestments in the gross subscriptions figure. After last amending Form N-MFP, the Commission adopted Form N- PORT, which requires other types of registered management investment companies to report shares sold in connection with reinvestments of dividends and distributions separately. Should we similarly require money market funds to report dividend reinvestments and distributions separately? Would using an approach that is similar to Form N-PORT benefit fund complexes by allowing them to use consistent systems across different types of mutual funds for purposes of reporting flow information and allow the Commission and investors to better identify whether the fund is receiving new subscriptions? Or would such a change burden fund complexes and require systems changes, without significantly enhancing the current data because dividend reinvestments by money market fund investors are less substantial than for other fund types?

No.

SEC PROPOSAL QUESTION 137 AND FEDERATED HERMES RESPONSE

Should we, as proposed, require money market funds to report 7-day yield information each business day? What are the advantages and disadvantages of requiring higher-frequency reporting of yield information? Should we instead require funds to report this information for each Friday of the month and for month-end, or on a different time cycle?

MMFs should, at most, be required to report 7-day yield information on a weekly basis, preferably monthly. Such requirements would place an undue burden on MMFs and would fail to add value and enhance MMFs.

SEC PROPOSAL QUESTION 138 AND FEDERATED HERMES RESPONSE

Should we require funds to provide both the name and LEI for the registrant and the series and the full name of the class of the series, as proposed? Is there other identifying information about the registrant, series, or class that would be helpful?

No.

<u>SEC PROPOSAL QUESTION 139 AND FEDERATED HERMES RESPONSE</u>

As proposed, should we amend the definition of LEI in the form and provide a separate item for providing an RSSD ID as a securities identifier, as applicable?

No.

<u>SEC PROPOSAL QUESTION 140 AND FEDERATED HERMES RESPONSE</u>

Are there other definitions we should amend, include, or exclude from the form? Please explain.

No.

XI. COMPLIANCE DATE

<u>SEC PROPOSAL QUESTIONS 141 & 142 AND FEDERATED HERMES RESPONSE</u>

Are the proposed compliance dates appropriate? If not, why not? Is a longer or shorter period necessary to allow affected funds to comply with one or more of these particular amendments? If so, what would be a recommended compliance date? Should removal of the fee and gate provisions be effective when the final rules become effective, as proposed? Alternatively, should these provisions not be effective until the compliance period ends for the increased liquidity requirements or the swing pricing requirement?

The appropriateness of the compliance dates depends entirely on the composition of the final proposal. As made clear in our discussion above on the costs associated with implementation of the Proposal, there is an enormous amount of complicated systems design and building, accounting, tax and legal analysis and documentation and other work involved in implementing it, particularly as regards the swing pricing and negative rate aspects of the proposal and the associated additional disclosures. No MMFs have operated under a swing pricing regime; not in the U.S., not anywhere. The process for doing this will need to be developed from scratch. There is no model.

We fully support the immediate effectiveness of Delinking. However, the fee and gate provisions should not be removed, just delinked. Fund boards should retain the ability to impose fees and gates as they deem necessary upon effectiveness of the final rule with an additional six-month transition period for fund Board's to adopt enhanced procedures surrounding the monitoring of a fund's liquidity. While we believe the benefits of Delinking are vast and render a need to increase required liquidity levels as moot, should the Commission determine to increase liquidity levels we urge the Commission to provide a 12-month compliance period for any material increase.

Aspects of the Proposal that will eliminate the utility of MMFs in the U.S., including any mandated use of swing pricing or prohibition on RDM accompanied by a requirement for intermediaries to confirm their ability to transact at a four-digit NAV, should be subject to a 24-month compliance period, consistent with the October 2016 compliance date for the 2014 Amendments. This may allow for systems revisions and portfolio rebalancing to shorter term and more liquid assets, so that MMFs can handle (i) the transition in a way that does not cause investor dislocation, (ii) a sudden destabilizing movement of assets out of prime and government MMFs, (iii) an immediate de-funding of municipal governments and other borrowers from MMFs, or (iv) the closure of MMFs that are no longer viable.

XII. COST BENEFIT ANALYSIS

The SEC is required, in any rulemaking under the Investment Company Act, to engage in a rigorous cost benefit analysis as part of its rational decision-making process in deciding whether to regulate to address an issue involving MMFs and in adopting or amending the terms of the rule.[108] The SEC is not exempt from this requirement because it is an independent agency. Rather, both the organic statutes at issue and the Administrative Procedure Act require it.[109]

An initial question in any cost benefit analysis is whether the proposed rule change accomplishes the intended result. In other words, will the expected benefit be realized at all? The unsupported assertions and sheer speculation upon which the Proposal is based are inadequate and fail to justify its adoption. With respect to swing pricing, the only empirical economic study on which the SEC hangs its hat concludes that swing pricing does not reduce redemptions in a market stress situation, except in non MMF mutual funds in which institutional investors invest alongside retail investors.[110] Since October 2016, U.S. prime MMFs have been divided into separate retail and institutional funds. Retail and institutional investors do not invest in the same prime MMFs. So, the only context in which swing pricing is shown to work by the SEC's own favored study does not exist is U.S. MMFs.[111]

If a rule will not achieve its intended purpose, there is no benefit. By any measure the sufficiency of the cost benefit analysis in support of the Proposal does not pass muster. Four trillion dollars in U.S. Government MMFs and over six hundred billion dollars[112] in institutional prime and municipal MMF assets are put at risk by the terms of the Proposal. The cost benefit analysis of any proposal which comes with such significant costs to the markets and investors must be performed to a higher standard. The data used to justify the Proposal is incomplete and puts the cart before the horse by requesting more data by which a final rule can be justified – leading to conclusions drawn not based on the terms of the Proposal but on responses provided to the Proposal which will not be subject to further non-judicial scrutiny. Notwithstanding the incompleteness of the cost benefit analysis performed, or the reliance on unsupported

---

[108] *See Michigan v. Environmental Protection Agency*, 576 U.S. 743 (2015) (Clean Act and APA require rigorous cost/benefit analysis); *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (Securities Exchange Act and APA require rigorous cost/benefit analysis). Note the specific requirement to take into account the economic impact in rulemakings in Investment Company Act 2(c), 15 U.S.C. 80a-2(c) ("the Commission shall also consider . . . whether the action will promote efficiency, competition, and capital formation"), with the more ambiguous Clean Air Act language at issue in *Michigan v. Environmental Protection Agency*, 42 USC 7412(n)(1)(A) (whether such action is "appropriate and necessary").

[109] *Id.*

[110] Jin et al., *supra* note 11, at 28-35
(effects of swing pricing in reducing redemptions in stress periods not significant at purely institutional funds and instead "are pronounced for funds with higher retail ownership, [but] it is not driven by the retail investors that sell more in these funds, rather it is the institutional investors facing the presence of retail investors."), cited in 2022 MMF Release, 87 Fed. Reg. at 7303 at n.354. That study also surveys other recent empirical analyses and concludes that the other two empirical studies "do not find any stabilizing flow effect during stress periods" at mutual funds using swing pricing). Jin et al., at 8.

[112] Including $281 billion in public institutional prime and $346 billion in non-public institutional prime. SEC Division of Investment Management Analytics Office, Money Market Fund Statistics, Form M-NFP Data Period ending February 2022, at 1, available https://www.sec.gov/files/mmf-statistics-2022-02_1.pdf.

assumptions instead of data, given the alternative reform proposals available and the hugely beneficial removal of the improper linkage, other than Delinking and working to improve the functioning of the short-term funding markets, no further reforms are justified. Action taken in reliance on inaccurate data or fallacious assumptions are arbitrary and capricious.[113]

MMFs play an important role in the capital markets by providing an efficient means for institutional and retail investors to put short-term cash balances to work at a competitive market rate, providing relatively low-cost short-term financing to creditworthy governments and businesses. MMFs provide investors with a convenient means to access professional management of highly diversified portfolios of high-quality short-term instruments. MMFs are much more efficient (and for very large balances, safer) than banks at intermediating between short-term cash investors and short-term government and corporate borrowers.[114] In considering the costs associated with changes to MMF rules, it is necessary to include the costs to investors and to state and local governments and businesses that obtain financing from MMFs that would result from the rule change. Rule changes that will force the shift of investor balances from prime and municipal MMFs to U.S. Government MMFs, bank deposits, and digital currencies, will result in lower returns (or no returns) to investors and higher borrowing costs to municipalities and businesses that must shift to more expensive bank loan and bond financing. Municipalities and business cannot obtain financing from U.S. Government MMFs or cryptocurrency issuers. They must resort to borrowing from banks or issuing longer-term bonds at much higher interest rates. Between lower returns on the investor side and higher costs on the borrower side, the shift of balances out of prime MMFs results in lost income and higher borrowing costs of roughly 2% to 3% per annum on the aggregate amount of prime MMF balances shifted to alternative forms of intermediation, such as banks.[115]

The utility of MMFs to both retail and institutional investors recently received the most sincere and perhaps unintended endorsements from PWG constituent agencies and their proxies in the form of enforcement actions brought by the Office of the Comptroller of the Currency (the "OCC"), the SEC and FINRA against banks, broker-dealers and investment advisers for breaches of fiduciary duties and disclosure obligations to customers by failing to invest customer cash balances at a competitive market yield in institutional MMF

---

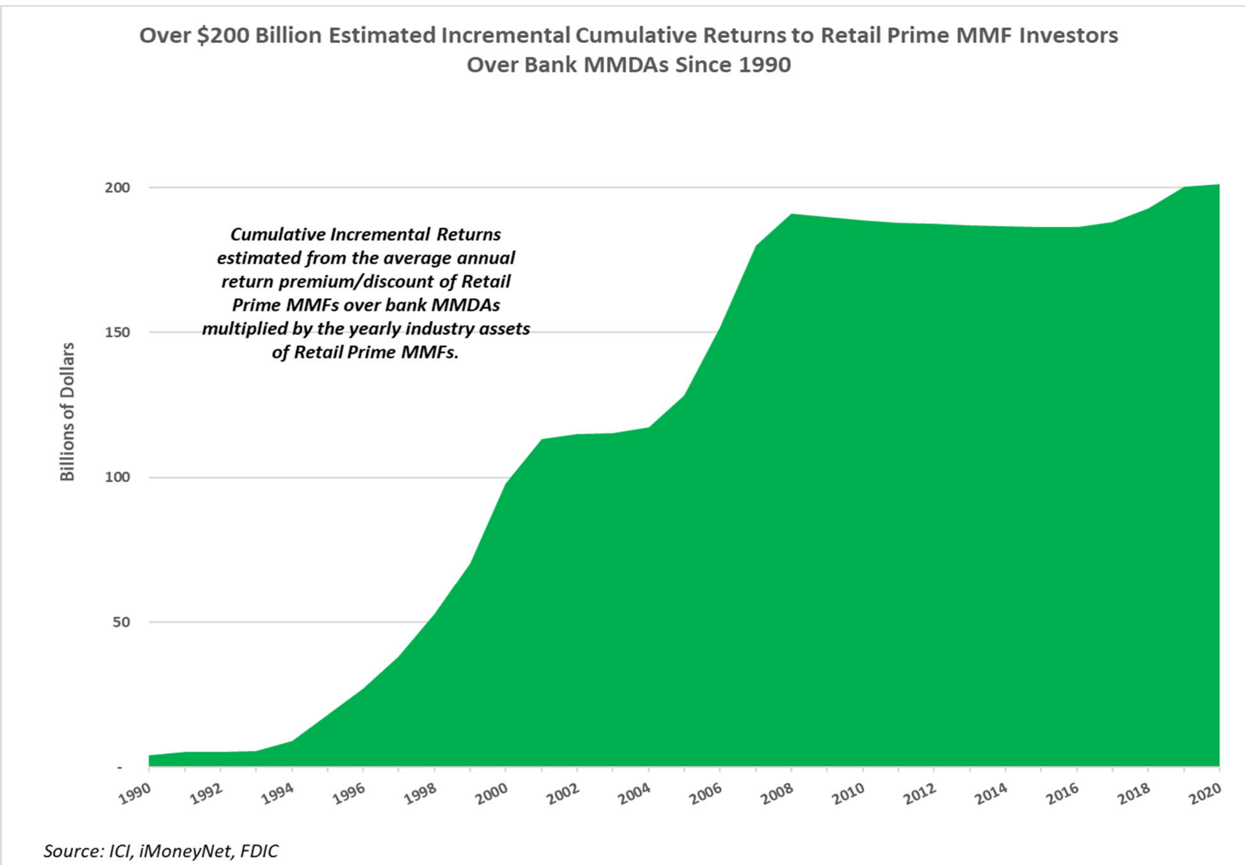
[113] *See* 5 U.S.C. § 706(2)(A) (2018) (requiring courts to set aside agency action found to be arbitrary or capricious); Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (holding that "an agency rule would be arbitrary and capricious if the agency has . . . entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise").

[114] *Compare* ICI, 2021 Investment Company Fact Book, at 137 fig.6.5, available at https://www.ici.org/system/files/2021-05/2021_factbook.pdf (asset-weighted average expense ratio of MMFs at 0.22% of total assets) *with* Federal Financial Institutions Examination Council Uniform Bank Performance Report, Peer Group Average Report, All Banks in Nation, Summary Ratios, https://cdr.ffiec.gov/public/ManageFacsimiles.aspx (average non-interest expense ratio of all U.S. banks at Dec. 31, 2021 of 2.57% of average bank assets) (last visited Mar. 17, 2022) *and* Board of Governors of the Federal Reserve System ("Federal Reserve"), Selected Interest Rates (Daily) - H.15, https://www.federalreserve.gov/releases/h15/ (one to three month commercial paper rates in March 2022 of 0.19% to 0.91% depending on term and type, and bank prime rate at 3.25%) (last visited Mar. 17, 2022).

[115] *Id*. (spread between average MMF expense ratios and bank expense ratios in excess of 2% and spread between commercial paper rates and benchmark bank lending rates in excess of 2%).

share classes and failing to disclose the clear benefits of investing in institutional classes of MMFs and instead investing those balances in bank deposits.[116]

Unlike bank deposits, which pay an administered rate, MMFs provide investors with a market rate of return. This allows a fair and competitive return to investors, rather than potentially lower non-market rates. This puts smaller investors on par with high-net-worth investors and institutions in terms of access to market-based rates of return on their cash. The benefit to investors of more than $200 billion from these higher returns from MMFs over bank deposits from 1990 through 2020 is shown in the following chart:



---

[116] *See* OCC News Rel. 2020-159, OCC Assesses $250 Million Civil Money Penalty Against JPMorgan Chase Bank, N.A. (Nov. 24, 2020), https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-159.html; Stephanie Avakian, Director, SEC Division of Enforcement, *What You Don't Know Can Hurt You*, Keynote Remarks at the 2019 SEC Regulation Outside the United States Conference (Nov. 5, 2019), https://www.sec.gov/news/speech/speech-avakian-2019-11-05; Crane Data, FINRA Fallout: More on Sweeps, Fin-Tech Cash Accounts by ignites, FP (Jan. 22, 2020), https://cranedata.com/archives/all-articles/8056/; Clifford E. Kirsch et al., *Regulators Have Bank Deposit Sweep Programs in Their Sights,* EVERSHEDS SUTHERLAND (Nov. 21, 2019), https://us.eversheds-sutherland.com/mobile/NewsCommentary/Legal-Alerts/227079/Regulators-have-bank-deposit-sweep-programs-in-their-sights.

The costs to be weighed in any cost benefit analysis of potential changes to the MMF rule must include the lower returns to investors and high costs to borrowers from changes that would force investors out of prime and municipal MMFs into lower yielding alternatives and require state and local governments and businesses to obtain financing from more expensive sources than MMFs. This is of acute concern in our current inflationary environment when the potential alternatives for investors might not be a market rate of return but rather a lower, administered, rate provided by a bank. Moreover, in the current rising interest rate environment, the benefits of MMFs to both issuers (lower cost financing) and investors (market return) will only increase.

Furthermore, to the extent that the costs of addressing market turmoil are to be weighed into the SEC's cost benefit analysis, the costs of resolving alternative places where investors may park cash must be considered. The Fed and Treasury turned very large profits and incurred no losses in both the 2008 and 2020 financing and guarantee programs for MMFs,[117] but the FDIC and Treasury have paid hundreds of billions of dollars over the years to resolve failed banks,[118] and as shown in the chart below from the FDIC's website, during the fourth quarter of 2021, the assets of troubled U.S. banks (those CAMELS[119] rated 4 or 5) ominously rose from roughly $50 billion to $170 billion, apparently as the result of the addition of a single undisclosed troubled bank with over $120 billion in assets.[120]

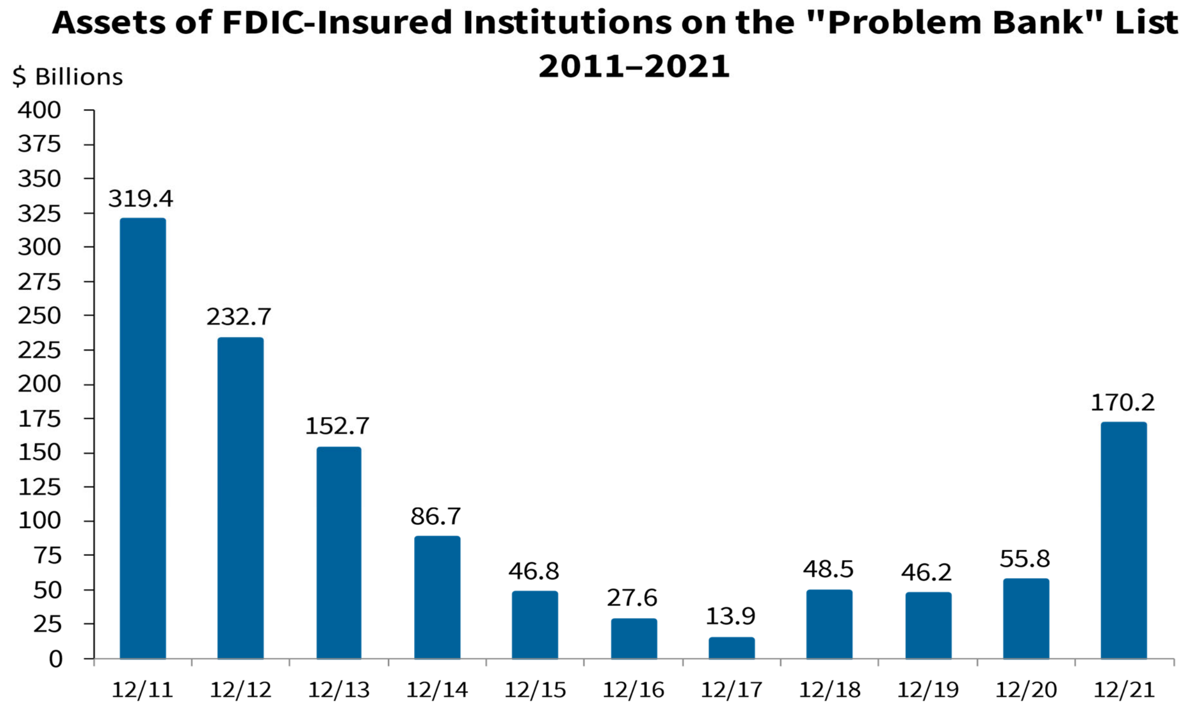
---

[117] *See supra* notes 45, 46; Cochran et al., *supra* note 98 at 903-904.

[118] See Federal Deposit Insurance Corporation ("FDIC"), Bank Failures & Assistance Data, available at https://banks.data.fdic.gov/explore/failures (last visited March 31, 2022).

[119] CAMELS stands for "Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity."

[120] FDIC Quarterly Banking Profile, as of December 31, 2021: List of Problem Banks, *and* Assets of Problem Banks, as of December 31, 2021, available at https://www.fdic.gov/analysis/quarterly-banking-profile/graph-book/2021dec/dproblb1.html and https://www.fdic.gov/analysis/quarterly-banking-profile/graph-book/2021dec/dproblb2.html.



Source: FDIC.
Note: Assets shown are what were on record as of the last day of the quarter.

The potential cost of resolving the financial meltdown that might be caused by cryptocurrencies currently is unknowable. But it has rightfully raised very serious concerns at the White House, in Congress, and at each of the financial regulatory agencies. If balances move out of MMFs due to adverse regulatory changes, there will be much higher resolution costs associated with those new cash repositories in the next financial crisis than would be the case were those balances to remain in MMFs.

The direct costs of implementing the Proposal for MMFs and their services providers and intermediaries would also be substantial. Federated Hermes estimates its own expenses for implementing all parts of the Proposal for its family of MMFs between $10 to $20 million in initial costs and thereafter annual on-going expenses of $2 to $4 million per year. These estimated expenses include, among others: staffing and personnel costs, legal fees, printing and mailing costs and fees to custodians. Roughly two-thirds of these estimated costs are to implement the swing pricing, new disclosures and negative interest rate aspects of the Proposal.

The family of MMFs serviced by Federated Hermes is neither the largest nor the smallest in the U.S. Some of these estimated expenses are fixed, while others are variable based upon the number and size of the funds and the number of shareholders and intermediaries, among other factors. As a result, Federated Hermes anticipates that the expenses of other MMFs will be somewhat larger for larger MMF families and their services providers, and somewhat smaller for smaller MMF families and their services providers but will not vary exactly in proportion to the size of the MMF family. We anticipate that this additional expense would put continued pressure on smaller MMF families and result in additional consolidation and shrinkage

of the number and size of MMFs. Like the 2014 amendments, the latest Proposal, if adopted and implemented, would be very expensive, and profoundly anti-competitive.
Broker-dealers, custodian banks and other intermediaries that make prime and tax-exempt MMFs available to investors through their platforms would also bear a substantial additional layer of expenses for re-tooling their systems, re-documenting MMF arrangements, disclosures, statements, and reporting, and engaging in client communications to implement the Proposal. As an example, Federated Hermes engages with over 11,000 institutions and intermediaries – each of which, should they offer MMFs, will have increased costs.

Some intermediaries may choose to avoid these costs by removing non-government MMFs as options on their platforms. This will further reduce competition for short-term cash balances and further reduce returns to the intermediaries' client base as cash balances get shifted to government MMFs, bank deposits and stablecoins. The Commission may be tempted to ignore and paper over the costs to investors of being shifted to a lower return. The Commission and other agencies acting in concert with it have not been so blasé on reduced returns on mutual funds in the share class enforcement arena,[121] or the shifting of client MMF balances to bank sweep deposits,[122] but has instead labeled those shifts as a breach of fiduciary duty and/or securities fraud on the part of intermediaries.[123] The federal securities laws impose on the Commission a statutory duty in its rulemaking process to attend to the interest of investors and to not reduce competition.[124]

Would it not be a breach of that duty for the Commission to adopt the Proposal in its current form and thereby force onto MMF investors precisely the same harms that the Commission has found to be a breach of fiduciary duty and fraudulent when imposed on those same investors by investment advisers, broker-dealers and banks?

In Questions 143-155 of the Proposal, the Commission asks whether it has properly considered the costs associated with the Proposal. The short answer is "no." The Commission has not provided a reasonable or careful (or really, any) assessment of the costs and the impact on investors, the markets, efficiency, competition, or other issues. The Commission simply has thrown up its hands and said it is hard to estimate those costs. Nor has the Commission provided any evidence that the swing pricing requirement and negative rate prohibition aspects of the Proposal will have the desired effects or provide any benefits whatsoever. That approach to a cost benefit analysis in a rulemaking does not pass statutory muster and does not serve the public interest.

To summarize:

---

[121] *See, e.g.*, SEC Rel. No. 34-94352 (Mar. 3, 2022); SEC Division of Enforcement, Share Class Selection Disclosure Initiative, https://www.sec.gov/enforce/announcement/scsd-initiative; SEC, Press Release 2018-15, *SEC Launches Share Class Selection Disclosure Initiative to Encourage Self-Reporting and The Prompt Return of Funds to Investors* (Feb. 12, 2018), https://www.sec.gov/news/press-release/2018-15 .
[122] OCC News Rel. 2020-159, OCC Assesses $250 Million Civil Money Penalty Against JPMorgan Chase Bank, N.A. (Nov. 24, 2020), https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-159.html; Stephanie Avakian, Director, SEC Division of Enforcement, What You Don't Know Can Hurt You, Keynote Remarks at the 2019 SEC Regulation Outside the United States Conference (Nov. 5, 2019), https://www.sec.gov/news/speech/speech-avakian-2019-11-05; Crane Data, FINRA Fallout: More on Sweeps, Fin-Tech Cash Accounts by ignites, FP (Jan. 22, 2020), https://cranedata.com/archives/all-articles/8056/; Kirsch et al., *supra* note 117.
[123] *See id*
[124] *See, e.g.,* 1940 Act §§ 1, 6(b), (c), (d), 38; 1934 Act §§ 2, 23(a)(2), 36, 39; 1933 Act §§ 2(b), 19(a), (e), 28.

- The Commission provides no evidence that the absence of swing pricing has harmed investors. During the height of the March 2020 crisis, the Proposal reports that:

  > prime money market funds sold an estimated … [$23 billion] in the secondary market. Thus, we find that prime money market funds, particularly institutional funds, were engaging in greater than normal selling activity in these markets which, when combined with similar selling from other market participants such as hedge funds and bond mutual funds, both contributed to, and were impacted by, stress in short-term funding markets.[125]

  However, no evidence is provided to demonstrate that these sales created material dilution for remaining shareholders. Moreover, the sale of longer dated securities almost certainly related to the advisers' inability to use WLA to meet redemptions. Indeed, the Commission acknowledges that such sales may have resulted from the flaw in current 2a-7 connecting WLA levels with mandatory board action:

  > We considered several factors that may have driven investors' redemptions during this period of market stress, including the potential for the imposition of fees and gates as funds neared the 30% weekly liquid asset threshold [126]

- The Commission provides no assessment of the adverse impact that swing pricing will have on the utility of institutional prime and tax exempt funds, the inevitable reduction in their use, or the resulting adverse impact on the returns to shareholders or the borrowing costs for issuers. History demonstrates that these losses will undoubtedly be incurred and will represent a further retrenchment of the Commission from its statutory mandate of capital formation, market efficiency and competition.

- The Commission therefore fails to acknowledge that its proposed swing pricing "cure" is worse than the "disease." Federated Hermes estimates that nearly all institutional investors will abandon funds subject to swing pricing. If they were to invest in the nearest alternative – government MMFs – then the annualized reduction in return will be 10 – 12 basis points, based on historical averages of the difference in yields between prime and government funds. This loss compares with an unquantified alleged benefit that Federated Hermes expects is near zero, if it can even be measured.[127] Indeed, the Commission has already acknowledged the absence of data to support its position:

  > Staff analysis and an external study did not find a correlation between market prices and institutional prime fund redemptions during this time.[128]

  It appears that the Commission has intentionally failed to provide a rigorous cost benefit assessment under the view that the relevant issues and related data will be identified through the

---

[125] 2022 MMF Release, 87 Fed. Reg.at 7255.
[126] 2022 MMF Release, 87 Fed. Reg. at 7253.
[127] To provide adequate evidence that swing pricing creates a benefit to shareholders, the Commission would have to demonstrate a material systematic decline in fund NAVs that result from redemptions that equal or exceed 4% of fund AUM. There is not observed in practice.
[128] 2022 MMF Release, 87 Fed. Reg. at 7254.

comment process, and that a final rule will provide a thorough analysis. For instance, the Proposal states:

> We request comment on all aspects of the economic analysis of the proposed amendments. To the extent possible, we request that commenters provide supporting data and analysis with respect to the benefits, costs, and effects on competition, efficiency, and capital formation of adopting the proposed amendments or any reasonable alternatives.[129]

However, there are numerous defects in the Proposal that cannot be cured in this manner.

- The Proposal implicitly assumes that the industry will undertake the infrastructure changes necessary to support swing pricing. A similar assumption was made explicitly made with the adoption of Rule 22c-1:

  > As discussed in greater detail … below, we believe that the challenges to implementing swing pricing can be addressed by the fund industry and overcome.[130]

  These changes were never made and no domestic 1940 Act funds currently employ swing pricing. The Proposal does not seek public comment from intermediaries, transfer agents, custodians or fund accountants regarding their costs to implement swing pricing; or whether they expect to make the necessary changes on behalf of the 16 institutional funds in the market.[131] In particular, the above-referenced omnibus request for comment does not entitle the Commission to assume that the industry is obligated to provide it all relevant information for a cost benefit analysis. The Commission is surely aware that this is a threshold issue for the legitimacy of the Proposal. Without this information, the Commission cannot in good faith determine that the Proposal can be implemented and is not a de facto abolishment of institutional prime and tax-exempt funds. Furthermore, the Commission must be aware, and certainly has the responsibility to be aware, of the failure of the industry to "overcome" the operational obstacles associated with Rule 22c-1. Therefore, the omission of a specific request for public comment, and the implied decision of the Commission to be deliberately uninformed on this matter, renders a future cost/benefit analysis incomplete and meaningless.

- The Proposal is disingenuous when it limits the objective of swing pricing as follows:

  > ***Purpose and Terms of the Proposed Requirement*** We are proposing a swing pricing requirement specifically for institutional prime and institutional tax-exempt money market funds that would apply when the fund experiences net redemptions. This requirement is designed to ensure that the costs stemming from net redemptions are fairly allocated and

[129] 2022 MMF Release, 87 Fed. Reg. at 7326.

[130] SEC, Investment Company Swing Pricing, Final Rule, 81 Fed. Reg 82084, 82093 (Nov. 18, 2016).

[131] The Proposal identifies that 16 funds are impacted by the swing pricing requirement. *See* 2022 MMF Release, 87 Fed. Reg. at 7328, tbl. 7.

> do not give rise to a first-mover advantage or dilution under either normal or stressed market conditions.[132]

In fact, the overarching motivation behind the 2014 reforms to Rule 2a-7 and the current Proposal concerns the FSOC's belief that MMFs pose risks to financial stability. The pertinent regulatory history of Rule 2a-7 begins in its most overt form with FSOC's Section 120 letter to the SEC, [133] continues 2014 reforms and concludes most recently with FSOC's February 4th, 2022 release stating:

> MMFs are significant participants in short-term funding markets, which are a substantial source of funding for businesses and local governments and liquidity for investors. As described in the *Overview of Recent Events and Potential Reform Options for Money Market Funds* released by the President's Working Group on Financial Markets in December 2020, significant outflows from MMFs during the early stages of the COVID-19 pandemic destabilized short-term funding markets. As in 2008, taxpayer-backed government intervention was necessary to support MMFs and short-term funding markets more broadly and to restore market functioning. These events underscored that MMFs have structural vulnerabilities that can create or transmit stress to short-term funding markets.
>
> The SEC recently proposed reforms that would increase the minimum liquidity requirements for MMFs, require some MMFs to adopt swing pricing, and remove MMFs' ability to impose liquidity fees and redemption gates when funds fall below certain liquidity thresholds. These measures should help reduce the financial stability risks posed by MMFs. The Council supports the SEC's efforts to reform MMFs and strengthen short-term funding markets. [134]

The Proposal makes only oblique references to this elephant in the room by stating:

> ***Connection between Money Market Fund Outflows and Stress in Short-Term Funding Markets*** In markets for private short-term debt instruments, such as commercial paper and certificates of deposit, conditions significantly deteriorated in the second week of March 2020. Spreads for commercial paper and certificates of deposits began widening sharply, and new issuances declined and shifted to shorter tenors. While there is limited secondary activity in these markets even in normal times, several industry commenters discussed particular difficulties selling commercial paper in March 2020. Moreover, where money market funds were able to sell commercial paper during this period, increased selling activity from institutional prime funds may have contributed to stress in these markets as

[132] 2022 MMF Release, 87 Fed. Reg. at 7261.

[133] FSOC, Proposed Recommendations Regarding Money Market Mutual Fund Reform (Nov. 2012), available at FSOC, Proposed Recommendations Regarding Money Market Mutual Fund Reform (Nov. 2012), available at https://www.treasury.gov/initiatives/fsoc/Documents/Proposed%20Recommendations%20Regarding%20Money%20Market%20Mutual%20Fund%20Reform%20-%20November%2013,%202012.pdf.

[134] FSOC, Press Release, Financial Stability Oversight Council Statement on Nonbank Financial Intermediation (Feb. 4, 2022), available at https://home.treasury.gov/news/press-releases/jy0587 (citation omitted).

> discussed below. …. Thus, we find that prime money market funds, particularly institutional funds, were engaging in greater than normal selling activity in these markets which, when combined with similar selling from other market participants such as hedge funds and bond mutual funds, both contributed to, and were impacted by, stress in short-term funding markets.[135]
>
> The proposed amendments are intended to reduce run risk, mitigate the liquidity externalities transacting investors impose on non-transacting investors, and enhance the resilience of money market funds. To the degree that the proposal would increase the resilience of money market funds, it may enhance the availability of wholesale funding liquidity to market participants and enhance their ability to raise capital, particularly during severe stress. The proposed amendments may also reduce the probability that runs would result in future government interventions, inform investors about liquidity risks of their money market fund investments, and enhance the ability of investors to optimize their portfolio allocations.[136]

The Commission is therefore attempting to justify a proposed rule based on an unstated primary motivation for which: (i) it has no statutory mandate; (ii) has sought no public comment; and (iii) apparently believes it can sidestep a required cost/benefit analysis. Perhaps one reason for avoiding this issue is the awareness that swing pricing will not reduce systemic risk, and is more likely to increase it.[137] For this reason, the required cost/benefit analysis justifying a final rule that adopts swing pricing as proposed will be irreparably flawed; and the imposition of mandatory swing pricing is likely to be found to be arbitrary and capricious.

XIII. CONCLUSION

Thank you for the opportunity to comment on the Proposal. As we have outlined, policy decisions based on inaccurate assumptions and false narratives as to the underlying cause and effect of market events inevitably lead to poor regulatory policy and unintended consequences. The final rule as adopted should be limited to (1) delinking compliance with daily and weekly liquidity levels to considerations on imposition of fees and gates, (2) requiring FNAV MMFs to use bid prices on portfolio assets to calculate NAV and purchase and redemption prices, and (3) specifying criteria upon which a MMF's board's independent directors could impose a discretionary liquidity fee or redemption gate. The remaining aspects of the Proposal should not be adopted, including in particular the swing pricing proposal, as they will not result in the desired results to reduce investor redemptions in stressed market conditions, but instead will be harmful to investors in MMFs, those who use MMFs to obtain short-term financing, and will interfere with capital formation and the stability and efficiency of short-term markets.

As such, they conflict with the statutory mandates of the SEC that apply to rulemakings under the federal securities laws to promote efficiency and the functioning of markets, protect investors, and not undermine competition. In addition, the other aspects of the Proposal are based on flawed assumptions, are contrary

[135] 2022 MMF Release, 87 Fed. Reg. at 7255.
[136] 2022 MMF Release, 87 Fed. Reg. at 7325.
[137] *See* Federated Hermes Comment Letter II, *supra* note 2.

to the empirical studies that the SEC cites and are not supported by any meaningful cost/benefit analysis. It therefore would be arbitrary and capricious for the SEC to adopt the other aspects of the Proposal. Let's remember to "first, do no harm" in further amending MMF regulations.

The Commission should instead work with the Fed, Treasury and other relevant agencies on a proposal to improve the functioning of the short-term funding markets in times of market stress, as is suggested by the OFR's 2020 Annual Report and in a manner consistent with the statutory text of the Federal Reserve Act and the federal securities laws.

We appreciate your consideration of our views on this important subject and look forward to working with the Commission to enhance the safety and resilience of MMFs. We welcome any questions you may have and are happy to meet to discuss any matters in further detail at your convenience.

Sincerely,

/s/ J. Christopher Donahue
J. Christopher Donahue
Chairman, CEO & President

/s/ Deborah Cunningham
Deborah Cunningham, CFA
Executive Vice President, Chief Investment
Officer of Global Liquidity Markets and
Senior Portfolio Manager

cc: Gary Gensler, Chair, Securities and Exchange Commission
Hester M. Peirce, Commissioner, Securities and Exchange Commission
Allison Herren Lee, Commissioner, Securities and Exchange Commission
Caroline A. Crenshaw, Commissioner, Securities and Exchange Commission
Dan Berkovitz, General Counsel, Securities and Exchange Commission
William A. Birdthistle. Director, Division of Investment Management
Sara ten Siethoff, Deputy Director, Division of Investment Management's Rulemaking Office
Securities and Exchange Commission

APPENDIX A: DISCRETIONARY FEE PROVISION

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

(i) *Discretionary liquidity fees.* 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), 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 discretionary fees, 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 (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;

(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) Duration and application 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**.

(B) 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 a discretionary liquidity fee to the Security and Exchange Commission within 5 business days of making such decision.