



Federated Hermes, Inc.  
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February 14, 2023

VIA E-MAIL TO [RULE-COMMENTS@SEC.GOV](mailto:RULE-COMMENTS@SEC.GOV)

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

**Re: Comment Letter of Federated Hermes, Inc. on the Securities and Exchange Commission's Request for Comment on Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting (File No. S7-26-22)**

Dear Ms. Countryman:

Federated Hermes, Inc. and its subsidiaries ("**Federated Hermes**")<sup>1</sup> submit this comment letter to the U.S. Securities and Exchange Commission (the "**Commission**" or "**SEC**") regarding the Commission's request for comments on the Commission's proposed amendments to Rules 22c-1 (the "**voluntary swing pricing rule**") and 22e-4 (the "**Liquidity Rule**") under the Investment Company Act of 1940, as amended, (the "**Investment Company Act**") and certain disclosure forms under the Investment Company Act for open-end management investment companies, other than money market funds and exchange-traded funds, (collectively referred to herein as "**open-end funds**" or "**funds**").<sup>2</sup>

Federated Hermes has significant concerns with the Proposing Release and the amendments proposed therein and fully supports the comments and recommendations of the Investment Company Institute (the "**ICI**") and largely supports the comments and recommendations of the Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**"), as set forth in their comment letters regarding the Proposing Release (respectively, the "**ICI Letter**" and "**SIFMA AMG Letters**"). Below is a summary of our main concerns:

1. Federated Hermes strongly opposes the use of mandatory swing pricing because it is unnecessary to achieve the Commission's anti-dilution objective, would be extremely costly and would be very difficult, if not impossible, for the industry to implement. The concept of swing pricing will be difficult for investors to understand and would represent an unwarranted change in the character of a hugely popular investment vehicle which provides investors a cost-effective means to access the benefits of professional management, diversification and access to the capital markets to help them meet their financial goals. Importantly, in those extremely rare circumstances where material dilution is a legitimate concern, there are less onerous alternatives to mandating swing pricing, such as bid pricing, use of discretionary liquidity fees and fair value pricing, applied in the discretion of a fund's board in the exercise of their fiduciary duty to the fund and its shareholders.

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<sup>1</sup> Federated Hermes, Inc. (NYSE: FHI) is a global leader in active, responsible investment management, with \$668.9 billion in assets under management as of December 31, 2022. We deliver investment solutions that help investors target a broad range of outcomes and provide equity, fixed-income, alternative/private markets, multi-asset and liquidity management strategies to more than 11,000 institutions and intermediaries worldwide. Our clients include corporations, government entities, insurance companies, foundations and endowments, banks and broker-dealers.

<sup>2</sup> Release Nos. 33-11130; IC-34746; (November 2, 2022) at <https://www.sec.gov/rules/proposed/2022/33-11130.pdf> (the "**Proposing Release**").

2. Federated Hermes strongly opposes a hard close concept, which was proposed to ensure fund managers have the appropriate data necessary to determine whether a fund's net asset value ("NAV") should be swung, but which would result in unintended consequences to third-party intermediaries and underlying investors. It would be particularly detrimental to retirement plan participants in 401(k) plans using open-end mutual funds on their menu.
3. Federated Hermes strongly opposes eliminating the "*less liquid*" investment category from the existing four category liquidity classification framework under the Liquidity Rule because it subjects these funds to unwarranted harm and would also result in significant market disruption. This amendment would limit investments for certain funds potentially impacting returns for investors. It could also force some funds to restructure as alternative investment vehicles and negatively impact investors by causing them to move to products that are less regulated.
4. In the event the Commission decides to adopt mandatory swing pricing and the hard close substantially as proposed, Federated Hermes proposes that the compliance period for the proposed amendments be a minimum 36 months after the effective date of the amendments.

More specifically, with respect to our highlighted positions above, Federated Hermes wishes to provide additional comments on the Proposing Release as noted below.

### **I. Swing Pricing and Hard Close Amendments**

The Commission appears to misapprehend the gravity of the damage that would be done to shareholders and funds by the changes set forth in its Proposing Release, particularly the operational difficulties they would create and exorbitant expense that would be required to fully implement such changes. Federated Hermes agrees with Commissioner Peirce's observation on the Proposing Release that it: "[...] *fundamentally alters the way open-end funds operate, how investors interact with them and the infrastructure surrounding them.*"<sup>3</sup> Changes of such a fundamental nature impacting investors and the capital markets should be the province of Congress and may be beyond the lawful powers of the Commission based on the scant record and rationale for the amendments in the Proposing Release.

Like the ICI, Federated Hermes strongly opposes mandating swing pricing for all funds during times of elevated redemptions. It simply does not follow that elevated redemptions cause material dilution to remaining shareholders. Moreover, the implementation of mandatory swing pricing, as proposed, would be highly disruptive to the funds' current operations and will come at a substantial cost to funds, intermediaries and shareholders. None of which the Commission seems to appreciate.

The Commission uses Europe as an example of having successfully implemented swing pricing, but Commissioner Peirce correctly denotes that Europe's swing pricing regime is *voluntary* and that United States and Europe have "*fundamental differences in our markets and retirement plan systems.*"<sup>4</sup> The fact that swing pricing works in Europe does not mean it is the solution to the Commission's anti-dilution concerns. Under the Proposing Release, the Commission looks to mandate swing pricing in a prescriptive

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<sup>3</sup> Peirce, Hester M. *Closing Act: Statement on Proposed Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT Reporting*, SEC Website, 2 Nov. 2022, <https://www.sec.gov/news/statement/peirce-statement-open-end-funds-110222>.

<sup>4</sup> *Id.*

manner<sup>5</sup>, a stark contrast from the voluntary and principles-based approach for swing pricing it established in 2016.<sup>6</sup> Due to the inevitable operational disruption and substantial cost concerns, the industry did not voluntarily implement, and shareholders did not demand, swing pricing in the United States.

In an extremely misguided attempt to mitigate operational issues associated with swing pricing, the Commission proposed a “hard close”, requiring shareholder transaction data be submitted to the Funds transfer agent by 4:00 p.m. Under a hard close, an order to purchase or redeem a fund’s shares would be eligible to receive a given day’s price only if the fund, or its designated transfer agent, received the order before the fund’s cut-off time (i.e., the time which the fund calculates its net asset value, typically 4:00 p.m. EST). The Commission believes that a hard close would ensure that funds receive timely flow information and would also have ancillary benefits like modernizing/improving order processing and preventing late trading.<sup>7</sup> However, the Commission admits that, in response to the hard close requirement, funds and third-party intermediaries (e.g., broker-dealers, retirement plan recordkeepers, etc.) would need to make “significant changes to their business practices, including updating their computer systems, altering their batch processes, or integrating new technologies that facilitate faster order submission” and would need to “reengineer their systems to ensure disseminated order information reaches the transfer agent or Fund/SERV before 4 p.m.”<sup>8</sup> These changes would come at a considerable cost and may severely limit access to the capital markets for retail investors. It would also result in different classes of shareholders whose trading flexibility would be limited by their distribution channel.<sup>9</sup>

The proposed hard close would abolish the current practice of permitting authorized intermediaries to place orders at the current day’s price provided that the order was received by such intermediaries prior to the fund’s daily cut-off time. The Commission recognizes that this change would directly impact investors, “Investors transacting through intermediaries may lose some flexibility in when they may submit orders through an intermediary to receive that day’s price as intermediaries may institute earlier cut-off times.”<sup>10</sup> Additionally, as cautioned by the ICI and SIFMA AMG, leading trade associations, a hard close would have a detrimental impact on shareholders, particularly the retirement market which would be severely disadvantaged by this hard close. Funds would be subject to many consequences.

Commissioner Uyeda similarly warns that funds may be eliminated as investment options for retirement plan recordkeepers/sponsors “due to the complexities of swing pricing and the hard 4:00 pm close.”<sup>11</sup> Commissioner Uyeda cautions, “Unregulated pools such as collective investment trusts may replace mutual funds regulated under Investment Company Act – thus not only reducing investor choice but also undercutting investor protection.”<sup>12</sup>

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<sup>5</sup> *Proposing Release* at 291

<sup>6</sup> See Investment Company Swing Pricing, Investment Company Act Release No. 32316 (Oct. 13, 2016) [81 FR 82084 (Nov. 18, 2016)].

<sup>7</sup> *Proposing Release* at 128-129. Of course, the adoption of Rule 22c-2 and use of fair value pricing to vitiate the risks of time zone arbitrage have all but eliminated late trading

<sup>8</sup> *Id.* at 140

<sup>9</sup> See ICI Letter’s section on “Specific Comments on the Hard Close Proposal”, including the “Current Distribution Trade Processing Model” and “Proposed Distribution Trade Processing Model” charts.

<sup>10</sup> *Proposing Release.* at 141

<sup>11</sup> Uyeda, Mark T. *Statement on Proposed Rule: Open-End Fund Liquidity Programs and Swing Pricing; Form N-PORT Reporting*, SEC Website, 2 Nov. 2022, <https://www.sec.gov/news/statement/uyedar-statement-open-end-funds-110222>.

<sup>12</sup> *Id.*

With respect to a hard close's alleged benefit of the prevention of late trading, Federated Hermes is not aware and has seen no data which indicates that late trading remains such an industry issue that it requires a remedy as draconian as a hard close. The Commission has failed to provide any evidence that it does.

The challenges, confusion and costs generated by implementing swing pricing and a hard close would likely impact an investor's choice of investment vehicle as intermediaries may modify their product offering lineups to include more exchange-traded funds or collective investment trusts and other non-traditional fund structures, including private funds. In an attempt to remedy the mere possibility of dilution, the Commission has proposed a solution that is, in some ways, more harmful than the dilution itself.

Mandating swing pricing and the related hard close are not required to satisfy the Commission's dilution concerns. Dilution concerns are mitigated if the Commission mandates funds to price at the bid. This effectively reduces any potential NAV impact of net redemptions and extinguishes any "first-mover advantage." Federated Hermes believes pricing at the bid would be effective in preventing dilution during a time of market stress and would, therefore, support this particular mandate. Similarly, fair value pricing would reduce any potential NAV impact that could result from funds transacting in securities to satisfy net redemptions. However, if the Commission maintains the position that an anti-dilution mechanism (an "ADM") is somehow still necessary for funds, then Federated Hermes strongly proposes that the Commission permit a fund's board to determine how to handle dilution through the use of an alternate ADM, which may include the use of voluntary swing pricing as proposed in the ICI Letter, a discretionary liquidity fee<sup>13</sup>, fair value pricing or other alternatives. We believe this is already part of the board's fiduciary duty. A mutual fund, after all, by its very nature mutualizes the investment and expense experience of the shareholder. It is part of the product structure. The focus of the securities laws and fund boards has been on preventing material dilution. The proposal would seem to want to turn the mutual fund accounts into separately managed accounts.

We firmly believe that the use of a mandatory liquidity fee is not necessary or appropriate. Widespread application of mandatory swing pricing or mandatory liquidity fees to those asset classes otherwise considered liquid is simply unsupported by any credible data and would be detrimental to both investors and the capital markets.

In sum, the Commission should require funds to price at the bid or make use of fair value pricing to alleviate concerns about potential material dilution in times of market stress. If the Commission requires more, then it should permit a fund's board to determine how to handle material dilution through the use of ADMs. Prescriptive mandatory swing pricing, with its operational complexities and steep but unquantified costs and risks, is neither necessary nor appropriate and fails any reasonable cost/benefit analysis. The Commission has failed to provide any evidence as to the need for mandatory swing pricing and the related hard close. We welcome additional conversations with the Commission on this topic.

## **II. Liquidity Rule Amendments**

The Commission's proposed amendments to the Liquidity Rule are purportedly designed to "*enhance open-end fund resilience in periods of market stress by promoting funds' ability to meet redemptions in a timely manner while limiting dilution of remaining shareholders' interests in the fund.*"<sup>14</sup> Notwithstanding the Commission's admirable goal of promoting resilience, Federated Hermes believes that the Liquidity Rule

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<sup>13</sup> This is the same alternative that Federated Hermes proposed in our comment letters on the Commission's proposal on Money Market Fund Reforms ("MMFR") and also the comment letters submitted by the ICI and SIFMA AMG on MMFR, respectively. See Money Market Fund Reforms, SEC Release No. IC-34441 (December 15, 2021) (Release), available at <https://www.sec.gov/rules/proposed/2021/ic-34441.pdf>

<sup>14</sup> *Proposing Release* at 12

amendments contained in the Proposing Release are arbitrary, prescriptive and unduly harmful to funds and do not protect investors. If adopted as proposed, these amendments would in fact hurt investors, undermine capital formation and impair market efficiency.

For example, with respect to the elimination of the “*less liquid*” category from the existing four category liquidity classification framework, Federated Hermes believes that, based on their settlement period, the elimination of the “*less liquid*” investment category would be devastating to funds investing primarily in bank loans (“**bank loan funds**”) and other funds that invest in bank loans or other “less liquid” investments.

This is because most bank loans, as a result of the elimination of the “*less liquid*” category, would be deemed to be illiquid based on their settlement period, and the funds primarily investing in them, including bank loan funds, would not be able to comply with the 15% illiquid limitation under the Investment Company Act. Consequently, as a result of this amendment, bank loan funds and other funds that invest in bank loans or other “less liquid” investments may be forced to close, reallocate their assets to another investment vehicle (thereby shifting the Commission’s perceived loan liquidity risk to another investment product) or restructure an alternative investment product in order to comply with the 15% illiquid limitation. These funds may also have issues maintaining their investment objectives, investment policies and the requirements of Rule 35d-1 of the Investment Company Act (the “**names rule**”). The elimination of the “*less liquid*” category would result in significant, unwarranted market disruption without any apparent consideration for the investors. Investors wishing to maintain exposure to these asset classes would be forced to move to products that they might otherwise wish to avoid, potentially impacting investor protection and/or their returns on investment. Federated Hermes questions the purpose of this amendment as these funds have historically been in strong demand and have properly handled market stress for decades, including the liquidity crisis in March 2020.

Should the Commission insist on removing the “*less liquid*” category, then Federated Hermes agrees with SIFMA AMG that a new “bank loan specific” category should be established, which may be subject to a greater highly liquid investment minimum. This would allow for the continuation of bank loan funds and other impacted funds and not unnecessarily limit an investor’s choice of investment product or deprive the bank loan market of liquidity.

### III. Compliance Period

The Commission proposes that funds must comply with the swing pricing and related disclosure requirements, and mutual funds, transfer agents, registered clearing agencies, and intermediaries must comply with the hard close requirements, 24 months after the effective date of the amendments.<sup>15</sup> All other aspects of the proposed amendments have a compliance period of 12 months after the effective date of the amendments.<sup>16</sup> The Commission should not underestimate the significance of the amendments in the Proposing Release which are substantial, complex and expensive. Accordingly, if the Commission decides to proceed with mandating swing pricing and its other proposals, the Commission should provide the industry with at least 36 months to comply with any amendments under the Proposing Release.

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<sup>15</sup> *Id.* at 226

<sup>16</sup> *Id.* at 227

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For all reasons stated in this letter and in the ICI Letter and SIFMA AMG Letters, Federated Hermes strongly opposes the Proposing Release and the proposed amendments therein.

Federated Hermes appreciates the opportunity to comment on the Proposing Release. Please let us know if you have any questions or comments on this submission.

Sincerely,



Peter J. Germain  
Chief Legal Officer

Cc: The Honorable Gary Gensler  
The Honorable Hester M. Peirce  
The Honorable Caroline A. Crenshaw  
The Honorable Mark T. Uyeda  
The Honorable Jaime Lizárraga

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