Federated Hermes, Inc.
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16 August 2021

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

By email: fsb@fsb.org

Re: Comment Letter of Federated Hermes, Inc. on 30 June 2021 Financial Stability Board's Consultation Report: Policy Proposals to Enhance Money Market Fund Resilience

Dear Ladies and Gentlemen:

I. Introduction

We are writing on behalf of Federated Hermes, Inc. and its subsidiaries ("Federated Hermes"). Federated Hermes has been in business since 1955 and has more than 45 years of experience[1] managing money market funds ("MMFs"). Federated Hermes has participated actively in the money market as it developed over the years. Federated Hermes manages Low-Volatility Net Asset Value MMFs ("LVNAV"), and Public Debt Constant NAV MMFs ("CNAV") domiciled in the EU, and LVNAV and Variable NAV MMFs ("VNAV") in the UK. Federated Hermes also manages MMFs in the United States, including U.S. government MMFs, municipal MMFs and prime MMFs as well as MMFs in other jurisdictions. In addition to MMFs, Federated Hermes manages accounts for institutional customers that invest in money market instruments, as well as US local government investment pools that invest in money market instruments. In all, Federated Hermes manages more than $400 billion (€330 billion) in money market assets, the vast majority of which have ESG integrated into their investment process. We appreciate the opportunity to comment on the consultation report on the FSB's policy proposals to enhance money market fund resilience that was published on 30 June 2021.

II. Executive Summary

In March 2020, financial markets around the world experienced a liquidity crisis caused by the affirmative decisions of governments around the world to shut down their local economies in response to the Covid-19 Global Health Pandemic ("Liquidity Crisis"). Contrary to assertions made in the FSB report, the Liquidity Crisis was not caused or amplified by MMFs and any statements to such effect are simply untrue and are not supported by the data.

In assessing the events of the Liquidity Crisis, it is critically important to follow the data and understand

[1] The registration statement for Federated Hermes' Money Market Management fund in the US first became effective on 16 January 1974, making it one of the two longest continuously operating MMF managers.

the timeline of events as they unfolded and how the markets were impacted. The Liquidity Crisis started with public reaction to the then rapidly spreading COVID-19 pandemic, the very sharp contraction of the real economy in early March as people stayed home to avoid contracting the illness under government-imposed lockdowns in many jurisdictions around the globe. These government actions to stem the pandemic sharply reduced investor confidence, price discovery and liquidity across all markets. Predictably, a contagion then ensued as the prospect of the worst pandemic in 100 years shut down global markets.

The data clearly shows that the Liquidity Crisis did not discriminate against any one asset class, it impacted funds across the spectrum and investors of all types. While MMFs experienced significant liquidity pressure in March 2020, such pressure exposed a critical error in previous regulatory reform efforts: the improper linkage of potential liquidity fees and gates to a MMF's weekly liquid asset ("WLA") requirement. This linkage created an unnecessary incentive for investors to redeem and led to artificially high redemptions in both the United States ("US") and in the European Union ("EU") during the Liquidity Crisis. **This linkage of WLA and potential imposition of fees and gates is without question the key vulnerability in US and EU MMFs that should be remedied, and it is supported by the data.**

In addition to delinking the WLA thresholds from the potential imposition of fees and gates, the FSB should expand its review and focus on improving the resilience of the short-term funding markets ("STFMs"). The FSB must better analyse how the STFMs function and the role of their market participants. A proper analysis of the STFMs needs be a collaborative endeavour. MMFs are but one small player in the STFMs and playing a role in the markets and reacting to market stresses should not be confused with causing such market stresses. Additionally, vulnerabilities in the STFMs should not be confused or designated as vulnerabilities in MMFs. Most of the vulnerabilities identified in the FSB report are inherent to the STFMs, not MMFs.

We appreciate the desire for central banks to avoid having to step in and provide liquidity in the markets and we fully support any enhanced regulation that makes sense, is supported by the data, and increases the safety and stability of MMFs. However, in a Liquidity Crisis caused by affirmative actions by governments around the world, central banks, however reluctant, will need to step in and support market-wide liquidity. A desire to eliminate any risk that central bank intervention will be required again is simply not realistic, contrary to a fundamental tenet of central banks (to provide liquidity) and ill-conceived if one believes regulating MMFs out of existence will accomplish an impossible objective.

To enhance the safety and stability of MMFs the FSB should focus on the following *<u>Reforms which would strengthen and enhance the safety and stability of MMFs in the US and EU:</u>*

1. **Eliminate the Link Between WLA Requirements and Potential Fee/Gate Implementation.** Reducing/removing the ill-conceived regulatory incentive to runs by delinking the 30% WLA requirement and potential imposition of a fee or gate addresses the FSB's point on "*reducing the demand from the non-bank financial system for liquidity rising unduly in stress periods*";

2. **Enhance Know Your Customer ("KYC") Requirements.** In the EU, MMFs are already required to "establish, implement, and apply procedures and exercise all due diligence with a view to anticipating the effect of concurrent redemptions by several investors, taking into account at least the type of investor, the number of units or shares in the fund owned by a single investor and the evolution of inflows and outflows" as part of KYC requirements set forth in Article 27 of the Money Market Fund Regulation[2] ("MMFR"). However, for an intermediated investor, whilst MMF managers are required to ask for such information, intermediaries are not subject to a regulatory obligation to provide the information. In the US, the scope of Rule 22c-2 under the Investment Company Act of 1940 should be expanded to apply to MMFs (currently excluded).
3. **Short-Term Funding Market Reform.** Enhancing the resiliency of STFMs by addressing the vulnerabilities in the STFM structure addresses the FSB's point on "*ensuring the resilience of the supply of liquidity in stress; and assessing what can, or should, be done by central banks to backstop market functioning effectively, without creating incentives for market participants to take on more risks*".

In addition to the reforms noted above, to further enhance the safety and stability of MMFs in Europe, the FSB should also focus on the following reforms:

1. With a MMF's liquidity delinked from the potential imposition of a liquidity fee or gate we believe that the current regulatory requirements of 10% daily and 30% weekly (subject to increase by the KYC Rule) are appropriate and should not be increased. These levels are consistent in both the EU and the US but for one type of EU MMF (VNAV MMFs) which are subjected to lower liquidity requirements, which likely contributed to its stress during the Liquidity Crisis. As such, we support increasing the required liquidity levels of EU VNAV MMFs from 7.5% daily and 15% weekly liquidity, to 10% daily and 30% weekly liquidity requirements consistent with other EU MMFs and US VNAV MMFs;
2. MMFs in the EU are also subject to arbitrary restrictions on holding high-quality government securities, which is inconsistent with the economic realities of these securities. We support removing the arbitrary 17.5% restriction on including high-quality government securities as WLA for EU MMFs as, through both the 2008 Financial Crisis and Liquidity Crisis, high-quality government securities have proved to be the most liquid; and
3. MMFs in the EU are also restricted on their ability to use repo due to a drafting inconsistency. The global standard should support the inclusion of 5-day repo as eligible WLA. The conflict between Article 15 of the EU MMFR, which limits investments in repo to 2 days, and Article 24 of the MMFR, which specifically sets forth the inclusion of 5-day repo as part of an EU MMF's WLA, should be corrected.

[2] Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds. See: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R1131&from=EN

MMFs are important short-term high-quality diversified and transparent investment products which have provided significant benefits to investors and issuers in the US and EU since their inception. MMFs in the EU and the US are the highest regulated product in the market and they are fully transparent to not only regulators but to investors. MMFs are 100% capitalized and investment risk remains with the investors. It is critically important that MMFs remain a viable product available for global investors.

III. FSB Request for Comments

1. What are the key vulnerabilities that MMF reforms should address? What characteristics and functions of the MMFs in your jurisdiction should be the focal point for reforms?

What are the key vulnerabilities that MMF reforms should address?

In March of 2020 financial markets around the world experienced a liquidity crisis caused by the affirmative decisions of governments around the world to shut down their local economies in response to the Covid-19 Global Health Pandemic. Contrary to assertions made in the FSB report, the Liquidity Crisis was not caused or amplified by MMFs and any statements to such effect are simply untrue and are not supported by the data.

In assessing the events of the Liquidity Crisis, it is critically important to follow the data and understand the timeline of events as they unfolded and how the markets were impacted. The Liquidity Crisis started with public reaction to the then rapidly spreading COVID-19 pandemic, the very sharp contraction of the real economy in early March as people stayed home to avoid contracting the illness under government-imposed lockdowns in many jurisdictions around the globe. These government actions to stem the pandemic sharply reduced investor confidence, price discovery and liquidity across all markets. Predictably, a contagion then ensued as the prospect of the worst pandemic in 100 years shut down global markets.

On Monday 9 March 2020, the stock markets experienced their largest single day drop since 2008, with the Dow index dropping 2,000 points. On the same date, the volatility expanded into the bond market, due in part to margin calls and unwinding of leveraged positions. The equity markets only deteriorated from there, with further major declines in global equity markets on Thursday 12 March. On Monday 16 March, global equity markets took a one-day decline of 12-13% which was the largest one-day drop of the period. The equity market slide continued through 7 April 2020. The turmoil also impacted the market for government securities in the US, EU, and other jurisdictions in the first week of March 2020, which became quite volatile by early in the second week of March 2020, before the impact was felt in other credit markets or the commercial paper ("CP") market. Dealers widened the bid-ask spreads they offered their clients on average by a factor of 13 in the first weeks of March.

This led to a dramatic increase in the VIX - a market indicator of fear - to a record high of 83%. Credit spreads for investment grade and high yield bonds had already increased by approximately 150% from mid-February to 18 March. This was an unparalleled economic collapse and a stress on financial markets with unprecedented speed and of a magnitude on a par with the 2008 Financial Crisis. The sequence of events is crucial: the widening of FRA-OIS spreads on CP during March 2020 was largely noted in early March 2020, before outflows from MMF commenced. It was attributed to market concerns over the COVID-19 pandemic. The FRA-OIS spread 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. Thus, the turmoil in the CP 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.

The data clearly shows that the Liquidity Crisis did not discriminate against any one asset class, it impacted funds across the spectrum and investors of all types. While MMFs experienced significant liquidity pressure in March 2020, such pressure exposed a critical error in previous regulatory reform efforts: the improper linkage of potential liquidity fees and gates to a MMF's weekly liquid asset ("WLA") requirement.

Following the 2008 Financial Crisis, MMFs in the US and EU were subjected to enhanced regulatory reforms intended to increase the safety and stability of MMFs. The reforms included unprecedented levels of transparency, restricted MMF portfolios' weighted average maturity ("WAM") and weighted average life ("WAL") and adopted minimum levels of daily and weekly liquidity. With the exception of EU VNAV MMFs which as discussed below are required to hold significantly lower levels of liquidity, each of the US and EU MMFs' structures require MMFs to hold a minimum 10% daily and 30% WLA, each supported by a KYC liquidity overlay. These enhanced reforms directly led to MMFs in both the US and EU (excluding EU VNAV MMFs) to enter the Liquidity Crisis with very high levels of liquidity. Unfortunately, the regulatory enhancements adopted after the 2008 Financial Crisis also linked a MMF's WLA threshold to when a MMF's board must consider imposing a liquidity fee or gate. This linkage created an unnecessary incentive for investors to redeem and led to artificially high redemptions in both the US and EU during the Liquidity Crisis. **This linkage of WLA and potential imposition of fees and gates is without question the key vulnerability in US and EU MMFs that should be remedied, and it is supported by the data.**

Notwithstanding the regulatory induced artificially high levels of redemptions, and the freezing of the global STFMs, MMFs in both the US and EU proved incredibly resilient, maintaining required levels of liquidity throughout the Liquidity Crisis, and providing US and EU investors with access to short-term, high-quality, diversified investments. Moreover, as IOSCO noted in its Thematic Note "Money Market Funds during the March-April Episode" published in November 2020, "*Despite the strains faced by non-public debt MMFs in March and based on the responses to the IOSCO Financial Stability Engagement Group (FSEG) survey, it appears that all redemptions have been honoured, no MMFs have suspended redemptions, imposed fees and/or gates, or converted from LVNAV to VNAV*".

In addition to delinking the WLA thresholds from the potential imposition of fees and gates, the

FSB should expand its review and focus on improving the resilience of the short-term capital markets. The FSB must better analyse how the short-term markets function and the role of its market participants. A proper analysis of the short-term funding markets needs be a collaborative endeavour. MMFs are but one small player in the short-term money markets and playing a role in the markets and reacting to market stresses should not be confused with causing such market stresses. Additionally, vulnerabilities in the short-term funding markets should not be confused or designated as vulnerabilities in MMFs. Most of the vulnerabilities identified in the FSB report are inherent to the short-term funding markets, not MMFs.

Lastly, we fully appreciate the desire for central banks to avoid having to step in and provide liquidity in the markets and we fully support any enhanced regulation that makes sense, is supported by the data, and increases the safety and stability of MMFs. However, in a Liquidity Crisis caused by affirmative actions by governments around the world, central banks, however reluctant, will need to step in and support market-wide liquidity. A desire to eliminate any risk that central bank intervention will be required again is simply not realistic, contrary to a fundamental tenet of central banks (to provide liquidity) and ill-conceived if one believes regulating MMFs out of existence will accomplish an impossible objective.

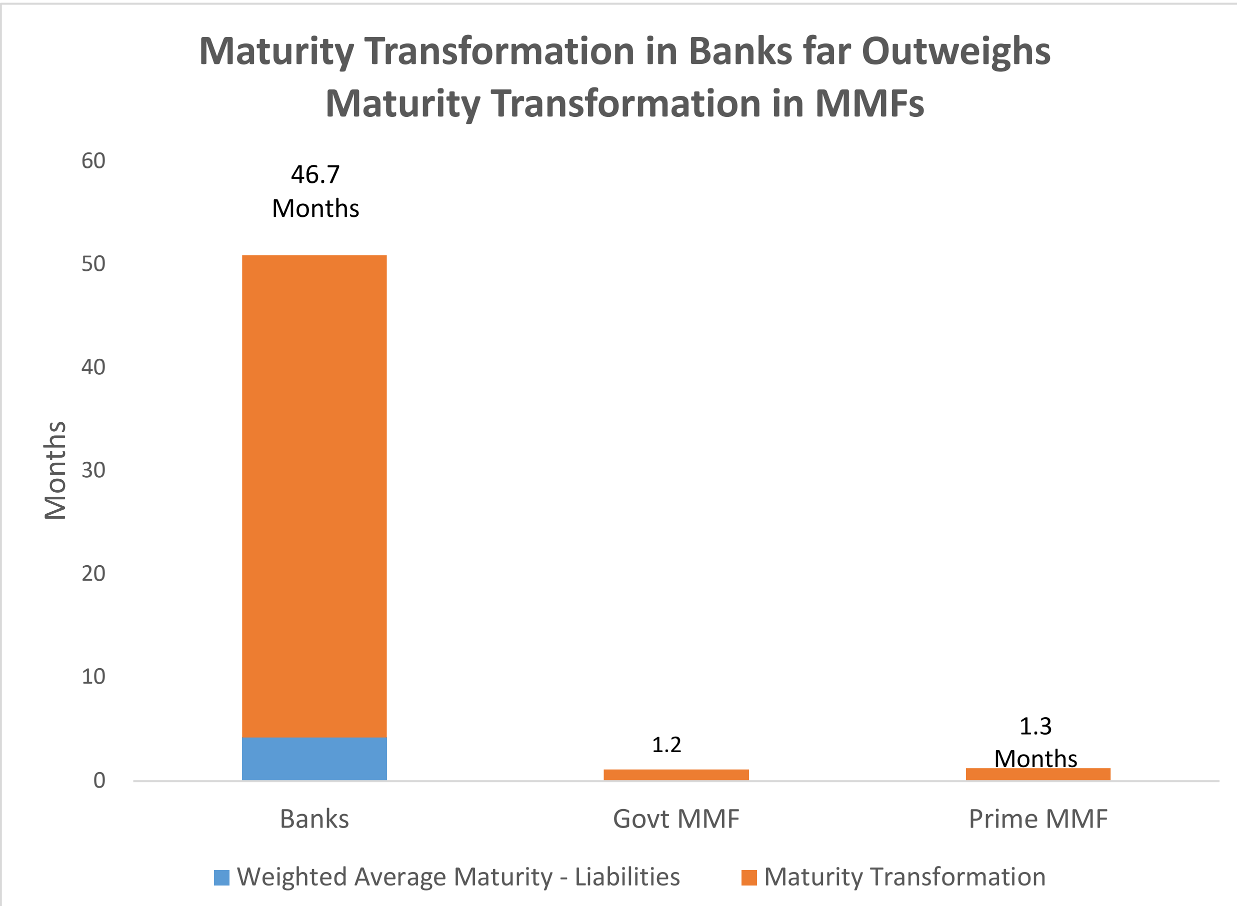
What characteristics and functions of the MMFs in your jurisdiction should be the focal point for reforms?

Any recommendations arising out of the FSB Report must consider the unique investor, product and market issues that exist in MMFs not only in the US and EU, but globally. There is no one size fits all reform, as each jurisdiction's set of MMF regulations has room to improve. We focus our comments on characteristics and functions of MMFs in the EU, UK, and US.

MMFs are important short-term high-quality diversified and transparent investment products which have provided significant benefits to investors and issuers in the US and EU since their inception. A MMF's diversified high-quality investment portfolio provides investors with a means of risk diversification that would not be available should they cease to exist, and investors forced to move their short-term cash into single banks (taking on credit risk – see Icelandic Banks or Cyprus Banks), especially when banks do not want to take onto their books such excess cash.

MMFs in the EU and the US are the highest regulated product in the market and they are fully transparent to not only regulators but to investors. They are subject to strict portfolio construction requirements which make any argument of maturity transformation moot. For instance, as of June 2021, the WAM for prime and government MMF assets were 38 and 35 days. In contrast, bank portfolio duration is opaque, over 4 years, and can only be estimated[3] and includes exposure to mortgages in excess of 30 years.

[3] Banks, Maturity Transformation, and Monetary Policy 9/2020, Pascal Paul, Federal Reserve Bank of San Francisco.



Most importantly, a MMF is 100% capitalized and investment risk remains with the investors. MMFs are not guaranteed products and any consideration which would lead to confusion on the nature of MMFs as an investment product should be discarded.

It is critically important that MMFs remain a viable product available for global investors and for that to occur MMFs must retain their ability to provide investors with daily liquidity and a diversified investment portfolio including MMFs which invest in government securities and MMFs which invest in prime securities. In the US, retaining prime, municipal and government MMFs available to retail and institutional investors is critical. Similarly, in the EU and UK, retaining the MMF investment options in prime VNAV and LVNAV and public debt securities is equally important for European investors and issuers.

That said, we believe there are certain improvements that can be made and additional research which should be conducted on the global short-term markets to alleviate much of the unnecessary pressure experienced in the Liquidity Crisis.

Reforms which would strengthen and enhance the safety and stability of MMFs in the US and EU

1. **Eliminate Link Between WLA Requirements and Potential Fee/Gate Implementation.** Reducing/removing the ill-conceived regulatory incentive to runs by delinking the 30% WLA requirement and potential imposition of a fee or gate addresses the FSB's point on "*reducing the demand from the non-bank financial system for liquidity rising unduly in stress periods*" (see our response to Questions 1, 2, 3, 6, 7, 9, 14, 15, 16, and 18);

2. **Enhance Know Your Customer Requirements.**

   - In the EU, MMFs are already required to "establish, implement, and apply procedures and exercise all due diligence with a view to anticipating the effect of concurrent redemptions by several investors, taking into account at least the type of investor, the number of units or shares in the fund owned by a single investor and the evolution of inflows and outflows" as part of know your customer requirements set forth in Article 27 of the Money Market Fund Regulation[4] ("MMFR"). However, for an intermediated investor, whilst MMF managers are required to ask for such information, intermediaries are not subject to a regulatory obligation to provide the information.

   - In the US, Rule 22c-2 under the Investment Company Act of 1940[5] does not apply to MMFs. A potential regulatory enhancement could include amending Rule 22c-2 to require MMFs to enter into agreements with intermediaries to provide shareholder information. This would equip MMFs even better to plan for sufficient portfolio liquidity to meet anticipated redemptions above and beyond the 10% daily and 30% weekly liquid asset minimums.

3. **Short-Term Funding Market Reform.** Enhancing the resiliency of short-term markets by addressing the vulnerabilities in the short-term funding market structure addresses the FSB's point on "*ensuring the resilience of the supply of liquidity in stress; and assessing what can, or should, be done by central banks to backstop market functioning effectively, without creating incentives for market participants to take on more risks*".

   - **Firstly, there is an issue with transparency of STFMs**. We believe there needs to be a significant increase in the transparency in the short-term markets. The MMF footprint is small compared to other players in the markets, however we can only estimate the actual size. For instance, in the US, it is acknowledged that US prime MMFs held only 29% of outstanding CP at the end of February 2020. The other 71% was held by investors ranging from non-financial corporates and foreign entities to pension plans, hedge funds, mutual funds, and insurers. Basing any policy reform on assumed metrics or by focusing on one specific type of minority player will not result in effective regulation. MMFs are highly

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[4] Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds. See: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R1131&from=EN

[5] 17 C.F.R. at § 270.22c-2. See: https://www.sec.gov/rules/final/1968/34-8429.pdf

regulated and transparent capital market instruments. We fully support the FSB imposing similar MMF transparency requirements to all short-term funding market players, including both buy-side institutions and sell-side operators. In addition, we would welcome increased transparency on programmes and outstanding volumes as, beyond giving a better indication of the size, volume, and depth of these markets, it would improve the valuation process for assets and improve risk management processes.

- **Secondly, the STFM structure should be further reviewed before any action is taken**. These markets are chiefly over-the-counter ("OTC"). MMFs typically purchase these securities from the issuing banks on the primary market. MMFs hold the vast majority (ca. 98.5%) of these assets to maturity. During the Liquidity Crisis, to maintain weekly liquidity levels, MMFs looked to sell some of their securities back to the bank from whom they purchased the security. However, this was when all market participants were looking to increase liquidity in such uncertain times. As such, even issuers of the underlying securities, who would normally be expected to repurchase some of their own issuance, were reluctant to buy them, quoting "balance sheet constraints". Also, many banks are unwilling to bid in the secondary market paper from issuers where they are not a named dealer on that programme.

- **Thirdly, like the Federal Reserve in the US**[6], **consider the creation of a permanent standing repo facility** that would be a market-based solution to support smoother functioning in short-term funding markets.

EU Specific Reforms:

In addition to delinking the 30% WLA threshold and the potential imposition of a fee or gate, enhancing the Know Your Customer requirements, and addressing the vulnerability in the short-term markets, in the EU, we support the following additional regulatory enhancements:

- With a MMF's liquidity delinked from the potential imposition of a liquidity fee or gate we believe that the current regulatory requirements of 10% daily and 30% weekly (subject to increase by the Know Your Customer Rule) are appropriate and should not be increased. These levels are consistent in both the EU and the US but for one type of EU MMF (VNAV MMFs) which are subjected to lower liquidity requirements, which likely contributed to its stress during the Liquidity Crisis. As such, we support increasing the required liquidity levels of EU VNAV MMFs from 7.5% daily and 15% weekly liquidity, to 10% daily and 30% weekly liquidity requirements consistent with other EU MMFs and US VNAV MMFs;
- MMFs in the EU are also subject to arbitrary restrictions on holding high-quality government securities, which is inconsistent with the economic realities of these securities. We support removing the arbitrary 17.5% restriction on including high-quality government securities as

[6] See Minutes of the Federal Open Market Committee meeting on 27-28 April 2021 and Minutes of the Federal Open Market Committee meeting on 15 June 2021

WLA for EU MMFs as, through both the Financial Crisis and Liquidity Crisis, high-quality government securities have proved to be the most liquid; and

- MMFs in the EU are also restricted on their ability to use repo due to a drafting inconsistency. The global standard should support the inclusion of 5-day repo as eligible WLA. The conflict between Article 15 of the EU MMFR, which limits investments in repo to 2 days, and Article 24 of the MMFR, which specifically sets forth the inclusion of 5-day repo as part of an EU MMF's WLA, should be corrected.

Important Note on US Federal Reserve ("Fed") and European Central Bank ("ECB") Intervention

In the US, the Money Market Mutual Fund Liquidity Facility ("MMLF") support utilized by prime MMFs is miniscule compared to other Fed facilities. The Fed's balance sheet expanded by over $3 trillion during 2020 to accommodate the financing facilities (which totalled over $2.3 trillion at their peak), and other actions taken by the Fed. The Coronavirus Aid, Relief, and Economic Security Act ("Cares Act") and Paycheck Protection Program ("PPP") (which were essentially grants to small business and targeted industries) totalled an additional $1.2 trillion. In contrast, the MMLF was the second smallest of the 2020 Fed financing facilities ($53 billion at its peak) and the Commercial Paper Funding Facility ("CPFF") was even smaller, and both were quickly paid off in full (with interest) at no loss to US taxpayers.

Notwithstanding the indirect benefits of the US Fed's MMLF on USD denominated EU MMFs, in Europe, EU MMFs were not beneficiaries of any ECB or Bank of England ("BoE") action. The adoption of the Pandemic Emergency Purchase Programme ("PEPP") by the ECB was intended to support the money markets and the financing of the European economies. It is clear, however, that the PEPP was not intended to support EU MMFs. The PEPP specifically excluded the assets typically held by EU MMFs (bank CP or non-Euro denominated assets). Despite this lack of central bank support, all EU MMFs managed to meet investors' liquidity needs throughout the Liquidity Crisis.

2. What policy options would be most effective in enhancing the resilience of MMFs, both within individual jurisdictions and globally, and in minimising the need for extraordinary official sector interventions in the future?

As set forth in our response to question 1 above, the removal of the linking of WLA thresholds and the potential imposition of fees and gates would address the key issue which contributed to the stress experienced by MMFs in the Liquidity Crisis. Moreover, reforms to the global short-term capital markets are critical. No amount of reform however will alleviate the need for central banks to act in times of extreme stress, such as when governments around the world make affirmative decisions to shut down their economies in response to a global health crisis.

The FSB report asserts "*MMFs are subject to two broad types of vulnerabilities that can be mutually reinforcing: they are susceptible to sudden and disruptive redemptions, and they may face challenges in selling assets, particularly under stressed conditions*". We do not agree with these assertions. MMFs have proved being resilient to large redemptions and the pressure experienced by MMFs in the Liquidity Crisis was felt across all asset classes and as previously noted, MMFs were one of the last market participants to experience the impact of the Liquidity Crisis. Even then, the levels of redemptions were artificially high due to the linkage of WLA requirements and consideration of fees and gates, which created regulatory incentive for investors to redeem.

We also take issue with the singling-out of MMFs as somehow being more challenged in selling assets under stressed conditions than other market participants. The global short-term markets should be studied, and we have advanced ways to improve the operation of the global short-term markets in the future. However, singling out MMFs as somehow being subject to challenges in selling assets under stressed conditions is misleading, as the entire market was frozen, and moreover the implication that MMFs also face challenges in normal times is simply false.

In its 13 July report[7], the BoE rightly puts forward:

> *"Reforms to enhance the resilience of market-based finance should build on work to increase the resilience of the financial system to date.*
> *Consistent with the FSB's workplan, the FPC's work to identify ways to increase the resilience of market-based finance is focusing on three key areas (see July 2021 FSR):*
> - *reducing the demand from the non-bank financial system for liquidity rising unduly in stress periods;*
> - *ensuring the resilience of the supply of liquidity in stress; and*
> - *assessing what can, or should, be done by central banks to backstop market functioning effectively, without creating incentives for market participants to take on more risks."*

Applied to MMFs, the question is how to address the two main vulnerabilities that March 2020 events highlighted: i) artificially high redemption demands; and ii) vulnerability in short-term funding market structure. Simply, by adopting a two-pronged approach:

- **Reducing/removing the ill-conceived regulatory incentive to runs by delinking the 30% WLA requirement and potential imposition of a fee or gate** (see our response to Questions 1, 2, 3, 6, 7, 9, 14, 15, 16, and 18). This would respond to "*reducing the demand from the non-bank financial system for liquidity rising unduly in stress periods*"; and

- **Enhancing the resiliency of short-term markets by addressing the vulnerabilities in the short-term funding market structure**. This would respond to "*ensuring the resilience of the supply of liquidity in stress; and assessing what can, or should, be done by central banks to backstop market functioning effectively, without creating incentives for market participants to take on more risks*".

[7] See Assessing the resilience of market-based finance - A report produced by Bank of England staff, under the guidance of the Financial Policy Committee that includes the conclusions of the joint Bank of England and Financial Conduct Authority review into vulnerabilities associated with liquidity mismatch in open-ended funds.

In their July 2021 paper[8] "Regulatory constraints for money market funds: The impossible trinity?", Baes, Bouveret, and Schaanning state: "*The COVID-19 crisis has shown that the limited liquidity of CP and CD market was one of the main challenges for MMFs. One reform could seek to improve the functioning and liquidity of money markets. This would encompass a range of reforms related to market structure and transparency, as well as reforms related to incentives for dealers to provide liquidity in time of stress.* […] *In our model, improving the liquidity of money markets has a very large effect on MMF resilience.* […] *Any policy that increases the market depth of the assets and thus reduces the price impact will have a very large influence on the NAV constraint and thus allow for a larger maximum redemption, R^{max}. Conversely, any measures that reduce liquidity also reduce the maximum level of redemptions*". The European Securities Markets Authority ("ESMA") was making a similar conclusion in its March 2021 Report[9] on Trends, Risks and Vulnerabilities.

It is time to address the problem at its roots, not its symptoms.

3. How can the use of MMFs by investors for cash management purposes be reconciled with liquidity strains in underlying markets during times of stress?

We reiterate the two key policy reforms the FSB should focus on: i) delinking the 30% WLA requirement and potential imposition of a fee or gate; and ii) addressing the vulnerabilities in the short-term funding market structure.

The FSB should ensure that its recommendations are supported by the data. **In March 2020, the MMFs that experienced the highest redemption pressure were those where a link between the 30% WLA and potential imposition of a fee or gate existed**. In both the EU and US, MMFs were able to meet redemptions without effectively being able to use the liquidity within the fund as intended. The linking of WLA thresholds to potential imposition of fees and gates converted what was once usable liquidity (30%+) and instead converted that liquidity into an unusable floor.

This linkage was ill-conceived and had the unintended and damaging consequence of artificially increasing redemptions in a period of market stress.

See next page:

[8] See: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3884890

[9] See: https://www.esma.europa.eu/sites/default/files/library/esma50-165-1524_trv_1_2021.pdf

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

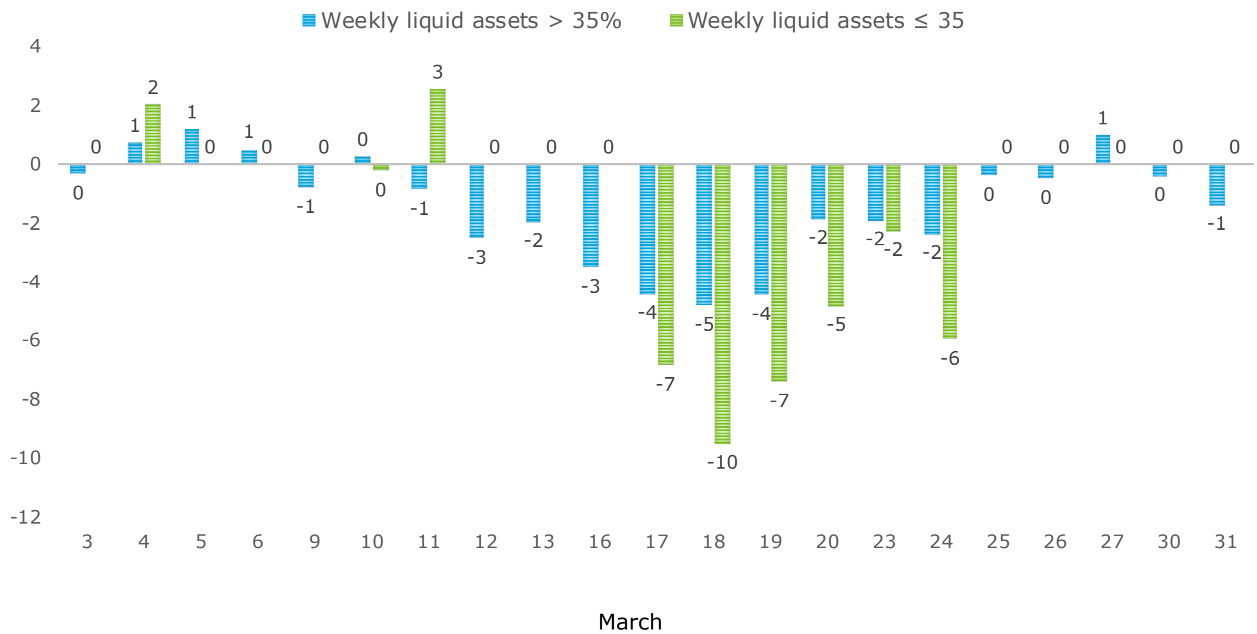
	Prime		Tax-exempt	
Time period	**Number**	**Percent of total**	**Number**	**Percent of total**
June 2, 2010 - October 11, 2016	**162**	**68%**	**21**	**10%**
October 19, 2016 - February 25, 2020	**0**	**0%**	**0**	**0%**

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

As weekly liquid assets dropped below 35%, institutional prime money market funds had larger outflows.
Average percentage change in assets of institutional prime funds, daily, 3 March – 31 March 2020



Delinking would have freed up MMFs so that they could have utilised existing 30% internal liquidity as intended: i.e., an amount of liquidity more than sufficient to cover redemptions experienced by MMFs in the Liquidity Crisis. The real question is what the redemptions would have been if there was no link between WLA thresholds and potential imposition of fees and gates.

Delinking liquidity fees and gates should be a top priority in both the EU and US, the two most meaningful MMF markets globally.

In addressing the "challenges in selling assets", the FSB must address the vulnerabilities in the short-term markets. We reiterate our recommendation at Question 1: the FSB must better analyse how the short-term markets function and the role of its market participants. The FSB should consider, among others, reforms to the secondary market structure, standardisation of issuances, improving transparency, reviewing regulations that affect market-making, and the creation of a permanent standing repo facility.

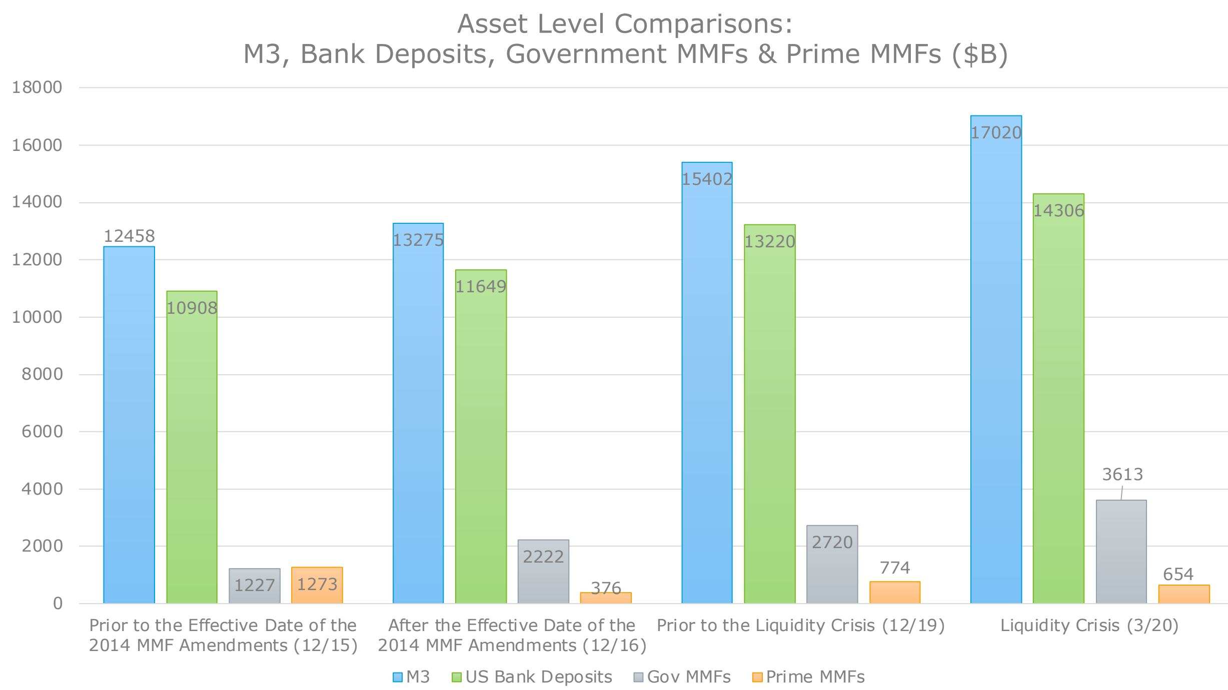
Forms, functions and roles of MMFs

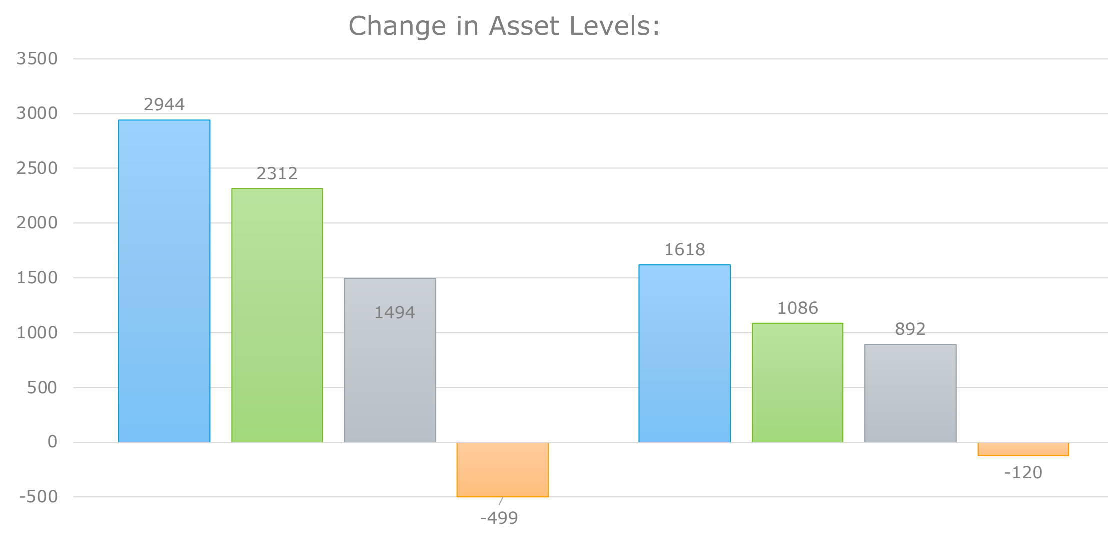
4. **Does the report accurately describe the ways in which MMFs are structured, their functions for investors and borrowers, and their role in short-term funding markets across jurisdictions? Are there other aspects that the report has not considered?**

The FSB Report includes a number of inaccuracies and assumptions which need to be addressed before any recommendations which could critically alter the short-term fund markets are considered.
First, the consultation report does not accurately describe the role MMFs play in short-term funding

markets. The FSB asserts: "*The market was flooded with one-way flows from MMFs and other investors seeking to sell paper and issuers looking to raise cash*". This is neither accurate nor supported by the data. As we explain at Question 1, events in the real world and in other segments of the financial markets occurred before MMFs experienced significant outflows. Moreover, the size of prime MMFs and the impact prime MMFs had in the CP and certificate of deposits ("CD") market during the Liquidity Crisis is greatly exaggerated.

For instance, in the US, as a result of the 2014 Amendments, between 2015 and 2019 US prime MMFs were reduced in size by over $499 billion, leading to a significant shift in funding, away from US businesses and state and local governments, with funds moving to bank deposits and US government MMFs. In 2016, US prime MMF assets were 10.2% of M3, the institutional measure of US money supply. At the beginning of 2020, before the onset of the pandemic, US prime MMFs made up only 5% of the liquidity market.





	Pre-2014 MMF Amendments & Pre-Liquidity Crisis Change in Asset Levels (Dec 15 - Dec 2019)	Liquidity Crisis Change in Asset Leveles (Dec 2019 - Mar 2020
M3	2944	1618
US Bank Deposits	2312	1086
Gov MMF	1494	892
Prime MMF2	-499	-120

Second, the report's position on the CP and CD markets in normal times is simply not correct. As noted in our response to question 1, significant work should be undertaken to improve the functioning of the short-term capital markets, including proposals intended to improve the liquidity of the CP and CD markets in times of extreme stress. The performance, however, of these markets in extreme stress, like those observed in the Liquidity Crisis, does not equate to the CP and CD markets being illiquid "even in normal times." In normal times, these markets are absolutely liquid. Even though MMFs hold most all their assets until maturity (short-term securities which are cash equivalent), in normal times a MMF can, and should, expect to sell its CP and CDs to either the dealer or, in some cases, to the issuer itself. In normal times, activity in secondary CP and CD markets may be low, but low activity does not equate to low levels of liquidity. CP and CDs held in MMFs are high (credit) quality paper and can always be sold in normal conditions without issue. In the Liquidity Crisis, an extreme market event, many issuers and dealers refused to buy CP and CD, in part because of banking regulations which limit the ability of dealers to take securities into inventory. As noted previously, a thorough analysis on how to improve the short-term funding markets, including the impact on banking regulations, should be undertaken to improve market liquidity in times of stress.

Lastly, we do not believe that the report properly considers the impact to markets if MMFs were to be eliminated. Any regulation which either directly or indirectly eliminates the utility of MMFs as a product, will be done at no benefit to the markets, issuers or global investors and (i) shift more assets into riskier, less transparent, unregulated markets, (ii) shift more assets into government / public debt funds at the expense of funding the real economy, or (iii) further concentrate assets in systemically risky banks which do not provide investors with the diversification intended.

5. Does the report accurately describe potential MMF substitutes from the perspective of both investors and borrowers? To what extent do these substitutes differ for public debt and non-public debt MMFs? Are there other issues to consider?

If regulations eliminate MMFs (either directly or indirectly), investors, issuers, and the global short-term markets will be negatively impacted without any corresponding benefits. Investors will be forced to take on less diversified investments, take on more risk, or shift their funds out of prime markets and into government/public debt funds – removing a critical source of funding for the real economy. Retail and small institutional investors would be unable to effectively manage their cash in a professional way, would likely have to revert to placing funds with one or two banks – institutions that have little desire or capacity to absorb short-dated cash deposits as it requires additional capital. Larger investors may be able to take the management of their liquid assets in-house, however the actions of numerous institutional investors, without the benefit of professional asset management, in times of severe market stress would be extremely volatile and potentially increase the liquidity pressure in the system in a less transparent way.

It is clear that the FSB recognizes the risks caused by eliminating MMFs but has not yet fully analysed the potential systemic risks that substitutes may pose. We urge the FSB to analyse the risks associated with any policy options that would have the effect of eliminating MMFs either directly or indirectly before making any recommendations. The report identifies the significant risks associated with the elimination of MMFs, stating: "[…] *reforms that bring significant changes for MMFs could result in the emergence of new substitutes, which is more difficult to predict. Such developments could have important effects on investors and borrowers since they could shift the risks to other parts of the financial system*." The Report does not, however, go any farther and fails to provide any real analysis on the risks. It would be irresponsible to recommend any MMF substitute without fully considering the consequences of such actions.

Most of the reforms being considered have been reviewed and rejected in the past as either inappropriate to fix the issue at hand (liquidity) or so draconian as to eliminate the utility of MMFs to investors. The solution is clear, the link between WLA and the potential imposition of fees and gates should be removed in both US and EU MMF regulations. Moreover, KYC should be enhanced in both the EU and US and in the EU, VNAV MMFs should be required to hold daily and weekly liquidity on par with all other global MMFs.

The FSB seems to assume that, if prime MMFs are eliminated and government / public debt MMFs are retained, investors will simply shift to government / public debt MMFs. This may be the predominant option in certain jurisdictions, or more accurately put in certain currencies, however investors would also increase their exposure to unregulated or less regulated products and in doing so take on increased risk from a lack of diversification and credit quality. As noted above, the risks of any such action are simply not understood, and a net result of "shifting" any perceived risk does not justify the negative implications and risk of removing a proven short-term investment vehicle.

We are concerned that the FSB amalgamates the 2008 and 2020 crises. The 2008 crisis ("Financial Crisis") was a credit crisis. There is much more to the story than events involving the Reserve Primary Fund breaking the buck in September 2008. MMFs were not even close to being the main event of the 2008 Financial Crisis. There were more than 800 MMFs in operation in the US when the 2007-2009 Financial Crisis began. While a few owned Lehman paper when Lehman filed for bankruptcy, only one broke a buck. The March 2020 events were not a credit crisis but a flight-to-liquidity issue. We are concerned the FSB fails to distinguish between systemic *liquidity* events and systemic *credit* events. The data is abundantly clear that the real problem in March 2020 was not MMFs but systemic illiquidity and the seizing up of markets that are essential to financial stability.

Finally, while we do not believe this to be a real alternative today, the FSB Report fails to consider the use of crypto-assets as a MMF substitute in the future. Regulators around the world have observed the rise of a relatively new subset of crypto-assets – the so-called 'stablecoins'. While the crypto-asset market remains modest in size and may not currently pose a threat to financial stability, this may change with the advent of 'global stablecoins', which seek wider adoption by incorporating features aimed at stabilising their value and could become a credible means of exchange and store of value. A development we appreciate the FSB is investigating[10].

Vulnerabilities in MMFs

6. **Does the report appropriately describe the most important MMF vulnerabilities, based on experiences in 2008 and 2020? Are there other vulnerabilities to note in your jurisdiction?**

MMFs did not cause or amplify the crisis, they were one of the last financial products to be impacted in the Liquidity Crisis and were subject to regulatory incentivized artificially high levels of redemptions because of the link between the 30% WLA threshold and the potential imposition of fees and gates. That link is without question the key vulnerability identified in MMFs as a result of the Liquidity Crisis. However, just as important, the vulnerabilities in the short-term fund markets observed in the Liquidity Crisis, impacting the entirety of the global money markets, need to be analysed and addressed to ensure that markets function as efficiently as possible in times of stress.

Furthermore, in Europe, in addition to delinking the 30% WLA threshold and the potential imposition of a fee or gate, we reiterate the upcoming MMFR Review should address the following issues:

1. With a MMF's liquidity delinked from the potential imposition of a liquidity fee or gate we believe that the current regulatory requirements of 10% daily and 30% weekly (subject to increase by the Know Your Customer Rule) are appropriate and should not be increased. These levels are consistent in both the EU and the US but for one type of EU MMF (VNAV MMFs) which are subjected to lower liquidity requirements, which likely contributed to its stress during the Liquidity Crisis. As

[10] See the 13 October 2020 Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements - Final Report and High-Level Recommendations

such, we support increasing the required liquidity levels of EU VNAV MMFs from 7.5% daily and 15% weekly liquidity, to 10% daily and 30% weekly liquidity requirements consistent with other EU MMFs and US VNAV MMFs;

2. MMFs in the EU are also subject to arbitrary restrictions on holding high-quality government securities, which is inconsistent with the economic realities of these securities. We support removing the arbitrary 17.5% restriction on including high-quality government securities as WLA for EU MMFs as, through both the Financial Crisis and Liquidity Crisis, high-quality government securities have proved to be the most liquid; and

3. MMFs in the EU are also restricted on their ability to use repo due to a drafting inconsistency. The global standard should support the inclusion of 5-day repo as eligible WLA. The conflict between Article 15 of the EU MMFR, which limits investments in repo to 2 days, and Article 24 of the MMFR, which specifically sets forth the inclusion of 5-day repo as part of an EU MMF's WLA, should be corrected.

Policy proposals to enhance MMF resilience

7. **Does the report appropriately categorise the main mechanisms to enhance MMF resilience? Are there other possible mechanisms to consider? Should these mechanisms apply to all types of MMFs?**

The key to enhancing MMF resilience is to remove the link between the WLA thresholds and the potential imposition of fees and gates. This will allow MMFs to manage their liquidity as intended and use the required levels of liquidity as liquid assets. The link has effectively converted what should be used as liquidity to a floor, requiring managers to avoid using weekly liquid assets. Removing this link in both the US and EU is critical. Moreover, KYC provisions in each jurisdiction should be enhanced, and in the EU VNAV MMFs should be subject to daily and weekly liquidity requirements on par with the rest of the global MMF industry.

The other policy reforms that the FSB has requested comments on are either unnecessary (not related to liquidity) or inappropriate (would eliminate the utility of MMFs).
We are grateful for the opportunity to develop our assessment of each representative option as well as the variants the FSB suggests.

***Representative Option: swing pricing*:**

We do not agree with the FSB assessment of the potential need to require MMFs to use swing pricing. When the link between liquidity fees and gates is removed, swing pricing is unnecessary.

Swing pricing is not only unnecessary, but it would also eliminate a critical element of MMFs (same-day and intra-day settlement), effectively regulating MMFs out of existence. Regulating MMFs out of existence would be a bad outcome for investors, issuers, and markets and entirely unnecessary given the tools available to MMFs' boards today. First, 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. As a result, the "dash for cash" or credit crisis would not be mitigated – but rather shifted to unregulated and less transparent vehicles. Second, 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.

Any variant where authorities would be mandating macroprudential swing pricing would be even worse and counter to the fundamental principles of fund governance. We agree with the FSB that this variant would present more risks and downsides than any benefits.

Notwithstanding the above, **MMF Boards, however, should have the discretion to implement liquidity fees and gates in its discretion, as t**he board of a MMF is singularly best placed to make a determination on the appropriateness of a fee or gate based on all of the information related to a particular fund, as each fund is subject to its own unique facts and circumstances. Second, with respect to EU MMFs (UCITS), it should be noted that they already have the ability to impose liquidity fees and redemption gates.

Representative Option: minimum balance at risk:

Federated Hermes opposes any redemption restriction that would impair investor liquidity when liquidity is readily available within the MMF, such as minimum balance at risk ("MBR"). Throughout the almost 50 year history of MMFs, investors have benefited from the convenience, liquidity, and stability of these funds. Individual or retail investors use MMFs as savings vehicles to amass money for future investments or purchases; as transaction accounts; and as stable-value investments in their retirement or other investment portfolios. Institutional investors – which include corporations of all sizes, state and local governments, securities lending operations, bank trust departments, sweep programs, securities brokers, and investment managers – use MMFs as a cost-effective way to manage and diversify credit risk, while providing same-day liquidity with market-based yields. An MBR (or a holdback variant of the same basic concept) would eliminate the very liquidity of MMFs that has been central to their widespread use in a variety of applications, including corporate payroll processing, escrow balances, storing corporate and institutional operating cash balances, pension, and employee benefit plan processing, and holding broker-dealer customer cash balances.

An MBR requirement would also limit the utility of MMF shares as collateral. It would lead to ever-higher collateral requirements when MMF shares serve as collateral. Same-day settlement of the entirety of a transaction amount is a crucial feature of MMFs that underpins their widespread use to hold short-term cash balances. Imposition of an MBR or holdback requirement—no matter the amount—for any number of days would destroy the ability of companies and individuals to use MMFs as a liquid investment that can be readily redeployed, on a same-day basis, towards other uses. The net result of an MBR or holdback requirement would be to make MMFs impractical to hold the large, short-term cash balances used in transaction processing systems across a wide variety of businesses and applications. This, in turn, will result in many existing institutional investors choosing not to continue to invest in MMFs if such requirements are imposed.

Furthermore, we note that an MBR would not remove the risk of large-scale redemptions from MMFs, and, if adopted, could even precipitate redemptions. While the FSB Consultation report justifies an MBR on the basis that it could reduce the vulnerability of MMFs to redemptions, it also notes that an MBR also poses several significant implementation and administration challenges that significantly complicate its potential effectiveness.

Representative Option: capital buffer:

A capital buffer would not have the desired effect of reducing redemptions. A capital buffer does not prevent large scale redemptions or stop them once they have begun. Liquidity, available cash to pay investors, is what prevents or resolves large scale redemptions. Capital buffers do not serve a purpose in an investment product such as MMFs where the investor bears the risk of loss of a portion of its investment.

We believe that both the enormous cost and the marginal utility of capital buffers does not come close to justifying the adverse costs to shareholders and financial markets. However, Federated Hermes acknowledges that capital buffers could in theory allow a MMF to incur small trading losses without breaking a dollar and that it is possible that small trading losses could help to avoid later and more significant credit losses. The concept of establishing a capital buffer has been put forward as a means of absorbing portfolio credit losses without a decline in share value. The options for a capital buffer include a slow build-up of capital through retained earnings, purchase of a new subordinated class of equity by the fund manager or sale of subordinated equity to third party investors.

Any of these options would be a departure from the concept of what a mutual fund fundamentally is – a mutually-owned pool of equity owned by shareholders, who share equally in the profits or losses of the fund. In its place, there would be created a two-tiered equity structure, introducing a form of leverage into MMFs for the first time.

Due to the very low yields on money market investments that have persisted over a period of more than a decade and are likely to continue for the foreseeable future, currently there is insufficient portfolio yield to generate returns that could be used to create a meaningful capital buffer through retained earnings. In the current rate environment, a subordinated capital layer would take many years to build up to any significant level through retained earnings, will cause adverse tax consequences to the MMF and its investors, and further reduce yields in an already very low yield environment. If provided by the investment manager, it would be expensive for the manager to provide and would be difficult or impossible to finance.

It is doubtful that third-party investors would be willing to purchase subordinated capital of a MMF under economic terms that would make sense for the main shareholders of the MMF. The subordinated class of investors would expect a yield on their more risky class commensurate with that risk, which would be a further reduction to yields to the other investors.

Adding subordinated debt or equity would also turn a rather simple product—the MMF—into a considerably more complex offering. Also, small funds and small fund managers/sponsors would likely find it difficult and costly to issue and roll over subordinated securities, resulting in industry consolidation and raising a barrier to entrants. Furthermore, the approach potentially would create competing interests between the subordinated and senior investors, such as the subordinated investors' desire to avoid losses and senior investors' desire for the fund to take greater risks to boost fund yields.

The concept of raising capital through subordinated securities raises a number of additional issues that precludes the use of this structure. In all jurisdictions, MMF regulations are designed to preclude use of leverage by registered funds in the form of classes of equity of different seniority and limit the use of leverage in the form of borrowings in order to protect fund investors and limit the systemic impact that the leverage in funds would add to the markets. This proposal would go against that bedrock principle and add leverage to MMFs through creation of subordinated equity classes.

This would increase, not decrease, the potential risk posed by MMFs. Capital buffers would drive most shareholders out of MMFs and into banks or alternative (often unregulated) cash products by making it impractical for shareholders to use the funds for cash management or by taking away the advantages of using MMFs.

The variant of permitting MMF sponsors to provide financial support intended to stabilize a MMF's NAV is not appropriate, and we support applying such prohibition across jurisdictions. Sponsor support is unnecessary as MMFs are 100% capitalised and investors bear the risk. Issues associated with sponsor support include: (i) confusing investors as to the fundamental nature of MMFs as an investment product that has risk and is not guaranteed, (ii) creation of moral hazard if managers of MMFs believe they will be bailed out by their sponsor should an issue arise (could lead to an increase in the credit risk taken or levels of liquidity maintained), and (iii) for bank-sponsored MMFs, the risk of contagion to the affiliated banking organisations. Investors in MMFs should make an investment decision in an MMF based on the credit work of managers, not the ability of a sponsor to bail out a fund. In the US, the President Working Group ("PWG") report notes that "the discretionary nature of sponsor support contributes to uncertainty about who will bear risks in periods of stress, including when there is a run on an MMF".

The variant of liquidity exchange bank (or facility) has been studied in detail and determined to be unfeasible. We do not agree with the suggestion of creating a liquidity exchange facility ("LEF") for MMFs. This proposal is financially untenable. As noted in the PWG Report, a LEF would need significant capital to both be in a position to provide meaningful liquidity for MMFs in stress events and be seen as a credible liquidity backstop. Building adequate capacity from MMF income could take decades, particularly in a low interest rate environment. For instance, a US trade body's 2010 study concluded that a LEF would require an initial equity contribution of $350 million which, assuming 5% leverage, would allow for $7 billion in lending capacity, which could potentially increase to approximately $23 billion over three years. Given current yields and fee waivers in the MMF market, this is simply not feasible.

Representative Option: removal of ties between regulatory thresholds and imposition of fees and gates:

Federated Hermes supports eliminating the requirement for a fund's board to consider imposing redemption gates and liquidity fees if WLA drop below 30% of the fund's total assets. However, Federated Hermes supports a MMF board being permitted, in its discretion and in accordance with its exercise of its fiduciary duty, to impose liquidity fees or redemption gates when doing so is in the best interests of the fund and its shareholders, without reference to any specific level of liquidity. Federated Hermes supports the existing MMF daily and weekly liquid asset threshold requirements of 10% and 30%, respectively. We note that if a fund does not satisfy these requirements at any time, the fund is limited to purchasing assets that would cause the percentage of its liquid assets to increase. These daily and weekly liquidity requirements should continue to be applied to all MMFs, including VNAV MMFs domiciled in the EU.

The link between regulatory thresholds and the imposition of fees and gates served as an accelerant to redemptions and led to artificially high levels of redemptions in the March 2020 Liquidity Crisis. Data show that, in March 2020, the MMFs that experienced the highest redemption pressure were those where a link between the 30% WLA and potential imposition of a fee or gate existed. This linkage was ill-conceived and had the unintended and damaging consequence of artificially increasing redemptions in a period of market stress. As a consequence, MMF managers in the EU as well as the US made sure that WLA levels, which are publicly disclosed, remained comfortably above 30%. The average was well above 40% for many MMFs before March 2020 and generally rose during 2020 as the pandemic unfolded. This means that MMF managers were not only penalised for using their internal liquidity, but they were also unnecessarily constrained in their ability to invest in short-term instruments with a maturity beyond one week because of the linkage between the 30% WLA and potential imposition of fees and gates.

Removing the link between the 30% WLA thresholds and funds' potential imposition of gates and fees would remove one of the major incentives for redemptions that IOSCO[11] and other policymakers observed in March 2020. In addition, delinking would have freed up MMFs so that they could have utilised existing 30% internal liquidity as intended: i.e., an amount of liquidity more than sufficient to cover redemptions experienced by EU MMFs in the Liquidity Crisis. In the US, the Securities and Exchange Commission ("SEC") itself has found (see: October 2020 U.S. Credit Markets Interconnectedness and the Effects of the COVID-19 Economic Shock) that: "staff outreach to market participants indicate that prime fund outflows accelerated as WLA fell close to 30 percent".

[11] IOSCO rightly observed in its November 2020 Thematic Note "Money Market Funds during the March-April Episode", further consideration should be given to the "broader ecosystem and the functioning of the money markets" and "elements of existing regulatory frameworks which may have played a role in accelerating flows out of certain types of money market funds".

Delinking liquidity fees and gates should be a top priority in both the EU and the US, the two most meaningful MMF markets globally. Each of the EU and US MMF regulatory requirements include the linkage of fees and gates with liquidity usage, something that has proven to be an unintended negative consequence of the regulations. We note that the US is considering delinking the 30% WLA thresholds and a fund's potential imposition of gates and fees (see the December 2020 Report of the PWG on Financial Markets "Overview of Recent Events and Potential Reform Options for Money Market Funds" and the US SEC's request for public comments on potential reform measures to improve the resilience of money market funds as highlighted in the PWG's report).

We do not support the artificially constructed "countercyclical" WLA requirements. The variant "countercyclical liquidity buffer" would be entirely unnecessary if MMFs were permitted to use their internal liquidity as intended. Therefore, we reiterate that the priority policy change to make is decoupling the 30% WLA threshold and potential imposition of fees or gates. By removing a major incentive to redeem, such a reform would greatly improve MMF resilience in times of stress. 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.

Additionally, we do not support either imposing investor concentration limits as a variant to the top priority reform of delinking regulatory thresholds and consideration of fees and gates. As the FSB rightly assesses, this variant presents more problems than benefits. We note that investor concentration limits are already addressed by KYC requirements, as a fund that has a concentrated investor base should be holding higher levels of liquidity.

Representative Option: removal of stable NAV:

There is no justification to support eliminating stable (or constant) NAV MMFs for retail investors in the US or eliminating LVNAV MMFs in the EU. There is no evidence that floating NAV MMFs reduced redemptions and in fact the data is clear that redemption pressures existed regardless of MMF structure. Redemption data from March 2020 in the US as well as in the EU shows that variable/floating NAV MMFs experienced increased redemptions on par with LVNAV MMFs in the EU. See for instance, in France where nearly all MMFs are VNAV, redemptions in French MMFs were of similar magnitude[12] to what the sector had experienced during the 2008 Financial Crisis, with €48.6 billion in redemptions between 12 and 30 March 2020. In the US, institutional prime MMFs that were subject to floating NAVs experienced outflows.

A floating NAV requirement for all MMFs would not advance the regulatory goal of reducing or eliminating redemptions from MMFs. The data is clear, a floating NAV does not affect investor behaviour in times of severe stress. Moreover, eliminating LVNAV or Stable NAV for retail investors

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[12] See: Analysis of French money market fund portfolios during the surge in withdrawals recorded at the onset of the COVID-19 crisis, by the Autorité des marchés financiers (AMF).

could significantly impair the utility of MMFs as cash management tools and lead to significant and disruptive disintermediation. Mandating a floating NAV for all MMFs could also force current MMF investors to less regulated and less transparent products such as bank "short-term investment funds" and private "liquidity funds". A floating NAV for MMFs would also accelerate the flow of assets to "Too Big to Fail" banks, further concentrating risk in that sector.

***Representative Option: limits on eligible assets**:*

Federated Hermes does not support adding additional detail and tiers to the existing liquid asset requirements. This would unnecessarily tie the hands of MMF portfolio managers and limit their flexibility in how they structure the maturities of the portfolios to address current market conditions and anticipated client redemptions. It may also artificially reduce the spread between different types of MMFs, thus making some MMFs less attractive to investors, shrinking the MMF industry and increasing the cost of funding to issuers in the prime money markets.

However, as mentioned above, the internal liquidity within MMFs needs to be made usable by delinking the 30% WLA threshold from the consideration of fees and gates. Ensuring that all MMFs have ample internal liquidity - that is, able to be used as intended (removing the linking of the 30% WLA threshold from consideration of fees and gates) would eliminate an unnecessary incentive for redemptions. We fully support the proposal to delink the consideration of imposing gates or fees by the board of a MMF from compliance with portfolio liquidity levels. The linkage has had the unintended consequence of creating a redemption incentive for some shareholders as a MMF approaches the minimum required liquid asset levels.

Imposition of liquidity management tools should remain with an MMF board. The 10% daily and 30% weekly liquidity requirements are minimums, and funds hold higher liquidity based on KYC rules and market conditions. This is evidenced by MMFs holding more than 40% in WLA entering the Liquidity Crisis in the US and EU.

Federated Hermes strongly supports regulations that require MMFs to be subject to daily and weekly liquid asset requirements and the daily disclosure of a MMF's compliance with such requirements, and the requirement that MMFs have a process for anticipating investor redemptions and hold additional liquid assets above and beyond these daily and weekly liquid asset thresholds in order to meet the anticipated outflows. These requirements have worked remarkably well. Moreover, Federated Hermes believes that most of the amendments to MMF regulation adopted in 2014 in the US and in 2017 in the EU also worked well (except for imposing a floating NAV requirement on institutional prime and municipal MMFs and linking mandatory consideration of gates and fees to threshold liquidity levels).

In addition to removing the linkage of the 30% WLA threshold and the potential imposition of fees and gates, there are additional enhancements that will improve MMFs' ability to maintain sufficient liquidity in times of stress in the EU. First, EU LVNAV MMFs should not be subject to restrictions on holding high-quality government securities. Today, the EU MMFR includes an arbitrary

17.5% restriction on counting high-quality government securities as liquid assets. Through both the Financial Crisis and Liquidity Crisis, high-quality government securities have proved to be the most liquid. This restriction should be removed. Second, EU MMFs should be permitted to count investments in 5-day repo as part of the WLA. A drafting inconsistency in the EU MMFR currently prohibits this and it is contrary to the global position of being able to include 5-day repo as part of WLA. While the definition of what constitutes a WLA for EU MMFs specifically references 5-day repo, an earlier provision in the EU MMFR (See Article 15) limits repo to 2 days and effectively negates a fund's ability to include 5-day repo in its WLA. Third, we believe the 10% daily and 30% WLA requirements should be applied to EU VNAV MMFs, as the Liquidity Crisis did not discriminate based on MMF structure and we do not believe an appropriate justification exists that warrants lower liquidity requirements for EU VNAV MMFs. This would provide uniformity on required levels of liquidity across EU and US MMFs.

We do not support the variant that would require MMFs to hold public debt instruments only. The key for all MMFs is that they maintain appropriate levels of liquidity at all times, and that such liquidity is able to be used when needed. Whether that liquidity is made up of high-quality government securities or other high-quality securities redeemable within a day or a week should be left to the determination of the fund manager. As noted above, in the EU, the arbitrary limitations on a fund's ability to consider high-quality government securities as liquid assets should be removed.

We also oppose the idea of setting each MMF's required liquidity buffer based on the MMF's own characteristics, such as its investor base (MMFs sold to institutional investors might be subject to higher liquidity requirements). This variant is a "one size fits all" solution. Beyond the administrative complexity that the FSB underlines, this variant supposes that all investors belonging to a group defined by regulation (e.g., institutional investors) behave in the same way whereas they do not in practice. We reiterate this is already captured by the KYC rule and should be left with the manager to assess and determine subject to board oversight. However, as noted in our response to questions 1 and 7, KYC frameworks should be improved in both the US and EU to ensure that a MMF manager has transparency into its investor base.

Representative Option: additional liquidity requirements and escalation procedures:

As already indicated, Federated Hermes opposes adding additional detail and tiers to the existing liquid asset requirements (such as adding a biweekly liquid asset requirement). This would, as a practical matter, simply result in an increase in the WLA holdings of MMFs and would unnecessarily tie the hands of MMF portfolio managers and limit their flexibility in how they structure the maturities of the portfolios to address current market conditions and anticipated client redemptions.

We reiterate that we strongly support that MMFs are subject to daily and weekly liquid asset requirements and the daily disclosure of a MMF's compliance with such requirements, and the requirement that MMFs have a process for anticipating investor redemptions and hold additional liquid assets above and beyond these daily and weekly liquid asset thresholds in order to meet the anticipated outflows. These requirements have worked remarkably well, as documented above.

We caution against "escalation procedures" if they combine mandatory liquidity fees, swing pricing, and tools with the effect of limiting the daily liquidity, for the many reasons explained above. However, we support requiring funds to have internal liquidity escalation procedures designed to ensure the board is fully apprised of the status of the liquidity in the funds and the basis for any movements in liquidity, so that they are in a position to fully discharge their fiduciary duty in the best interest of the funds and can determine which, if any, liquidity tools are appropriate.

8. **Does the assessment framework cover all relevant aspects of the impact of MMF policy reforms on fund investors, managers/sponsors, and underlying markets? Are there other aspects to consider?**

Investors have been using MMFs for decades because of the economic function they fulfil and the benefits they offer. Ineffective regulations could increase bank deposits or direct access to short-term funding markets to replace MMF, but it would be a policy failure and would increase risk not only to investors, but to markets generally. Moreover, the impact on investors, managers, and markets of one or several of the policy options impacting MMFs being adopted has not been adequately studied.

9. **Are the representative policy options appropriate and sufficient to address MMF vulnerabilities? Which of these options (if any) have broad applicability across jurisdictions? Which of these options are most appropriate for public debt and non-public debt MMFs? Are there other policy options that should be included as representative options (in addition to or instead of the current ones)?**

No, with the sole exception of delinking regulatory thresholds and potential imposition of fees and gates, the suggested policy options are not appropriate. See our detailed explanations at Questions 1 and 7 in particular.

In other terms, only the option of removal of ties is appropriate to address the artificially high levels of redemptions that MMFs experienced in March 2020. However, this option is not sufficient. To address the "challenges in selling assets, particularly under stressed conditions", the FSB must initiate another policy priority: addressing the vulnerabilities in the short-term funding markets.

10. **Does the summary assessment of each representative option adequately highlight the main resilience benefits, impact on MMFs and the overall financial system, and operational considerations? Are there any other (e.g., jurisdiction-specific) factors that could determine the effectiveness of these options?**

As stated in response to Question 5, there is no assessment of the systemic risks that MMF substitutes may pose. We are concerned there is an assumption that regulating some, if not all, MMFs out of existence would address any perceived or inappropriately assigned vulnerabilities. This might be due to the false narrative that MMFs are not regulated and have amplified the stress on STFMs. We caution against moving forward with policy options that could move investors to other, less regulated, less transparent solutions without first assessing thoroughly whether and how these substitutes would be more or less susceptible to vulnerabilities than MMFs. We also oppose any regulatory framework that would be designed with the wrong starting point in mind: central banks should never have to intervene on STFMs.

11. Is the description of variants and the comparison of their main similarities/differences vis-à-vis the representative options appropriate? Are there other variants to consider?

We do not see the need for any extensions or variants, provided the right, relevant, and appropriate policy options are considered and adopted. See our response to Question 7 in which we have assessed each of the extensions and variants the FSB report suggests in regard of the relevant representative options.

We reiterate again that the FSB should put forward two major representative options - removal of ties between regulatory thresholds and imposition of fees and gates; and addressing vulnerabilities in the short-term funding market structure and functioning – at the global level and a set of more minor options for some jurisdictions, e.g., the EU.

12. Are measures to enhance risk identification and monitoring by authorities and market participants appropriate complements to MMF policies? Which of these measures are likely to be most effective and why? Are there other measures to consider?

In all jurisdictions, MMFs are the most transparent investment product and are subject to not only increased stress testing and regulatory reporting, but also enhanced transparency requirements to ensure that investors have access to key information on the MMF holdings.

We do not see any need to amend the requirements on stress tests included in regulations in jurisdictions around the world. Obviously, the March 2020 episode has been a real-life test of an unprecedented magnitude for MMFs and other market segments. Some commenters dubbed the effects of the pandemic and related shutdowns on capital markets as the "mother of all stress tests". If we look at this real stress test from the policy perspective, the question is: which MMFs did not pass the test? Simply put, none. All MMFs have passed the March 2020 stress test. MMFs demonstrated their resilience in March-April 2020 despite severe stress and large outflows.

We do not agree with the FSB's assessment on the potential need to require MMFs to provide additional MMF reporting to authorities. As already stated, MMFs are one of the most transparent investment products in jurisdictions around the world (see IOSCO surveys[13]) and are subject to extensive

[13] September 2015 Peer Review of Regulation of Money Market Funds: Final Report and November 2020 Thematic Note: Money Market Funds during the March-April Episode

reporting requirements. We believe the current frequency is appropriate in normal times. When markets are stressed like they were in March 2020, securities market regulators have the power and legitimacy to require any additional reporting they need. We are not aware of any regulators who did not obtain any additional information requested during the Liquidity Crisis. Furthermore, we do not see a minimum level of harmonisation of reporting requirements across jurisdictions as a policy priority. While we understand the FSB's desire to foster comparability of MMFs, we remind that "*MMFs are not homogeneous and as such demonstrate a range of characteristics dependent on their structure, which is reflected in the regulatory approach adopted by different jurisdictions*[14]."

We agree with the FSB that "*lack of granular data on (particularly) CP and CD markets makes it difficult to monitor market conditions and assess the ability of those markets to absorb different volumes of sales*." We also agree that STFM participants (other than MMFs which are already subject to such a reporting) should be required to report data on primary markets (e.g., volume and yield at issuance, and outstanding amount by type of issuer, rating, and maturity), secondary markets (volumes and prices), dealer inventories and holdings by investor type. However, we do believe such reforms must be part of a more comprehensive and ambitious policy workstream to resolve the STFM structure and functioning.

Considerations in selecting policies

13. Are the key considerations in the selection of policies to enhance MMF resilience appropriate? Are there other considerations that should be mentioned?

We reiterate again that the FSB should put forward two major representative options - removal of ties between regulatory thresholds and imposition of fees and gates; and addressing vulnerabilities in the short-term funding market structure and functioning.

14. Which options complement each other well and could potentially be combined? What are the most appropriate combinations to address MMF vulnerabilities in your jurisdiction? Which combinations are most effective for different MMF types and their functions?

We disagree that the removal of ties between regulatory liquidity thresholds and the potential imposition of fees and gates would be appropriate to combine with the other MMF policy options the FSB puts forward in its report. As the evidence suggests that the ties between regulatory liquidity thresholds and the potential imposition of fees and gates may have created adverse incentives, eliminating those ties will reduce the likelihood of pre-emptive runs on MMFs. We also agree that this option would have broad applicability in many jurisdictions.

Therefore, we suggest the sole appropriate combination of policy options is:
1. **Delinking** the 30% WLA threshold and the potential imposition of a fee or gate;

[14] See IOSCO November 2020 Thematic Note: Money Market Funds during the March-April Episode.

2. **Addressing the vulnerability in the short-term markets**, which impacted the functioning of the entire money markets, by conducting a broad and thorough review which addresses the root causes of the pressures experienced in the short-term markets during the Liquidity Crisis; and
3. In some jurisdictions, in combination with delinking the 30% WLA threshold and the potential imposition of a fee or gate, addressing some more minor issues at the regional/domestic level.

15. To what extent should authorities seek to align MMF reforms across jurisdictions? Is there a minimum set of policies or level of MMF resilience that should be considered at the international level to avoid fragmentation and regulatory arbitrage?

The two top priority policy options we suggest (delinking the liquidity threshold and the potential imposition of a fee or gate and addressing the vulnerability in the short-term markets) should be initiated, adopted, and implemented across jurisdictions.

Other proposals regarding the EU – increasing daily/weekly liquidity requirements for EU VNAV, eliminating EU arbitrary restrictions on using government securities and repos as weekly liquid assets - would be consistent with global standards.

We agree with the FSB that it will be important for jurisdictions to consider the issues in their domestic MMFs as well as cross-border linkages with flexibility.

Short-term funding markets (STFMs)

16. Does the report accurately describe problems in the structure and functioning of STFMs and how these have interacted with MMFs in stress periods?

First, the assertion that MMFs somehow caused or amplified the stress in the STFMs is simply incorrect and does not follow the data. As noted in our response to Question 1, the turmoil in the CP 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. In its interim report[15] "Lessons Learnt from the COVID-19 Pandemic from a Financial Stability Perspective", the FSB wrongly asserts that "[T]*he actions of certain investors may have contributed to the amplification of liquidity imbalances and their propagation through the financial system. MMFs are susceptible to sudden and disruptive redemptions, and they may face challenges in selling assets particularly under stressed conditions, as was evident in March 2020. These features can lead to a first-mover advantage for redeeming investors in a stress event and thus make MMFs susceptible to runs that may contribute to stress in short-term funding markets*." This does not follow the data from March 2020 events. MMFs play a major role in the short-term financing of the economy. They were significantly affected by the March-April 2020 crisis and yet were still able to meet

[15] See: https://www.fsb.org/wp-content/uploads/P130721.pdf

all the redemptions, even though the underlying commercial paper market was frozen and even though they faced artificially high levels of redemptions caused by a regulatory incentive to redeem. If MMFs were able to use the 30% liquidity within the funds it is very possible that no market action would have been required.

Second, we fully support improving the functioning of the STFMs. The FSB should convene a working group of private market stakeholders to arrive at a model that provides greater transparency and liquidity in periods of market stress. This could include:

- Expansion and coordination of electronic trading platforms such as Boom and Tradeweb;
- Central repository of credit information on all issuers for participants to review and use; and
- Allowing for buyers and sellers to directly interact, not just through brokered transactions.

Central banks should encourage banks to make markets in all bank CP, not just their own issues.
A platform (like REPO in the US) that allows investors, issuers, and dealers to view bids and offers of all market participants would improve the functioning and liquidity in the STFMs, particularly in stressed conditions.

Third, consider the creation of a permanent standing repo facility that would be a market-based solution (market risk would stay in the MMF) to support smoother functioning in short-term funding markets.

Thus, we reiterate our position that policymakers must improve the STFM structure and functioning in the major jurisdictions, particularly in times of stress. This is the top priority just after delinking the regulatory thresholds and the potential imposition of fees and gates. We believe that STFMs that do not freeze in times of stress would greatly improve financial stability. See more detail in our response to Question 17.

We reiterate, however, that these proposals do not mean CP and CDs are illiquid in normal times.

17. What other measures should be considered to enhance the overall resilience of STFMs? How would those measures interact with MMF policy reforms and how effective are they likely to be in preserving market functioning in stress times?

"***A reform targeting solely MMFs, which does attempt to remedy the gaps in the CP market, would not address the real problem***. *[...]* ***The lack of a market-maker of last-resort makes this market very vulnerable to liquidity crises***" rightly observes the French Autorité des marchés financiers (AMF) in its 2021 Markets and Risk Outlook[16]. The way in which short-term finance markets operate (STFMs fall under the supervision of central banks in Europe) remains very opaque and characterised by an almost non-existent secondary market.

We recommend, as a top priority, enhancing the resiliency of short-term funding markets by initiating a workstream that should include:

[16] See: https://www.amf-france.org/sites/default/files/private/2021-07/2021-markets-and-risk-outlook.pdf

- **Considering reforms to the secondary market structure for CP**: this market is fragmented and the example of non-financial corporate CP where trading is electronic could be replicated by offering a valuable expansion of electronic venues to enable investors, issuers and broker/dealers to all view and post bids and offers (all-to-all platform). Broadening participation and capital allocation would be beneficial. For instance, EU institutions could consider standardisation in the CP market;
- Working with investors, issuers, broker/dealers, and venue providers to arrive at a model that provides **greater transparency** and thus liquidity in periods of market stress. For instance, a central repository of credit information on all issuers for participants to review and use;
- **Reviewing regulations indirectly affecting market-making during liquidity events**. We suggest that international policymakers give consideration to studying how new bank regulations reduced market-making in March 2020 and evaluate means of reducing these constraints during a liquidity crisis; and
- Like the Federal Reserve[17] in the US, **considering the creation of a permanent standing repo facility that would be a market-based solution** (market risk would stay in the MMF) **to support smoother functioning in short-term funding markets**. This underlines the need for a standing facility rather than an emergency mechanism.

Additional considerations

18. Are there any other issues that should be considered to enhance MMF resilience?

Yes, in the EU, in addition to delinking the 30% WLA threshold and the potential imposition of a fee or gate as well as addressing the STFM structure issues, **the upcoming review[18] of MMF regulation should address the following issues**:

1. With a MMF's liquidity delinked from the potential imposition of a liquidity fee or gate we believe that the current regulatory requirements of 10% daily and 30% weekly liquidity (subject to increase by the KYC Rule) are appropriate and should not be increased. These levels are consistent in both the EU and the US but for one type of EU MMF (VNAV MMFs) which are subjected to lower liquidity requirements, which likely contributed to its stress during the Liquidity Crisis. As such, we support increasing the required liquidity levels of EU VNAV MMFs from 7.5% daily and 15% weekly liquidity, to 10% daily and 30% weekly liquidity, consistent with other EU MMFs and US VNAV MMFs;

[17] See Minutes of the Federal Open Market Committee meeting on 27-28 April 2021 and Minutes of the Federal Open Market Committee meeting on 15 June 2021

[18] Potential reforms of the EU MMF regulatory framework that could be envisaged, in particular in the context of Article 46 of the MMF Regulation, which provides that "[b]y 21 July 2022, the Commission shall review the adequacy of this Regulation from a prudential and economic point of view, following consultations with ESMA and in light of the lessons learnt from the difficulties faced by MMFs during the COVID-19 crisis in March 2020.

2. MMFs in the EU are also subject to arbitrary restrictions on holding high-quality government securities, which is inconsistent with the economic realities of these securities. We support removing the arbitrary 17.5% restriction on including high-quality government securities as WLA for EU MMFs as, through both the Financial Crisis and Liquidity Crisis, high-quality government securities have proved to be the most liquid; and

3. MMFs in the EU are also restricted on their ability to use repo due to a drafting inconsistency. The global standard should support the inclusion of 5-day repo as eligible WLA. The conflict between Article 15 of the EU MMFR, which limits investments in repo to 2 days, and Article 24 of the MMFR, which specifically sets forth the inclusion of 5-day repo as part of an EU MMF's WLA, should be corrected.

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

Sincerely,

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