

April 18, 2023

The Honorable Gary Gensler, Chair
United States Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Chair Gensler:

Re: Supplemental Comment Letter of Federated Hermes, Inc. on the Proposed Amendment to Rule 2a-7 Requiring the Use of Swing Pricing in Institutional Prime and Tax-Exempt Money Market Funds (SEC File No. S7-22-21)

In light of the current banking crisis, we are writing to reiterate our concerns regarding the SEC's proposed rulemaking on money market funds ("MMFs"). The current crisis provides an essential lens through which to assess both the 2014 and current proposed amendments to Rule 2a-7, the extent of MMF impact on systemic risk, and the evolution of the Fed crisis management tools that are relevant to addressing the Fed's historic MMF concerns. We believe that the current circumstances warrant a pause in considering further MMF reform and a re-examination of the unintended consequences of prior MMF reform efforts.

EXECUTIVE SUMMARY

- **Institutional Prime and Tax Exempt MMFs are safer than uninsured bank deposits. They are more diversified, invest only in short-term instruments that present minimal credit risk and perform comparatively little maturity transformation (with a weighted-average asset maturity typically in the 30 – 45 day range).**
- **Institutional Prime and Tax Exempt MMFs have less systemic risk than equivalent bank deposits and they have not cost the taxpayer one penny, in sharp contrast to banks.**
- **The Proposed MMF Rule will increase systemic risk by driving institutions into less regulated vehicles (or securities subject to fire sales) or bank deposits (likely uninsured).**
- **MMFs are inconvenient for the Fed because they believe such investments disintermediate banks and raise their cost of capital. The short-term capital markets, including MMFs, have twice needed liquidity assistance during unprecedented market crises, as have many other market entities. The Fed, however, prefers having everything tightly regulated so it can remain on autopilot and not have to exercise its lender of last resort obligations.**
- **History demonstrates that FSOC and the Fed are poor judges of the materiality and necessary action in response to actual or perceived systemic risks. If FSOC and the Fed had turned off the autopilot and paid as much attention to the immense build-up of systemic risk in the banking system (from subprime mortgages or the current rate-hiking cycle) as it has to regulating**

MMFs, then the true economic damage to the country from recent crises would have been far less.

- **The accumulated evidence on the effectiveness of the Fed Discount Window as a tool for combating liquidity crises, and the success of Fed efforts in destigmatizing its use, now demonstrate that it can be used in lieu of many emergency lending programs, such as the MMLF. This will substantially relieve the Fed of the felt obligation to employ targeted emergency facilities to segments of the capital markets in a liquidity crisis; and allow the Fed to roll many of these operations up under a single standing facility, the Discount Window, that the Federal Reserve Act of 1913 originally intended for this purpose. Federated Hermes has provided a second supplemental comment letter and an accompanying paper to substantiate this assertion.¹**
- **The SEC should pause or withdraw its proposed reforms to Rule 2a-7 and re-examine the 2014 amendments to remove the acknowledged flaw that contributed to institutional MMF liquidity challenges in March 2020. Moreover, we recommend that the SEC Chair, within his FSOC participation for promoting financial stability, consider how some banks would be better served by moving uninsured institutional depositor cash into MMFs.**

I. MMFs Are Safer Than Uninsured Bank Deposits And Have Less Systemic Risk

Most involved in the current banking crisis, from the Federal Reserve and FDIC to the corporate customers of the banks caught up in the maelstrom, as well as the public, have learned an important lesson: more large corporate deposits above FDIC insurance limits should probably have been swept off bank balance sheets into MMFs. MMFs can only invest in high-quality securities which present minimal credit risk, are subject to strict diversification requirements, typically have a 30 – 45 day average asset maturity; and have had an average 8 – 15 day average maturity during the current Fed hiking cycle. It is noteworthy that MMFs have weathered this storm without notice, while confidence in the banking system had to be preserved through the extraordinary measure of federal guarantees of all uninsured bank deposits of failing banks.

A further comparison of institutional prime MMFs to uninsured bank deposits is instructive. Subsequent to the 2014 reforms, these funds have a floating NAV. Bank deposits have a fixed dollar value and are typically invested in a range of instruments, from zero risk (e.g., reserves held at the Fed), to longer dated governments, to loans, etc. The average maturity transformation is dramatically longer than for MMFs. The securities portfolio is divided into the “Held to Maturity” portfolio and the “Available for Sale” portfolio. The Held to Maturity book is the equivalent of the amortized cost accounting method that the SEC disallowed for prime funds in the 2014 reforms.

The theory of why this banking structure is viable is that the banks hold loss absorbing capital and have access to the Fed discount window. However recent events appear to have challenged this thinking. In her March 16th testimony before the Senate Finance Committee, Secretary Yellen stated:

¹ See Federated Hermes, Inc. Supplemental Comment Letter II, dated April 18, 2023, and the accompanying paper, Granito, Michal R., *Liquidity Crises and the Fed: The Need for Standing Facilities as a First Line of Defense Against Market Liquidity Events* (Apr. 1, 2023). Both available from Federated Hermes, Inc.

No matter how strong capital and liquidity supervision are, if a bank has an overwhelming run that's spurred by social media or whatever so that it's seeing deposits flee at that pace, a bank can be put in danger of failing.²

Today, if bank balance sheets were measured on a full mark-to-market basis, as prime funds are, many banks would be undercapitalized or insolvent.³ It is therefore arguable that today's banking model, with uninsured deposits, is only viable if there is poor transparency into the true market value of bank assets. As current events force a spotlight into these shadows, bank runs may become more common, with the only stable endpoint being full deposit insurance.⁴ The modern world may have overtaken our century-old banking model.

II. The Proposed MMF Rule Will Increase Systemic Risk

The prevalence of large volumes of uninsured deposits demonstrates investor preference for a fixed NAV. The proposed rule to require intermediaries to be able to transact at 4-digit NAV for all MMFs, including Government MMFs, will likely drive many investors into other vehicles, including bank deposits, many of which will be uninsured. This of course will increase systemic risk: recent steps to protect uninsured depositors have vastly expanded the federal safety net, amplified moral hazard, and made many more banks “too big to fail.” On a bipartisan basis, Congress is rightly focused on how banking regulation and supervision so badly failed the country. Conclusions will inevitably be drawn that a far more cautious management of uninsured depositor cash, and certainly “surge deposits” resulting from Quantitative Easing (QE),⁵ is required.

² Sarah Ewall-Wice and Melissa Quin, *Treasury Secretary Janet Yellen tells Senate panel nation's "banking system is sound" after Silicon Valley Bank Collapse*, CBS NEWS (Mar. 16, 2023, 1:06 PM), <https://www.cbsnews.com/news/janet-yellen-congressional-testimony-today-banking-system-remains-sound-silicon-valley-bank-signature-bank-collapse/>.

³ On March 14th, 2023, Moody's Investor Services revised its outlook on the US banking industry from stable to negative:

... Moody's said that while the three banks [SVB, Silvergate and Signature] were unique in their focus on cryptocurrency and venture capital or private equity, areas of non-bank finance that grew quickly during the era of easy monetary policy, “it is increasingly evident that other US banks are also facing ALM strains”.

Lenders with substantial unrealised securities losses and “with non-retail and uninsured US depositors may still be more sensitive to depositor competition or ultimate flight, with adverse effects on funding, liquidity, earnings and capital”, Moody's said.

Massoud A. Derhally, *Moody's warns of risks to US banks and lowers outlook of financial system to negative*, NATIONAL (Mar. 15, 2023), <https://www.thenationalnews.com/business/banking/2023/03/15/moodys-warns-of-risks-to-us-banks-and-lowers-outlook-of-financial-system-to-negative/#:~:text=Rating%20agency%20projects%20the%20US,the%20latter%20part%20of%202023&text=The%20US%20banking%20system%20faces,Moody's%20Investors%20Service%20has%20warned.>

⁴ In a painful irony for the Fed and FDIC, the largest “shadow banking” system, may be the Federal Reserve System itself.

⁵ Today, “surge deposits” particularly means the rapid accumulation of deposits in the banking system post March 2020 that resulted from large-scale QE (primarily), the distribution of federal stimulus spending and draw-downs on credit lines. This deposit accumulation coincided with low market interest rates, very low rates paid to depositors and an imprudent investment into longer dated fixed rate securities (reaching for yield) by many banks.

Federated Hermes, Inc. (FHI) has argued in other comment letters that MMFs reduce systemic risk for these very reasons.⁶ MMFs attract rate-sensitive deposits out of the banking system into vehicles with dramatically less maturity transformation and minimal credit risk that are managed to meet uncertain redemptions. However, these arguments were not accepted by regulators prior to today's teaching moment.

Given these developments, it is clear that the SEC should table their current MMF rule proposal which could further hobble MMFs. MMFs should be viewed in this context as a part of the solution – particularly to avoid overreliance on uninsured bank deposits to hold corporate cash and fund bank balance sheets. Further, we believe that the SEC should examine the 2014 reforms to determine the extent to which they may have contributed to the current crisis. For instance, many intermediary sweep systems that previously used institutional prime funds have switched to deposit products.

III. What Systemic Risk Do Institutional Prime and Tax Exempt MMFs Actually Represent?

While MMFs materially reduce systemic risk overall, history illustrates a minimal degree of risk in some funds during market-wide catastrophic events. The central question is: what are the benefits of institutional prime and tax-exempt MMFs versus the actual – not sensationalized – risk that these funds present? Here the current banking crisis again provides a useful perspective.

Through massive QE, followed by a rapid rate-hiking cycle paired with quantitative tightening, the Fed has created one of the largest accumulations of systemic risk in history. The banking system became flooded with deposits, a large portion being uninsured. When interest rates began to rise, depositors began moving funds to higher yielding vehicles, or in the case of Silicon Valley Bank, deposits were withdrawn to meet operating expenses. Poorly supervised banks with less liquid or underwater assets had a problem; and not just any problem – the quintessential bank run paradigm that every banking examiner knows or should know. In evaluating the scale and scope, apparently Janet Yellen believed the risks were potentially comparable in magnitude in the current crisis to the buildup of sub-prime mortgage risk leading to the 2008 financial crisis.⁷ Janet Yellen commented on March 21st:

First, we worked with the Federal Reserve and FDIC to protect **all** [emphasis added] depositors in the resolutions of Silicon Valley Bank and Signature Bank. ... Our intervention was necessary to protect the broader U.S. banking system.⁸

By contrast, the challenges for prime MMFs during the 2008 and 2020 market turmoil arose after the crises had been underway for a prolonged period. Their underlying structure of minimal credit risk, diversification, and modest maturity transformation (30-45 days vs. 8 years or more for many banks) enabled them to withstand the enormous pressures to which other institutions, particularly in 2008, had

⁶ Federated Hermes Comment Letters I (at pp 19, 86) and II (at pp. 31-32) each dated April 11, 2022, <https://www.sec.gov/comments/s7-22-21/s72221-20123456-279701.pdf>; <https://www.sec.gov/comments/s7-22-21/s72221-20123730-279989.pdf>; Federated Hermes Comment Letter dated Oct. 31, 2022, <https://www.sec.gov/comments/s7-22-21/s72221-20149092-316280.pdf>.

⁷ Both crises emanated from the banking sector; both resulted from underwater assets. Both suffered from a lack of transparency in what institutions were impacted and to what extent. Both experienced panic and contagion. In 2023, the Fed acted more quickly than in 2008 to prevent what would likely have been a broad devastating run on the banking system.

⁸ Remarks by Secretary of the Treasury Janet L. Yellen at the American Bankers Association's Washington DC Summit (Mar. 21, 2023), available at <https://home.treasury.gov/news/press-releases/jy1354>.

already succumbed. In 2008, after the Lehman bankruptcy, Secretary Paulson determined amid the chaos of many other events, that the fastest way to preempt any MMF contagion was to guarantee all of them, including government funds, an action which many in the industry opposed. But prime and, inexplicably, tax-exempt MMFs were then targeted by banking regulators, despite containing far less systemic risk than the banking industry overall. It should be noted that none of the government or Federal Reserve actions in 2008 with respect to MMFs cost the US taxpayers anything and in fact, in aggregate, the 2008 and 2020 Treasury and Fed facilities earned approximately \$1.93 billion.⁹

In 2020, after the crisis had been raging in other markets for at least a month due to the exogenous shock of the pandemic-related government lockdowns, the money markets froze. No institutions – primary issuers, broker/dealers, MMFs, or other market participants could transact in any but the smallest increments in the secondary or primary markets. (It should be noted that MMFs couldn’t even access their most liquid assets representing 30% of their portfolio because of the unforced error of linking weekly liquid assets with mandatory board consideration of fees and gates in the 2014 amendments to Rule 2a-7.) After an embarrassing and unnecessary lag, the Fed stepped in with eight emergency lending facilities under Section 13(3) of the Federal Reserve Act. Here again, the challenge to MMFs was not a structural vulnerability, but an entire market failure unrelated to MMFs and a regulatory mistake. Nonetheless, institutional prime MMFs were again targeted, but not the other seven recipients of Section 13(3) programs.

Prime and tax-exempt money market funds have been among the most successful financial products in history, providing investors with over \$200 billion in returns in excess of bank deposit rates since 1990 while significantly lowering borrowing costs for corporations and municipalities.¹⁰ Just two MMFs have ever “broken the buck,” with zero cost to taxpayers, and investors recovering over 96% percent of their principal in one case and over 99% of their principal in the other.¹¹ Today, MMFs must conduct and report regular stress tests that, in many respects, are more stringent than Fed requirements for banks with less than \$250 billion in assets.¹² Over this same period, over 3,600 federally insured depositories have failed

⁹ The 2008 Treasury MMF Guarantee Program incurred no losses and earned approximately \$1.2 billion in fees. See Ezekiel Vergara, *United States: Temporary Guarantee Program for Money Market Funds*, 4 J. Fin. Crises 652 (2022), available at <https://elischolar.library.yale.edu/cgi/viewcontent.cgi?article=1319&context=journal-of-financial-crises>. The 2008 AMLF Program earned approximately \$543 million in net interest for the Fed. See Office of the Inspector General, *The Federal Reserve’s Section 13(3) Lending Facilities to Support Overall Market Liquidity: Function, Status, and Risk Management* 66 (Nov. 2020), available at https://oig.federalreserve.gov/reports/FRS_Lending_Facilities_Report_final-11-23-10_web.pdf. The 2020 MMLF incurred no losses for the Fed and generated approximately \$187 million in interest and fees. See Federal Reserve, *Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act* (May 10, 2021), available at <https://www.federalreserve.gov/publications/files/pdcf-mmlf-cpff-pmccf-smccf-talf-mlf-ppplf-msnlf-mself-msplf-nonlf-noelf-05-10-21.pdf#page=3>; see also Federated Hermes Comment Letter in SEC comment docket No S7-01-21 on President’s Working Group Report on MMFs at 17 (Apr. 12, 2021), available at <https://www.sec.gov/comments/s7-01-21/s70121-8662821-235311.pdf> (citing [Federal Reserve January 9, 2021, financial statements on profitability of MMLF and CP Funding Facilities](#)); Martha L. Cochran, David F. Freeman & Helen Mayer Clark, *Money Market Fund Reform: SEC Rulemaking in the FSOC Era*, 2015 COLUM. BUS. L. REV. 861, 903-905.

¹⁰ See Federated Hermes Comment Letter in SEC comment docket No S7-01-21 on President’s Working Group Report on MMFs at 3-4 (Apr. 12, 2021), available at <https://www.sec.gov/comments/s7-01-21/s70121-8662821-235311.pdf>.

¹¹ One of these failures was due to the fund owning ineligible securities. See Martha L. Cochran, David F. Freeman & Helen Mayer Clark, *Money Market Fund Reform: SEC Rulemaking in the FSOC Era*, 2015 COLUM. BUS. L. REV. 861, 884-885.

¹² For example, Federated Hermes Prime Obligations Fund’s 2-28-2023 stress test measured the immediate combined effect of: (i) 40% redemptions; (ii) a 75 basis point rise in interest rates; (iii) a 50 basis point widening in

costing taxpayers over \$200 billion.¹³ Bailing out just a few smaller banks in the current crisis has already cost the US \$23 billion.¹⁴ This should provide some helpful perspective for the SEC in evaluating the actual extent of prime and tax-exempt MMF risk.

IV. FSOC and Fed Pressure on the SEC Now Looks Misplaced After Distracting the Commission from Its Statutory Mission

Although the Commission justifies the proposal for institutional prime and tax-exempt MMFs on the basis of investor protection, there is little or no evidence that investors have suffered any harm that the proposed amendments purport to address.¹⁵ However, there are material adverse effects and costs associated with implementing these amendments. The combined effect of swing pricing, to which investors will be highly averse, and costly implementation will undoubtedly hasten the further demise of these fund vehicles.¹⁶

The 2014 Rule 2a-7 amendments have already caused a dramatic decline in the utility of these funds, increasing the cost of borrowing for issuers and reducing the returns to shareholders. This outcome is contrary to the SEC's statutory mission of capital formation, market efficiency, and competition. The 2014 amendments had the effect of disrupting the short-term markets, by taking \$1 trillion out of prime funds and increasing both government MMFs and uninsured bank deposits – thus causing the banking sector to grow at the expense of MMFs. The newly proposed amendments will only double down on this departure from the SEC's core mission.

Apart from preventing a theoretical harm not seen in practice, a strong motivation for the proposed rule appears to be to appease banking regulators. In fact, the SEC has often been pressured by FSOC and the Fed to amend Rule 2a-7. We caution against obliging the false narrative put forth by FSOC. For instance, we refer to such statements as FSOC's press release following its February 4, 2022, meeting:

... significant outflows from MMFs during the early stages of the COVID-19 pandemic destabilized short-term funding markets [emphasis added]. As in 2008, taxpayer-backed government intervention was necessary to support MMFs and short-term funding markets more broadly and to restore market functioning. These events underscored that MMFs have structural vulnerabilities that can create or transmit stress to short-term funding markets. ...

... The SEC recently proposed reforms that would increase the minimum liquidity requirements for MMFs, require some MMFs to adopt swing pricing, and remove MMFs' ability to impose liquidity fees and redemption gates when funds fall below certain

bank commercial paper; and a 50 basis point widening of spreads on floating rate paper. We are aware that Congress is considering reducing the threshold for mandatory annual bank stress testing from \$250 billion in assets. State chartered banks can have additional requirements.

¹³ See Federal Deposit Insurance Corporation ("FDIC"), BankFind Suite: Bank Failures & Assistance Data, <https://banks.data.fdic.gov/explore/failures>.

¹⁴ Katherine Doherty et al., *FDIC Considers Forcing Big Banks to Pay Up After \$23 Billion Hit*, BLOOMBERG (Mar. 29, 2023, 4:12 PM EDT), https://www.bloomberg.com/news/articles/2023-03-29/fdic-mulls-squeezing-big-banks-hard-to-plug-23-billion-hole?utm_source=google&utm_medium=bd&cmpId=google&sref=enGs3N51.

¹⁵ Recall that the one MMF that broke the \$1.00 NAV in the aftermath of the 2008 crisis returned to investors in their fund more than 99 cents per share.

¹⁶ Where would investors go with their liquidity? They would likely go to either US Government MMFs or uninsured bank deposits. While US Government MMFs are good, sound investments, prime and tax-exempt funds provide capital to different economic sectors, private and public, that help promote business growth and public services by state and local governments.

liquidity thresholds. These measures should help reduce the financial stability risks posed by MMFs. *The Council supports the SEC’s efforts to reform MMFs and strengthen short-term funding markets* [emphasis added].¹⁷

In fact, there were not significant outflows from MMFs during the early stages of the pandemic, although prime funds began to experience outflows by mid-March, a month after the onset of the panic. Moreover, MMFs did not materially contribute to either the 2008 financial crisis or the seizing up of short-term funding markets in March of 2020, yet they are cast in the role of scapegoat. More recently, in a speech dedicated to financial stability, Secretary Yellen commented:

If there is any place where the vulnerabilities of the system to runs and fire sales have been clear-cut, it is money market funds. These funds are widely used by retail and institutional investors for cash management; they provide a close substitute for bank deposits. Before the post-crisis reforms implemented by the SEC, all money market funds were generally expected to maintain a fixed \$1 net asset value per share....

... This created an incentive for a run in times of extreme stress. The first redeemers could exit the fund at \$1 per share, but those who waited might be subject to a reduced market value as they are left with claims on less-liquid assets. This created a “first-mover advantage” – an incentive for investors to redeem at the whiff of a problem.¹⁸

It would appear that Secretary Yellen has lost track of her March 16 testimony referenced above or the fact that the prime funds to which she refers now have a floating NAV. Secretary Yellen continues on the topic of bond funds:

Even without a fixed NAV, liquidity mismatch in other kinds of funds can still make them vulnerable to runs and fire sales. Open-end funds offer daily redemptions, but some hold assets that cannot be sold quickly – particularly in large volumes. Like money market funds, this liquidity mismatch does not typically pose problems in normal times when flows to and from funds are not outsized. But in times of market stress, shareholders are incentivized to redeem early – before fire sales of illiquid assets lower the value of their holdings. Driven by this dynamic amid the pandemic shock, a record \$255 billion flowed out of bond mutual funds in March 2020.¹⁹

Here again, Secretary Yellen stretches to associate bond outflows with financial instability. In fact, financial economics 101 teaches that market prices react primarily to new information. Market

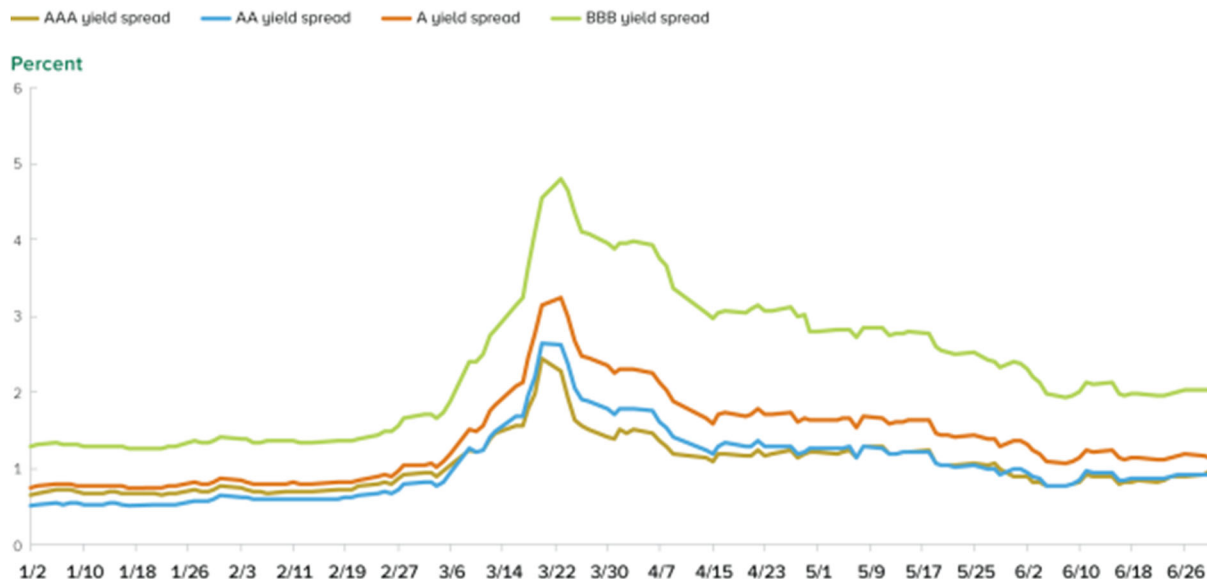
¹⁷ Financial Stability Oversight Council Statement on Nonbank Financial Intermediation February 4, 2022, *available at* <https://home.treasury.gov/news/press-releases/jy0587>. Rather than seeking to eliminate MMFs, the Fed would better serve the public by learning from the SEC’s regulation of MMFs and applying these lessons to the regulation of bank liquidity, including requiring marking-to-market of, and very short portfolio duration requirements for, high quality liquid assets (HQLAs) used by banks to meet liquidity coverage ratio and net stable funding ratio requirements and not assuming corporate operational deposit accounts will not be withdrawn in a banking crisis. Compare MMF portfolio and liquidity requirements at 17 C.F.R.270.2a-7(d)&(g), with large bank liquidity requirements at 12 C.F.R. 50.20-.22, .32(h) (national banks), 249.20-.22, .20-.22, .32(h) (bank holding companies and state member banks), and 329.32(h) (FDIC-insured state non-member banks).

¹⁸ Remarks by Secretary of the Treasury Janet L. Yellen at the National Association for Business Economics 39th Annual Economic Policy Conference (Mar. 30, 2023), *available at* <https://home.treasury.gov/news/press-releases/jy1376>.

¹⁹ *Id.*

transactions are the mechanism of price discovery. Corporate spreads widened throughout February and March of 2020, and remained wider for a prolonged period as shown in the figure below, thus demonstrating that selling pressure could not have caused this permanent effect.²⁰

Corporate Bond Spreads During H1 2020



To be clear, MMFs are a “near money” because shareholders view them as safe interest-bearing cash balances that can be used to make payments. Their safety and soundness is important to the smooth functioning of the capital markets. However, in giving FSOC the bully pulpit, the Dodd – Frank Act (DFA) did not clarify how to weigh financial stability risks in a cost/benefit calculation that other agencies must undertake. Thus, there is no materiality standard. While the economy faces grave risks from rising threats such as the dept/GDP ratio, and we have just witnessed the buildup of extraordinary systemic risk in the banking system, the risk in MMFs is consistently exaggerated by Central Bankers who would prefer to sacrifice yields paid to depositors to provide low-cost capital to banks, the opposite of investor protection. It is noteworthy that the 2014 annual report of the Office of Financial Research, a creature of FSOC, stated that top financial stability risks facing the nation are money market funds and the consequences of low interest rates.²¹

The simple fact is that FSOC’s mandate is to identify and stamp out systemic risk – without a materiality test, and in the case of recent FSOC statements, using false inferences to achieve its objectives. Agencies such as the SEC, without a financial stability mandate, are pressured to oblige FSOC with rulemakings justified by other objectives that are within its remit. But, as an example, the cost/benefit analyses for the swing pricing rules (for MMF and other 1940 Act funds) do not support the proposed rules under the SEC’s statutory mission.

²⁰ Sean Collins and Shelly Antoniewicz, *Policymakers Need to Focus on Economic Fundamentals and Not Blame Bond Mutual Funds: Examining the Evidence of Investment Grade Corporate Bond Yield Spreads in March 2020* (July 6, 2022), available at <https://www.ici.org/viewpoints/22-view-bondfund-survey-4#:~:text=The%20yield%20spread%20on%20AAA,4.80%20percent%20on%20March%2023.>

²¹ Office of Financial Research, 2014 Annual Report at 16, available at <https://www.financialresearch.gov/annual-reports/files/office-of-financial-research-annual-report-2014.pdf>.

In reality, the tight strictures of Rule 2a-7 enable MMFs to function effectively up to the point in a crisis that the Fed would already have had to intervene because of the greater fragility of banks and other capital market institutions. However, in the aftermath of its overreach in 2008,²² the Fed simply does not like creating Section 13(3) facilities, with the associated Congressional scrutiny, despite its original role as Lender of Last Resort.

We respectfully submit that the Fed needs to get its own house in order. It has been inserting itself into the SEC's regulatory agenda in order to avoid the future "inconvenience" of a Section 13(3) program to stem a national financial crisis – all while obviously creating massive systemic risks through its own conduct of monetary policy and lax supervision. As will be discussed further, the Fed is now visualizing a route to crisis management that employs standing facilities that were originally envisioned by the framers of the FRA as the method for arresting panics. Soon, the Fed's already thin justification will be seen alongside its other notable missteps of the 20th century.²³

We believe that the markets and investors would greatly benefit from the SEC focusing on its own mission, particularly when it will be legitimately criticized after the fact for dismantling highly effective products, that are emblematic of its mission, at the behest of a politicized FSOC.

V. The Solution Hidden in Plain Sight

The often alleged "vulnerability" of MMFs does not arise from their structure nor any "maturity transformation" which is insignificant when compared to the maturity transformation that routinely occurs with banks (30-45 days on average versus 8 years or more). What creates vulnerability, not just to MMFs but to the markets themselves, are financial panics. As is further discussed below, the Fed exists in large part to provide liquidity to the system in times of financial crises to prevent or ameliorate the impact of these panics. We submit that, had the Fed employed the standing facilities, which it now sees as a first line of defense in the 2008 and 2020 crises, the angst around institutional prime MMFs would not have developed. Interestingly, MMFs which had an 8 to 15-day average maturity during the current rate hiking cycle and, unlike most of the "surge deposits," actually promote the flow of credit to households and business, should be seen as a solution and not the problem.

This brings us to the central observation: so far in this century we have had at least three serious financial crises (in 2008, 2020, and 2023) or bouts of severe illiquidity in the Treasury market (in 2014, 2019, and 2021). Financial or liquidity crises are a fact of life, and the Fed cannot shirk its Lender of Last Resort obligations. But since its creation in 1913, the Fed has shied away from the use of its standing facilities to address market "panics."²⁴ It has instead resorted to emergency lending facilities, which it now distains,

²² See Federated Hermes, Inc. Supplemental Comment Letter II, 4/14/2023 and its accompanying paper, Granito, Michael R., *Liquidity Crises and the Fed: The Need for Standing Facilities as a First Line of Defense Against Market Liquidity Events* (Apr. 1, 2023). Both available from Federated Hermes, Inc.

²³ One notable misstep was to discourage and stigmatize the use of the Discount Window, which the framers of the Federal Reserve Act of 1913 viewed as the mechanism by which market panics would be prevented; and which the Fed today sees as a key means of arresting market crises.

²⁴ The Fed's failure to act in 1929 exacerbated the greatest financial crisis in U.S. history. See, e.g., Remarks by Governor Ben S. Bernanke at the Conference to Honor Milton Friedman, University of Chicago, Chicago, Illinois November 8, 2002, *On Milton Friedman's Ninetieth Birthday*, available at <https://www.federalreserve.gov/boarddocs/speeches/2002/20021108/> (summarizing M. Friedman and A. Schwartz, *A Monetary History of the United States* (1963)) ("Let me end my talk by abusing slightly my status as an official representative of the Federal Reserve. I would like to say to Milton and Anna: Regarding the Great Depression. You're right, we did it. We're very sorry. But thanks to you, we won't do it again.").

and which may require a Treasury backstop and will draw Congressional scrutiny as a bailout. Money Market Funds were impacted in the 2008 and 2020 crises only *after* the markets were in a severe decline that had already destroyed other firms. They were recipients of targeted emergency programs—amid the many others created during those periods.²⁵ In fact, the Fed is now increasingly aware that standing comprehensive facilities are necessary as part of its tool kit to deal with financial disruptions that are increasingly prevalent, and require timely intervention as part of normal operations. This will reduce or eliminate the need for individual targeted programs that stigmatize their recipients.

Federated Hermes has submitted a second supplemental comment letter including a companion paper that chronicles the history of Fed lending facilities and clarifies how the discount window can be effectively used to timely address emerging crises, including today's.²⁶ Thus, hidden in plain sight is a standing facility that, if actually used, would have prevented the need for special MMF programs and many others.

²⁵ In March 2020, in response to the financial panic associated with the COVID Pandemic, the Federal Reserve established multiple emergency secured lending facilities, including (1) the Commercial Paper Funding Facility, an SPV financed by Federal Reserve purchases of 3-month commercial paper (CP) through dealers from active issuers of highly rated CP up to amounts outstanding pre-crisis. There was not a maximum size announced by the Fed to the facility, but there were \$336 million in assets as of July 31, 2020; (2) the Primary Dealer Credit Facility, a collateralized lending term facility of up to 90 days to primary dealers in US government securities, against a broad range of collateral including equity securities and investment-grade municipal securities and corporate debt securities and commercial paper with \$1.18 billion outstanding at July 31, 2020; (3) the Money Market Mutual Fund Liquidity Facility, which involved loans to banks and bank holding companies secured by assets purchased from MMFs to provide liquidity for redemptions with \$13.7 billion as of July 31, 2020; (4) the Primary Market Corporate Credit Facility, which purchased new bonds issued by and loans to large employers; (5) the Secondary Market Corporate Credit Facility, which purchased existing loans to and bonds of, large employers (together, the Primary Market Corporate Credit Facility and the Secondary Market Corporate Credit Facility had \$12 billion in assets as of July 31, 2020); (6) the Term Asset-Backed Securities Loan Facility, an SPV financed by the Fed to purchase AAA-rated asset-backed securities involving commercial and consumer loans as the underlying assets with total outstanding assets of \$1.2 billion as of July 31 2020; (7) the Paycheck Protection Program Liquidity Facility, which made secured loans to lenders in the SBA-backed PPP-program, secured by loans in that program, and which had \$70.7 billion in outstanding advances as of July 30, 2020; (8) the Municipal Liquidity Facility, which purchased notes and bonds from state and local governments; and (9) the Main Street Liquidity Facility, which involved five lending programs to small and medium-sized businesses and non-profits that were in a strong financial position prior to March 2020, with \$87.5 million in outstanding loans at July 31, 2020). *See* Federal Reserve Policy Tools, <https://www.federalreserve.gov/monetarypolicy/pdcf.htm>. In 2008, in response to the 2007-2008 Financial Crisis, the Federal Reserve established multiple emergency credit facilities, including (1) the Term Asset-Backed Securities Loan Facility, “a funding facility under which the Federal Reserve Bank of New York issued loans with terms of up to five years to holders of eligible asset-backed securities”; (2) Commercial Paper Funding Facility, a facility to enhance liquidity in the commercial paper markets, which involved the creation of a limited liability company, the CPFF LLC, “which purchased 3-month unsecured and asset-backed commercial paper directly from eligible issuers”; (3) Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, a lending facility with detailed collateral rules, which financed the purchases of high-quality asset-backed commercial paper from money market mutual funds by US depository institutions and bank holding companies; and (4) Money Market Investor Funding Facility, a lending facility to provide liquidity to US money market mutual funds and certain other money market investors. *See* Federal Reserve, Other Lending Facilities, https://www.federalreserve.gov/monetarypolicy/bst_lendingother.htm; *see also* Federated Hermes Comment Letter in SEC comment docket No S7-01-21 on President’s Working Group Report on MMFs at 17 (Apr. 12, 2021) (citing Federal Reserve January 9, 2021 financial statements on profitability of MMLF and CP Funding Facilities), available at <https://www.sec.gov/comments/s7-01-21/s70121-8662821-235311.pdf>; Martha L. Cochran, David F. Freeman & Helen Mayer Clark, *Money Market Fund Reform: SEC Rulemaking in the FSOC Era*, 2015 Colum. Bus. L. Rev. 861, 903-905.

²⁶ *See* Federated Hermes, Inc. Supplemental Comment Letter II, dated April 18, 2023, and the accompanying paper, Granito, Michal R., *Liquidity Crises and the Fed: The Need for Standing Facilities as a First Line of Defense Against Market Liquidity Events* (Apr. 1, 2023). Both available from Federated Hermes, Inc.

Why is this relevant? The benefits of prime and tax-exempt MMFs can accrue to the economy with less systemic risk than uninsured or brokered deposits. What is required is for the Fed to accept its responsibilities and use this standing facility – one that the framers of the Federal Reserve Act originally foresaw as the essential tool to avert crises. This will lead to the commonsense insight that the economic benefits of MMFs that the proposed rulemaking would curtail, provide a significant net positive benefit to our economy.

In sum, we strongly recommend that the SEC pause or withdraw its proposed amendments to Rule 2a-7. Moreover, the 2014 Rule 2a-7 amendments may have curtailed the use of safer and higher yielding MMFs in favor of uninsured bank deposits, contributing to the current crisis; therefore, we also recommend that the SEC revisit the 2014 amendments to Rule 2a-7 and roll back those provisions that, with the benefit of hindsight, were unnecessary and harmful to investors and the markets.

Very truly yours,

/s/ Christopher Donahue

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