July 22, 2014

To the Editor:

As the SEC nears Wednesday's vote on a final rule on the Commission's proposal to reform money market mutual funds (MMMFs), state and local governments and other issuers are growing concerned about the contents of the final rule and potential impacts that the rule could have on governments. While we understand the Commission's desire to further increase the resiliency of MMMFs, we believe that many of the reforms included in the SEC's 2013 proposed rule would limit or eliminate the ability for state and local governments to purchase the funds, and would limit the funds' purchase of municipal securities.

Floating NAV

For example, with respect to the Commission's proposal to require all institutional MMMFs to transact at a floating net asset value (NAV), we believe that this change would impose significant costs on state and local governments as both investors and issuers of debt. As investors, governments and other issuers rely on money market funds as one of the main components of their short- and mid-term investing needs. Many of our members invest in money market funds because of their secure nature, simple accounting methodology and management, and liquidity – all features that are necessary for us to protect public funds, access cash and pay bills when they are due. Changing the main feature of these funds to a floating NAV would create administrative and costly burdens to governments and other issuers, large and small.

Further, many state and local governments are subject to policies and legal restrictions permitting them to invest only in funds that do not fluctuate in value. If a floating NAV is imposed on money market funds, governments will be forced out of these funds and will have to look to other investment vehicles that have historically paid lower yields, or to other less secure products with equal or less liquidity than MMMFs[1]. All of these potential scenarios would increase costs to state and local governments.

Under a floating NAV, governments and other issuers who choose to maintain their investments in MMMFs would be confronted with new and costly cash management and accounting system needs, as our cash management systems are not equipped to handle such a change. While no official estimate has been generated to illustrate these cost increases, a recent report by cash-management consultants Treasury Strategies Inc. estimates that the total up-front costs for U.S. money market fund institutional investors to modify operations in order to comply with a floating NAV will be between $1.8 and $2 billion. We expect that moving to a floating NAV would also carry similarly significant costs for state and local governments.

A floating NAV would also impact government and other issuers' debt management practices. MMMFs are the largest investor in short-term municipal bonds, holding 80 percent of all outstanding short term bonds totaling over $350 billion. State and local governments and other issuers rely on the sale of these bonds to build and maintain schools to support an educated

[1] For example, bank deposits are only insured up to $250,000 and many state and local governments have laws that require their bank deposits to be collateralized by marketable securities at a higher amount (often over 100 percent of the deposits after the deduction of the amount of deposit insurance).

workforce, and to build our roads, public transportation systems and airports, all of which are essential for supporting commerce. They also help to address the country's water infrastructure, public utilities, health care and affordable housing needs, as well as provide public safety infrastructure that ensures local and national security. Changing the NAV from fixed to floating would make MMMFs far less attractive to investors, thereby limiting the availability for MMMFs to purchase municipal securities. Losing this vital investing power would lead to higher debt issuance costs for many of our members across the country. These increased costs would either be borne by taxpayers, or would result in the delay or cancellation of much-needed infrastructure projects that would have otherwise helped drive and support national economic output.

A floating NAV requirement would also adversely affect Local Government Investment Pools (LGIPs). Many state governments operate LGIPs, which are critical investment tools, especially for smaller governments who are able to utilize these programs with the state pooling together the investments of numerous local governments into one larger fund that has greater investing power. States running LGIPs must comply with standards set for them by the Government Accounting Standards Board (GASB). As GASB requires LGIPs to operate in a manner consistent with the SEC rule governing money market funds (Rule 2a-7), the SEC's proposal to modify this rule and institute a floating NAV would put many of these LGIPs out of compliance with GASB. GASB rules state that those LGIPs not complying with Rule 2a-7 must report to each participant its share of any unrealized gains or losses. Participants must also report these gains or losses on their balance sheets. Because this would not be an acceptable option for most states, many LGIPs will be faced with higher operational costs related to floating NAV compliance.

We are also troubled with the proposed rule's deviation from parity between U.S. government and state and local government financing in imposing the floating NAV. The proposed rule would allow money market funds that invest largely in Treasury and U.S. government agency securities to continue to use a stable NAV. However, institutional tax-exempt funds that invest in state and local government securities would be required to float their NAVs. This lopsided treatment favors financing for the federal government and its agencies over the funding needs of state and local governments, which are no less pressing or important to taxpayers. Municipal securities are the second safest investment, aside from U.S. Treasuries, with state and local governments having nearly a zero default rate. The SEC should not grant one level of government finance advantages over another in its rules.

In its final rule we hope that the SEC also recognizes the differences between tax-exempt and institutional prime money market funds. Last year the SEC proposed to impose floating NAVs on both institutional tax-exempt funds (which invest in municipal securities) and institutional prime money market funds (which invest in a wider range of securities). The proposals came as a further response to the heavy redemption pressure that institutional prime funds experienced during the financial crisis of 2008–2009. We believe that the change of the NAV should not apply to municipal securities funds, as these funds did not show a heavy sell-off or present any problems during the financial crisis. In fact, they behaved more like government money market funds and retail prime funds, which the SEC proposed to exempt from the floating-NAV requirement.

Liquidity Fees, Redemption Gates and Redemption Limitations

Another concerning feature of the SEC's 2013 proposed rule would require all MMMFs to impose a 2 percent liquidity fee on all redemptions if a MMMF's level of weekly liquid assets

falls below 15 percent of its total assets. Further, should a MMMF breach this threshold the fund would also be able to temporarily suspend redemptions under this alternative. Our organizations are wary about how this alternative proposal would impact state and local government investors. Adopting a proposal that would impose liquidity restrictions on MMMF investors at a time fiscal stress will drive state and local MMMF investors away from MMMFs due to concerns about liquidity and potential losses that could result during such times. We believe that this alternative is unnecessary given the additional fund reporting requirements adopted in 2010, which, coupled with the enhanced disclosure and transparency requirements included the SEC's broader 2013 MMMF reform proposal should be sufficient to increase investor awareness of the market-based value of a fund's asset and reduce fund susceptibility to heavy redemptions.

Further, with regard to the SEC's proposal to define retail money market funds as those which limit investor redemptions to no more than $1 million per business day (and are therefore exempt from the float NAV), it is important to note that some governments and public sector entities have money market fund cash flows that are greater than $1 million per business day, and that some may need to redeem more than $1 million of their investments per day. If the money market funds that these governments are invested in will no longer be permitted to use a stable NAV, this will only add to pressures on issuers to discontinue investing in MMMFs. As a result governments and other issuers will be forced out of these funds and required to look to other investment vehicles that have historically paid lower yields or to other less secure products with equal or lesser liquidity.

Many of our organizations have met directly with SEC Commissioners and their staff to alert them to our concerns and seek their support in modifying their proposal to alleviate impacts on state and local governments and public sector entities. Bicameral groups of lawmakers from the House and Senate have also weighed in with the SEC on these concerns. We hope the SEC has earnestly considered these requests and that the final rule will be one which accomplishes SEC's goal of increasing the resiliency of MMMFs, while also ensuring that governments, other issuers and taxpayers are not harmed.

Sincerely,

Government Finance Officers Association
International City/County Management Association
National Association of State Auditors, Comptrollers and Treasurers
National Association of State Treasurers
National Association of Counties
U.S. Conference of Mayors
National League of Cities
American Public Power Association
National Association of Health and Educational Facilities Finance Authorities