Statement of the State Financial Officers Foundation

Submitted to the

U.S. SENATE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
SUBCOMMITTEE ON SECURITIES, INSURANCE AND INVESTMENT

For

HEARING ON IMPROVING COMMUNITIES' AND BUSINESSES' ACCESS TO CAPITAL AND ECONOMIC DEVELOPMENT

Submitted by

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We appreciate the opportunity to submit this Statement for the Subcommittee's Hearing to explore improving communities' and businesses' access to capital and economic development. The State Financial Officers Foundation ("SFOF") supports the remarks of The Honorable Ron G. Crane, Idaho State Treasurer, and Treasurer Crane's Statement.[1] We make this Statement to reiterate both (1) the importance of the efficient access to capital markets' funding provided to state and local government, as well as the business community, by money market funds; and (2) the need for the nongovernment money market fund as a simple, convenient and safe tool for SFOF members, and all state and local government finance officials, to prudently seek and obtain the highest market returns on cash in their management of public money.

We support policies that build strong, growing and liquid capital markets. We seek an entrepreneurial and competitive financial services industry that, along with healthy and efficient capital markets, rewards conservative, fiscally responsible public management with the freedom to make borrowing and investment choices among

[1] SFOF is a 501(c)(3) non-partisan organization which operates to promote free market and free enterprise principles and educate the public on the vital role state financial officers play in the operation of state government.

financial instruments, products and services that provide the lowest possible borrowing costs and highest available market returns in the management of public funds.

About SFOF.

SFOF provides a select group of state financial leaders a forum to partner with each other, and the private sector and academia, to develop, implement and promote conservative, fiscally responsible ("pro-growth") public policy. Although united in purpose, and sharing many challenges and opportunities, SFOF financial officers span the nation, geographically, in states from north to south and east to west; from heavily to sparsely populated; from low growth to high growth economies; and range in every other dimension.

In addition to Idaho Treasurer Crane, SFOF membership includes the highest financial officers of Arizona, Arkansas, Colorado, Florida, Georgia, Indiana, Kansas, Kentucky, Maine, Mississippi, Nebraska, Nevada, North Dakota, Ohio, South Carolina, South Dakota and Wyoming.

Money Market Funds provide critical, low-cost funding to state and local government.

Whether viewed in terms of the absolute dollar amounts, or on a per capita basis, the funding presently being provided directly to state and local government, as well as to other non-government, community organizations through the issuance of tax-exempt debt purchased by tax-exempt money market funds, is substantial.

The key point is that all of state and local government, regardless of size, will be seriously impacted and hurt by the loss of efficient, low cost financing from money market funds. The following table provides a breakdown of the aggregate amount, as of December 31, 2015, for the states of SFOF financial officers.

Figure 1.

Funding from Tax-Exempt Money Market Fund Assets

of States Represented in SFOF.[2]

State	Funding from TE MMFs ($M)	Population	Per Capita ($)
Arizona	1,945	6,828,065	285
Arkansas	122	2,978,204	41
Colorado	3,653	5,456,574	670
Florida	8,174	20,271,272	403
Georgia	3,517	10,214,860	344
Idaho	605	1,654,930	366
Indiana	4,490	6,619,680	678
Kansas	715	2,911,641	246
Kentucky	1,411	4,425,092	319
Maine	263	1,329,328	198
Mississippi	2,168	2,992,333	725
Nebraska	1,017	2,992,333	536
Nevada	2,693	2,890,845	932
North Dakota	473	756,927	626
Ohio	4,288	11,613,423	376
South Carolina	1,655	4,896,146	338
South Dakota	325	858,469	379
Wyoming	600	586,107	1,023
Total	**38,114**	**90,276,229**	**422**

[2] Source: Crane Data, U.S. Census Bureau

Figure 2.

Funding from Tax-Exempt Money Market Fund Assets

of States Represented by

Members of the Senate Banking Securities Subcommittee[3]

State	**Funding from TE MMFs ($M)**	**Population**	**Per Capita ($)**
Idaho	605	1,654,930	366
Illinois	8,439	12,859,995	656
Indiana	4,490	6,619,680	678
Kansas	715	2,911,641	246
Louisiana	2,705	4,670,724	579
Massachusetts	10,109	6,794,422	1,488
Montana	152	1,032,949	148
Nebraska	1,017	2,992,333	536
Nevada	2,693	2,890,845	932
New Jersey	5,888	8,958,013	657
New York	39,837	19,795,791	2,012
Pennsylvania	6,593	12,802,503	515
Rhode Island	455	1,056,298	431
Tennessee	2,779	6,600,299	421
Virginia	2,891	8,382,993	345
Total	**89,368**	**100,023,416**	**894**

We believe, along with Treasurer Crane, that the record is extensive and clear that most cash investors do not want, and will not use, a floating net asset value ("NAV") for cash investments. Without "non-natural person" investors in stable NAV money market funds, the assets available for funding of state and local government, and businesses, will substantially diminish.

[3] Source: Crane Data, U.S. Census Bureau

Money Market Funds are a critical cash management tool for state and local government.

For more than four decades, money market funds have been used for investment and cash management by millions of investors – individuals, businesses, and governments – who have relied upon them for liquidity, stability, efficiency, and returns.

Therefore, it is difficult to understand why the Securities and Exchange Commission ("SEC") acted to, in effect, completely bar any "non-natural person" investor from the stable value prime money market fund, as well as from the stable value tax-exempt money market fund. As just illustrated for tax-exempt funds, the impact of the outflows from tax-exempt will shrink the market for municipal debt and raise borrowing costs for government and community issuers. Indeed, the repercussions of this rule change are already being felt.

This means that, at the same time that borrowing costs for state and local government are increasing, government is also impacted by yields on cash going down. By banning state and local government investors from using stable value prime money market funds for cash management, we are deprived of a simple, convenient and effective tool for achieving higher yields on cash. We will be required to instead use government money market funds, bank deposits, invest directly in individual securities, or invest in less transparent, less regulated alternative cash management vehicles to the extent permissible under state law.

The utility of the money market fund for cash management – the stable share price – is based on its use of amortized cost accounting to offer investors a stable net asset value ("NAV") or $1 price per share – which a money fund may offer only if it abides by strict risk-limiting requirements of SEC rules. Because these funds are restricted to investing in high-quality, short-term investments and must hold large amounts of cash to meet redemptions, the difference between their estimated "market-based" value and the stable $1 per share at which they are offered is generally within a hundredth of a penny.

Clearly, the SEC did not decide to prohibit amortized cost valuation for money market funds accepting “non-natural persons” because amortized cost is inappropriate for a money market fund’s portfolio holdings. Otherwise, how could the SEC still permit amortized cost to be used for “retail” prime and tax-exempt money market funds, as well as for U.S. government funds? The SEC’s decision to disallow amortized cost was based on the type of investor in the fund, which, of course, has nothing to do with the value of a fund’s holdings.

Then, after the SEC’s 2014 rule changes, the Governmental Accounting Standards Board (“GASB”)[4] chose to act to continue to permit stable NAV structures, amortized cost valuation, and penny rounding by local government investment pools (“ LGIPs”) for local government investments (with aggregate assets of $200 billion at 2011) notwithstanding the SEC’s new floating NAV requirement.[5] Thus, state Treasurers are in the anomalous position of being able to offer a stable value LGIP to their local government constituents; but not, themselves, to invest in a prime money market fund.

As Treasurer Crane indicates, virtually all units and agencies of state and local government continue to rely, to a significant extent, on money market funds for cash management in addition to using a state-sponsored LGIP, if available. We would add that not all states, for various reasons, sponsor and offer LGIPs. Without the ability to use either an LGIP or a prime money market fund for cash management, local governments in those states are left with no ability to access prime money market instruments through a pooled investment vehicle.

[4] GASB sets accounting standards for state and local governments. GASB shares office location with the Financial Accounting Standards Board, which sets U.S. generally accepted accounting principles (“GAAP”).

[5] iMoney, December 2011.

Conclusion.

In conclusion, we believe all can agree that money market funds have been a safe and sound investment for institutional and individual investors and "that MMFs historically have been a paragon of stability" (Comments of Fund Democracy and the Consumer Federation of America to the SEC (Sept. 8, 2009))[6]. This is largely a result of prudent regulation: the successful product of decades of cautious oversight by SEC over the development of a safe and reliable means for investors to obtain market rates of return on their cash investments through the application of very conservative rules for money market fund's structure, operations and assets.

There is no justification for impairing such a critical element of the U.S. financial system. The SEC's new requirement, to impose a floating NAV on "non-natural person" investors, will have the effects of both eliminating a substantial portion of the short-term, capital markets financing and impairing the ability to maximize investment returns on invested cash for state and local government finance officers.

[6] Available at http://www.sec.gov/comments/s7-11-09/s71109-79.pdf