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Dear House Financial Services Committee Member:

The House Financial Services Committee is soon expected to consider bipartisan legislation supported by GFOA to address the unintended consequences of the SEC's 2014 amendments to Rule 2a-7 that require institutional, non-government money market funds (MMFs) to price their shares at a floating net asset value (NAV). The legislation, H.R. 2319, would allow those funds to return to a fixed or stable NAV, thereby addressing the problems caused by the rule for municipalities both as investors and as issuers of debt.

GFOA urges the Financial Services Committee to approve H.R. 2319 as written, without amendment.

Restoring the stable NAV for both prime and municipal money market funds will restore the ability of state and local government to access permissible funds for investing their operating cash. In addition, it will lower short-term funding costs for municipalities by increasing overall liquidity in the market.

State and Local Governments Depend on the Safety and Stability of Prime MMFs

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. As a result of the floating NAV, governments have been forced out of prime money market funds and steered into lower yielding government funds or other alternatives from what was already a safe and highly liquid market. As we stated in testimony and previous correspondence, this has had the effect of increasing costs to state and local governments, without any corresponding benefit in terms of investor protection and systemic risk.

According to Federal Reserve data, state and local governments hold over $186 billion of assets in money market funds.[1] Because of the SEC rule, the only money market fund options available to state and local governments are those that invest solely in U.S. government debt. They are no longer able to invest their short-term cash in prime money market funds, which have always been a safe investment providing a market rate of return. Over the past year, the average spread between prime and government funds has been 26.5 basis points.[2] As a result, state and local governments were prevented from taking advantage of up to $500 million in additional investment earnings that would otherwise have been available, and had to be made up through reduced services or higher taxes.

State and Local Governments Need Both Prime and Tax-Exempt MMFs to Finance Infrastructure and Economic Development

Both prime and tax-exempt funds have been a significant source of low-cost short-term capital used to finance the infrastructure and economic development priorities of state and local governments. However, as a result of the SEC rule, tax exempt MMFs assets under management fell by 50 percent, from $254 billion to $135 billion, dramatically shrinking an important market for municipal debt.

At the same time, the dramatic drop in prime money market fund assets further limited access to capital for state and local governments. In August 2017, municipal debt represented 2.5 percent of the assets in prime

[1] See https://www.federalreserve.gov/releases/z1/current/z1.pdf, page 84.
[2] See https://www.sec.gov/divisions/investment/mmf-statistics/mmf-statistics-2017-11.pdf, page 5.

money market funds, which lost $1 trillion as a result of the floating NAV rule. Over the past year, prime funds have held bonds issued to finance affordable housing, student loan programs, water and sewer projects, hospitals, universities, assisted living facilities and redevelopment projects.

Between January 2016 and August 2017, municipalities issuing variable rate demand bonds to both prime and tax-exempt funds saw their borrowing costs nearly double the Federal Reserve's rate increases over the same period. Many state and local governments determined that issuing variable rate debt to MMFs was excessively costly, and opted to issue higher cost fixed-rate bonds. These increased costs are shouldered by taxpayers and ratepayers.

State and Local Governments Look to MMFs for Infrastructure and Disaster Recovery

Restoring the stable NAV for both prime and tax-exempt allow more than $1 trillion to flow back into these funds, thereby significantly increasing the pool of low-cost short-term capital available to finance the operations of state and local governments, as well as their infrastructure and economic development priorities.

As states and communities seek to recover from some of the costliest natural disasters in our nation's history, they need more than government disaster assistance to repair and rebuild homes, schools, hospitals, utilities, businesses, bridges, roads and other critical infrastructure. They need low-cost private sector financing, and money market funds are among the most efficient sources of capital for infrastructure investment and economic development.

Prime and tax-exempt MMFs have historically been the largest purchasers of short-term debt used as working capital and infrastructure investment by municipalities and businesses. Unfortunately, just as those resources are needed most in states hard-hit by hurricanes, floods, wildfires and other disasters, the SEC's floating NAV rule is preventing money market funds from serving that purpose, thereby reducing liquidity in the market and driving up the cost of borrowing when it is needed most.

We look forward to working with you and supporting your efforts to help state and local governments on this money market mutual funds issue and other regulatory and financial matters of mutual interest.

Sincerely,

Emily Swenson Brock
Director, Federal Liaison Center