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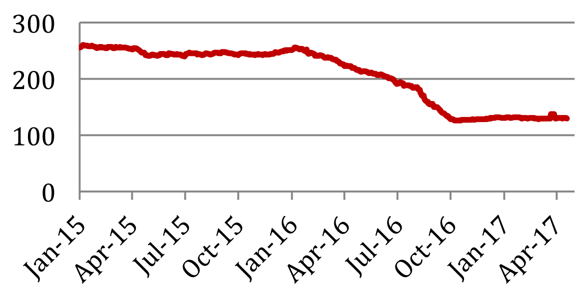
H.R. 2319/S. 1117 and the Business of Education: Negative Impacts of Recent SEC Money Market Fund Regulations

New money market fund (MMF) regulations implemented in October 2016 are having major negative consequences for public issuers and conduit borrowers, such as municipalities and educational institutions. The regulations required Prime and Tax-Exempt money market funds to change from a fixed to a floating net asset value (NAV). This resulted in investors pulling $1.2 trillion of capital out of these funds, shrinking the pool of funds available to borrowers.

As a result, Tax-Exempt MMFs (TE MMFs) are closing and, as shown in Figure 1, have lost 50% of their assets. This dries up a very important source of financing for state and local governments and educational institutions. Additionally, the flight of assets out of Prime MMFs has resulted in higher borrowing costs as the total pool of available capital decreases.

Figure 1.Tax-Exempt Money Fund Asset Levels ($B), Source: CraneData.com, Treasury Strategies (December 2017)



Educational financing is one of the biggest victims of this asset flight. State and local educational agencies and schools themselves account for over 10% of all TE MMF assets. Thus, as those assets shrink, so too has funding for educational initiatives. Without TE MMFs, education authorities are forced to use higher-cost financing sources like bank credit and longer term (higher cost) bonds, or else reduce their investments in education.

Between January 2016 and August 2017, the SEC regulations have negatively impacted education finance in three significant ways:

- TE MMF **investments in education fell $14 billion**, nearly 50%.
- Interest rates paid by educational institutions rose eleven-fold from .07% to .82%. This was almost double the Fed rate increase over the same period.[1]
- 25 states lost more than $100 million each in education funding from TE MMFs.

The Consumer Financial Choice and Capital Markets Protection Act (H.R. 2319 in the House of Representatives and S. 1117 in the Senate), would permit all MMFs to return to a fixed NAV. This would let investors pour money back into Prime and Tax-Exempt MMFs, increasing the capital pool for education and other public infrastructure and economic development needs.

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[1] Fed Funds rose from 50 to 125 bps - an after-tax increase equal to only 45 bps assuming only a 40% tax rate.

The decline in TE MMF assets is affecting education in every state.

Figure 2 shows the impact of asset outflows for educational issuers in several states – all of which have declined by $100M or more.

Figure 2. Loss of Funding to Education Related Tax-Exempt Money Fund issuers ($MM)
Source: Cranedata.com, Treasury Strategies (August 2017)

State	Principal Jan 31 2016	Principal Aug 31 2017	Change in Funding	% Change
TX	4,004	2,099	(1,904)	-48%
NY	4,346	2,673	(1,674)	-39%
CA	3,342	1,721	(1,621)	-48%
MA	1,789	843	(946)	-53%
OH	1,225	551	(674)	-55%
FL	849	214	(636)	-75%
CT	797	250	(547)	-69%
MI	999	469	(530)	-53%
MO	1,017	494	(523)	-51%
IL	1,076	629	(447)	-42%
NC	602	176	(426)	-71%
MD	654	231	(423)	-65%
PA	1,306	892	(415)	-32%
MN	496	107	(389)	-78%
GA	437	98	(338)	-77%
SC	364	61	(303)	-83%
NH	283	42	(241)	-85%
RI	281	44	(237)	-84%
IN	326	96	(230)	-71%
TN	449	224	(225)	-50%
WI	652	433	(218)	-33%
AL	212	18	(195)	-92%
NJ	427	252	(175)	-41%
WA	244	96	(148)	-61%
IA	186	54	(133)	-71%
All 50 States	**28,976**	**14,957**	**(14,019)**	-48%
Avg. Rate	**0.07%**	**0.82%**		**11X**

Conclusion

The shift of $1.2 trillion from Prime and Tax-Exempt MMFs to Government and Treasury funds as a result the SEC regulations implemented in October 2016 is having a significant negative impact on the ability of state and local governments to finance education. With a 50% decline in TE MMF assets, educational institutions are forced to seek higher cost borrowing options like bank credit or longer term debt. For those still able to borrow from TE MMFs, the cost of financing is dramatically higher than before the rule was implemented.

Either way, fewer resources are available to support the educational needs of students. H.R. 2319/S. 1117 would effectively reverse these unintended consequences of the SEC regulations.

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