STATEMENT OF
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ON BEHALF OF THE GOVERNMENT FINANCE OFFICERS ASSOCIATION

LEGISLATIVE PROPOSALS TO INCREASE ACCESS TO CAPITAL

BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

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Chairman Crapo, Ranking Member Brown and distinguished members of the Committee on Banking, Housing, and Urban Affairs, thank you for holding today's hearing on legislative proposals to increase access to capital. My name is Chris Daniel and I serve as the Chief Investment Officer for the City of Albuquerque, New Mexico. My remarks here today are in my capacity as a representative of the membership of the Government Finance Officers Association (GFOA). GFOA represents nearly 20,000 public finance officers from State and local governments, schools and special districts throughout the United States.

GFOA is dedicated to the professional management of governmental financial resources by advancing fiscal strategies, policies and practices for the public benefit, including issues related to issuing tax exempt bonds and investing public funds. We appreciate this Committee's continued support for efforts to strengthen the municipal bond market, especially the recent enactment of legislation designating municipal securities as high-quality liquid assets. Such actions help States, local governments and other governmental entities maintain access to low-cost capital, which is vital to infrastructure investment across the United States and contributes to a healthy and vibrant economy. On behalf of the GFOA and its members, I appreciate the opportunity to provide comments at this hearing in support of S. 1117, the *Consumer Financial Choice and Capital Markets Protection Act of 2017*.

This morning I will describe how money market funds have been utilized effectively to both manage liquidity for public sector investments and provide a reliable source of working capital to fund public services and finance infrastructure investment and economic development. I will also describe the impact of the U.S. Security and Exchange Commission's (SEC) change of net-asset-value (NAV) accounting methodology for money market mutual funds (MMMF) from stable to floating.

State and local governments access the capital markets and issue short term debt for a variety of reasons. This important legislation would allow state and local governments to continue this access and investor appetite for short term debt issuance without increasing costs for taxpayers or creating risks to the financial system For governments like the City of Albuquerque, variable-rate debt has been a very low-cost method of financing as compared to issuing fixed-rate bonds. GFOA has published best practice guidance on the use of variable rate debt by government issuers to ensure that it is used appropriately. Also, variable rate debt issued by state and local governments has historically been a reliable low risk investment type for money market fund sponsors. Money market funds themselves are key purchasers of municipal securities – historically, they have been the largest purchasers of short-term tax exempt debt. Therefore, the impact of SEC Rule 2a-7 of the Investment Company Act of 1940, as amended in

2010 and 2014, on governments is real and it affects not only large governmental entities, but also small communities throughout the country.

Additionally, money market funds are a widely-used cash management and investment tool for state and local governments. According to Federal Reserve data, state and local governments hold over $190 billion of assets in money market funds.[1]

While we have supported and continue to support initiatives that both strengthen money market funds and ensure that investors are investing in high-quality securities, we applaud Senators Toomey, Manchin, Rounds, and Menendez for introducing legislation which focuses on addressing the unintended consequences of the SEC's 2014 Amendments to Rule 2a-7 that require institutional, non-government MMFs to price their shares at a floating net asset value (NAV), by allowing those funds to return to a fixed NAV.

The original objectives of the floating NAV rule were to protect investors in money market funds by preventing runs that hamper access to short-term capital, shield taxpayers from future financial bailouts, and promote general market stability. Those objectives were effectively addressed in the 2010 Amendments to Rule 2a-7. GFOA supported those amendments which dramatically increased the credit quality of the assets held in MMFs, required money market funds to have a minimum percentage of their assets in highly liquid securities so that those assets can be readily converted to cash to pay redeeming shareholders, and increased transparency by requiring funds to regularly calculate their portfolios' per-share values at market prices.

Despite the success of the 2010 reforms, the SEC adopted additional amendments to Rule 2a-7 in July 2014. Among other things, those amendments require institutional prime and tax-exempt funds to use a floating NAV. The SEC's reasoning for the 2014 Amendments was that a floating NAV would provide investors with a more frequent and accurate assessment of the value of a fund's assets. Under previous rules, institutional prime and tax-exempt MMFs were allowed to round their share price to $1.00, so long as the actual value of a share does not fall below $0.9950 ("known as breaking the buck"). The SEC's change from fixed to floating was predicated on the belief that investor awareness of the actual value of the fund's assets will make investors less likely to redeem shares in times of economic distress.

Throughout the rulemaking process, GFOA and public finance officers throughout the country submitted analysis showing that a floating NAV would do little to deter heavy redemptions

[1] See https://www.federalreserve.gov/releases/z1/20180607/z1.pdf , page 84.

during a financial crisis but would, instead, impose substantial costs on state and local governments. That is exactly what has come to fruition.

The 2014 Amendments have dramatically shrunk an important market for municipal debt. Between January 2016 and April 2018, tax exempt MMFs assets under management fell by nearly 50 percent, from $254 billion to $135 billion[2], as MMF investors, including government investors, preferred or were required to hold stable-NAV government MMF's comprised of Treasury and/or U.S. Agency securities. The lack of investor appetite for floating-NAV tax-exempt MMMF's resulted in municipalities issuing variable rate demand bonds seeing 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.

In addition to the impact that the 2014 Amendments had on governments finding investors for their short-term debt issuances, there are also implications for the investments that state and local governments use to protect public funds. Many governments have specific state or local statutes and policies that require them to invest in financial products with a stable NAV. The policy reason for this is to ensure that public funds are appropriately safeguarded.

It is important to emphasize that MMFs with a stable NAV, particular prime MMFs, are required to meet the highest liquidity and credit quality standards, which is why they are a commonly used vehicle by state and local governments for managing operating cash. This important legislation would lift an unnecessary obstacle that has steered state and local entities into very low yielding U.S. government backed funds or other alternatives from what was already one of the safest sources for earning market returns on the management of cash, short of FDIC-insured bank accounts.

By allowing all MMFs – prime, tax-exempt and government funds accessible to both retail and institutional investors – to offer a stable NAV, S. 1117 would allow state and local governments to once again utilize suitable investments as defined by state and local elected officials, rather than by the SEC. The disruptions to the short-term capital markets caused by the SEC's floating-NAV rule are real and irrevocable short of restoring the stable NAV. The legislation fixes that problem, and does so without undermining the other important reforms that have made MMFs resilient to the kind of market disruptions that occurred in 2008. GFOA is working with a coalition of stakeholders to advance S. 1117 and we have submitted our most recent letter of

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[2] https://www.sec.gov/divisions/investment/mmf-statistics/mmf-statistics-2018-04.pdf, page 4.

support for the record. Thank you again for considering this important legislation. We look forward to working with you and supporting your efforts to help state and local governments on this and other regulatory and financial matters of mutual interest.