



STATEMENT OF
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ON BEHALF OF THE GOVERNMENT FINANCE OFFICERS ASSOCIATION

LEGISLATIVE PROPOSALS TO IMPROVE SMALL BUSINESSES' AND COMMUNITIES'
ACCESS TO CAPITAL

BEFORE THE
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES AND INVESTMENTS
UNITED STATES HOUSE OF REPRESENTATIVES

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Chairman Huizenga, Ranking Member Maloney and distinguished members of the Capital Markets, Securities and Investment Subcommittee, thank you for holding today's hearing on legislative proposals to improve small businesses' and communities' access to capital. My name is Pat McCoy and I serve as the President of the Government Finance Officers Association (GFOA). My remarks here today are in my capacity as President of GFOA and not of the Metropolitan Transportation Authority in New York where I serve as the Director of Finance. GFOA represents over 19,000 public finance officers from State and local governments, schools and special districts throughout the United States. This includes about 2,500 Michigan and 1,500 New York national GFOA and state GFOA members.

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. On behalf of the GFOA and its members, I appreciate the opportunity to provide comments at this hearing on H.R. 2319, the *Consumer Financial Choice and Capital Markets Protection Act of 2017*.

Specifically, 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 governments to continue this access without increasing costs for taxpayers. I am particularly interested in these issues as a finance officer with a large and diverse portfolio of over \$38 billion of tax exempt bonds outstanding. Variable rate debt structured with hard puts has historically been a reliable low risk investment choice for money market funds and it has also 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 to ensure that it is used appropriately.

Overall, money market funds are a widely-used cash management tool for individuals as well as for state and local governments. According to Federal Reserve data¹, state and local governments hold over \$183 billion of assets in money market funds. In addition, money market funds themselves are key purchasers of municipal securities – historically, they have

¹ See <https://www.federalreserve.gov/releases/z1/current/z1.pdf>, page 84.

been the largest purchasers of short-term tax exempt debt. Therefore, the impact of the SEC rule on governments is real and it affects not only large governmental entities like mine, but also small communities throughout the country.

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 Representatives Rothfus, Stivers and Moore 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), and to allow 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 the 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 "shadow prices" (i.e., 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 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 ("break 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 during a financial crisis but would, instead, impose substantial costs on state and local governments. That is exactly what has come to fruition.

Between January 2016 and July 2017, tax exempt MMFs assets under management fell by 50 percent, from \$254 billion to \$135 billion², dramatically shrinking an important market for municipal debt. At the same time, municipalities issuing variable rate demand bonds 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.

In addition to the impact that the SEC's 2014 actions had on governments accessing the capital markets, 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. MMFs with a stable NAV 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 a safe and highly liquid market.

By allowing all MMFs – prime, tax-exempt and government funds accessible to both retail and institutional investors – to offer a stable NAV, H.R. 2319 would allow state and local governments to once again utilize suitable investments defined by state and local elected officials, rather than by the SEC.

GFOA is working with a coalition of stakeholders to advance H.R. 2319 and we have submitted our most recent letter of 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.

² See: <https://www.federalreserve.gov/releases/efa/exempt-money-market-funds-investment-holdings.htm> Money Market Mutual Funds: Investment Holdings Detail, Figure 4