# Coalition for Investor Choice, Inc.
# Government Finance Officers Association
# Association for Financial Professionals

April 13, 2017

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| The Honorable Michael Crapo<br>Chairman<br>Committee on Banking,<br>Housing and Urban Affairs<br>United States Senate<br>Washington, DC 20510 | The Honorable Sherrod Brown<br>Ranking Member<br>Committee on Banking,<br>Housing and Urban Affairs<br>United States Senate<br>Washington, DC 20510 |

***Re: Legislative proposals to increase economic growth***

Dear Chairman Crapo and Ranking Member Brown:

The undersigned organizations collectively represent tens of thousands of public and private sector institutions that invest cash, and issue or borrow debt used to finance infrastructure, economic development and business expansion. We appreciate the opportunity to respond to your March 20 announcement soliciting legislative proposals to increase economic growth.

We urge you to consider legislation to reverse the significant unintended consequences of two Securities and Exchange Commission (SEC) amendments to Rule 2a-7 of the Investment Company Act governing money market funds, which took effect on October 14, 2016. Those amendments have undermined conventional cash management practices, as well as investments in infrastructure improvements and economic growth and development, without a corresponding benefit to the stability, safety and soundness of our financial system.

In particular, we ask that you support legislative efforts to restore the stable net asset value (NAV) accounting methodology for all money market funds, and remove arbitrary provisions in Rule 2a-7 that give unnecessarily broad authority to boards of directors of non-government funds to impose liquidity fees and redemption gates. Addressing both of these provisions will have little impact on the operational activities of money market funds during times of stress, but will have significant positive economic benefits. This includes restoring the opportunity for public and private sector investors to invest their short-term cash in prime and tax-exempt funds that earn a market return, and financing public infrastructure and economic expansion.

## <u>Economic Impact of the SEC Amendments</u>

During the SEC's rulemaking process on the amendments, many of our organizations warned repeatedly that the amendments would have far reaching consequences on the ability of non-financial organizations to raise short-term capital and manage cash. In particular, they warned the SEC that a floating NAV would not provide any incremental benefit to market stability but would, instead, do irreparable harm to money market fund investors, issuers and borrowers. That is exactly what has come to pass.

As a result of the implementation of SEC's amendments to Rule 2a-7 on October 14, 2016, over $1.15 trillion has exited non-government money market funds, leaving the private sector and moving into Treasury and Government funds. Short-term interest rates, including rates on short-term municipal debt, spiked to their highest levels since the financial market crisis. Prime funds, a key source of funding for corporations, have seen a 72 percent drop from January 2015 while tax-exempt funds, a key source of funding for municipalities, universities and hospitals, experienced a more than 50 percent decline over the same period. In turn, private sector borrowing costs have risen by tens of billions of dollars, and municipal short-term borrowing has increased on average from under five basis points at the beginning of the year to as high as 75 basis points at the end of 2016.

In its July 2014 final rule, the SEC argued that applying a floating NAV to just a subset of money market funds was needed to address an "incremental incentive to redeem" as a result of a potential first mover advantage inherent in a stable NAV fund, and to reduce the potential for unfair investor dilution. But nowhere in the release did the SEC cite or provide an analysis suggesting that a floating NAV would be any more likely to reduce this incentive, or that this "incremental" benefit was worth the cost of destroying the utility of prime and tax-exempt money market funds and with it, nearly $1.2 trillion in capital and tens of billions more in lost interest income as public and private entities are unable to benefit from market rates of return on their short-term cash investments.

Virtually all of the assets that have left prime and tax-exempt funds have moved into Government and Treasury funds, thereby maintaining this important cash management tool for institutional investors. But this is of little consolation to the users of money market funds that no longer have access to low cost financing provided by prime and tax-exempt funds, or a convenient and safe tool for obtaining market returns on the short-term management of money.

## **Why Institutions Rely on Stable Value Prime and Tax-Exempt Money Market Funds**

Government and private sector institutions rely on the hallmark stable NAV feature in a variety of ways. Many invest in money market funds because of their secure nature, simple accounting methodology and management, and liquidity – all features that are necessary to protect public and shareholder funds, access cash and pay bills when they are due. Changing the main feature of prime and tax-exempt funds to a floating NAV has created administrative and costly burdens to governments and businesses, large and small, in addition to having to look to other, more expensive investments.

Another problem with the changes to Rule 2a-7 is the impact on companies that issue commercial paper and governments that issue debt, especially short term debt. Prime money market funds were among the largest purchasers of commercial paper that businesses issue as a short term funding source for payrolls and inventories. Tax-exempt funds are the largest purchasers of short term municipal bonds. Due to the amendments to Rule 2a-7, state and local governments lost $135 billion in funding, while businesses lost over $50 billion in commercial paper funding.

This puts added pressure on state and local governments in particular as the amendments led to higher debt issuance costs at a time when policy makers in Washington are focused on rebuilding the country's crumbling infrastructure. Policies such as this actually harm the ability of governments to fund capital projects with municipal bonds, for the benefit of their citizens.

In addition, all investors in prime and tax-exempt money market funds continue to be adversely affected by the overly broad gates and fees authorities provided in Rule 2a-7. Such a provision creates another artificial barrier to the utilization of prime and tax-exempt funds due to internal investment policies that require immediate liquidity and the preservation of principal.

We look forward to working with the Banking Committee on this and other efforts to promote infrastructure investment and economic growth, and to protect investors and taxpayers. We would be happy to answer any questions or provide additional information on the need to reverse the unintended economic consequences of the SEC's recent amendments to Rule 2a-7.

Sincerely,

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