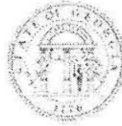

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September 16, 2013

Ms. Elizabeth M. Murphy, Secretary
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: State of Georgia Comment on the Proposed Rulemaking on Money Market Fund Reform File No. S7-03-13

Dear Ms. Murphy:

The State of Georgia appreciates the opportunity to provide comments on the proposed rulemaking of the U.S. Securities and Exchange Commission (the "SEC") on money market funds ("MMFs").[1]

In Section III(A)(6)(C) of the rulemaking release, the SEC requests comment as to the potential impact of the proposed rulemaking on Local Government Investment Pools ("LGIPs") that operate as cash investment vehicles used exclusively for the investment of public funds. The Office of the State Treasurer ("OST") manages two LGIPs, one of which is operated as a "2a-7 like" LGIP. The "2a-7 like" LGIP, Georgia Fund 1 ("GF1"), provides a much needed service to state and local government entities that otherwise would have difficulty safely and efficiently investing public funds in investments that provide sufficient liquidity to meet their cash management needs. GF1 has successfully and safely operated as a stable net asset value ("NAV") fund since its inception in 1981.

Because of their sovereign ownership, LGIPs like GF1 are exempt from SEC regulation under section 2(b) of the Investment Company Act. However, the proposed changes to Rule 2a-7, if adopted, could inadvertently harm the State and our local governments. Therefore, we believe it is important to provide comments to the SEC in connection with its proposed changes to Rule 2a-7.

Our objectives for managing GF1 are to provide safety of capital and liquidity while optimizing interest for state and local participants. GF1 is designed to serve as a short-term investment for funds that can be accessed by our participants on a day-to-day basis. Entities eligible to invest in GF1 are determined by state statute which does not differentiate between large and small depositors. GF1 accepts deposits from cities, counties, colleges, school districts, authorities and other government entities that need to safeguard operating funds, trust funds, bond proceeds, fiduciary funds, reserve funds and other funds that must be invested to preserve capital and liquidity.

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[1] 78 FR *36834-37030* (June 19, 2013).

Unlike private money market funds, GF1 has cyclical asset flows resulting from state general fund activities, regular tax receipts, bond proceeds, and salary expenditures. Georgia must be able to assure GF1 participants that their funds are available to meet payments upon request and that the value of their deposits does not change.

Georgia was one of the first states to apply for a rating on its LGIP dating back to June 1995. GF1 has maintained its triple A rating from Standard & Poor's due to OST's conservative management style and adherence to our prudent investment policy.

Throughout the credit crisis of 2008, GF1 was able to maintain a stable NAV and did not experience significant redemptions from the fund. At June 30, 2008, GF1 had net assets of $11.7 billion. At that time 39% was invested in overnight repurchase agreements, 53% in federal agencies, and 8% in banker's acceptances. At December 31, 2008, the assets stood at $11.1 billion and had a similar composition of assets with 44% in overnight repurchase agreements, 6% term repurchase agreements, and 50% federal agencies. In 2008, GF1 did not have any exposure to Lehman Brothers or other securities that subsequently defaulted.

OST is concerned with the SEC's two proposals for amending rules that govern MMFs. As stated in the rulemaking release, the first alternative proposal would require MMFs to sell and redeem shares based on the current market-based value of the securities in their underlying portfolios, i.e., transact at a "floating" NAV per share. The second alternative proposal would require MMFs to impose a liquidity fee if a fund's liquidity levels fell below a specified threshold and would permit the funds to suspend redemptions temporarily, i.e., to "gate" the fund under the same circumstances. Adherence to either of these proposals by GF1 would likely lead to participants withdrawing funds to invest in direct investments that may not be suitable for their risk tolerance and would reduce their portfolios' diversification compared to investing in GF1.

Most GF1 participants have limited investment alternatives. Local governments cannot purchase privately managed money market funds except for investment of bond proceeds. Numerous governmental entities, many with little or no investment experience would face losing the most reliable and cost-effective investment vehicle they have depended upon, some for over thirty years, without a problem. Should such disruption occur, most local government participants would likely look to their local banks for investing their cash. However, acceptance of governmental deposits is costly and burdensome to banks due to the high cost of collateralizing public bank deposits, a common requirement among municipalities in order to safeguard public funds. Banks without an existing relationship with a local government may not have an appetite for additional deposits nor offer attractive interest rates.

Disintermediation out of LGIPs could also cause significant concentration risks for governmental entities that currently achieve broad diversification by investing in GF1. For instance, our statutes require local government deposits in banks to be secured by marketable securities valued not less than 110% of the deposits after the deduction of the amount of deposit insurance. If participants in Georgia's $9.3 billion LGIP were to seek local banks to accept their current LGIP deposits, banks could only accept those funds if they pledged over $10 billion in eligible securities as collateral. Many local governments do not have the expertise or analytical tools to assess and monitor the financial strength of counterparties, or monitor the value of pledged securities.

OST has both experienced investment staff and systems to evaluate the various counterparties whereas most local governments would not be able to afford the systems and process OST employs. Attached is a copy of a report the OST investment staff produces bi-weekly which is used to assess counterparty credit risk ("Exhibit A"). The model uses real time market driven factors to measure credit risk. An overall score is used to assess risk and rank counterparties accordingly. The model inputs include independent credit services' short term default probabilities based on equity and debt market behavior. Most local governments would not have the investment staff or systems to replicate this process or otherwise closely monitor and manage counterparty risks.

Increasing concentration of public deposits in banks would heighten risks for many governmental investors. Since 2007, eighty-eight banks have failed in Georgia. A change in Rule 2a-7 that could effectively change the suitability of GF1 for our participants could force some participants to withdraw funds if GF1 converted to a floating NAV. Most of those funds would be deposited into local banks, an option that may pose a risk to municipalities that do not have local banks willing and able to pay competitive rates or fully collateralize deposits.

Bank deposits are not a viable substitute for GF1. In addition to concentration risks and collateralization requirements, some bank products carry liquidity constraints imposed by the "Reserve Requirements of Depository Institutions (Regulation D)" which could prohibit government entities from having immediate access to their funds. Such constraints would be unsuitable for local government deposits needed to fund payroll, bond payments, and other critical payments where any delay would be catastrophic. Unlike private participants, governmental entities typically do not have the capability or authorization to borrow funds to cover unexpected shortfalls and therefore liquidity is paramount to their investment needs. Liquidity constraints imposed by banks could lead to payment defaults by municipalities.

In addition, GF1 is a low cost provider (currently charging 3.3 basis points on an annualized basis) for budget-strapped municipalities within the State. The fund administration expense for GF1 is well below the typical expenses that public investors would incur investing in other eligible investment options.

Although not regulated by the SEC, GF1 is indirectly impacted by the SEC as a result of references to Rule 2a-7 in Governmental Accounting Standards Board ("GASB") reporting statements 31 and 59. As GASB 31 explains, governmental external investment pools that are "2a-7 like" pools are permitted to report their investments at amortized cost. Rule 2a-7 currently allows MMFs to use amortized cost to report net assets. Although a "2a-7 like" pool is not registered with the SEC as an investment company, nevertheless it must have a policy that it operates in a manner consistent with Rule 2a-7. GASB 59 (issued June 2010) clarified GASB 31 to indicate that a "2a-7 like" pool is an external investment pool that operates in conformity with SEC Rule 2a-7 as promulgated under the Investment Company Act of 1940, as amended. A strict interpretation of GASB 59 would require a "2a-7 like" pool to satisfy all SEC requirements of Rule 2a-7.

GASB Statements 31 and 59 prescribe use of amortized cost by external pools that conform to most Rule 2a-7 requirements. This method is available to those LGIPs that voluntarily comply with Rule 2a-7 and operate as "2a-7 like" external pools. The specific conditions of Rule 2a-7 referenced in the guidance as supporting this accounting treatment include asset quality, portfolio maturity, liquidity, and

diversification requirements. These conditions in the current Rule 2a-7 help assure the stable asset value of LGIP portfolios.

For the most part, LGIPs such as GF1 are buy and hold portfolios. Therefore, many securities that fall in the 2a-7 space are not actively traded. A lack of active trading means there is no true market value at the end of each day for these securities. "Mark-to-Market" is a misnomer in the context of both LGIPs and MMFs. To calculate the daily or "shadow" NAV of a money market fund, most pricing services use a matrix to determine the value of these securities. Current market prices on a small subset of money market instruments that trade are extrapolated by the model to estimate the current value of most LGIP assets based on similarities and differences in maturity, credit risk and other historical pricing relationships. A set of amortized cost-like assumptions is factored into the model to extrapolate among the values of instruments that have different maturity dates. Model pricing is not a true market price, is not more accurate in establishing market values, and it is not devoid of amortized cost-like assumptions. The difference between "mark-to-model" pricing of a portfolio and amortized cost pricing of the same portfolio is very small and is not material in the context of the value of the shares, particularly where rounded to the nearest cent. It is noted on page 15 of the SEC proposal "that the vast majority of money market fund portfolio securities are not valued based on market prices obtained through secondary market trading because the secondary markets for most portfolio securities such as commercial paper, repos, and certificates of deposit are not actively traded."[2] Thus the calculated NAV would prove to be a very costly and inaccurate assessment of the value of our LGIP. GF1 cannot afford these changes and the assessments would not benefit our participants yet would increase the costs.

The use of amortized cost to value portfolio assets is far more efficient and faster than using "mark-to-model" pricing and is shown to be as reliable. A movement away from amortized cost accounting by GF1, to the extent indirectly triggered by changes to Rule 2a-7, would impose administrative and staffing burdens, significant expenses, slow settlement times, and increases in settlement risks for GF1. Particularly given the low interest rate environment, GF1 would be unable to obtain funding from pool earnings to cover such expenses and the possibility of obtaining state appropriations in most cases is unlikely given a tight state budget and timing for consideration of budget matters. LGIPs may also face statutory prohibitions to assessing charges against existing participants for modifications that will affect future participants only.

The proposed SEC rule changes also classify MMFs as either retail or institutional and provide an exemption for retail funds. Unlike private MMFs, LGIPs cannot properly be classified as either retail or institutional funds since eligible participants are defined by enabling legislation and range in size of account balances and transactions as well as financial sophistication. LGIPs are established and designed to serve a variety of unique investors – state and local entities of a wide range of sizes and needs – that often have no other permitted investment options that meet their investment needs. Most LGIPs experience cyclical asset flows based on tax payments and receipts, bond proceeds, and salary and benefit payments, to name a few. Participants must be assured that portfolios are managed so that sufficient monies are available to fund their withdrawals and their principal is not diminished. Within GF1, over half of our participants carry smaller balances (less than $1 million) and have minimal activity in their accounts. A quarter of GF1 participants have balances ranging from $1 to $5 million. However, GF1 also serves state and local governments that have sizeable accounts with state entities at

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[2] 78 FR 36837 (June 19, 2013).

times comprising 40% of the pool participants. Often participants use GF1 as a source of operating liquidity (some as an alternative to a bank demand deposit account) or for investing proceeds used for debt repayment. Some GF1 participants routinely withdraw more than $1 million per day for operating expenses or to make bond payments. In the case of GF1, a small number of shareholders make up a substantial percentage of the fund and thus have withdrawals that are in excess of $1 million. For example, in Georgia, the Department of Revenue has partnered with the OST to set up LGIP accounts for those municipalities choosing to have their sales tax collections electronically transferred into their accounts. For the large metro counties in Georgia, these monthly deposits are over $10 million per month. Eventually these funds are used for operating purposes and the draws for these large metro counties are well in excess of $1 million per day. These counties are legally entitled to withdraw their sales tax collections as needed without charge or delay. The SEC proposed liquidity fees and gating would not be a viable option.

Although most GF1 participants do not meet the definition of a retail type shareholder based on the size of their withdrawals, their withdrawal history reveals that their behavior more closely models a retail type investor than an institutional type investor. As noted on page 73 of the SEC proposal, "Institutional shareholders tend to respond more quickly than retail shareholders to potential market stresses because generally they have greater capital at risk and may be better informed about the fund through sophisticated tools to monitor and analyze the portfolio holdings of the funds in which they invest."[3] However, our GF1 participants, like retail investors, tend to be more patient. The profile of many GF1 participants more closely models the behavior of retail investors in MMFs, meaning that GF1 did not typically experience heavy redemptions based on participants' fear of credit or liquidity issues. Neither did they perceive safer opportunities outside of GF1. Furthermore, the stability of all LGIPs, including GF1, was evidenced by LGIPs not being viewed as systemically important and therefore not offered the same U.S. government guarantee as were MMFs in September 2008.

GASB Statements 31 and 59 do not contemplate Rule 2a-7 providing various options for sponsors to select from depending on the make-up of their participants, size of participants' withdrawals, history of withdrawals during times of financial stress or other factors. We hope GASB would provide clarification for external pools to continue utilizing amortized cost accounting if Rule 2a-7 no longer prescribes a viable methodology for operating a stable NAV pool which, as emphasized, is the primary objective of most LGIPs.

Likewise, GF1 does not and cannot fit in the 'government only' category. GF1 has traditionally provided competitive rates to participants and would risk tempting participants to withdraw funds searching for higher yielding, riskier options should we convert to a 'government only' fund in order to continue to use amortized cost. Both the lower yields and reduced deposits would produce financial hardships on OST as we already operate at very slim margins. An election by a "2a-7 like" LGIP to use the 'government only' exemption in the proposed rule changes would also be problematic for another reason. Although 'government only' MMFs seek to preserve principal and maintain liquidity, an LGIP designed to be a "2a-7 like" 'government only' fund could experience problems in extremely low or negative interest rate environments. 'Government only' funds are required to keep 30% weekly liquidity and may be forced to accept negative interest rates that would in effect erode principal. Purchasing securities carrying a negative yield, as short-term U.S. Treasuries experienced on September 28, 2012,

[3] 78 FR 36856 (June 19, 2013).

would violate state statutes and investment policies that require OST to first consider the probable safety of capital when buying any security. In a negative interest rate environment, particularly triggered by a flight to quality into securities backed by the full faith and credit of the U.S. government, GF1's attempt to operate as a 'government only' type pool would have no alternative but to purchase overnight repos backed by U.S. Agencies or short term U.S. Treasuries at negative yields. Even at zero or slightly positive rates, the overall yield on a 'government only' pool would likely be too low to cover operating expenses and result in a loss of principal if OST could not subsidize operations. Clearly, an LGIP seeking to protect accountholders by maintaining a stable NAV in times of market stress should not be constrained by rules requiring it to either violate investment statutes and policies designed to preserve principal or lose its ability to use the amortized cost method for valuing the pool.

The SEC's two proposed alternatives, floating NAV and/or liquidity fees or gating, for amending rules that govern MMFs could pose significant risks to participants in GF1 to the detriment of the financial condition of those municipal entities. As stated in the SEC's current money market fund reform proposal, "We understand that investors use money market funds for cash management, and that lack of access to their money market fund investment for a long period of time can impose substantial costs and hardships."[4] If GF1 were to be gated, participants would have to wait for the money they scheduled to be withdrawn to meet payroll, vendor payments and debt repayments. We acknowledge that over a 40-year period there have been a few LGIPS, two that we are aware of, that utilized gating in a crisis while the sponsor assessed its options. However, this is not a viable strategy that GF1 should adopt as a means of operation. The problem with liquidity fees and gating alternatives for GF1 would be that many participants could not afford to lose their liquidity or accept loss of principal. Public fund investments in GF1 are typically earmarked for operational liquidity. Most GF1 participants do not have liquidity lines or other authorized methods to borrow funds should their operating funds become unavailable due to GF1 being gated.

OST agrees with the SEC's statements that changes to Rule 2a-7 do not directly or immediately apply to LGIPs. However, we are concerned that the SEC's proposals could affect GF1 indirectly, depending on future actions of GASB in response to any rule change. Changes to Rule 2a-7, whether moving to a floating NAV, which prohibits the use of amortized cost accounting in valuing portfolio assets, or imposing gating and liquidity fees, would require considerable time and expense. The process for the State to analyze the need and suitability of possible statutory or policy changes and, if necessary, proposing legislation and, if adopted, disclosing and implementing those changes would burden GF1 with significant costs in an environment without revenue sources to fund such changes.

Should the SEC adopt its proposed changes to Rule 2a-7 with an effective two-year phase-in period for MMFs, states would be at a distinct disadvantage that may prohibit continuation of any LGIP opting to be "2a-7 like". Since GASB regulations do not consider multiple options and exemptions for LGIPs to choose among in order to continue use amortized cost accounting, any consideration by GASB to amend its Statements 31 and 59 would take time to consider, possibly as long as two years. Georgia could not even consider policy or statutory changes until GASB determined whether to amend its current regulations. In addition, our state Legislature requires significant time to research and contemplate legislative changes. Bond issuers also would require much time to explore whether indentures could be changed to protect bondholders if the prescribed investment in GF1 would no longer

[4] 78 FR 36888 (June 19, 2013).

be stable NAV. Alarmingly, GF1 would have to continue to operate under great uncertainty while private MMFs adjust to new rule changes. This inequity would be extremely detrimental to GF1, the state of Georgia, and all our participants.

To the extent that GF1 reluctantly converted to a floating NAV or abandoned use of amortized cost accounting, the usefulness of GF1 to numerous state and local government entities would be diminished. This would result in disruption as some investors sought to redirect investments with few viable alternatives, especially for small to mid-size entities with limited bank or other counterparty willingness to accept collateralized, interest-bearing deposits. Governmental entities would face complex decisions in determining viable options for investing funds that have historically been deposited into the stable value GF1. Legality, affordability and suitability would substantially limit investment options for public sector investors.

GF1 has safely operated as a stable NAV LGIP since its inception. The 2010 amendments to Rule 2a-7 made both MMFs and LGIPs stronger without damaging their core features or undermining competition. The 2010 reforms were designed to reduce the interest rate, liquidity, and credit risks of money market funds. These reforms were tested and proven in 2011, when Europe's sovereign debt crisis and the federal debt-ceiling crisis rattled the markets. For most of 2011, GF1 maintained more than 45% allocation in overnight liquidity via repurchase agreements and collateralized bank deposits, far more than the required 10% overnight and 30% weekly liquidity. As a triple A rated fund, GF1 was required to report portfolio holdings, market-based NAV and liquidity to S&P on a weekly basis. In addition, as mentioned before, OST developed a model using real time, market driven factors to measure credit risk that allows OST to assess credit risk at the counterparty level. We have also added additional counterparties which has allowed us to continue to broadly diversify GF1's holdings even on an overnight basis.

In conclusion, as evidenced by our comments above, OST is concerned that the SEC would act to the detriment of state and local governments if it adopts either of the two proposed alternatives to Rule 2a-7 or a combination of the two without clarifying that it does not intend for LGIPs to have to adopt such rule changes in order to remain a stable NAV. Furthermore, given that GF1 operates as a "2a-7 like" fund, the excessive costs and burdens to implement and maintain the proposed changes and modifications to this proven cash management vehicle for municipal governments would actually increase risk of participant withdrawals. If we had to adapt to such proposed changes, GF1 would incur a significant financial burden in attempting to implement such changes, especially in this low rate environment.

The SEC should make clear that any changes it makes to reform MMFs are not intended to affect LGIPs. As the National Association of State Treasurers has commented in its response to the SEC, we also believe the SEC should not implement any rule change that might be interpreted as attempting to coerce LGIPs to choose between compliance with Rule 2a-7 or prudently protecting their participants' capital and liquidity. Should Rule 2a-7 changes trigger unintended problems, local governments most strapped for funds and those in communities least served by large financial institutions will experience the greatest financial harm. The financial impact on state and local governments could well harm economic growth, market efficiency, jobs creation, competition, and credit worthiness of municipal governments across the U.S.

In summary, the SEC's proposed rule changes would be detrimental to competition, efficiency, and capital formation for states as well as cities, counties, and other municipal entities. If changes to Rule 2a-7 are adopted, we urge the Commission to include a comment that it is not the SEC's intent to promulgate changes to LGIPs. Georgia is concerned about the financial strength and integrity of all governmental units within our state and we appreciate this opportunity to offer our views encouraging the SEC not to take action that might harm LGIPs.

Sincerely,

Steve McCoy
State Treasurer

cc: Teresa MacCartney, State of Georgia Chief Financial Officer, Director of the Office of Planning and Budget

Counterparty Risk Assessment

Counterparty Risk Ranking Criteria

Risk Level	Equity Indicators	Default Probabilities		Credit Default Swaps		5 YR Bond	Agency Ratings			OST Overall Ranking
	Spread over Call Volatility Index	Kamakura 1 YR Default Probability	Bloomberg 1 YR Default Probability	Number of times Counterparty Bloomberg Implied CDS is over IG	Number of times Counterparty Market CDS is over IG	Spread over 5 YR Treasury	S&P	Moody's	Fitch	
Very Low	≤ 10 % 0 points	≤ 0.01 % 12.5 points	≤ 0.01 % 12.5 points	≤ 1X 12.5 points	≤ 1X 12.5 points	≤ 100 bps 25 points	A1 + Positive A1 + Stable	P1 Positive	F1+ Positive F1+ Stable 20 points	**80+ points**
Low	> 10 % & ≤ 25 % 0 points	> 0.01 % & ≤ 0.033 % 10 points	> 0.01 % & ≤ 0.033 % 10 points	> 1X & ≤ 1.5X 10 points	> 1X & ≤ 1.5X 10 points	> 100 bps & ≤ 200 bps 20 points	A1 + Negative A1 Positive	P1 Stable	F1+ Negative F1 Positive 16 points	**64-79 points**
Moderate	> 25 % & ≤ 30 % -2 points	> 0.033 % & ≤ 0.153 % 7.5 points	> 0.033 % & ≤ 0.153 % 7.5 points	> 1.5 X & ≤ 2 X 7.5 points	> 1.5 X & ≤ 2 X 7.5 points	> 200 bps & ≤ 300 bps 15 points	A1 Stable	P1 Negative	F1 Stable 12 points	**47-63 points**
High	>30 % & ≤ 35 % -3 points	> 0.153 % & ≤ 0.30 % 5points	> 0.153 % & ≤ 0.30 % 5points	>2 X & ≤ 2.5 X 5 points	>2 X & ≤ 2.5 X 5 points	> 300 bps & ≤ 400 bps 10 points	A1 Negative A2	P2	F1 Negative F2 8 points	**31-46 points**
Very High	>35 % & ≤ 40 % -4 points	>0.30 % & ≤ 0.80 % 2.5 points	>0.30 % & ≤ 0.80 % 2.5 points	> 2.5X & ≤ 3.0 X 2.5 points	> 2.5X & ≤ 3.0 X 2.5 points	> 400 bps & ≤ 500 bps 5 points	A3	P3	F3 4 points	**15-30 points**
Extremely High	> 40 % -5 points	> 0.80 % 0 points	> 0.80 % 0 points	> 3.0 X 0 points	> 3.0 X 0 points	> 500 bps 0 points	< A3	<P3	< F3 0 points	**under 15 points**

Assumptions:

1. If there is only one default probability for a counterparty, the score of the one probability will be doubled
2. If there is only one CDS indicator, the score of the one indicator will be doubled
3. If there is no 5 year bond, points will be given based on the corresponding risk level of the combined default probability
4. If there are no Agency ratings, points will be given based on the corresponding risk level of the combined default probability

Exhibit A