



September 17, 2013

To: Elizabeth Murphy
Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

From: Jeffery Flynn
SEC Registered Investment Advisor (MSRB)
TRACS Financial/Institute of Public Investment Management

Re: Money Market Reform; Amendments to Form PF
Release No. IC-30551; File No. 57-03-13

To Whom It May Concern:

Pursuant to the request by the SEC for comments regarding proposed reform to SEC Rule 2a7 and specifically how such proposals, if implemented, would potentially impact LGIPs; and whereas in your request for information regarding such potential impact you state: “Because we are unable to predict how various state legislatures and other market participants will react to our floating NAV proposal, we do not have the information necessary to provide a reasonable estimate of the impact on LGIPs or the potential effects on efficiency, competition, and capital formation”.

Therefore, based on my research I offer the following comment and analysis:

1.) There appears little doubt that LGIP (public sector) market participants are highly unlikely to remain in any money fund or LGIP which adopts a floating rate NAV. While the amount of that NAV change may be virtually insignificant, the unfamiliarity and uncertainty of that FNAV and the inability of most Public Sector accounting systems to handle a changing NAV on LGIPs or money funds would likely cause the withdrawal of deposits at such LGIPs and money funds. Furthermore, the actual managers of these LGIPs and especially Prime LGIPs indicate almost unanimously that they are not likely to follow such FNAV requirements and will look for other remedies in order to maintain

their \$1 NAV. That may include revisions to state and local investment policy which potentially creates a conflict with GASB guidelines.

2.) If proposed reforms are adopted which include a FNAV on all LGIPs, it appears likely that the current estimated \$600B in State & Local Investment Pools would decline sharply, potentially creating runs on those pools in advance of any implementation of the proposed reforms. If a FNAV were only to apply to Prime LGIPs, most of the Public Sector deposits in Prime LGIPs would migrate rather quickly to exempt “Government” type pools and money funds.

3.) Regarding amendment of state statutes, most state statutes allow for the use of LGIPs by that states municipalities and other public sector entities without reference to SEC 2a7 guidelines. Simply, LGIPs are generally approved investments under state and local investment statutes by nature of being created under a joint powers or cooperative act as defined by the laws of most states. There are generally no policy guidelines stated for LGIPs.

It is GASB which has connected LGIPs to SEC rule 2a7 and we believe the decision as to whether LGIPs have to follow either current or revised 2a7 rules would also have to fall back upon GASB to make that determination.

c. Implications for Local Government Investment Pools

The Government Accounting Standards Board (“GASB”) states that LGIPs that are operated in a manner consistent with rule 2a-7 (*i.e.*, a “2a7-like pool”) may use amortized cost to value securities (and presumably, facilitate maintaining a stable NAV per share).

4.) Other ways that LGIPs may be affected. If a FNAV is enacted for just Prime LGIPs, Prime LGIPs are likely to either be converted to “Government” type LGIPs or actually be liquidated reducing the amount of investment alternatives available and thus reducing competition. Further, we do believe that the reduced number of investment alternatives available could cause some public sector entities to pursue other investment options which could contain higher levels of risk than appropriate, especially for operating fund proceeds akin to the investment disasters of the early 90’s in CMOs when certain public sector entities sought yield without understanding the risks.

Summary:

Based on our findings, we believe that LGIPs will only be affected by any such potential changes to SEC Rule 2a7, and especially Prime LGIPs, if GASB continues to connect LGIPs with Rule 2a7. We believe that if Prime LGIPs are forced to use a FNAV and therefore all LGIPs eventually become “Government” type pools exempt from a FNAV, certainly the level of credit risk in LGIPs would decline sharply and perhaps represent a safer cash investment for the public sector in general. But we believe in general that LGIPs represent a different type of depositor base than do money market funds and that current 2a7 rules are sufficient for LGIPs especially the given the maturity based reforms implemented in 2010.

Another area of concern and *unintended consequence* that might have been missed in reform debate is that while Prime LGIPs have the ability to use and fund commercial paper and short term municipal debt, all 2a7 LGIPs and money funds generally maintain a very high level of overnight “repo” as a way to provide high liquidity. The spreads available on that VRDN and CP could help serve as a buffer against the possibility that repo rates turn negative because of unforeseen flights to liquidity, especially out of Euro based repo. Both the SEC and Federal Reserve have recently issued very strong statements regarding concern about the repo markets and the need for reform, especially in the tri-party repo markets. S&P wrote a very concerning report about repo risk in March 2013 called “Lifting the Veil”.

It is assuredly in everybody’s interest to prevent runs and to mitigate the need for another government backstop of the LGIP and money market fund space and it appears that the implementation of a FNAV might be unwise at this time. If a FNAV is imposed on Prime LGIPs and money funds, it will likely send a large part of the deposits into the Government type, with yields already teetering on 0%, and given portfolio positions of 40%+ exposed to repo yields, the likelihood of negative rates for both LGIPs and money funds becomes a highly credible risk.

Regarding LGIPs, it would be my recommendation to have GASB step in and maintain current 2a7 rules for all 2a7 like LGIPs, government or prime, regardless of what may happen with additional 2a7 reform. I do believe that LGIPs themselves also have need of reforms including greater oversight, transparency, fees, concentration risks, and the use of the \$1 NAV for short term bond fund portfolios, but these issues are for another day and to be addressed by the LGIPs and participants themselves.



Regarding SEC 2a7 Proposals, I would also recommend that any FNAV provisions for 2a7 money funds be postponed until such a time that Fed rates rise well above current 0% levels to allow enough of a cushion or spread to absorb potential shocks in the repo markets. Repo risk may be a greater problem which may be due to poor collateral quality, the unintended impact of Fed QE, a curious and prolonged crisis level of monetary policy, and likely regulatory flaws within the repo markets themselves.

Best Regards,

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