



NASACT

National Association of State
**Auditors, Comptrollers
and Treasurers**



NATIONAL ASSOCIATION OF
STATE TREASURERS

October 31, 2014

Mr. David A. Vaudt
Chairman
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Mr. David R. Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Dear Messrs. Vaudt and Bean:

The National Association of State Treasurers (NAST) and the National Association of State Auditors, Comptrollers and Treasurers (NASACT) recently created a work group to examine the amendments to Rule 2a-7 impacting money market mutual funds (MMFs) that were approved by the Securities and Exchange Commission (SEC) on July 23, 2014. Among other things, the amendments will require institutional prime MMFs to adopt a floating net asset value (NAV) instead of the traditional stable NAV. Our work group is focusing primarily on the impact the amendments will have on local government investment pools (LGIPs), which in many cases are operated by state governments. As described below, the work group believes that GASB should (1) add this issue to its technical agenda and (2) consider options that will allow LGIPs to continue using amortized cost (stable NAV).

Technical Agenda

We understand that GASB is currently in the research phase on this issue and will vote soon on whether to add it to its technical agenda. Based on our work group discussions, we believe there are a number of significant changes required by the revised Rule 2a-7 that in the absence of GASB action, will require important changes in financial reporting for LGIPs. Accordingly, we believe that GASB should add this issue to its technical agenda. We respect the rigor of GASB's due process, and we believe this issue warrants that level of review.

There is concern, however, with timing. The SEC's revised Rule 2a-7 is effective October 14, 2016. While this may seem like an adequate transition period, governments may have to update or replace their current accounting systems to accommodate moving to a floating NAV. These system changes would likely require funding and states are already preparing their FY 2016 budgets. If funding for new accounting systems is going to be necessary, states need to include that in their budget requests now. To provide some certainty in the interim while GASB works through its due process, we suggest that GASB make it clear that it is appropriate to follow the provisions of Rule 2a-7, as amended in 2010.

Certain legal considerations should also be contemplated. In some states, current statutes limit investments to only those with a stable NAV. Many require preservation of capital and liquidity as primary objectives and the requirements of the revised Rule 2a-7 may conflict with such statutes. As the 2014 amendments require a floating NAV, these statutes would need to be revised, again

causing a timing issue in regards to implementation due to the lengthy and uncertain legislative process.

Options for Consideration

Our work group believes that there are a number of options for GASB to consider. First, we question whether it is still necessary or appropriate to link to SEC Rule 2a-7. The SEC is a regulatory agency and GASB promulgates accounting principles for financial reporting purposes. As such, we question whether it is still necessary or appropriate for state and local government accounting principles to be tied to the SEC. From a practical perspective, this means that any time the SEC modifies its rules for money market funds, GASB must re-examine the appropriateness of the change for LGIPs. Further, the SEC does not regulate LGIPs. In fact, in its release accompanying the Rule 2a-7 amendments, the SEC acknowledged that it has no regulatory authority over LGIPs or the accounting standards for LGIPs. The SEC indicated that state and local governments and GASB may wish to consider revisions to accounting standards for LGIPs in light of the Rule 2a-7 amendments. GASB may have linked to the SEC rule in the early years, but as GASB standards have matured, references like this have been reduced. The work group believes it is time to eliminate references to the SEC Rule 2a-7.

In addition, the work group believes there are some viable options that GASB can consider that will allow LGIPs to continue the use of amortized cost. For example, if an LGIP can offer an ongoing demonstration that amortized cost does not differ materially from fair market value, then we believe GASB could permit the use of amortized cost. There are a number of acceptable tests that could be used to make this determination including weekly shadow pricing and monthly stress testing. The work group believes that in many cases, the difference between amortized cost and fair market value are very small and clearly immaterial. In this case, the cost of moving to a floating NAV would undoubtedly outweigh the benefit. Adopting weekly shadow pricing and monthly stress testing would provide assurance that amortized cost is essentially the same as fair market value. For purposes of transparency, the results of weekly shadow pricing and monthly stress testing could be made available to pool participants.

Further, adopting weekly shadow pricing and monthly stress testing affords GASB and LGIP administrators a useful compromise for adapting the SEC's 2014 amendments to Rule 2a-7 to LGIPs. GASB can be satisfied that weekly shadow NAV and monthly stress testing provide the proof that amortized cost is the equivalent of fair market value for very high quality short maturity portfolios. GASB can also be assured that publishing shadow prices offers pool participants timely information about the market value of the LGIP without having to engage in daily pricing and recognizing gains or losses. LGIP administrators can be satisfied that they can continue to use amortized cost, avoid the difficulties of daily mark-to-market gains and losses for pool participants while forgoing the many new rules which are intended for very large publicly traded money funds.

We understand that GASB is examining the basis point difference as part of its research process, and we applaud that effort. If GASB is concerned about the outliers where the "buck has been broken" or where the variance between a floating NAV and stable NAV exceed acceptable parameters, we would be happy to work with GASB and others to establish guidelines requiring a floating NAV in those cases.

Lastly, we understand that GASB is researching alternatives to Rule 2a-7 that have been adopted by other entities. One such entity would be the U.S. Office of the Comptroller of the Currency (OCC). The OCC has adopted principles that banks must utilize in maintaining principal stability on short-term investment funds (STIFs). In doing so, these federal rules governing banks' STIFs allow such funds to value assets at amortized cost on a portfolio-wide basis and round unit prices

to the nearest penny to preserve a stable NAV. We believe a similar solution could work for LGIPs. If GASB is interested in this approach, we would be happy to provide some sample language.

We appreciate the opportunity to provide our views on this important topic. Should you have any questions, please contact John Provenzano, NAST Executive Director, at (202) 624-8593, or Kinney Poynter, NASACT Executive Director, at (859) 276-1147.

Respectfully,

A handwritten signature in black ink, appearing to read "Richard Ellis".

Richard Ellis, President
NAST

A handwritten signature in blue ink, appearing to read "William G. Holland".

William G. Holland, President
NASACT