Investing Local, County and State Funds for West Virginia

September 16, 2013

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

Re: Money Market Fund Reform; Amendments to Form PF Release No. IC-30551; File No. S7-03-13

Dear Ms. Murphy:

The State of West Virginia appreciates the opportunity to submit comments with respect to the above referenced notice of proposed rulemaking by the Securities and Exchange Commission ("SEC" or "Commission"). We are providing comment from the perspective of a combined state and local government investment pool ("LGIP"). It is our opinion that the proposed money market reforms will have negative unintended effects on LGIP's.

Although LGIP's are not regulated by the SEC, financial reporting requirements could require LGIP's to adopt any changes made to Rule 2a-7 with respect to floating net asset values ("NAV"), gating and liquidity fees. We believe that the LGIP's are different in nature from institutional funds in that the investor base is more stable and the funds significantly less likely to experience "runs" in times of financial market stress. During September 2008 the WV Board of Treasury Investment's pools did not experience any unusual outflows and closed out the month up $152 million.

As more fully discussed in the attachment to this letter, we believe that implementation of this proposal will have unintended, detrimental effects on state and local government investment pools. State and local governments are generally risk averse and seek investments that have stable principal values. The side effect of eliminating amortized cost accounting for institutional prime money market funds could be that LGIP's and state run investment pools would be forced to comply with this change to Rule 2a-7. This could result in a limited set of suitable alternatives for state and local government investors that desire or require a stable value investment.

Exempting government funds from the floating NAV proposal is likely to result in a significant inflow of new investments in the funds. We believe that it is highly likely that government funds would be unable to absorb this volume of new investments and would have to close themselves to new investors seeking an investment alternative with a stable value. It is also our opinion that

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banks may be potentially unable to absorb new state or local government deposits. It is our experience that West Virginia banks are not seeking new deposits due to suppressed loan demand, collateral requirements imposed by West Virginia Code, changing regulations and higher capitalization requirements.

It also appears likely that many state and local governmental entities investing in the BTI's pools would not meet the criteria to be considered retail investors. These entities regularly have transactions in excess of one million dollars. Of the state agencies investing in the BTI's pools, an overwhelming majority have transactions in excess of a million dollars. Between one quarter to nearly one half of local governmental entities regularly have transactions in excess of this threshold.

We also believe that floating NAV's could result in loss of the BTI's ability to offer same day liquidity to its investors. The largest single investor in the BTI's funds is the State itself. The State uses the BTI's funds as a type of sweep vehicle and requires the ability to make daily contributions and withdrawals to manage the State's cash position.

There could also potentially be significant costs incurred in updating the State's accounting systems to handle a floating NAV. The State's participant accounting system is designed to operate on a share basis. To process transactions using a variable NAV, the State would be required to upgrade or replace its existing system, incurring what would otherwise be unnecessary expenses during tight budgetary times.

Based on these concerns, we would urge the SEC to reject the proposal to move to a floating NAV for prime money market funds. As acknowledged by the SEC, LGIP's and government run funds may be forced to adopt changes to Rule 2a-7 even though these funds are not necessarily the intended target of the proposed reforms. Due to the size of daily state and local government investment activity, it would appear likely that the universe of potential daily liquidity management investment alternatives would be constrained under the proposal put forth by the SEC.

Thank you for your consideration of our comments on this matter.

Sincerely,

Honorable John D. Perdue
Chairman, WV Board of Treasury Investments
West Virginia State Treasurer

Attachment: (7 pages)

WV Board of Treasury Investments
RE: Money Market Fund Reform; Amendments to Form PF Release No. IC-30551; File No. S7-03-13
Attachment

Background

The WV Board of Treasury Investments ("BTI") is responsible for managing the investment of the State of West Virginia's (the "State") operating funds, short term trust deposits and short term investments of local governments of the state. The BTI offers three commingled investment funds: the WV Money Market Pool ("MMP"), the WV Government Money Market Pool ("GMM") and the WV Short Term Bond Pool ("STB"). The MMP and GMM both seek to maintain a stable net asset value ("NAV") of $1.00 per share. The STB does not maintain a stable net asset value and all shareholder transactions are processed using a floating NAV.

State agencies, unless specifically permitted by State code, are required to invest funds with the BTI and may invest in the MMP, GMM or STB. In addition to agency directed investments, the State invests idle operating funds in the MMP and STB. State agencies that require surety deposits from businesses, such as wage and hour, mitigation and performance bonds, have the option to invest these deposits in the MMP or GMM. The BTI does not offer an investment fund specifically for local governments (a local government investment pool or LGIP). Instead, local governments, including counties, municipalities and county boards of education, are permitted to invest in the MMP, GMM or STB. From the time the State created and offered commingled pools, it was determined that it would not be cost effective for the State to segregate local government investments into a LGIP.

The MMP is the largest commingled fund offered by the BTI, with a balance of $2.497 billion as of June 30, 2013. This pool is co-managed by UBS Global Asset Management ("UBS") and JP Morgan Asset Management ("JPM"). The MMP would meet the definition of a prime money market fund and is operated in conformity with Rule 2a-7. Although the pool is not required by law to be registered with the SEC or follow Rule 2a-7, in order to report fair value of investments at amortized cost, it is required by Governmental Accounting Standards Board ("GASB") Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* to operate in a manner consistent with the requirements of Rule 2a-7. Some ambiguity exists on whether a state pool must follow every part of Rule 2a-7 in exactly the same way as an SEC-registered money market fund. GASB recently has added to its technical plan for 2013 a potential project on resolution of issues regarding "2a7-like" state pools under the SEC's proposed money market mutual fund Rule 2a-7 amendments.

The GMM, managed by UBS, invests only in U.S. government and agency securities and repurchase agreements backed by such securities. As of June 30, 2013, the pool had a balance of $287 million. This pool was created for State agency and local government funds that are restricted to investing only in U.S government and agency securities. The balance of this pool will fluctuate more dramatically than the balance of the MMP as the entities investing funds in the pool are often times "parking" the funds for a short period of time. Over the period from January 1, 2007 through June 30, 2013, the balance of the pool ranged from $187 million (June 30, 2008) to $416 million (March 26, 2009). The GMM would meet the definition of a government fund and is also operated in conformity with Rule 2a-7. As with the MMP, the GMM uses amortized cost accounting and operates in a manner consistent with 2a-7 as required by GASB Statement 31.

Both the MMP and GMM are rated as principal stability funds by Standard & Poor's ("S&P"). The pools are both rated AAAm and have carried this rating since August 2007. To maintain this rating, the pools must meet more stringent criteria than those imposed by Rule 2a-7. For example, S&P's ratings criteria

for the AAAm rating prohibits investment in second tier securities where Rule 2a-7 permits investment of up to three percent of a fund's assets in second tier securities. Additionally, the pools must submit weekly surveillance reports to S&P regarding key metrics such as redemption activity, shadow NAV and detail and summary holdings data.

Beyond the requirements of Rule 2a-7 and S&P's ratings criteria, the West Virginia Code imposes one additional restriction: a minimum of fifteen percent must be invested in U.S. Treasury securities. Based upon the definitions of daily liquid assets in Rule 2a-7, the MMP and GMM automatically have fifteen percent in daily liquid assets before considering other sources of daily liquidity. When including other daily liquid assets, the MMP had daily liquidity of 30% and the GMM had daily liquidity of 54% as of June 30, 2013. These percentages do fluctuate, but are not out of the ordinary for these pools. Through code and policy, the BTI has sacrificed some yield for maximum liquidity.

Although the MMP and GMM act like 2a-7 funds and would be more closely identified with institutional rather than retail funds, these pools do not behave in the same manner as either type of fund. First and foremost, the largest participants in these funds are State agencies and, in the case of the MMP, the State itself is the single largest participant. As such, the core investors in these funds represent a stable foundation for the pools. In the MMP, the top 20 shareholders, 19 of which are State agencies, own 90% of the pool. The top 7 investors in GMM, which includes 2 State agencies, own 92% of the pool. The top shareholder in the GMM, a State agency, owns 57% of the pool.

As of June 30, 2013, the MMP had approximately 859 unique entities investing in the pool. Table 1 provides the breakdown of investors in the MMP (amounts presented in thousands):

Table 1: MMP Investor Breakdown

Entity Type	Number	Total Amount	Average Balance	Percent of Pool
State General Cash	1	$ 926,272	$ 926,272	37%
State Agencies	38	1,347,400	35,457	54%
Local Governments	120	68,414	570	3%
Surety Deposits	700	154,770	221	6%

Table 2 provides a snapshot of general transaction activity for the MMP, at the participant and not individual account level, at both the $1 million and $5 million transaction threshold for the period from January 1, 2007 through June 30, 2013:

Table 2: MMP Participant Level Redemption Activity Summary at Different Thresholds

Entity Type	% With Transactions > $1 Million	% With Transactions > $5 Million	Largest Transaction (in thousands)
State Agencies	76%	62%	$ 350,000
Local Governments	28%	5%	$ 10,000
Surety Deposits	<1%	<1%	$ 6,020
Pool as a Whole[1]	5%	3%	$ 398,220

1 – Represents highest total gross redemption activity for a single day

As of June 30, 2013, the GMM had 37 unique entities investing in the pool. Table 3 provides the breakdown of investors in the GMM (amounts presented in thousands):

Table 3: GMM Investor Breakdown

Entity Type	Number	Total Amount	Average Balance	Percent of Pool
State Agencies	8	$ 198,374	$ 24,797	69%
Local Governments	29	88,879	3,065	31%

Table 4 provides a snapshot of general transaction activity for the GMM, at the participant and not individual account level, at both the $1 million and $5 million transaction threshold for the period from January 1, 2007 through June 30, 2013:

Table 4: GMM Participant Level Redemption Activity Summary at Different Thresholds

Entity Type	% With Transactions > $1 Million	% With Transactions > $5 Million	Largest Transaction (in thousands)
State Agencies	61%	29%	$ 121,665
Local Governments	46%	17%	$ 52,410
Pool as a Whole[1]	40%	27%	$ 121,665

1 – Represents highest total gross redemption activity for a single day

Financial Crisis of 2007-2008

During the 2007-2008 time period, money markets experienced an unprecedented level of turmoil as the entire financial and banking industry was under tremendous stress. In spite of the stresses evident in the short term markets, the shadow NAV and asset flows of the MMP and GMM were not materially affected. The shadow NAV of the MMP ranged from $0.9997 to $0.9999 until September 2008. On September 26, 2008, the shadow NAV of the MMP reached its lowest point during the financial crisis, bottoming out at $0.9993. At this level, the NAV of the MMP was still well above the $0.995 threshold at which the NAV would no longer be considered $1. During September 2008, redemption activity was normal and there were no redemptions greater than 5% of net assets. The greatest individual redemption during the month, excluding normal operating cash transfers, occurred on September 24, 2008 and was less than 1% of net assets. That date experienced the greatest net redemption for the month, totaling 3% of net assets. Redemptions that occurred on this date were not unusual in nature.

The GMM experienced similar, modest NAV and asset movements over the same time period. The NAV opened 2007 at $0.9996 and ranged from $0.9995 to $1.0014 over 2007 and 2008. The primary driver for the low end of the NAV range appeared to be interest rate actions taken by the Federal Reserve Open Market Committee ("FOMC"). The NAV hit its peak in January 2008 as the FOMC began cutting short term rates. In September 2008, the NAV fell to $0.9996 on the 25th. Again, the NAV was well above the point at which it would be considered stressed. Contribution and redemption activity was not out of the ordinary for September, with the largest single redemption of the month occurring on September 10th. The single redemption was 13% of pool assets and was part of the largest net redemption for the month, which totaled 14% of pool assets. The activity was not out of the ordinary as the participant making the largest transaction (a local government) normally makes such redemptions in September of each year.

Overall, during and after the financial crisis, participants in the MMP and GMM were understandably concerned about the safety of their investments. However, this concern did not translate into large withdrawals or a run on the funds. The MMP began September 2008 with a balance of $2.496 billion and ended the month with $2.610 billion. The GMM's balances were $221 million at the beginning of the month and $259 million at month end.

Proposed Changes to 2a-7

The BTI has reviewed the proposed changes to Rule 2a-7 and desires to provide its comments on parts of the proposal. Specifically, the BTI objects to the provisions of the proposal regarding moving to a floating NAV for prime funds. The BTI does not believe that a floating NAV will lessen the incentive to redeem shares in times of fund and market stress. It is the BTI's opinion that a floating NAV could increase the incentives for investors to withdraw funds in times of market stress as it will be more of a certainty that fund values will fall. Should the SEC choose to go forward and enact the proposed floating NAV requirement for prime funds, the BTI is of the opinion that LGIP's and pools managed by state governments with conservative investment policies similar to the MMP should be exempt from this requirement.

Should the SEC choose to go forward and enact the proposed floating NAV requirement for prime funds, the BTI agrees with the Commission's statements that changes to Rule 2a-7 do not directly or immediately apply to LGIPs. The Commission's proposals could affect LGIPs indirectly, depending on future actions of the Government Accounting Standards Board ("GASB") and individual states in establishing the operating and accounting standards for LGIPs. Changes to Rule 2a-7, particularly the movement to a floating NAV or the prohibition of use of amortized cost accounting to value portfolio assets, could require further work and action by state and local governments or GASB, depending on the exact terms of their existing LGIP requirements and whether they choose to follow all of the changes implemented by the Commission in amending Rule 2a-7.

The primary purpose of the MMP, the only pool directly affected by the floating NAV proposal, is to provide for the investment of State operating funds. To take advantage of economies of scale, the MMP is also open to local governments and has been made available to State agencies for investment of surety deposits. All of these entities share one requirement, that principal risk be minimized while earning a rate of return commensurate with the level of risk taken. This conservatism is required by West Virginia Code, the requirements imposed by S&P for maintaining the pool's AAAm rating and the conservative investing philosophy of the BTI.

Although not required by State or Federal laws or regulations to follow Rule 2a-7, a change to the rule requiring a floating NAV could force the BTI to adopt the methodology as a result of the requirements of GASB Statement 31, depending upon how GASB and our auditors ultimately resolve the current ambiguity on whether all aspects of Rule 2a-7 must be followed by a "2a7-like" LGIP that wants to use amortized cost to value all of its portfolio assets. We note that GASB could choose to de-link the use of amortized cost by state pools from some or all of Rule 2a-7. In addition, a state pool could choose to round unit prices to the nearest cent without using amortized cost to value all portfolio assets of the pool. If, however, the MMP were required to adopt a floating NAV, it is likely that local governments would

withdraw their funds and redirect them to other alternatives that promise stable principal values. This would also likely be the case for surety deposits and other State deposits such as Federal funds and bond payment funds. The BTI estimates that this outflow could represent approximately 20% to 25% of the pool balance. There appear to be two likely candidates for the investment/deposit of these funds: retail or government funds not subject to the floating NAV requirement and time or demand deposit bank accounts.

With respect to retail or government funds not subject to floating NAV requirements, the BTI believes that these may not be suitable alternatives, or even viable, alternatives for all of the departing participants. State agencies that hold Federal funds or bond payment funds would likely not qualify as retail investors as these agencies will typically have transactions in excess of $1 million or $5 million. Depending on the threshold established for retail investors anywhere from 5% to 28% of the local governments would not qualify as retail investors. An overwhelming majority of the surety deposits would qualify for retail status, as a very limited number have balances in excess of $1 million. For entities not meeting the definition of a retail investor, the options would appear to be limited to government funds or bank deposits.

The suitability of government funds as an alternative may be questionable if a significant amount of funds are also seeking stable principal investments. During the financial crisis, government funds were deluged with new deposits as investors sought a safe haven from perceived and actual risks in prime funds and other investments. The high demand for Treasuries and compression of Treasury and repo spreads forced many government funds to close themselves to new investments. During the period from December 2008 to February 2009, the government fund used by the BTI as a sweep vehicle at its custodian bank was closed to new deposits. For the BTI, this resulted in excess cash balances being left uninvested in a demand deposit account. Without the FDIC Transaction Account Guarantee Program ("TAGP"), which provided unlimited insurance for transaction account balances at participating financial institutions, the BTI's cash deposits in excess of FDIC limits would have been uninsured and subject to the collateralization requirements of the West Virginia Code (described below). If enough institutional investors move from prime funds to government funds, this scenario could be replayed. In the current market environment, supply and demand dynamics, as well as FOMC policy, have placed downward pressure on Treasury yields and repo spreads.

If government funds were not available, then the remaining option would be bank deposits. In the current environment, few banks in West Virginia are seeking new deposits. With upcoming changes to capital and collateralization requirements, the current low interest rate environment and muted loan demand, banks have limited opportunities to profitably utilize new deposits. Additionally, under West Virginia Code, State and local government deposits in excess of FDIC insurance limits are required to be collateralized by Treasury or agency securities, Federal Home Loan letters of credit, or other high quality collateral. The amount of funds in excess of insurance limits cannot exceed ninety percent of the value of the collateral pledged (effective collateral level of 111% of the value in excess of insurance limits). This further reduces the attractiveness of State and local government deposits due to the costs incurred by financial institutions in pledging collateral.

As an example of the BTI's experience with the demand for deposits, the BTI offers six month certificates of deposit ("CD's") via an auction process to qualified State depositories. At the inception of the program

in 2006, twelve to fifteen West Virginia banks regularly competed for these CD's and the BTI was able to place all funds offered. Over the past two years, competition has dropped to the point where only three banks routinely participate in the auctions. With only three banks competing, the BTI has been unable to place all funds offered. The BTI surveyed individual banks and the State's banking associations to determine why interest in the program had dropped off. The responses fell into two categories: banks do not need the funds as there are limited opportunities to deploy those funds profitably, and the cost of pledging collateral further constrains the profitability of holding the funds.

Larger regional and national banks would likely be able to absorb State and local government funds, however this would not appear to limit risks to these funds. During the financial crisis, banking institutions, especially the large national banks, were in danger of failing and faced a run on deposits. If State and local government funds were concentrated at these institutions, along with the funds of other former prime institutional fund investors, would the security and safety of these deposits be any more assured than if they were invested in a prime money market fund? If a large financial institution were to fail and the State be forced to liquidate collateral to recover its deposit balances in excess of insurance limits, would the State be selling collateral into a buyer's market where the value of the collateral could be less than the deposits they insured?

Operational Issues with Floating NAV

There are also operational issues that would face the BTI in implementing a floating NAV. First, the BTI's pricing service only offers pricing data after market close and does not offer intraday pricing. The BTI obtains its pricing feed from its custodian bank and the service is provided at no additional charge above contractual custodian fees. If the BTI found it necessary to seek a service that could provide intraday pricing, this would be an additional expense that would be incurred by the BTI.

Without intraday pricing, the BTI would not be able to provide same day transaction settlement. It is very likely that redemption transactions would have to be processed using next day settlement. For certain investors in the BTI's funds, this would not present an issue. However, for the general operational funds of the State, this would not be feasible. Operational funds are needed daily to fund settlement of State obligations at the State's disbursement banks.

Beyond the loss of same day settlement, the shareholder accounting system used by the State would not be suitable for full time processing of transactions using a floating NAV. The shareholder accounting system is designed to account for balances and process transactions as shares. In processing transactions for the MMP and GMM, this does not present any issues since one share equals $1.00 (or fractions thereof). For the STB, the State's sole floating NAV pool, manual processes have had to be implemented to process share transactions using a variable NAV. Since that pool is limited to monthly transactions, and has a limited number of participants, the processes employed are workable. These processes can also be used for MMP and GMM transactions using a floating NAV on a temporary basis in the event of a crisis. However, processing daily transactions for a floating NAV pool on a permanent basis would require the State to either purchase a new shareholder accounting system or pay to have the existing system upgraded/modified.

The shareholder accounting system also offers online access to participants to view account balances and request deposit and withdrawal transactions for MMP and GMM pool accounts. The transaction request option is not offered to STB participants, as system design requires entries be made in shares. Without knowing the current NAV, the participants are unable to convert their requests into shares. In going to a floating NAV, MMP and GMM participants would lose online transaction access due to the same restrictions currently limited to STB participants, namely the current NAV must be known in order to convert dollars to shares. Although the State would likely be required to upgrade its shareholder accounting system, the source of funding for such a project is not clear at this time. The BTI does not have a current estimate of the costs of an upgrade, but believes that it would, at a minimum, be in excess of $300,000. The area of the Treasurer's office responsible for shareholder accounting is funded through a portion of interest earnings on excess State funds. The persisting low interest rate environment has resulted in interest earnings being insufficient to cover current operating costs for this area. Additionally, with the general revenue budget of the State facing challenges over the next few years, a supplemental general revenue appropriation to fund the upgrade is extremely unlikely.

It is likely that an additional fee would have to be charged to participants to cover the cost of system upgrade. Ongoing maintenance may result in additional charges until interest rates normalize depending on whether the maintenance charges exceed existing levels.

Conclusion

Based on the above concerns, the BTI would urge the SEC to reject the proposal to move a floating NAV for prime money market funds. Due to ambiguity in financial accounting and reporting standards, LGIP's and state government managed investment pools could be forced to adopt changes to Rule 2a-7 even though these types of pools are not regulated pools. It is the BTI's opinion that LGIP's and state managed pools are not subject to the same investor flight risk as institutional prime money market funds. It is possible that implementation of the proposed changes could result in unintended negative consequences for state and local government investors.