Date: September 8, 2015

TO: Director of Research and Technical Activities
    Project No. 3-29E

FROM: Alan Skelton, State Accounting Officer

RE: Proposed Statement of the Governmental Accounting Standards Board, Project No. 3-29E; Accounting and Financial Reporting for Certain External Investment Pools

The State of Georgia appreciates the opportunity to provide comments to the Proposed Statement of the Governmental Accounting Standards Board (“Board”) addressing Accounting and Financial Reporting for Certain External Investment Pools (the “Exposure Draft”).

GASB’s link to the Securities and Exchange Commission’s (“SEC”) Rule 2a7 through Statement 31 was of great concern to many state-sponsored Local Government Investment Pools (“LGIPs”) when Rule 2a7 was amended in 2014 to require a floating net asset value (“NAV”). Thank you for listening to and addressing our concerns through your fieldwork and research. We appreciate the Board’s timely and extensive work that went into preparing this Exposure Draft.

We support the intent of the Exposure Draft and applaud the Board’s efforts to improve financial reporting by establishing criteria that permits external investment pools to determine how investments can be measured for financial reporting purposes at either amortized cost or fair market value. We would like the Board to consider the following clarifications relative to a few paragraphs in the standard:

- For paragraph 15 under “Portfolio Maturity Requirements”, we would appreciate clarification that for U.S. government securities (regardless of maturity date) with a variable interest rate, the maturity should be the period remaining until the next readjustment of the interest rate. For securities other than U.S. government securities, the maturity should be calculated based on the criteria described in 15 (b) or 15 (c).

- For paragraph 16, would the Board clarify whether all U.S. government securities with a floating interest rate, regardless of maturity, have a maturity of one day?

- Paragraph 17 defines the maturity of a repurchase agreement. Georgia utilizes term repurchase agreements (“term repos”) with several counterparties that have put features. Are we correct in understanding if a term repo has a put feature we can use the put date as the maturity date of the term repo and utilize the put date in calculating the weighted average maturity (“WAM”) of the LGIP?
• Paragraph 22 allows an external pool to hold a security that has not been rated by a Nationally Recognized Statistical Rating Organization ("NRSRO") if it is determined based upon the external pool’s analysis to be of comparable quality to securities that have been rated within the highest category of ratings. Why not allow for the same type of analysis if a security has a split rating where one NRSRO has a security in the highest category and another NRSRO has it in a lower category? We are concerned the proposed standard provides more flexibility for unrated securities than for split-rated securities.

• Paragraph 27 allows corporate collateral for a repo. The portfolio quality requirement for a repo within paragraph 27 says “the underlying collateral should meet the credit quality requirements of paragraphs 19-24.” However, it appears bullet (c) eliminates corporate collateral by requiring “the securities collateralizing the repurchase agreement are securities of the U.S. government, its agencies, or instrumentalities.” We are asking for the consideration of a revision of the Portfolio Quality requirements to allow external investment pools to acquire repurchase agreements backed by collateral other than U.S. Treasuries and Agencies. Specifically, we would like to include corporate securities as eligible collateral. Rationale to support this argument is included below:

  o Georgia utilizes repos backed by non-traditional collateral to provide incremental yield to the state sponsored LGIP (Georgia Fund 1) participants without increasing risk. The risk that repos collateralized by non-traditional securities such as corporates would cause the fund’s amortized cost to significantly deviate from its fair value is no greater than the risk associated with repos backed by U.S. government securities. In accordance with Rule 2a7, Georgia Fund 1 applies counterparty credit quality standards to all repurchase agreement counterparties. Georgia utilizes a proprietary Counterparty Risk Assessment Model to assess counterparty credit risk. The model uses real time market-driven factors to measure credit risk. These factors include counterparty credit risk swaps, counterparty bond spread to treasuries, equity indicators and counterparty agency short-term ratings. An overall score is used to assess risk and rank counterparties accordingly. Credit limits have been assigned to each credit risk category, which range from very low to extremely high risk. Credit exposure is determined for each counterparty. Only those counterparties in the very low and low risk categories can post non-traditional securities such as corporates for both overnight and term repos. In addition, the collateral backing non-traditional repos require higher margin valuation percentages (i.e. collateral haircuts). Georgia requires non-traditional collateralization of 105% versus 102% for traditional collateral.

  o In addition, since the end of 2008, the supply and demand of U.S. government securities used as collateral in repo transactions has changed substantially and will change even further with the 2014 amendments to SEC Rule 2a7. Specifically, the requirement for institutional prime funds to price and transact at a floating NAV will force many money market fund investors out of prime funds and into U.S. Treasury and government money market funds in order to transact at a stable NAV. This movement of shareholders from...
prime to government funds will put pressure on traditional collateral which is already in short supply. Hence, another reason to allow corporates as acceptable collateral.

- Under Portfolio Diversification Requirements, Paragraph 32 has bullet (b) that discusses repos. We are confused why this requirement for repos is listed here and we are unsure how this would be implemented in regards to portfolio diversification.

- The exposure draft, via paragraph 34, only allows for a pool to hold 5% of its assets in illiquid investments. Although this is consistent with SEC Rule 2a7, Standard & Poor’s criteria for a AAAm rated principal stability fund allows for 10% of assets to be invested in illiquid investments. We are proposing a 10% illiquid investment requirement. This proposal takes into consideration the shareholder characteristics of LGIP participants. Most LGIP participants model the mindset of retail investors in money market funds. LGIPs do not typically experience heavy redemptions based on participants’ fears of credit issues, illiquid securities, or safer opportunities outside a LGIP. In addition, most LGIPs experience cyclical asset flows based on tax payments and receipts of local government participants. OST has over 20 years of shareholder history that routinely shows the seasonal flows of our participants. We believe this stable cash flow pattern of LGIP participants warrants a 10% investment in illiquid securities.

- Finally, paragraph 9 does not allow for a LGIP to measure for financial reporting purposes, all of its investments at amortized cost if it does not elect amortized cost upon initial application of this Statement. We would ask GASB to reconsider this requirement as we view this decision as a change in accounting principle. We would like an option to elect amortized cost or fair value reporting at the start of a fiscal year.

We appreciate the opportunity to provide our thoughts on the proposed statement and hope the Board will consider our feedback when determining how to proceed.

Regards,

Alan Skelton
State Accounting Officer