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Bringing Money Market Funds' European Investments into Focus

By Brian Reid

In his written testimony on Capitol Hill today, Federal Reserve Board Chairman Ben Bernanke created a fuzzy and incomplete picture of money market funds and their investments in European-headquartered financial institutions. Whether by intent or not, the Fed testimony left the impression—magnified by media accounts—that these funds have a unique and substantial vulnerability to any future turmoil in overseas markets.

The full picture: the majority of money market funds' European exposure is invested in banks that are integral players in the U.S. financial system—including banks that are on the Fed system's own list of official counterparties. The fact that they're getting some of their financing from money market funds doesn't add risk to the U.S. financial system.

What's unfortunate is that all the data that the Fed would need to provide a clearer picture are publicly available. We've been pointing out the exaggerations in coverage of this issue for the last nine months.

The Fed chairman made headlines with his statement that investments in European banks made up 35 percent of the portfolios of U.S. prime money market funds in February. That's true. But while his testimony was careful to explain away the exposures that U.S. banks have to potential financial strains in Europe, it failed to provide any of the detail that would put money market funds' investments into similar context.

First, it's important to note that European-based financial institutions that borrow in the short-term U.S. dollar market are typically large global banks with operations stretching well beyond Europe's borders—including in the U.S.

There's also the fact that Europe is a big continent, and the risks of the eurozone debt crisis aren't spread evenly. Bernanke correctly noted that "U.S. money market funds have almost no exposure" to "the most vulnerable euro-area countries."

In fact, more than half of prime money market funds' European holdings are in banks headquartered in the United Kingdom, Sweden, and Switzerland—all countries that don't use the euro for currency, and thus are outside the single-currency zone that's vulnerable to debt crises in Greece and other "peripheral" countries.

Money market funds' holdings in the eurozone amount to 15.5 percent of their portfolios, and virtually all of those holding are in banks headquartered in Europe's strongest economies—France, Germany, and the Netherlands.

To get the most accurate picture, it helps to drill down to the holdings in individual banks. We can do that because money market funds are the most transparent financial product in America, disclosing every holding in their portfolios to the public every month. Here's what we find:

- 52 percent of U.S. money market funds' holdings of European-based institutions are invested in securities of banks that have U.S. affiliates that serve as "primary dealers." Primary dealers are financial institutions designated by the Federal Reserve Bank of New York to serve as trading counterparties in the Fed's implementation of monetary policy. These dealers are required to participate every time the U.S. Treasury auctions its securities. They are central players in the U.S. financial system.
- Among the instruments of these primary dealers that U.S. prime money market funds hold, half (51 percent) are repurchase agreements. Such repos are fully collateralized, usually with U.S. Treasury and government agency securities that these institutions hold precisely because they are primary dealers.

- When money market funds invest in European banks that aren't primary dealers, they tend to be institutions with significant U.S. operations, even if they're not household names. For example, Rabobank Nederland NV has both retail and corporate banking operations in the United States.

Institutions like Barclays, Deutsche Bank, UBS, HSBC, and Credit Suisse are deeply embedded in the U.S. financial markets. The fact that money market funds buy their short-term debt does not create unique risks to the U.S. financial markets. In fact, as primary dealers, these European-headquartered banks would be heavy borrowers in the U.S. markets even if money market funds didn't exist.

Congress and the public deserve a clear picture of financial risks, and the details do matter.

Here's the latest data on U.S. prime money market funds' holdings by country.

Prime Money Market Funds' Holdings by Home Country of Issuer

February 29, 2012

Country	Billions of dollars	Percentage of total assets
World Total	**$1,409.7**	**100%**
Europe	**506.6**	**35.9**
Eurozone	*217.7*	*15.5*
France	77.3	5.5
Germany	72.4	5.1
Netherlands	62.3	4.4
Belgium	2.3	0.2
Austria	2.5	0.2
Spain	0.9	0.1
Luxembourg	0.0	0.0
Italy	0.0	0.0
Non-eurozone	*287.9*	*20.5*
UK	135.6	9.6
Sweden	67.2	4.8
Switzerland	62.8	4.5
Norway	18.8	1.3
Denmark	3.5	0.3
Americas	**653.9**	**46.4**
USA	505.9	35.9
Canada	147.5	10.5
Chile	0.4	0.0
Venezuela	0.1	0.0
Asia and Pacific	**248.4**	**17.6**

Japan	126.1	8.9
AUS/NZ	118.4	8.4
Singapore	3.2	0.2
India	0.4	0.0
China	0.3	0.0
Korea	0.0	0.0
Supranational	**0.9**	**0.1**
Unclassified	**0.9**	**0.1**

Note: Calculations are based on a sample of 104 funds, representing an estimated 96.4 percent of prime funds' assets.

Source: Investment Company Institute tabulation of data provided by Crane Data

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