

## ICI VIEWPOINTS

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## Déjà vu—U.S. Money Market Funds and the Eurozone Debt Crisis

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In [June](#), we wrote about the indirect exposure that U.S. prime money market funds have to European sovereign debt, especially Greek debt, through their holdings of securities issued by European banks. At that time, we noted that these funds had no direct exposure to Greek sovereign debt, and that they were managing their indirect exposure by constantly examining the quality of their portfolio and the creditworthiness of investments. By [July 1](#), we could report that U.S. prime money market funds had no direct exposure to Portuguese or Irish government or bank debt.

Since then, U.S. prime market funds have continued their careful monitoring and risk management on their portfolios. They have reduced their direct exposure to issuers in Italy and Spain to virtually zero, and have shortened maturities for their holdings of core European banks. Overall, U.S. prime money market funds remain well positioned to respond to potential developments in Europe. Some specifics:

**Any likely downgrades in the long-term credit rating of large French banks would not affect money market funds' ability to hold these banks' short-term securities.** Under Securities and Exchange Commission regulations, money market funds are required to hold short-term, highly liquid, high quality securities, with the vast majority of their assets in "First Tier" securities, those with the highest short-term rating. Moody's Investor Service or other credit rating agencies may well decide to lower the long-term ratings for large French banking groups by one or possibly two notches. However, even a two-notch downgrade would leave the banks' short-term paper in the First Tier, and would not change those securities' status as eligible investments for money market funds. (For more on eligible securities for money market fund investment, see our [FAQs](#).)

**Direct exposure to both public and private issuers in the European "periphery" countries is virtually zero.** Since June, U.S. money market funds have almost eliminated holdings of Italian and Spanish government and private debt, including bank securities.

**U.S. money market funds have reduced the maturity of their holdings in banks in Europe's "core" (France, Germany, the United Kingdom, and other countries).** According to JP Morgan Securities, 60 percent of U.S. prime money market funds' holdings in French banks as of the end of August will mature in 30 days or less, compared to 28 percent of their holdings at the end of June. Shorter maturities provide flexibility and reduce the impact of any potential downgrades.

According to Crane Data, at the end of July, 69 percent of money market funds' holdings in German banks and 67 percent of holdings in British banks were set to mature in 30 days or less.

**U.S. prime money market funds have increased their liquidity this summer.** As the August 2 deadline for raising the U.S. debt ceiling approached, U.S. money market funds generally increased the share of their portfolios held in highly liquid securities (cash, Treasury and some other government securities, and other securities that mature or can be converted to cash within five business days). For prime money market funds, assets liquid within one week rose to 40 percent of portfolios on August 2 from 32 percent on June 21, according to iMoneyNet. One-week liquidity stood at 38 percent as of September 6. This increased liquidity allows prime funds to meet any increased redemptions associated with policy or market uncertainty in the U.S. and Europe.

**Prime money market funds remain well positioned to respond to potential developments in Europe.** Money market fund managers have been carefully monitoring and managing their exposure to European debt risks. Also, the core European banks are large, profitable banks, and all have access to liquidity facilities from the European Central Bank.

*Update: On September 14, Moody's Investors Service reaffirmed Prime-1 short-term ratings at three large French banks. See Moody's comments regarding [Crédit Agricole](#), [Société Générale](#), and [BNP Paribas](#). For Crédit Agricole and Société Générale, Moody's lowered the long-term debt and deposit ratings by one notch.*

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