

ICI VIEWPOINTS

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European Banks Significantly Reduced Borrowing from U.S. Money Market Funds in June

By Chris Plantier

As we discussed in [March](#) and [April](#), European banks have generally become less willing to borrow from U.S. money market funds due to regulatory pressures, especially at the end of the quarter. Specifically, the new Basel III requirements seek to increase capital ratios of banks and explicitly limit how much banks fund their operations through short-term borrowing (which includes short-term securities banks issue that money market funds invest in). This quarter-end effect was particularly strong at the end of June as European bank regulators continued to monitor bank progress toward meeting the new Basel III requirements, which will be fully phased in over the next few years.

In our [latest release](#) on money market funds' holdings, Table 3 shows that the share of European holdings in prime money market funds' portfolios fell to 32.01 percent in June 2014 from 39.99 percent in May 2014. In addition, Table 2 shows that the share of European holdings in government money market funds' portfolios fell to 9.60 percent in June 2014 from 14.83 percent in May 2014, primarily reflecting declines in repo (repurchase agreement) holdings with European counterparties. The June 2014 decline in the share allocated to European counterparties is larger than the declines seen in March 2014 and December 2013, suggesting that regulatory pressures on European banks are rising.

Large Drop Reflects Reduced Supply

The June drop in the share of prime money market fund portfolios allocated to European counterparties was the largest decline since Form N-MFP data have been collected, topping even the tumultuous summer of 2011. The large monthly decline indicates that European banks can shrink their balance sheets quickly and/or have the ability to find other sources of funding quickly. We suspect it is a fair amount of the former, since Federal Reserve H.8 data (banks' weekly balance sheets) indicate that branches and agencies of foreign banks ran off \$70 billion in their deposits at the Federal Reserve from June 18 to July 2 (H.8 data are weekly, ending each Wednesday). The largest monthly drops in money funds' holdings of European banks have tended to occur in June and December when [European regulators](#) currently assess progress toward Basel III's goals, but this pattern may evolve going forward.

Reverse-Repo Facility Picks Up Slack

Table 3 also shows that the share of U.S. holdings in prime money market funds' portfolios rose to 34.96 percent in June 2014 from 28.33 percent in May. The increase in lending to U.S. counterparties is almost entirely due to the large increase in money market fund lending to the Federal Reserve via the Fed's overnight reverse-repo facility. The Federal Reserve initiated the facility to help it soak up excess liquidity, which also has the effect of putting a floor under overnight repo interest rates.

The introduction and expansion of the Fed's overnight reverse-repo facility over the past year has greatly increased the central bank's role as a repo counterparty. On June 30, 2014, the Fed allotted \$339.5 billion in reverse repos (the highest amount ever), of which at least \$258 billion was allotted to money market funds, according to ICI's analysis of Form N-MFP data. In June, 47.88 percent of repurchase agreements reported by government money market funds and 45.67 percent by prime money market funds were attributable to the Federal Reserve as a counterparty.

The Importance of the Fed's Reverse-Repo Facility

Money market fund use of the Federal Reserve facility could increase further as major bank regulatory changes are implemented,

and as the structural changes likely to be imposed on money market funds are phased in over the next few years. Under this facility, 93 money market funds have been designated by the Fed as [eligible counterparties for its reverse-repo facility](#); each of these 93 funds can execute [up to \\$10 billion](#) in repo agreements. It is difficult to know exactly how large the Fed's overnight reverse-repo facility will be going forward, but we know that money market funds collectively are currently using less than one-third of their maximum \$930 billion allotment (93 funds x \$10 billion each). This facility will improve the Federal Reserve's ability to control short-term interest rates and will likely be an important safety value as Basel III and other regulatory changes are applied.

For more on money market funds, please visit ICI's [Money Market Fund Resource Center](#).

For more on Form N-MFP data, please visit the [Taxable Money Market Fund Portfolio Data](#) page.

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