

JP Morgan on Money Funds

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Sent: Friday, January 30, 2009 12:30 PM

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 JPMorgan's Staley Calls Money Funds 'Systemic Risk' (Update1) 2009-01-30
 18:24:17.460 GMT

(Adds Group of Thirty in fourth paragraph. For more about the World Economic Forum annual meeting, click DAVOS <GO>.)

By Christine Harper and Christopher Condon

Jan. 30 (Bloomberg) -- James "Jes" Staley, head of JPMorgan Chase & Co.'s investment unit, said the \$4 trillion money-market fund industry is the "greatest systemic risk" to the financial system that hasn't been adequately addressed.

"What keeps me up at night most of anything we do at JPMorgan Asset Management is the money-market fund space,"

Staley said at a discussion hosted today by Credit Suisse Group AG in Davos, Switzerland. "One of the things that has to come out and get a lot more attention and discussion is how do we take the systemic risk posed by money funds out of the system?"

JPMorgan Asset Management oversees about \$500 billion of money-market funds, Staley said. The funds aren't allowed to set aside capital to absorb investment losses, leaving no "margin of error" against a potential collapse, he said.

Staley's remarks follow a set of proposed regulatory changes for the money-market fund industry from the Group of Thirty, an independent policy organization whose members include Treasury Secretary Timothy Geithner and Lawrence Summers, head of the White House's National Economic Council.

The recommendations, if adopted by regulators, would force money funds to choose between accepting banking-industry controls or giving up accounting rules that help them maintain a stable \$1-a-share net asset value, or NAV, which makes them the safest investment after bank accounts and Treasury bonds.

Reserve Collapse

The proposals in the Group of Thirty's Jan. 15 report were made in reaction to the collapse of the \$63 billion Reserve Primary Fund in September. Reserve Primary became only the second money fund to drop below \$1 a share, or break the buck, because of losses on debt issued by bankrupt Lehman Brothers Holdings Inc.

Reserve Primary's fall triggered an industrywide run on money-market funds that invest in corporate debt. That, in turn, froze the global commercial-paper market, cutting off a source of short-term capital for thousands of companies.

"The widespread run on money-market mutual funds has underscored the dangers of institutions with no capital, no supervision and no safety net operating as large pools of maturity transformation and liquidity risk," the report said.

JPMorgan's Staley blamed money funds for Lehman's collapse and the near bankruptcy of Bear Stearns Cos. last year. The funds, which typically hold highly rated, short-term debt instruments, were forced to pull their money from the firms when they saw signs of trouble, he said.

'Brought Down Lehman'

"The people who brought down Lehman and almost Bear Stearns weren't the banks,

they were the money funds," Staley said.

David Glocke, head of taxable money-market investments at Valley Forge, Pennsylvania-based Vanguard Group defended the industry.

"I'm aware there are those who want to blame the money- market industry for taking away the punch bowl," he said. "But issuers need to maintain diverse sources of funding."

The Group of Thirty proposals would require money funds maintaining a \$1 NAV to be regulated like banks with similar regulation, supervision and government insurance. If a fund manager didn't want to reorganize as a special purpose bank, it would have to give up the stable NAV of \$1 a share, according to the proposals.

Legal Requirements

Money-market funds regulated by Rule 2a-7 of the Investment Company Act of 1940 strive never to fall below a \$1 NAV, preserving investors' principal while paying interest. Fund investments are restricted to highly rated securities maturing in 13 months or less and don't have to be marked to market value every day.

"It would split the fund business, in effect: half into bank deposits and half into ultra-short bond funds," said Peter Crane, president of Crane Data LLC, a money-fund tracking firm in Westborough, Massachusetts.

Crane predicted the industry would fight the proposal "tooth and nail" and has the influence to win. "It's too big and important for such a dramatic change to be made," he said.

Ianthe Zabel, spokeswoman for the Investment Company Institute, a Washington-based trade group, declined to comment on the recommendations.

"My first reaction was 'Don't kill the patient'," Joan Swirsky, an attorney at Philadelphia-based law firm Stradley Ronon Stevens & Young, said about the proposals. "This needs to be thought through quite a bit because there are a lot of possible unintended consequences."

Unintended Effect

Swirsky, author of the book "The Guide to Rule 2a-7: A Map Through the Maze for the Money Market Professional," warned the recommendations could have the unintended effect of drawing money out of the commercial-paper market.

Vanguard's Glocke said the regulatory proposals should focus on securities issuers that lack adequate liquidity.

The money-fund industry "has a strong history of performance and offers an attractive place for people to invest cash," said Glocke, whose firm oversees \$199 billion in money- market assets.

The ICI created a working group in November to offer recommendations following Reserve Primary's collapse. Zabel said the group would release its report in the first quarter of 2009.

"We are aware of the recommendations and we are studying them," John Heine, spokesman for the U.S. Securities and Exchange Commission, the principal regulator of money funds in the U.S., said.

Money funds that invest in corporate debt held \$1.84 trillion as of Jan. 20, still less than the \$1.97 trillion they held when Reserve Primary collapsed, according to iMoneyNet, also of Westborough, Massachusetts. Total money fund assets have risen since then by 11 percent to \$3.82 trillion.

JPMorgan Asset Management oversees about \$1.1 trillion for its clients, including \$500 million in money-market assets, Staley said.

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