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OCTOBER 22, 2008

Fed Offers More Help to Money Funds

By JON HILSENRATH and DIYA GULLAPALLI

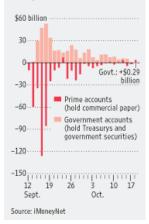
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In another move to bolster fragile credit markets, the Federal Reserve said it would lend as much as \$540 billion to the money-market mutual-fund industry, which has been plagued by investor withdrawals.

It is the third major step Fed officials have taken in the past month tailored to address troubles with money-market funds, which normally are low-risk investments that earn modest returns by investing in short-term debt.

Stemming the Flow

Daily net assets added to or withdrawn from institutional money-market accounts



The money-market industry has been in turmoil since mid-September, when a large fund called the Reserve Primary Fund, run by Reserve Management Co. of New York, was hit by losses from holdings of commercial paper issued by Lehman Brothers Holdings Inc., which filed for bankruptcy protection. Commercial paper is a kind of short-term debt that is widely held by many funds.

After the Primary fund's troubles became public, roughly \$500 billion flooded out of the "prime" money-market-fund sector -- which relies heavily on bank-issued commercial paper -- straining the ability of some funds to meet investor demands for cash.

More recently, some investors have been heading back into the prime-fund sector. For the week ended Oct. 14, retail prime money funds garnered \$13 billion, while institutional funds reaped \$3.38 billion, according to Money Fund Report. That is in contrast to outflows of \$5.6 billion and \$18.1 billion, respectively, a week earlier. Still, the inflows remain tentative.

"This is a really strong positive. It comforts funds and their investors by creating an alternative in the event a fund faces redemptions," said Joe Benevento, a managing director with Deutsche Bank's asset-management business.

Under the program, the money-market-fund industry will team up to create five new investment vehicles, known in accounting parlance as "special purpose vehicles." These vehicles will be managed by J.P. Morgan Chase & Co. and will buy certificates of deposit, bank notes and commercial paper held by money funds. Firms including Vanguard Group, BlackRock Inc. and Federated Investors Inc. offered input as the program was assembled.



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The money-market funds selling these instruments to the investment vehicle will get cash back in addition to 10% stakes in the special purpose vehicles. The Fed will lend to the special purpose vehicles, with the assets they hold as its collateral.

In effect, the move ensures that money funds can raise cash quickly from the Fed. The program can grow to up to \$600 billion, with the Fed providing \$540 billion in debt financing. It will backstop only high-rated A1/P1 short-term debt.

The move marks another dramatic transformation in the way the Fed manages its own finances. A year ago, it had an \$850 billion balance sheet that was filled mostly with U.S. Treasury bonds. It now has more than \$1.7 trillion in assets, most of them loans and commitments to banks and other struggling financial institutions in need of cash.

The money-market industry is a \$3.5 trillion business, according to the Investment Company Institute. Prime-money funds account for \$1.58 trillion of that, according to iMoneyNet Inc.

The Fed has taken a wide range of steps to support credit markets in the past few weeks. Under one program, it will begin buying commercial paper directly from some firms next week. Under another, it will backstop a kind of debt called asset-backed commercial paper.

Money-market-fund officials came to the Fed last month arguing that the programs were too narrow for them to handle the wave of investor redemptions they have faced. A senior Fed staffer said some funds could run out of liquid resources to meet redemption demands without Fed action.

Money funds remain nervous about holding instruments with maturities any longer than seven days. Big banks typically play a big role as so-called market makers facilitating trades. However, as such banks have become preoccupied with their own financial problems, a lot of secondary trading has seized up.

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