FINANCIAL TIMES
TUESDAY AUGUST 21 2007

Markets & Investing

Money market funds abused, claims founder

NEWS ANALYSIS

Bruce Bent, who introduced the idea of these vehicles in 1970, says they are being misused, write **Anuj Gangahar** and **Kate Burgess**

Bruce Bent, the inventor of the money market fund, has criticised the "flagrant abuse" of the concept – which he introduced in 1970 – that has come to light in recent weeks.

Mr Bent, who established the world's first money market fund, the Reserve Fund, says the original idea behind the fund is being ignored.

His displeasure stems from a sense that many money market funds have exposure to sectors or securities they should not be in, claiming his original concept was not designed to give investors any headline risk and should give them immediate liquidity and safety above all else.

"The money market fund was created to provide effective cash management, to guarantee at least a dollar in and a dollar back and beyond that, a reasonable rate of return," Mr Bent says.

Investors have sought safety during the subprime meltdown by moving their holdings to US Treasuries and money market funds.

They poured $49bn into such funds in just one week recently, following the recent collapse of two Bear Stearns hedge funds with exposure to US mortgages, according to the Investment Company Institute.

"Now many people and companies who are not cash managers are setting up money funds almost as an afterthought and a number of these fund managers have been found out recently," Mr Bent says.

He adds that the desire of some cash managers to post the best possible yield has left many overextending their reach and investing in areas such as subprime paper.

Analysts reckon money market funds with total assets of $300bn have invested in subprime debt this year.

Most investors, Mr Bent says, are unaware that some of the largest money market funds are putting their cash into one of the riskiest debt investments in the world – collateralised debt obligations backed by subprime mortgage loans.

"That is clearly inappropriate," Mr Bent says. "It really reflects poorly on what we are here to do. The sanctity of the dollar is key."

He adds that cash management must be viewed as a separate business and requires a certain skill. "In the current market environment, lots of money fund portfolio managers are acting as credit analysts when they are not. In fact, they wouldn't know if the underlying credit risk bit them on the behind."

Money market funds are important buyers of highly rated short-term debt such as commercial paper.

But many have changed their strategy recently, eschewing the higher returns on commercial paper and embracing a Treasury-only investment policy, contributing to the liquidity crisis.

Sentinel Management Group, a US money management firm, pointed to problems in the money markets when it filed for bankruptcy last week after having frozen its funds.

This month, Axa Investment Managers in France said it would shore up two of its money market funds that had invested heavily in subprime loans.

The funds were so-called "dynamic money market" or "Libor Plus" funds.

In early August, AXA reported that the funds lost more than a fifth of their value in a month with steep falls of about 13 per cent on July 18-19.

For more information about The Reserve's cash management products, services and solutions, please contact the appropriate area:

INSTITUTIONAL
Institutional Sales
888-851-7237
isales@TheR.com

BROKERAGE
Joe Martin
212-401-5797
800-637-1700, ext. 5797
jmartin@TheR.com

BANK
Steve Genereau
212-401-5759
800-637-1700, ext. 5759
sgenereau@TheR.com

You should carefully consider the investment objectives, risks and charges and expenses of a fund before investing. A fund's prospectus, which contains this and other information, may be obtained by writing to The Reserve, 1250 Broadway, New York, New York 10001-3701 or by calling 800-637-1700 and pressing "0." You should read the prospectus carefully before you invest.

"The Reserve", its related logos, "A Tradition of Financial Innovation", "The World's First Money-Market Fund" and "Founders of 'The World's First Money-Market Fund'" are service marks or registered service marks of Reserve Management Corporation in the United States and other countries.

R
The Reserve
A Tradition of Financial Innovation℠

© THE FINANCIAL TIMES LIMITED 2007