THE PERCEIVED GUARANTEE OF

BANK-AFFILIATED MONEY MARKET FUNDS

Excerpts from letters to the Federal Reserve Board concerning the growing investor perception that banking organizations are effectively guaranteeing their affiliated money market funds.
More importantly, the belief that banking organizations are guarantors of their affiliated money market funds creates a form of moral hazard that ultimately will prove harmful to investors and the financial system as a whole. If this belief persists, bank-affiliated money fund advisers will manage their fund portfolios at greater risk levels to achieve higher yields, expecting to be “bailed out” by their affiliated banking organizations if they encounter trouble.¹ Nonbank-affiliated money funds will feel competitive pressure to similarly increase their yields, but without any bank guarantor. An overall deterioration in the quality of money fund portfolios will result, ultimately with potentially disastrous consequences.

In addition to this moral hazard, the provision of financial support for money market funds by banking organizations has significant implications for bank balance sheets and the adequacy of capital in the banking system. An explicit guarantee of a money fund by a banking organization would require the organization to maintain additional capital to support the assumption of risk associated with the guarantee and, depending on the circumstances, an implicit guarantee also could subject the organization to additional capital charges. The amount of capital required would depend on the terms and conditions of the guarantee but could result in the entire fund being reflected on the bank’s balance sheet for capital purposes. As you know, the total assets in money market funds currently exceed $3.5 trillion, much of which is managed by bank-affiliated advisers.

The provision of financial support to an affiliated money fund by a banking organization also raises significant safety and soundness concerns. These concerns were addressed by the federal banking agencies in a 2004 policy statement.² The agencies stated that “banks are under no statutory requirement to provide financial support to the funds they advise” and expressed concern that a fund’s emergency liquidity needs “may prompt banks to support their advised funds in ways that raise prudential and legal concerns.”

Nevertheless, the agencies appeared to sanction and even encourage support for money market funds by banking organizations. The agencies acknowledged that “circumstances may motivate banks to do so for reasons of reputation risk and liability mitigation” and stated that, to avoid engaging in unsafe and unsound

¹ Although money market funds generally are considered to be safe investments, some funds carry more risk than others, depending on their portfolio composition. In the early 1990’s, a number of banking organizations were forced to bail out affiliated money market funds that pursued high-yield strategies by investing in inverse floaters on government securities and other derivatives that lost value when interest rates rose.

banking practices, banks should adopt appropriate policies and procedures governing routine or emergency transactions with bank advised investment funds. The agencies said that such policies and procedures should be designed to ensure that the bank will not “inappropriately” place its resources and reputation at risk for the benefit of the funds’ investors and creditors, violate sections 23A and 23B of the Federal Reserve Act, or create an expectation that the bank will prop up the advised fund. In lieu of bank support, the agencies encouraged banks to establish alternative sources of emergency support from their parent holding companies or other non-bank affiliates.

A bank holding company’s support of an affiliated money market fund creates the same moral hazard and capital burden as support by a bank and also raises significant bank supervisory issues. Under Regulation Y, a bank holding company is required to serve as a source of strength for its subsidiary banks.\(^3\) If bank holding companies were to become guarantors of bank-affiliated money market funds, their ability to support their subsidiary banks would be diminished.

The expectation that banking organizations will effectively guarantee their affiliated money market funds in the future also raises serious questions concerning the scope of the federal safety net that protects the banking system and whether it is appropriate to extend that protection on a routine basis to nonbanking institutions that historically have operated successfully outside of the safety net.

Accordingly, we urge the banking agencies to issue further guidance to both banks and bank holding companies dispelling the suggestion in the earlier policy statement that it is acceptable for a banking organization to provide support for an affiliated money market fund on a routine or emergency basis. Any such provision of support should be considered an extraordinary event resulting in extraordinary consequences for the banking organization. Among other things, the agencies should clarify the capital consequences of such support and require an organization to raise additional capital to cover the expectation that it is acting as a guarantor of its affiliated money market funds. Another consequence should be a supervisory review of the organization’s money fund advisory activities with the potential requirement that such activities be terminated.

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In this letter, we explain in greater detail the basis for our concerns that this perception is creating a source of moral hazard and systemic risk in the financial system. In an appendix hereto, we suggest ways that the banking agencies’

\(^3\) 12 C.F.R. § 225.4(a)(1).
The Interagency Policy Statement on this subject might be clarified to discourage such a perception.  

The Interagency Policy Strongly Supports the Perception of a Guarantee for Bank-Affiliated Money Market Funds by Creating a Supervisory Framework for Such Support

We understand that the Interagency Policy is not intended to encourage banks to act as guarantors of affiliated money market funds. Indeed, it highlights the legal impediments and safety and soundness concerns regarding such support by banks and instructs banks to adopt policies and procedures designed to avoid creating an expectation that a bank will prop up an affiliated fund.

Nevertheless, the Interagency Policy creates a supervisory framework for banking organizations to support their affiliated funds and strongly supports the perception of both an explicit and implicit guarantee. Notably, the Policy imposes no significant limitations on bank holding company support for bank-affiliated funds.

The Policy states that banks may be motivated to support their affiliated funds “for reasons of reputation risk and liability mitigation” and that, to avoid engaging in unsafe and unsound banking practices, “banks should adopt appropriate policies and procedures governing routine or emergency transactions with bank-advised investment funds.” The Policy thus condones support transactions that occur within a framework of policies and procedures. The Interagency Policy states:

The banking agencies “expect” banking organizations to establish alternative emergency support from the parent bank holding company or other affiliates. Such action is to be taken prior to seeking support from the bank.

The banking agencies “expect” a banking organization to institute policies and procedures for identifying circumstances triggering the need for financial support and the process for obtaining it.

In the limited instances when a bank (as opposed to bank holding company) provides financial support, the banking

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agencies “expect” a bank’s procedures to include an oversight process that requires formal approval from the bank’s board of directors, or an appropriate board designated committee, independent of the investment advisory function.

The banking agencies “expect” a banking organization to implement policies and procedures to mitigate the need for significant bank (as opposed to bank holding company) support.

The banking agencies “expect” a banking organization to ensure proper regulatory reporting of contingent liabilities (such as support agreements) arising from its investment advisory activities in accordance with FAS 5.

Bank management should notify and consult with the appropriate banking agency prior to (or immediately after, in the event of an emergency) the provision of material financial support by a bank (but not a bank holding company) to its advised funds. The banking agency will closely scrutinize the circumstances and address situations that raise supervisory concerns.

These supervisory expectations create a framework under which banking organizations may support their affiliated money market funds on both a routine and emergency basis. The framework for bank involvement in providing such support is more limited than for bank holding companies or nonbank affiliates. Indeed, bank holding companies appear to be subject to no significant limitations under the Interagency Policy.  

Investors often do not distinguish between a bank and its nonbank affiliates and are unable to ascertain which entity within a banking organization provides support to a bank-affiliated fund. This confusion is not surprising in light of the public reports filed by bank holding companies with the Securities and Exchange Commission that obscure the regulatory distinctions between banks and their affiliates. In those reports, banking organizations do not specifically address which entity within the consolidated organization has provided financial support to an affiliated fund. Nor is such information clearly provided in SEC no-action letters approving such support or otherwise readily available.

5 The title of the Interagency Policy Statement even suggests that it does not apply to bank holding companies.
In any event, support for an affiliated fund can be substantial regardless of whether it comes from a bank or nonbank affiliate within a banking organization. From an investor’s perception, it is immaterial which entity within a banking organization provides the support.

The Perception of a Guarantee is Affirmed by Numerous Financial Support Arrangements by Banking Organizations with Bank-Affiliated Money Market Funds

The perception that the federal banking agencies readily allow banking organizations to support their affiliated money market funds may arise from the numerous financial support arrangements that banking organizations have entered into with their affiliated money market funds during the past 18 months.

The SEC granted approximately 25 exceptions from the Investment Company Act to allow fund sponsors to provide various forms of financial support to their affiliated funds during this time. By far, the majority of these fund sponsors were affiliated with banks—mostly national banks. I am enclosing an appendix showing the amounts involved in these support arrangements as reported in public company filings with the SEC. What the data show is that:

Nearly all of the substantial money market fund support arrangements involved bank-affiliated funds.

Nearly all banking organizations that advise money market funds supported one or more of their funds.

Data is not available to show the total amount of fund assets that were supported by bank-affiliated fund advisers, but the number likely is in excess of $1.0 trillion. Based on the data we do have, it appears that banking organizations incurred losses in excess of $6.0 billion in providing this support.6

The Perception of a Guarantee is Affirmed by Banking Organization Support Agreements for SIVs and Other Investment Vehicles

The perception that banking organizations are guaranteeing their affiliated money market funds also may arise from arrangements by which banking

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6 It is impossible to know the total amount of support that has been provided to bank-affiliated money market funds or the related losses because this information is not always required to be disclosed, or disclosed clearly.
organizations have supported other types of investment vehicles. These include structured investment vehicles or “SIVs” and special purpose entities or “SPEs.”

Major banking organizations have purchased assets from their sponsored SIVs and SPEs and in some cases actually have consolidated the SIVs onto their own balance sheets. 7 These support arrangements have involved substantial billions of dollars. 8 In some cases, these arrangements may have threatened the solvency of the institution involved, absent federal assistance.

Assuming that the organizations providing this support followed the Interagency Policy, they would have consulted with the OCC and/or Federal Reserve and obtained supervisory approval for these arrangements.

In each case, it appears that the justification for allowing these bailout arrangements was to mitigate “reputation risk” and potential legal liability to the banking organization, even though the organization’s solvency was in question.

The Perception of a Guarantee is Affirmed by OCC Interpretive Letters and Regulations Authorizing National Banks To Guarantee Mutual Funds and Affiliates

The OCC in 2004 issued an interpretive letter authorizing a national bank to provide financial warranties on the investment advice and asset allocation services provided by the bank in the creation and operation of a mutual fund. 9 The OCC conditioned its approval on the bank’s adoption of satisfactory risk management procedures and internal controls designed to ensure that the activities were conducted

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7 See, e.g., Citigroup 10-K Annual Report for FY 2007, p. 8: “On December 13, 2007, Citigroup announced its decision to commit, not legally required, to provide a support facility that would resolve uncertainties regarding senior debt repayment facing the Citi-advised Structured Investment Vehicles (SIVs). As a result of the Company’s commitment, Citigroup included the SIVs’ assets and liabilities in its Consolidated Balance Sheet as of December 31, 2007. This resulted in an increase of assets of $59 billion. (emphasis added) On February 12, 2008, Citigroup finalized the terms of the support facility, which takes the form of a commitment to provide mezzanine capital to the SIV vehicles in the event the market value of their capital notes approaches zero.”

8 See Bank of America Corporation 10-K Annual Report for FY 2007. Bank of America reported that its total liquidity exposure to off-balance sheet SPEs was $104.1 billion as of December 31, 2007.

9 OCC Interpretive Letter No. 1010 (Sept. 7, 2004). The financial warranties were designed to guarantee that investment structuring advice and asset allocation monitoring services provided by the bank to the fund would perform as designed. The financial warranty guaranteed that the bank would make up any shortfall between the “guaranteed amount” to investors on the maturity date and the fund’s then current net asset value.
safely and soundly.\textsuperscript{10} Again, the OCC allowed a national bank to guarantee an affiliated fund within a framework of policies and procedures.

In April of 2008, the OCC amended its regulations to expand the authority of national banks to issue guarantees to their customers and affiliates. The regulation, which would cover affiliated money market mutual funds, states as follows:

\begin{quote}
a national bank may guarantee obligations of a customer, subsidiary or affiliate that are financial in character, provided the amount of the bank’s financial obligation is reasonably ascertainable and otherwise consistent with applicable law.\textsuperscript{11}
\end{quote}

The OCC stated that the issuing bank must be able to determine the extent of its exposure and engage in the activity in a safe and sound manner. A bank also must comply with other applicable laws, such as sections 23A and 23B of the Federal Reserve Act. In adopting the regulation, the OCC stated:

\begin{quote}
The OCC has emphasized that banks must be able to respond to the evolving needs of their customers, provided always that such guarantees be issued and managed in a safe and sound manner. Permitting national banks to exercise their broad authority to act as guarantor or surety benefits customers by giving banks greater ability to facilitate customers’ financial transactions and by providing banks with greater flexibility to provide financial services in evolving markets.\textsuperscript{12}
\end{quote}

\textsuperscript{10} The OCC stated that “the nature of this complex financial transaction requires sophisticated risk measurement and management capacities on the part of the bank and qualified personnel in order for the activity to actually function as described and to operate in a safe and sound manner.” An effective risk measurement and management process, the OCC said, would include appropriate oversight and supervision, managerial and staff expertise, comprehensive policies and operating procedures, risk identification and measurement, and management information systems, as well as an effective and independent risk control function that oversees and ensures the appropriateness of the risk management process. The OCC also required the bank to seek a regulatory capital opinion concerning treatment of the financial warranties for capital purposes.

\textsuperscript{11} 12 C.F.R. § 7.1017(b).

\textsuperscript{12} 73 Fed. Reg. 22215, 22226 (April 24, 2008). The OCC noted that a bank must adopt appropriate risk management processes in connection with its guarantee activities: “[A]dequate risk measurement and management processes tailored to manage and control the risks of financial guaranty activities are necessary to ensure that a bank is conducting its financial guaranty activity in a safe and sound manner. These include appropriate standards set by the board of directors, managerial and staff expertise, policies and operating procedures, risk identification and measurement, and ongoing evaluation of the specific guarantees issued; management information systems; and an effective risk control function that oversees and ensures the appropriateness of the risk management process. Such risk measurement and risk management processes should be of a scope and scale appropriate for the nature and complexity of the bank’s financial guaranty activities.” Id.
In response to one commenter’s suggestion that the OCC require national banks to conduct financial guarantee activities through separately capitalized subsidiaries, the OCC stated:

The OCC declines to adopt this approach. As indicated above, acting as a guarantor involves the core banking powers of both lending and acting as financial intermediary and is therefore a permissible banking activity that need not be conducted only in a separate legal entity. OCC rules prescribe the appropriate regulatory capital treatment for guarantor activities. Moreover, the circumstances under which the revised provision authorizes guarantor activities—the financial guaranty is reasonably ascertainable in amount and complies with applicable law—are safeguards promoting the conduct of these transactions in a safe and sound manner. Accordingly, it is not necessary to require national banks to conduct this activity in a separately capitalized affiliate.\(^\text{13}\)

The Capital Implications of Banking Organization Support for Money Market Funds Are Profound

The capital implications of banking organization support for affiliated money market funds are potentially profound. Under the Basel I capital rules that currently apply to all banks, such support may fall within the definition of a “direct credit substitute.”\(^\text{14}\) The capital rules require a bank to convert all of the assets supported by a direct credit substitute to an on-balance sheet credit equivalent amount and assign a credit conversion factor of 100 percent.\(^\text{15}\)

Thus, a banking organization that provides financial support to prevent an affiliated money market fund from breaking a dollar would be required to convert all of the assets supported by the arrangement to an on-balance sheet credit equivalent in an amount equal to all of the assets supported being supported—i.e., all of the assets

\(^{13}\) Id.

\(^{14}\) A “direct credit substitute” is defined to mean “an arrangement in which a bank assumes, in form or in substance, credit risk associated with an on- or off-balance sheet asset or exposure that was not previously owned by the bank (third party asset) and the risk assumed by the bank exceeds the pro rata share of the bank’s interest in the third-party asset. If a bank has no claim on the third-party asset, then the bank’s assumption of any credit risk is a direct credit substitute. Direct credit substitutes include . . . guarantees, surety arrangements, credit derivatives and similar instruments backing financial claims that exceed a bank’s pro rata share in the financial claim. . . .” 12 C.F.R. Pt. 3, Appendix A, § 4(a)(4).

\(^{15}\) 12 C.F.R. Pt. 3, Appendix A § 4(b)(1).
in the fund.\textsuperscript{16} In other words, the banking organization would be required to maintain capital as if the entire fund were on its balance sheet.

The underlying assets in the fund then would be risk-weighted according to the risk-based capital rules. Commercial paper held by the fund would be risk weighted at 100 percent. Mortgage-backed securities would be risk weighted at 50 percent. Obligations of government sponsored entities would be risk weighted at 20 percent, and direct U.S. obligations would be risk weighted at zero.

Moreover, a banking organization that provides credit support to a money market fund beyond the level of support it is legally obligated to provide under an explicit agreement may be deemed to be providing “implicit recourse.” When implicit recourse is found in the case of a securitization trust, for example, the regulators require the \textit{entire amount} of securitized assets to be put back onto the bank’s balance sheet. The banking organization may be presumed to provide implicit recourse to any new securitization trust it sponsors as well.

Accordingly, even though a banking organization may assume direct liability for a small percentage of a money market fund’s assets, the capital rules treat the bank as supporting the \textit{entire fund} for capital purposes. If the banking organization assumes liability beyond that which it is legally obligated to provide, the capital rules may treat the organization as supporting \textit{all of its other affiliated funds as well}.

Of the nearly $4 trillion in assets currently held in money market funds, a significant portion is held in bank-affiliated funds. Thus, banking organizations that lend credit support to their affiliated money market funds are incurring very substantial capital liabilities under the capital rules.

It does not appear that the banking agencies have required banking organizations to maintain capital in the amounts required under the capital rules to support their direct credit substitute arrangements with money market funds. In view of emergency conditions during the past 18 months, supervisory forbearance in this regard may be understandable. Going forward, however, it would seem appropriate for the banking agencies to remind banks of the applicability of the direct credit substitute rules (and also the implicit recourse rules) and to enforce those rules if banking organizations provide credit support for their affiliated money market funds in the future.

\textsuperscript{16}This result is consistent with the treatment of bank recourse arrangements in connection with securitizations, such as when a bank agrees to assume losses in connection with loans sold to a securitization trust. The banking agencies amended the capital rules in 2001 to address this kind of risk. 66 Fed. Reg. 59614 (Nov. 29, 2001).
Banking Organization Support of Money Market Funds
Creates Moral Hazard and Potential Systemic Risk

Bank-affiliated funds appear to have had a disproportionate need for support relative to the rest of the money market fund industry during the past 18 months. This disproportion raises questions concerning the quality of the credit standards and review processes at bank-affiliated funds, as well as other funds that required financial support.

The support typically was necessitated by credit downgrades of assets in the funds’ portfolios and was needed to prevent a fund’s net asset value from falling below $1.00 (i.e., breaking a dollar). In many cases, the credit-impaired assets were SIVs sponsored by large banks whose assets included residential mortgages.

The SEC has noted that “some money market funds invested more significantly in SIV securities while other money market funds avoided such investments entirely.” The SEC has suggested that the credit analysis performed by managers of funds that invested in SIVs was less rigorous than at funds that did not invest in SIVs and did not need support:

The staff’s recent examinations of money market funds indicate that credit analysts for money market funds that invested in SIVs that subsequently defaulted appear to have had access to the same basic set of information on SIVs as did analysts at money market funds that did not and that the judgment of these credit analysts regarding minimal creditworthiness of the SIVs that subsequently defaulted appeared to have been different. The staff’s exams also appear to indicate that credit analysts for money market funds that invested in SIVs that subsequently defaulted placed less emphasis on the length of time that payment experience was available on assets in the collateral pool and they were willing to accept sub-prime mortgage credits as a seasoned asset class. In addition, their decision, in part, may have been influenced by the greater amount of over-collateralization of the collateral pools and the high yields paid by notes supported by sub-prime credits.

A money market fund is permitted to invest only in securities that the fund’s board of directors or credit review committee determines present minimal credit

risks. The SEC previously had cautioned that SIVs and other asset-backed securities require careful credit review.

The apparent disproportionate need for financial support by bank-affiliated money market funds suggests the possibility that some of these funds may have been managed with less rigorous credit standards than funds that were not bank-affiliated and did not need support. One plausible explanation for this disproportion is the moral hazard that arises when fund managers know that bad investment decisions will be underwritten by an affiliate with deep pockets.

This moral hazard is amplified when a regulatory process exists for affiliate support, when affiliate support has occurred in numerous instances in the past, and when regulators have allowed banking organizations to provide large amounts of support in order to avoid harm to their reputations, even at the potential risk of the organization’s solvency.

This moral hazard creates the potential for systemic risk in the financial system. It creates the possibility that bank-affiliated money market funds will be managed with marginally greater risk to achieve marginally greater yields, creating competitive pressure on nonbank-affiliated money market funds to do the same. If that occurs, the result will be an overall lowering of credit standards in the money market fund industry with the potential for some future event to destabilize the industry, as occurred last year. Any destabilization of the money market fund industry could have potentially serious consequences for the commercial paper market and the economy as a whole, as we have seen.

Banking Organization Support of Money Market Funds Expands the Federal Safety Net Outside the Banking System

The expectation that banking organizations will effectively guarantee their affiliated money market funds in the future raises serious questions concerning the scope of the federal safety net that protects the banking system. The federal “safety

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19 SEC Rule 2a-7(c)(3)(i).
21 The Reserve Primary Fund broke a dollar in September of 2008, for example, because its portfolio managers held onto commercial paper of Lehman Brothers in the mistaken belief that the government would rescue Lehman, as it did Bear Stearns—a clear manifestation of moral hazard.
22 It also is known that regulators exerted significant pressure on banking organizations to bailout their affiliated money market funds in 1993 and 1994 when many of them experienced credit quality problems due to investments in “inverse floaters” related to government securities.
“Net” traditionally has been thought of as the system of implicit and explicit government guarantees that stand behind the banking system.\textsuperscript{23}

Banking supervisors in the past have sought to limit the scope of the safety net as a matter of policy and voiced concerns about the expansion of the safety net to cover nonbank affiliates of banks and risks from non-traditional activities.\textsuperscript{24} These concerns have focused on the potential for increased taxpayer costs stemming from large bank failures and demands on supervisory resources as well as complaints that the safety net effectively subsidizes nonbank affiliates, giving them an unfair competitive advantage over nonbank competitors that do not enjoy deposit insurance and other safety net benefits. Concerns also have been raised that the implicit federal safety net guarantee creates “moral hazard” by inducing excessive risk-taking and uneconomic market behavior, resulting in artificial distortions in the marketplace. These concerns seem even more relevant now.

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Based on the foregoing, we remain concerned by the growing perception that banking organizations are guarantors of bank-affiliated money market funds.

In the enclosed document, we suggest revisions to the Interagency Policy Statement to help minimize this perception and thereby minimize moral hazard and systemic risk.

Thank you for your attention to this matter.

Sincerely,

Melanie L. Fein

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\textsuperscript{23} Historically, the federal safety net has included federal deposit insurance, access to the Federal Reserve discount window for liquidity purposes, access to Fedwire and daylight overdrafts, and prudential supervision designed to ensure banking safety and soundness.

\textsuperscript{24} See generally Statement of Federal Reserve Board Chairman Alan Greenspan before the Senate Committee on Banking, Housing and Urban Affairs (June 17, 1998); Lehnert and Passmore, “The Banking Industry and the Safety Net Subsidy,” Federal Reserve Board, Finance and Economics Discussion Series 99-34.
The following are excerpts from filings with the Securities and Exchange Commission by some, but not all, of the bank holding companies and other firms that provided support for their affiliated money market funds during 2007 and 2008. As shown, banking organizations provided substantial amounts of support to their affiliated funds. SEC documents show that nearly every banking organization that advises a money market fund either provided cash support or purchased securities (primarily SIVs) from the funds. J.P. Morgan was the notable exception. Nonbank advisers that did not provide support to their funds include Fidelity, Vanguard, Blackrock, and Federated Investors, among others. The following also includes excerpts showing direct support for SIVs by Citigroup and Morgan Stanley.

Bank of America Corporation

(pg. 41 of 2008 10-K)

We entered into capital commitments under which the Corporation provided cash to these funds in the event the net asset value per unit of a fund declined below certain thresholds. The capital commitments expire no later than the third quarter of 2010. At December 31, 2008 and 2007 we had gross (i.e., funded and unfunded) capital commitments to the funds of $1.0 billion and $565 million. During 2008 and 2007, we incurred losses of $695 million and $382 million related to these capital commitments. At December 31, 2008 and 2007, the remaining loss exposure on capital commitments was $300 million and $183 million.

Additionally, during 2008 we purchased $1.7 billion of investments and recorded losses of $366 million related to these securities and $52 million of other-than-temporary impairment losses recorded subsequent to purchase. During 2007, we purchased $585 million of certain investments from the funds and subsequently recorded other-than-temporary impairment losses in All Other of $394 million. At December 31, 2008 and 2007, we held AFS debt securities with a fair value of $698 million and $163 million of which $279 million and $163 million were classified as nonperforming AFS securities. At December 31, 2008, $272 million of unrealized losses on these investments were recorded in accumulated OCI.
Wachovia

In the third quarter of 2007, the Company purchased and placed in the securities available for sale portfolio $1.1 billion of asset-backed commercial paper from Evergreen money market funds, which the Company manages.

Wells Fargo

We entered into a capital support agreement in first quarter 2008 for up to $130 million related to an investment in a structured investment vehicle (SIV) held by our AAA-rated non-government money market funds. In third quarter 2008, we fulfilled our obligation under this agreement by purchasing the SIV investment from the funds. At December 31, 2008, the SIV investment was recorded as a debt security in our securities available-for-sale portfolio. In addition, at December 31, 2008, we had outstanding support agreements of $101 million to certain other funds to support the value of certain investments held by those funds.

US Bancorp

The $344 million (4.9 percent) increase in 2007 noninterest income over 2006, was driven by fee-based revenue growth in most fee categories, offset somewhat by $107 million in valuation losses related to securities purchased from certain money market funds managed by an affiliate in the fourth quarter of 2007.

HSBC North America

Included in available-for-sale investment securities are structured investment vehicle and related securities (SIV) purchased in the fourth quarter of 2007 from certain money market funds managed by FAF Advisors, Inc., an affiliate of the Company. During 2008, the Company exchanged its interest in certain SIVs for a pro rata portion of the underlying investment securities according to the applicable restructuring agreements. The carrying amounts of exchanged SIVs were allocated to the investment securities received based on relative fair value. During 2008 the Company recorded $550 million of impairment charges on SIV-related investments subject to SOP 03-3.
Money Market Funds. We have established and manage a number of constant net asset value (CNAV) money market funds that invest in shorter-dated highly-rated money market securities to provide investors with a highly liquid and secure investment. . . At December 31, 2007, one of these sponsored CNAV funds, which had total net assets of $7.6 billion, held $558 million of investments issued by SIVs. As a result of the market conditions, those SIV investments experienced declines in market value. We have no legal obligation to offer financial support to this fund in the event that it is unable to maintain a constant net asset value as a result of becoming unable to value its assets at amortized cost. This fund, however, has received financial support from an affiliate, which provided a letter of limited indemnity in relation to certain SIV investments held by the fund.

SunTrust

(pg. 119-120 of 2008 10-K)

RidgeWorth Family of Mutual Funds. RidgeWorth Capital Management, Inc., (RidgeWorth), formerly known as Trusco Capital Management, Inc., a registered investment advisor and wholly-owned subsidiary of the Company, serves as the investment advisor for various private placement and publicly registered investment funds (collectively the Funds). . . While the Company does not have any contractual obligation to provide monetary support to any of the Funds, the Company did elect to provide support for specific securities on one occasion in 2008 and two occasions in 2007. In September 2008, the Company purchased, at amortized cost plus accrued interest, a Lehman Brothers Holdings, Inc. (Lehman Brothers) security from the RidgeWorth Prime Quality Money Market Fund. This fund received a cash payment for the accrued interest and a $70 million SunTrust-issued note which will mature on September 30, 2009. The Lehman Brothers security went into default when Lehman Brothers filed for bankruptcy in September.

In December 2007, the Company purchased, through a combination of cash and SunTrust-issued notes, approximately $1.4 billion in SIV securities from the RidgeWorth Prime Quality Money Market Fund and the RidgeWorth Institutional Cash Management Money Market Fund at amortized cost plus accrued interest. . . RidgeWorth is the investment adviser to these funds. The Company took this action to protect investors in these funds from possible losses associated with these securities. . . The Company recorded a pre-tax mark to market valuation loss of $250.5 million in the fourth quarter of 2007 as a result of purchasing these securities. During 2008, the Company recorded $40.4 million of net market valuation losses, sold approximately $359.0 million in securities, and received over $613.8 million in payments from paydowns, settlements, and maturities from these securities.

Northern Trust

(pg. 22 of 2008 annual report)
Client Support Related Charges
Pre-tax charges totaling $314.1 million ($198.8 million after tax, or $.88 per common share) in connection with support provided to cash investment funds under capital support agreements.

Credit Suisse

(pg. 77-79 of 2008 annual report)
Securities purchased from our money market funds. In the second half of 2007, we repositioned our money market funds by purchasing securities of CHF 9,286 million from these funds with the intent to eliminate SIV, ABS, CDO and US subprime exposure. The securities transactions were executed in order to address liquidity concerns caused by the US market’s challenging conditions. We had no legal obligation to purchase these securities. We lifted out CHF 269 million of corporate securities and CHF 108 million of ABS from our money market funds in 2008. As of the end of 2008, the fair value of our balance sheet exposure from these purchased securities was CHF 567 million, down CHF 3,354 million, or 86%, from 2007. Of the CHF 567 million balance sheet exposure, CHF 5 million was US subprime, compared to CHF 419 million as of the end of 2007, and CHF 356 million were securities issued by SIVs, of which the largest position was CHF 319 million. Net losses on securities purchased from our money market funds were CHF 687 million in 2008, compared to CHF 920 million in 2007. In the third quarter of 2008, one of the money market funds advised by us was under redemption pressure due to the deteriorating money and credit markets. In order to provide liquidity, we invested USD 2.2 billion (CHF 2.5 billion) in units issued by the fund. With redemptions totaling USD 0.7 billion (CHF 0.7 billion) in the fourth quarter, we decreased our investment in this money market fund to USD 1.5 billion (CHF 1.6 billion) as of the end of 2008. This fund is an SEC-registered Rule 2a-7 fund invested in commercial paper and other short-term securities rated at least A1/P1. At the end of 2008, in line with our strategy to focus on higher margin, scalable businesses, we decided to close these money market funds. Accordingly, these funds were consolidated as of December 31, 2008.

Citigroup

(pg. 11 of 2008 10-K)
Structured Investment Vehicles (SIVs). On December 13, 2007, Citigroup announced a commitment to provide support facilities to its Citi-advised SIVs for the purpose of resolving the uncertainty regarding the SIVs’ senior debt ratings. As a result of this commitment, the Company consolidated the SIVs’ assets and liabilities onto Citigroup’s Consolidated Balance Sheet as of December 2007. This resulted in an increase of assets of $59 billion.
On February 12, 2008, Citigroup finalized the terms of these support facilities, which took the form of a commitment to provide $3.5 billion of mezzanine capital to the SIVs. The mezzanine capital facility was increased by $1.0 billion to $4.5 billion, with the additional commitment funded during the fourth quarter of 2008. During the period to November 18, 2008, Citigroup recorded $3.3 billion of trading account losses on SIV assets.

To complete the wind-down of the SIVs, Citigroup committed to purchase all remaining assets out of the SIV legal vehicles at fair value, with a trade date of November 18, 2008. Citigroup funded the purchase of the assets by assuming the obligation to pay amounts due under the medium-term notes issued by the SIVs as the notes mature. The assets purchased from the SIVs and the liabilities assumed by the Company were previously recognized at fair value on the Company’s balance sheet due to the consolidation of the SIV legal vehicles in December 2007.

The net cash funding provided by Citigroup for the asset purchase was $0.3 billion. As of December 31, 2008, the balance for these repurchased SIV assets totaled $16.6 billion, of which $16.5 billion is classified as held to maturity. See “Structured Investment Vehicles” on page 15 for a further discussion.

(Structured Investment Vehicles (SIVs))

On December 13, 2007, Citigroup announced its decision to commit to provide a support facility that would resolve uncertainties regarding senior debt repayment facing the Citi-advised Structured Investment Vehicles (SIVs). As a result of the Company’s commitment, which was not legally required, Citigroup consolidated the assets and liabilities of the SIVs as of December 31, 2007. This resulted in an increase of assets of $59 billion.

Morgan Stanley

Money Market Funds and Structured Investment Vehicles. In September 2008, the Company purchased approximately $23 billion of securities from the funds, which are included in the Company’s condensed consolidated statement of financial condition. The securities were purchased by the Company to fund investor redemptions amidst illiquid trading markets for a wide range of money market instruments. Securities purchased included commercial paper, municipals, certificates of deposit and notes. All of the securities were short term in nature and rated A1 / P1 or better. These purchases were funded primarily through various available stabilization facilities.

In the second half of fiscal 2007, widespread illiquidity in the commercial paper market led to market value declines and rating agency downgrades of many
securities issued by SIVs, some of which were held by the funds. As a result, the Company purchased at amortized cost approximately $900 million of such securities from the funds during fiscal 2007 and $217 million of such securities during the nine month period ended August 31, 2008. During the quarter and nine month period ended August 31, 2008, the Company recorded losses of $10 million and $283 million, respectively, on these securities.

SEI

(pg. 21 of 2008 10-K)

Our earnings during 2008 were adversely affected by a non-cash charge of $148.9 million related to the ongoing support we are providing in the form of the Capital Support Agreements for two of our money market funds that hold senior notes issued by SIVs. We also recognized a loss of $9.3 million in 2008 from the decline in fair value of SIV securities purchased directly from the one of our funds. Total charges in 2008 from the Capital Support Agreements and the SIV securities were $158.2 million.

(pg. 22 of 2008 10-K)

We recorded a non-cash charge of $25.1 million in the fourth quarter 2007 related to agreements that provide capital support to money market funds holding investments that are exposed to liquidity and credit risk (See Money Market Fund Support later in this discussion).

(pg. 24-26 of 2008 10-K)

Money Market Fund Support. In late 2007, we entered into Capital Support Agreements with the SEI Daily Income Trust Prime Obligation Fund (the SDIT PO Fund), the SEI Daily Income Trust Money Market Fund (the SDIT MM Fund), and the SEI Liquid Asset Trust Prime Obligation Fund (the SLAT PO Fund) (each a Fund or, together, the Funds). We are the advisor to the Funds. The sub-adviser to the Funds is Columbia Management, which is the primary investment management division of Bank of America Corporation. Many of our clients are investors in the Funds.

Since the time we entered into the Capital Support Agreements in late 2007, significant illiquidity issues persisted in the credit markets which caused the market values of the collateral underlying the SIV securities to decline. This triggered ratings downgrades on the SIV securities from the principal rating agencies which required us to post additional capital support to the SDIT PO Fund in order for it to maintain a AAA rating by S&P. In late 2008, we amended the Capital Support Agreements with the SDIT PO Fund and the SLAT PO Fund. We also amended our credit facility to increase the aggregate amount available for borrowings up to $300.0 million (See Liquidity and Capital Resources section later in this discussion and Note 8 to the Consolidated Financial Statements).
On September 30, 2008, we purchased the Gryphon (formerly Cheyne) notes directly from the SDIT MM Fund. The Gryphon notes were the last remaining SIV securities held by this Fund. The cash purchase price paid to the SDIT MM Fund of **$15.3 million** was equal to the amortized cost of the Gryphon notes. The market value on that date was $8.7 million and as of December 31, 2008 was $5.7 million. The total loss recognized through December 31, 2008 was $9.3 million.

. . . . As of December 31, 2008, the amount of our obligation to commit capital to the Funds was **$174.0 million**, but this amount was not required to be paid since the Funds did not realize any loss from the sale of the SIV securities. The amount of our obligations recognized is reflected in Net loss from investments on the Consolidated Statements of Operations.

The obligations under the Amended Capital Support Agreements are secured by letters of credit of a third party bank rated A-1 by S&P. The letters of credit were issued under our existing credit facility that provides for borrowings up to $300.0 million. The letters of credit have a term of one year. As of December 31, 2008, we have $190.0 million of letters of credit outstanding (See Liquidity and Capital Resources section later in this discussion).

. . . . Our total risk of loss from SIV securities is limited to the aggregate remaining par value held by the Funds and on our balance sheet. As of February 20, 2009, the aggregate par value of these securities totaled **$336.5 million**. We do not engage in any lending activities or any other activity that exposes us to a risk of loss associated with the illiquidity issues in the credit markets.

The Amended Capital Support Agreements are considered derivative contracts in accordance with applicable accounting guidance and are categorized as Level 3 liabilities as specified by SFAS No. 157 (SFAS 157), Fair Value Measurements (See Fair Value Measurements section later in this discussion). These Level 3 liabilities comprise 53 percent of our total current liabilities at December 31, 2008.

**Legg Mason**

(p. 35 of 2008 annual report)

[W]e entered into several transactions during the fiscal year to provide support to liquidity funds that are managed by our asset managers that had invested in SIV-issued securities. These transactions resulted in aggregate charges during fiscal year 2008 of **$608.3 million** ($313.7 million, net of income taxes and compensation related adjustments).
Janus

(p. 14 of 2008 10-K)
During 2007, . . . JCG recognized impairment charges of $21.0 million and $18.2 million in 2008 and 2007, respectively, associated with structured investment vehicle (“SIV”) securities acquired from money market funds advised by Janus.

(p. 21-23 of 2008 10-K)
Money Market Funds Advised by Janus. . . . JCG's recently announced plan to exit the institutional money market business is expected to substantially reduce the likelihood of the Money Funds holding a distressed security. Institutional money market portfolios typically hold higher yielding assets, and therefore have a higher risk, as compared to retail money market portfolios.

Given recent market events impacting liquidity for mutual funds, including money market funds, JCG has enhanced its emphasis on managing the Money Funds for capital preservation and liquidity while remaining in line with their investment objectives.

Financial Support Provided to the Funds. On December 21, 2007, Moody's Investors Service, Inc. downgraded securities issued by certain SIVs including those issued by Stanfield Victoria Funding LLC ("Stanfield securities") to a rating below what is generally permitted to be held by the Money Funds. The Money Funds held $105.0 million of Stanfield securities plus $3.5 million of accrued interest at the time of the downgrade. In connection with this downgrade, JCG determined that it was in the best interests of the applicable Money Funds and their shareholders for JCG to purchase the Stanfield securities from the Money Funds at amortized cost plus accrued interest. Subsequent to purchase, JCG has recognized impairment charges totaling $39.2 million (including $3.5 million of purchased accrued interest), reflecting the difference between the low end of the range of estimated fair value and the purchase price of the Stanfield securities. In addition, JCG received a cash distribution totaling $17.1 million which reduced the carrying value of the Stanfield securities. Included in JCG's estimate of fair value is the assumption that no interest income payable on the securities will be received. JCG's total additional risk of loss with respect to the Stanfield securities at December 31, 2008 is limited to the $52.2 million carrying value of its investment.
SUGGESTED REISSUANCE OF INTERAGENCY POLICY STATEMENT

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Board of Governors of the Federal Reserve System
Office of Thrift Supervision

__________ 2009

Interagency Policy on Financial Support for Bank-Affiliated Funds

Purpose and Scope

This interagency policy is issued jointly by the federal banking agencies, including the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (Board), and the Office of Thrift Supervision (OTS) (the agencies) to alert banking organizations, including their boards of directors and senior management, of the safety and soundness implications of, legal impediments to, and supervisory concerns regarding a banking organization providing financial support to investment funds advised by the bank, its subsidiaries, or affiliates (“bank-affiliated funds”).

This interagency policy originally was issued in 2004 and is being re-issued at this time with clarifications to minimize the possibility of investor perception that banking organizations are guarantors of their bank-affiliated funds.

A banking organization’s investment advisory services can pose material risks to its liquidity, earnings, capital, and reputation, and can harm investors, if the associated risks are not effectively controlled. The agencies have concluded that recent market developments, including market volatility, the continued low interest rate environment, and operational and corporate governance weaknesses, warrant the issuance of this guidance.

25 Bank advised investment funds include mutual funds, alternative strategy funds, collective investment funds, and other funds where the bank, its subsidiaries, or affiliates is the investment adviser and receives a fee for its investment advice. For purposes of this guidance, the term “banks” includes banks and savings associations regulated by the federal banking or thrift agencies. The term “banking organization” includes a bank, its parent holding company, and any of their affiliates.

Banking organizations are under no statutory requirement to provide financial support to the funds they advise and indeed face significant supervisory and regulatory consequences if they do so. Federal laws and regulations place significant restrictions on transactions between banks and their advised funds. In particular, sections 23A and 23B of the Federal Reserve Act and the Board’s Regulation W (12 CFR 223) place quantitative limits and collateral and market terms requirements on transactions between banks and their affiliates. Additionally, the OCC’s fiduciary activities regulation (12 CFR 9) may restrict transactions between a bank and its advised funds. A banking organization could experience significant capital adequacy issues if it provided support to a bank-affiliated fund. Finally, the ability of a banking organization to serve as a source of strength for its FDIC-insured institutions could be weakened if it provided financial support to an affiliated fund.

In very limited circumstances, certain arrangements between a banking organization and its bank-affiliated funds have been expressly determined to be legally permissible and safe and sound when properly conducted and managed. For example, transactions pursuant to the Federal Reserve’s emergency liquidity facilities for money market funds instituted are permissible.

Policy

To avoid engaging in unsafe and unsound banking practices or raising supervisory concerns, a banking organizations should not (1) place its capital, resources and reputation at risk for the benefit of the funds’ investors and creditors; or (2) create an expectation that the banking organization will prop up the advised fund. Further, the agencies expect banking organizations to maintain appropriate controls over investment advisory activities that include:

- Ensuring that bank-affiliated funds are managed in such a way as to minimize the possibility that external support will be needed.

- Establishing sources of emergency support from external third parties rather than the banking organization, with no recourse to the banking organization.

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27 Other legal requirements may also restrict or prohibit transactions between a bank and its advised funds, including the Investment Company Act of 1940, the Investment Advisers Act of 1940, and the Employee Retirement Income Security Act of 1974 (ERISA).

28 The agencies acknowledge the SEC’s functional regulatory authority over the investment advisory activities of SEC registered investment advisers. However, the agencies remain responsible for evaluating the consolidated risk profiles of banking organizations, which may include assessing the risks posed to the bank from the activities and obligations of any subsidiary or affiliate.
• Instituting effective policies and procedures for identifying potential circumstances triggering the need for financial support and the process for obtaining such support.

• Implementing an effective risk management system for controlling and monitoring risks posed to the banking organization by the organization’s investment advisory activities. Risk controls should include establishing appropriate risk limits, liquidity planning, performance measurement systems, stress testing, compliance reviews, and management reporting to mitigate the need for significant external support.

• Implementing policies and procedures that ensure that the banking organization is in compliance with existing disclosure and advertising requirements to clearly differentiate the investments in advised funds from obligations of the bank or insured deposits.

• Ensuring proper regulatory reporting of contingent liabilities arising out of its investment advisory activities in the banking organization’s published financial statements in accordance with FAS 5, and fiduciary settlements, surcharges, and other losses arising out of its investment advisory activities in accordance with the instructions for completing Call Report Schedule RC-T– Fiduciary and Related Services.

Notification

Because of the potential reputational, litigation, and other risks that arise when a bank-affiliated fund requires financial support, banking organization management should notify and consult with its appropriate federal banking agency when a bank-affiliated fund requires financial support. The appropriate federal banking agency will closely scrutinize the circumstances and will address situations that raise supervisory concerns. Among other things, the appropriate agency will consider whether the banking organization should continue to be engaged in the business of advising investment funds.
APPENDIX:

Task Force on Regulatory Reform
Banking Law Committee
American Bar Association

Recommendations Regarding
Banking Organization Support For Affiliated Funds29

The federal banking agencies should strengthen the existing Interagency Policy Statement on bank support for affiliated funds to make clear that it applies to support for affiliated funds from bank holding companies and their affiliates as well as banks.

The Federal Reserve Board should not allow a bank holding company or its affiliates to provide assistance to a fund to the extent that such assistance would materially diminish the ability of the company to act as a source of strength to its subsidiary banks or otherwise constitute an unsafe and unsound practice.

The federal banking agencies should clarify the capital adequacy consequences for banking organizations that provide credit support for affiliated funds.

The SEC and FINRA should consider whether enhanced disclosures are needed to improve investor understanding that the adviser and its affiliates have no obligation to provide support to a money market or other fund and may have limited ability to do so due to regulatory or other constraints.

Background. Banking organizations have long-standing authority to act as investment advisers to money market and other funds. Such authority was upheld by the courts long ago as permissible under the Glass-Steagall Act.

Periodically in the past, and most recently during the past 18-24 months, a number of banking organizations, like other nonbank fund sponsors, have placed

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29 Available at: http://www.abanet.org/dch/committee.cfm?com=CL130055.

This recommendation was approved by members of the Banking Law Committee’s Task Force on Regulatory Reform in their individual capacities and is to be used for information purposes only. The recommendation has not been approved by the American Bar Association, its Presidential Task Force on Financial Markets Regulatory Reform, or any section or committee of the American Bar Association, including the Business Law Section and the Banking Law Committee.
their resources at risk to “prop up” their affiliated funds by providing credit extensions, cash infusions, asset purchases, and acquisitions of fund shares. This support has been required to mitigate “reputation risk” posed to organizations that sold their customers interests in structured investment vehicles (SIVs) and to prevent affiliated money market funds from “breaking a dollar” due to credit downgrades or other impairments in the funds’ portfolios. The total amount of fund assets supported by fund sponsors during the crisis has been large and resulted in significant losses to banking organizations.

As noted, both bank-affiliated and nonbank-affiliated fund sponsors supported their funds during the crisis. The expectation that fund sponsors will effectively guarantee their affiliated funds creates moral hazard in the financial system. It encourages the false perception among investors that the funds are safer than other investments. It allows portfolio managers of funds with sponsor backing to take risks without bearing the full consequences of their investment decisions, allowing them to earn marginally higher yields and putting pressure on other fund managers to do the same, resulting in incrementally higher risks.

Banking supervisors generally have sought to limit the safety net as a matter of policy and have voiced concerns about the expansion of the safety net to cover nonbank affiliates of banks and risks from non-traditional activities. Related to this concern, a bank holding company’s support for affiliated funds also may diminish its ability to serve as a source of strength to its subsidiary banks.

**Interagency Policy Statement.** In 2004, the federal banking agencies issued an Interagency Policy Statement to discourage bank support for affiliated funds. The Policy Statement states that “a banking organization’s investment advisory services can pose material risks to the bank’s liquidity, earnings, capital, and reputation, and can harm investors, if the associated risks are not effectively controlled.” The agencies noted that, while banks are under no statutory requirement to provide financial support to the funds they advise, “circumstances may motivate banks to do so for reasons of reputation risk and liability mitigation.”

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30 These concerns have focused on the increased risks in the financial system, the potential for higher taxpayer costs stemming from large bank failures, and demands on supervisory resources as well as complaints that the safety net effectively subsidizes nonbank affiliates of banking organizations.

Accordingly, the Policy Statement strongly discourages bank support for affiliated funds. But it imposes no significant limitations on bank holding company support for bank-affiliated funds.

We recommend that the banking agencies strengthen the Policy Statement to make clear that it applies to support for affiliated funds from bank holding companies.

In addition, the Policy Statement should require prior notification to the Federal Reserve Board and a review by the Board of the circumstances that require such support. The Federal Reserve Board should prevent a bank holding company from providing assistance to a fund to the extent that such assistance would materially diminish the ability of the company to act as a source of strength to its subsidiary banks or otherwise constitute an unsafe and unsound practice.

Enhanced Disclosures. To ensure that investors understand that money market funds and other funds are not guaranteed by banking organizations or other fund sponsors, the Securities and Exchange Commission should consider whether enhanced disclosures are needed to the effect that a fund adviser and its affiliates have no obligation to provide support to the fund in the event the fund experiences an impairment of its assets and may have limited ability to do so due to regulatory or other constraints.

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32 The Policy Statement requires banks to adopt policies and procedures governing routine or emergency transactions with bank-affiliated funds designed to ensure that a bank will not “(1) inappropriately place its resources and reputation at risk for the benefit of the funds’ investors and creditors; (2) violate the limits and requirements contained in sections 23A and 23B of the Federal Reserve Act and Regulation W, other applicable legal requirements, or any special supervisory condition imposed by the agencies; or (3) create an expectation that the bank will prop up the advised fund.”