

TOP MONEY FUNDS...

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straight months after withdrawing from them for most of 2011 because of concern that Europe's sovereign-debt crisis might lead to defaults. The European Central Bank offered three-year loans to the banks in December and February, easing funding worries surrounding French banks since August.

The funds' holdings in all European banks declined by \$2.8 billion to \$195.7 billion, Bloomberg's data show. Banks in countries seen by investors as safe havens, including Switzerland and Sweden as well as Canada, saw funding decrease.

Prime money funds are eligible to purchase debt and other securities issued by corporations and banks, as opposed to funds that invest exclusively in U.S. government-backed debt.

Vanguard Prime Money Market Funds was alone among the 10 funds maintaining its zero allocation to European banks for the third month in a row. The fund had been 27 percent invested in European banks in 2010. The \$120 billion **JPMorgan Prime Money**

Market Fund increased its European holdings to 42.2 percent of total assets from 41.9 percent the month before. The level stood at 54 percent in 2010.

Kristen Chambers, a JPMorgan spokeswoman, declined to comment.

Fidelity increased European bank holdings in its Money Market Portfolio and Prime Money Market Portfolio funds to 38 percent and 36 percent, respectively. Its Cash Reserves Fund decreased European holdings to 26 percent from 34 percent.

Vincent Loporchio, a Fidelity spokesman, said the firm's money funds are well-diversified and invest only in high-quality debt instruments with minimal credit risk.

BNP Paribas SA was the biggest beneficiary among the French banks in February, with holdings increasing to \$7.3 billion from \$2.7 billion. The Paris-based bank reduced its dollar assets by \$113 billion to \$257 billion in the second half of last year.

U.S. money funds aren't a crucial funding source, according to another Paris-based bank.

"We do not rely on money-market funds in the U.S. any more, and I think that's very good," said **Frederic Oudea**, chief executive officer of **Societe Generale SA**, on a Feb. 16 earnings call.

Outside of Europe, U.S. and Japanese banks attracted the largest amount of new investment in the month. U.S. bank paper increased to \$54.3 billion from \$46 billion at the end of January. Japanese banks saw a \$10 billion increase to \$60.6 billion.

The survey included **Fidelity Cash Reserves**, **JPMorgan Prime Money Market Fund**, **Vanguard Prime Money Market Fund**, **Fidelity Institutional Prime Money Market Portfolio**, **Fidelity Institutional Money Market Portfolio**, **BlackRock TempFund**, **Federated Prime Obligations Fund**, **Schwab Cash Reserves**, **Western Asset Institutional Liquid Reserves** and **Dreyfus Cash Management Fund**.

— With assistance from *Fabio Benedetti-Valentini* in Paris and *Christopher Condon* in Boston.

NEWS**Italy Said to Pay Morgan Stanley \$3.4 Billion to Exit Derivative**

When **Morgan Stanley** said in January it had cut its "net exposure" to Italy by \$3.4 billion, it didn't tell investors that the nation paid that entire amount to the bank to exit a bet on interest rates.

Italy, the second-most indebted nation in the European Union, paid the money to unwind derivative contracts from the 1990s that had backfired, said a person with direct knowledge of the Treasury's payment. It was cheaper for Italy to cancel the transactions rather than to renew, said the person, who declined to be identified because the terms were private.

The cost, equal to half the amount to be raised by Italy's sales tax increase this year, underscores the risk that derivatives countries use to reduce borrowing costs and guard against swings in interest rates and currencies can sour and generate losses for taxpayers. Italy, with record debt of \$2.5 trillion, has lost more than \$31 billion on its derivatives at current market values, according to data compiled by the Bloomberg Brief Risk newsletter from regulatory filings.

"These losses demonstrate the speculative nature of these deals and the supremacy of finance over government," said Italian senator **Elio Lannutti**, chairman of the consumer group **Adusbef**.

Morgan Stanley said in a Jan. 19 filing with the U.S. **Securities and Exchange Commission** that it "executed certain derivatives restructuring amendments which settled on January 3, 2012" and reduced its Italian exposure by \$3.4 billion.

Mary Claire Delaney, a spokeswoman for the New York-based firm, declined to comment further. Officials at the Italian treasury in Rome declined to comment on the contracts.

Morgan Stanley had a gain of about \$600 million in the fourth quarter related to the unwinding of contracts with Italy. That gain was a reversal of charges it took earlier in the year to

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Bloomberg Brief Risk

Newsletter Ted Merz
Executive Editor tmerz@bloomberg.net
212-617-2309

Risk Editor Nick Dunbar
ndunbar1@bloomberg.net
+44-20-3216-4818

Reporter Radi Khasawneh
rkhasawneh1@bloomberg.net
+44-20-7673-2763

Technical Editor Alberto Fuertes
afuertes@bloomberg.net
+44-20-3525-8364

Newsletter Business Manager Nick Ferris
nferris2@bloomberg.net
212-617-6975

Advertising bbrief@bloomberg.net
212-617-6975

Reprints & Permissions Lori Husted
lori.husted@theygsgroup.com
717-505-9701

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reflect the risk that the country wouldn't pay the full amount it owed, Chief Financial Officer **Ruth Porat** said in a Jan. 19 interview.

The \$600 million gain accounted for about half the bank's fixed-income trading revenue in the fourth-quarter, excluding a charge related to a settlement with **MBIA Inc.** and accounting gains tied to the firm's own credit spreads.

As Italy's borrowings rose beyond the 1-trillion-euro mark in the mid-1990s, the country started to use interest-rate swaps and swaptions, options to enter into a swap, to cut the cost of servicing that debt, a person with knowledge of Italy's contracts said.

Many bonds sold at the time had maturities of five or 10 years, some paying coupons of as much as 10 percent, according to data compiled by Bloomberg. Italy used swaps to spread its payments over 30 years or more, the person said.

The country also reduced its interest costs by issuing swaptions, using the income it received from selling the derivatives to pay debts.

As swap rates, which typically track German bond yields, plunged after 2008 and option volatilities increased, Italy found itself owing its banks money on the derivatives as its bets unraveled.

Bank Counterparty Exposure to Italian Sovereign

	DERIVATIVES MTM	HEDGES
Morgan Stanley	2,887	591
JPMorgan	6,400	2,800
Goldman Sachs	1,670	1,410
Bank of America	1,247	1,136
Citigroup*	7,300	6,700
E.U. Banks	11,820	6,600
Total	31,324	19,237

* Figures in \$m, Citigroup figures also include financial institutions, corporates
Source: Company 10-K filings, EBA Stress Test Results

The five largest U.S. swap dealers — **Goldman Sachs Group Inc.**, **Morgan Stanley**, **Bank of America Corp.**, **Citigroup Inc.** and **JPMorgan Chase & Co.** — have a combined net derivative counterparty exposure to Italy of \$19.5 billion, filings show. When added to figures for European banks released in the European Banking

Authority's round of stress tests last year, the total rises to as much as \$31 billion.

— *Nicholas Dunbar, Radi Khasawneh and Elisa Martinuzzi. With assistance from, Andrew Davis in Rome and Michael Moore in New York.*

Old Mutual Uses Options as Costs of Hedges Fall

Old Mutual Plc, the U.K.'s third-largest insurer by market capitalization, has started using options to hedge losses on guaranteed policies issued by its Bermuda-based guaranteed life insurance business.

The cost of using equity options to hedge has fallen in line with a 60 percent decline in the value of the Chicago Board Options Exchange Volatility Index in the second half of last year. This decline led Old Mutual to implement the new option hedging strategy to take advantage of the lower hedge costs. The company is still recovering from a restructuring caused by hedging failures in 2008, and policies issued by its Bermuda arm are in run-off.

The new option hedging strategy covers expected top-up payments under existing guaranteed minimum accumulation benefit policies that have hit the five-year eligibility threshold. The policies started paying off at the beginning of 2012, with the majority becoming eligible from Oct. 1, 2012, according to a preliminary annual results filing. The company estimated that the cost of the payments would amount to \$689 million in 2012 and 2013

"Since the year-end, rising equity markets and the declining volatility have had a favorable effect on the cost of hedging strategies that involve options, we've taken advantage of this and in the last few days implemented an option-based hedging arrangement which will protect against downside risks from equity markets," said **Philip Broadley**, chief financial officer of Old Mutual, on a March 9 earnings call.

Old Mutual hedged 58 percent of equity exposure to its \$3.1 billion variable annuity liabilities through swaps at the end of 2010.

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ON THE MOVE

Deutsche Said to Tap Lewis as CRO

Deutsche Bank AG plans to propose **Stuart Lewis** as the German lender's chief risk officer after German financial regulator **BaFin** opposed the appointment of **William Broeksmit**, according to a person close to the supervisory board.

Lewis, who is currently deputy chief risk officer for the group as well as head of risk for the corporate and investment bank, will be proposed to the supervisory board at a meeting tomorrow, said the person, who declined to be identified because talks are private.

Deutsche Bank and BaFin discussed several candidates and Lewis was selected based on the regulator's criteria, the person said. Broeksmit didn't receive unanimous support from BaFin because of concern about his lack of experience managing a large number of employees, the person said.

— *Aaron Kirchfeld*

Bawag PSK Appoints CRO

Bawag PSK Bank, the Austrian lender controlled by **Cerberus Capital Management LP**, said it appointed **Jochen Kloepper** as chief risk officer as of April. Kloepper, 44, is taking over from Chief Executive Officer **Byron Haynes** who was in charge of risk in addition to his other responsibilities, according to a statement today.

— *Zoe Schneeweiss*

Leighton Appoints CRO

Mike Rollo has been appointed chief risk officer at **Leghton Holdings Ltd.**, Australia's biggest builder, according to a release filed on the Australian Stock Exchange.

Rollo replaces **Craig van der Laan**, who was chief risk officer and group general counsel since June last year. He was the company's first chief risk officer.

Rollo has been a construction engineer at the company for six years.

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