IMMFA INSIGHTS

INSTITUTIONAL MONEY MARKET FUNDS ASSOCIATION

Bank Deposits and Money Market Funds Compared

The primary role of a cash manager is to maximise the **safety**, **liquidity**, and **yield** of their cash holdings. With this objective in mind, where should the prudent cash manager place their short-term cash holdings to ensure that each of these considerations is sufficiently met?

A bank deposit and an MMF both represent potential solutions which we compare below. An overnight bank deposit offers same-day access and normally pays interest, and a major international bank will usually hold a good rating from an authorised credit rating agency. An alternative liquidity management tool is a Money Market Fund (MMF). An MMF may offer enhanced features and benefits compared to those found with a bank deposit.

	Overnight bank deposit	**AAA/Aaa Money Market Fund***
Risk	Single counterparty risk	Credit diversification through broad portfolio mix
Return	Linked mainly to market overnight interest rates	Potential yield enhancement due to longer duration and diverse make-up of the portfolio
Fees	Agreed between client and bank (potential penalty to breaking term agreements)	Costs and fees embedded in product, so yields are received net
Interest	Paid daily	Accrued daily; paid monthly
Minimum Investment	None	No minimum transaction size

*Triple A refers to specific MMF ratings: AAAmmf Fitch, Aaa-mf Moody's and AAAm S&P

Safety

When an investor makes a direct deposit with a bank, they have sole concentration risk with that particular institution. Should that bank become financially distressed, there is a risk of principal loss to its depositors.

Safety or preservation of capital is the key priority for MMFs. In contrast to bank deposits, MMFs diversify their investments across a broad range of highly rated (minimum A1/P1/F1) investments, mitigating single counterparty risk.

Liquidity

The ability to transact daily, placing and receiving cash on the same day, is a key requirement of cash managers and is crucial in being able to meet obligations such as margin calls or other onward payments. Bank deposits offer this service, and so too do MMFs. The use of intraday dealing cycles[1] means that cash managers do not have to wait until fund cut-off time before they receive their cash.

[1] Not available on all MMFs

Yield

Bank deposit interest rates are linked mainly to market overnight interest rates and are historically low. MMFs can potentially offer better returns due to the longer duration of the portfolio (up to 60 day Weighted Average Maturity[2]) and diverse make-up of the portfolio. This will generally result in the fund outperforming short-term deposit rates.

Summary

MMFs are a useful and important tool in liquidity management. They can act as a complement to bank deposits whilst at the same time offering additional benefits.

Investors should consider a range of factors including their investment horizon and risk tolerance prior to selecting any cash management strategy.

[2] The 60-day WAM limit applies to short-term MMFs i.e. Public Debt Constant Net Asset Value, Low Volatility Net Asset Value and Short-term Variable Net Asset Value. Standard VNAVs have a 180-day WAM limit.