

Bank Deposits and Money Market Funds Compared - Considerations for Corporates

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 cycles¹ 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 Maturity²) and diverse make-up of the portfolio. This will generally result in the fund outperforming short-term deposit rates.

Considerations for Corporates

MMFs can be an attractive solution for corporates. Typically, a treasury function is tasked with managing the four pillars of treasury risk, specifically, liquidity, interest rate, market and credit and risk. MMFs address these as follows:

- MMFs hold sufficient liquidity to meet the fund's objective of providing same day liquidity to meet same day obligations as they fall due.
- MMFs manage interest rate risk by focusing on maintaining a short weighted average maturity of up to 60 days for their investments, reducing the impact of interest rate changes on the funds' portfolio.
- MMFs manage market risk through a superior level of diversification combined with active management by investment professionals who are well positioned to respond to prevailing/changing market conditions.
- MMFs manage credit risk by investing in high credit quality, low risk securities that adhere to strict AAA/Aaa rated investment and regulatory guidelines imposed by international authorised credit rating agencies. MMFs also benefit from an inhouse dedicated team of credit analysts involved in approving and reviewing eligible counterparties within the high credit quality universe and, where appropriate, adjusting or removing these limits.

For corporates holding debt on the balance sheet, the cash and cash equivalent nature of these funds make them an attractive solution to report a net debt position for financial reporting purposes.

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.

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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.