

Bank Deposits and Money Market Funds Compared - Considerations for Pension Schemes

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*
Access to cash/Settlement	Same day	Same day
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.

In addition to diversification, the investor also benefits from safeguards built into the MMF structure including the use of custodians and depositories as well as the fiduciary obligations of the fund manager.

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.

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 Pension Schemes

In the case of Pension Schemes, cash will form part of the strategic asset allocation. MMFs can be a helpful part of scheme cash flow management. Cash may be required at short notice or on a regular basis which makes investing in an MMF a key component when managing a scheme's assets.

The main benefits of an MMF are that they provide investors with daily capital stability, generate a return and provide liquidity. The regulatory requirement to hold minimum liquidity levels, along with multiple payment cycles and same day settlement which are features of an MMF, ensure that funds are available when needed and can be left invested in the MMF up until the day of redemption.

In addition, for a Defined Benefit (DB) Pension Scheme which has a Liability Driven Investment (LDI) arrangement, an MMF can be part of the scheme's approach to prudent cash management. DB pension schemes use LDI to achieve a better matching of assets against liabilities. Cash, cash equivalents and other assets are held as a buffer that can be drawn on should additional collateral be required as a result of changing market conditions. MMFs provide daily access to liquidity and ease of instruction with regard to redemption.

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.

This material is for information purposes only and does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed nor intended to provide legal, tax, accounting, investment or other professional advice on any matter. It may not be reproduced, in whole or in part, without the written permission of IMMFA and IMMFA accepts no liability whatsoever for the actions of third parties in this respect. IMMFA accepts no liability for any loss arising from any action taken or refrained from as a result of information contained in this material or any sources of information referred to therein, or for any consequential, special or similar damages even if advised of the possibility of such damages. This material is not an offer to buy or sell securities or a solicitation of an offer to buy or sell securities.

¹ Not available on all MMFs

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.