

Bank Deposits and Money Market Funds Compared – Considerations for Insurance Companies

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 Insurance Companies

MMFs can be an attractive solution for Insurance Companies. From a Solvency Capital Requirement under the Solvency II framework, money market funds are both well-defined and efficient. It should be noted that a look-through to the underlying assets within an MMF is required under Solvency II, and MMF providers should be able to provide this in the required Solvency II format. As such, MMFs can prove attractive to Insurance Companies both from a treasury management and investment perspective.

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.

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.