

# Comparing bank deposits to money market funds



February 2024

After a couple of years marked by a sustained period of interest rate rises from the Bank of England, European Central Bank (ECB), and the Federal Reserve (increasing by +515bps, +450bps, and +525bps respectively), we've reached a juncture where interest rates are at their peak, often referred to as "Terminal Rates." This, combined with events in the first quarter of 2023, further reinforces the value of diversification in cash investing. We believe it is prudent to understand the key differences between bank deposits and money market funds (MMFs).

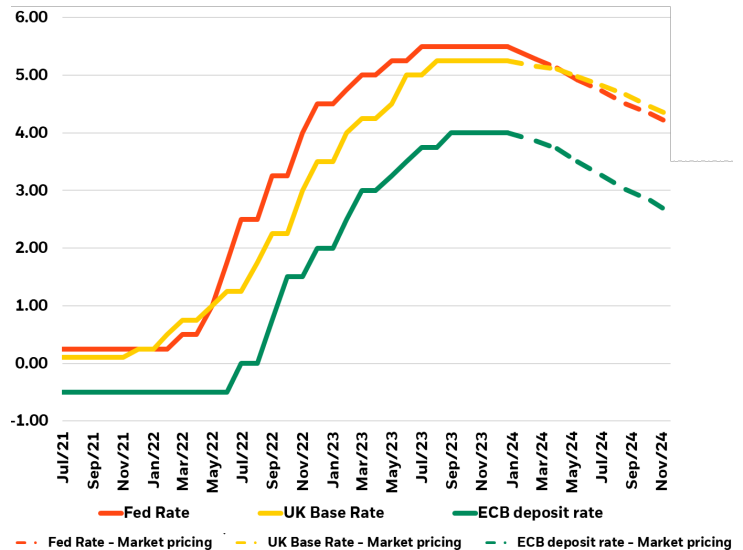
Bank deposits aim to provide clients with a location to store their cash for a specified length of time with a specified rate of interest.

MMFs traditionally seek to prioritize maintenance of capital and liquidity by investing in a broad range of high-credit quality assets across a wide range of issuers (excluding Government MMFs). This allows MMFs to diversify counterparty risk and facilitates reduced volatility.

\*As of 31 January 2024.

## Interest rates

Historic, current and potential



Sources: BlackRock & Bloomberg. Forward Overnight Indexed Swap used. Data 05/02/2024.

### Bank deposit

### Money market fund

#### Counterparty diversification

Exposure to a single bank counterparty.

Investment in multiple counterparties resulting in diversification.

#### Liquidity

Potential penalties for accessing cash prior to maturity of term deposit.

Most MMFs offer same or next-day liquidity with no lock up period.

#### Operational ease

Multiple bi-lateral agreements with banks typically required to achieve laddered and diversified investment. Multiple individual instructions may be required to execute.

Single transaction which can be executed in various ways. Instructions needed for subsequent redemptions and subscriptions.

#### Yield

Rates driven by bank funding needs, which can be volatile.

Active management of diversified money market securities allows for nimble positioning in changing market conditions. A MMF is not a guaranteed investment. Investment in MMFs can fluctuate and investors' capital is at risk.

#### Fees

Agreed between client and bank (often costs to break term agreements).

Costs and fees embedded in product so yields are received net. Liquidity fees and redemption gates remain mechanisms that may be incorporated in times of uncertainty.

The table above is intended to provide a general summary and is not exhaustive. A Money Market Fund (MMF) is not a guaranteed investment vehicle. An investment in MMFs is different from an investment in deposits; the principal invested in an MMF is capable of fluctuation and the risk of loss of the principal is to be borne by the investor. The MMF does not rely on external support for guaranteeing the liquidity of the MMF or stabilising the NAV per share.

# Money market funds are a cash management solution that seek to achieve diversification, daily access to cash and operational ease.

## Risk

### We believe diversification is key.

A bank deposit results in sole credit exposure to that single banking counterpart. To diversify this exposure, an investor may seek to enter into bank deposits with many different banks.

MMFs are actively managed in accordance with offering documents as well as various regulatory and best practice thresholds. MMFs seek to mitigate risk by allocating across high-credit quality issuers and money market sectors (excluding Government MMFs). Concentration risk is managed through diverse issuer counterparty selection<sup>1</sup>.

## Liquidity

### MMFs are designed to provide daily liquidity.

Overnight deposits provide the same liquidity profile as MMFs. However, term deposits typically lock up your capital for a defined period of time, and depending on the agreement, it can be difficult to gain access to your capital before maturity.

MMFs are required to hold minimum levels of daily maturing and weekly maturing assets to help provide sufficient liquidity to meet investors needs. The active management of MMFs allows the fund to tailor liquidity levels through changing market cycles.

## Fees

### Consider the cost of liquidity.

Depending on the agreement term, bank deposits may involve restrictions and/or penalties for accessing your capital before its maturity.

MMFs incorporate costs and fees within the product itself as a single charge. There are no additional fees for subscriptions. Liquidity fees and redemption gates remain mechanisms that may be incorporated to help maintain fair treatment towards all MMF investors in times of uncertainty.

1. Risk management cannot fully eliminate the risk of investment loss

## Yield

### Active management of MMFs allows for the potential of enhanced yield.

Deposits are issued either on a fixed- or floating-yield basis (often linked to an overnight reference rate). While the initial rate offered can often look attractive, we believe it is important to consider the 'break-even' compared to shorter-dated investments and how interest rate movements can impact the relative value.

MMFs blend highly-rated, short-term securities with longer-dated securities (final maturity of up to 13 months in short-term MMFs). The 'blend' of securities and duration exposures are determined by a team of portfolio managers' views on interest rates and market fundamentals. Thus often, MMFs can actively adapt their positioning in line with the latest market dynamics.

## Operational ease

### MMFs may achieve diversification whilst minimizing the volume of day-to-day operational needs.

Bank deposits are typically a direct bi-lateral agreement between the client and the bank. To achieve any level of counterparty and maturity diversification, multiple agreements may be needed to be executed with multiple banking entities, which can be resource intensive as they need to be rebooked each time.

Shares of MMFs can typically be traded directly with the MMFs transfer agent via various platforms. MMFs are also widely available across trading platforms with many execution options. After the initial subscription, only subsequent transactions based on your cash needs are required.

In most cases, MMFs can also benefit from a sweep functionality, which could automate the investment of surplus cash or the need to raise cash from existing holdings.

## Want to know more?

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