Maximising Returns

Reasons to Invest in European Money Market Funds

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Why Money Market Funds Are Popular Cash Investments

As the guardians of cash within their corporations, treasury teams are driven by the investment tenets of security, liquidity, and yield (SLY). What matters most when it comes to short-term investing is not the return on company cash, but the return of company cash. Yet, even with clear objectives in mind, making smart investment choices is never straightforward.

So, what do treasury organisations need to know about money market funds (MMFs), and what criteria should they be aware of when selecting MMFs that best align with their investment goals? Finally, how does technology aid in their use of MMFs in optimising liquidity? This whitepaper will address these questions and provide case study examples of why and how companies have used MMFs and supporting investment technology.

The rise of MMFs

In this report, we will also examine why MMFs are growing in popularity among corporate treasury teams. Reasons include the fact that in 2022, prolonged low interest rates in the UK and negative interest rates in Europe began to rise. As the Bank of England and the European Central Bank aggressively hiked rates throughout the year and beyond to tamp down inflation, inflows into MMFs surged.

In addition to earning higher returns and managing liquidity effectively, treasury departments also looked to diversify their cash investments beyond bank term deposits into MMFs as a means of mitigating counterparty concentration risk.

In March 2023, the importance of mitigating this risk came into sharp focus with the collapse of Silicon Valley Bank (SVB) in the US. The failure of this large regional bank sparked a crisis in the banking sector involving other regional banks such as First Republic Bank and Signature Bank – and highlighted ongoing turmoil involving the failure of Credit Suisse.

As we explore in this whitepaper, MMFs themselves provide diversification as a portfolio of high-quality debt instruments.

They deliver on all three of the SLY priorities, offering AAA-rated products, which are highly regulated, same-day liquidity (T+0), and returns that can be competitive to yields in bank deposits. It comes as no surprise, then, that 38% of treasury professionals from the UK/EU responding to the 2023 Client Survey by institutional investment technology provider ICD said they were increasing investments in MMFs.

All-weather investments

Another advantage of MMFs is that they can perform well regardless of which phase the interest rate cycle is in. And for members of treasury teams – who are all too aware of the pitfalls of chasing yield – MMFs can be a critical component in creating an investment strategy that functions smoothly, regardless of the economic climate.

Nevertheless, as we discover in Chapter Two (page 8), boards and shareholders are placing pressure on treasury teams to ensure excess cash is put to work in the current interest rate environment. The good news is that MMFs respond to rate rises relatively promptly. To capture increases in rates quickly, fund managers shorten the weighted average maturity (WAM) of their portfolios through a rising rate cycle. As a result, MMFs have the potential to offer competitive returns both now and in the future.

Efficient market access

Alongside the benefits of MMFs, the practical reality of the investment process is also increasingly positive, thanks to innovations in investment portal technology. Although functionality varies from provider to provider, portals offer efficiency, visibility, and control – and are swiftly becoming a key component in best practice liquidity management.

What's more, in this turbulent economic environment, treasury organisations are increasingly in need of easy market access and information about their investments. They must be able to track market and fund performance, as well as move cash in and out of different instruments. In Chapter Three (page 10), we'll explore how portal technology creates efficiencies for treasury teams and why independent portal technology, in particular, enhances control over cash investments.

BENEFITS OF MMFS FOR TREASURY TEAMS

MMFs remain a staple cash investment vehicle for treasury, given the advantages on offer:

- Diversification
- High credit quality
- Competitive yields
- Same-day liquidity
- Performance throughout the interest rate cycle
- Active management

> *"In addition to earning higher returns and managing liquidity effectively, treasury departments also looked to diversify their cash investments beyond bank term deposits into MMFs as a means of mitigating counterparty concentration risk."*

Choosing the Right MMF for Your Investment Strategy

Before assessing which MMF is right for your investment needs, it's important to grasp the basics of what MMFs are, how they function, and what types are on offer.

In a nutshell, a MMF is a pooled mutual fund that invests in short-term, high-quality debt instruments. MMFs are generally accepted as cash and cash equivalents, but there are geographical nuances to be aware of as well, so treasury teams should consult their auditors.

MMFs are structured as independent entities. From a governance perspective, there is a board of directors for each MMF, and their role is to safeguard shareholders' interests. Because of the nature of the fund structure, investors in MMFs in fact become shareholders of the fund.

This is to some extent why fund size matters, as we explain in more detail later in this chapter. Of course, investments in the fund are fully ring-fenced and kept separate from the asset manager's own balance sheet.

Robust oversight

The MMF industry is highly regulated, and in Europe the body responsible for this is the European Securities and Markets Authority (ESMA). Updates to ESMA's Money Market Funds Regulation (MMFR) were discussed at length throughout 2023, and in December of that year, ESMA published the Final Report on the Guidelines on stress test scenarios under MMFR. The Final Report combines an update of the methodology to implement the scenario related to the hypothetical changes in the level of liquidity of the assets held in the portfolio of the MMF, with annual calibration of the risk parameters. The majority of European MMFs also fall under the scope of the Undertakings for Collective Investment in Transferable Securities or UCITS framework.

In addition to ESMA, the Institutional Money Market Funds Association (IMMFA) – the trade association that represents the European short-term MMF industry – also seeks to improve governance, in particular through its Principles of Best Practice.

Furthermore, ratings agencies keep an extremely close eye on MMFs, and there are strict parameters that must be met in order for funds to retain their AAA credit rating.

Understanding MMF classifications

The MMFR defines two broad types of MMFs: short-term MMFs (which invest mainly in assets maturing within 120 days) and standard MMFs (which invest mainly in assets maturing within six months). Within the short-term category, which is where most treasurers will invest, there are three types of MMF:

- **Public debt Constant Net Asset Value (CNAV) MMFs.** According to the regulations, these must invest at least 99.5% of their assets in government debt, repo collateralised by government debt, or cash. Since they can use the amortised cost accounting method, CNAVs offer redemption of their shares at par value, but they must also calculate their mark-to-market NAV.

- **Variable Net Asset Value (VNAV) MMFs.** These can invest in a range of eligible assets (including government debt, commercial paper [CP] or certificates of deposit [CDs]) and they mark-to-market their NAV. This means that the NAV will vary, but given the short- duration, high-quality nature of the assets in these MMFs, the variation should be minimal.

- **Low Volatility Net Asset Value (LVNAV) MMFs.** Like VNAVs, these invest in a broader range of assets (including CP and CDs) than CNAVs. LVNAVs offer a constant NAV. As long as the fund stays within the specified parameters, the unit value stays at one. So, investors purchase in at one and redeem at one, but also receive yield. If, however, the mark-to-market NAV of LVNAVs deviates more than 20 basis points (bps) from par, LVNAVs have to price to four decimal places, effectively becoming VNAVs.

The majority of corporate treasurers invest in either VNAV or LVNAV MMFs. The choice between the two depends on the corporate's investment policy, aims, and the need for a stable unit price being front of mind. Market conditions may also impact the choice of LVNAV or VNAV.

Of course, there are numerous other factors weighing into the decision-making process. These include:

- **Fund size.** As an investor in MMFs, it is always better to be a small fish in a large pond rather than vice versa. A larger fund will typically be better equipped to handle sizeable inflows or outflows without significantly impacting the fund's NAV, resulting in greater stability and predictability. Diversification (see below) can also be easier to achieve in a large fund, not least because fund managers have more capital to allocate to different baskets.

DIFFERENT TYPES AND ATTRIBUTES OF MMFS

Short-term MMF			Standard MMF
Government (public debt) Constant Net Asset Value (CNAV) MMF	**Low Volatility Net Asset Value (LVNAV) MMF**	**Variable Net Asset Value (VNAV) MMF**	**Variable Net Asset Value (VNAV) MMF**
Permitted investments: 99.5% in Eligible Assets that are government issued or guaranteed assets, reverse purchase agreements secured with government issued or guaranteed assets, and cash	Permitted investments: Any government or non-government Eligible Assets	Permitted investments: Any government or non-government Eligible Assets	Permitted investments: Any government or non-government Eligible Assets
WAM (max): 60 days	WAM (max): 60 days	WAM (max): 60 days	WAM (max): 6 months
WAL (max): 120 days	WAL (max): 120 days	WAL (max): 120 days	WAL (max): 12 months
Maturity (max): 397 days	Maturity (max): 397 days	Maturity (max): 397 days	Maturity (max): 2 years with 397 days reset
Daily Liquid Assets (min): 30%	Daily Liquid Assets (min): 10%	Daily Liquid Assets (min): 7.5%	Daily Liquid Assets (min): 7.5%
Subscription/redemption price: Constant NAV	Weekly Liquid Assets (min): 30%	Weekly Liquid Assets (min): 15%	Weekly Liquid Assets (min): 15%
	Subscription/redemption price: Constant NAV	Subscription/redemption price: Variable NAV	Subscription/redemption price: Variable NAV

- **Bank relationship.** Naturally treasurers want to maintain good relationships with those banking partners that provide them with cash management services. Often the choice of MMF is swayed by existing banking arrangements. Some financial benefits in terms of reduced fees may also be on offer for existing bank customers. Despite their clout, bank relationships aren't always the deciding factor in the choice of one MMF over another, rather they are a piece of the puzzle.

- **Ratings agency involvement.** Treasury teams will be looking for AAA-rated MMFs to invest in – that is the gold standard in credit quality. But some funds will be rated by three agencies, while others may have fewer ratings. Teams must therefore decide whether they are looking for a full suite of ratings agency endorsements, or whether the stamp of approval from a particular agency is sufficient. This will require an understanding of the way individual agencies approach credit-quality evaluation and risk assessment.

- **ESG credentials.** Increasing numbers of treasurers are exploring the possibilities of ESG investments, and there are a growing number of ESG-compliant MMFs available. In Europe, the Sustainable Finance Disclosure Regulation (SFDR) imposes mandatory ESG disclosure obligations for asset managers – and MMFs within the EU must be classified according to their sustainability credentials. To aid treasury investors in their ESG journey, and to help them with their selection of products, ICD has developed an advanced transparency feature that enables clients to see how various fund providers designate their socially responsible investing (SRI) and ESG products.

Diversification matters

When it comes to the question of choosing an MMF over a bank deposit, diversification is arguably the most critical consideration.

The banking crisis of 2023, precipitated by the fall of SVB and highlighted by the failure of Credit Suisse, has led to a laser focus on counterparty risk. Treasury organisations are all too aware of the risks of high levels of single-party concentration through their bank deposits. As a result, much of their cash is flowing into MMFs.

Thanks to pooled investor funds and expert fund managers, VNAV and LVNAV MMFs can invest into a broad range of assets across multiple issuers, securities, and geographies. By choosing an MMF over a bank deposit, treasury leaders can reduce both counterparty and concentration risk, while still achieving the SLY principles. What's more, diversified investments also offer the opportunity for enhanced returns.

MMFR HAS DIVERSIFICATION BAKED IN

Article 17 of ESMA's Money Market Funds Regulation (MMFR) mandates MMFs to ensure diversification in several ways. For example:

- An MMF shall invest no more than:

  (a) 5% of its assets in money market instruments, securitisations and asset-backed commercial papers (ABCPs) issued by the same body

  (b) 10% of its assets in deposits made with the same credit institution, unless the structure of the banking sector in the Member State in which the MMF is domiciled is such that there are insufficient viable credit institutions to meet that diversification requirement – and it is not economically feasible for the MMF to make deposits in another Member State, in which case up to 15% of its assets may be deposited with the same credit institution.

However, a VNAV MMF may invest up to 10% of its assets in money market instruments, securitisations and ABCPs issued by the same body provided that the total value of such money market instruments, securitisations and ABCPs held by the VNAV MMF in each issuing body in which it invests more than 5% of its assets does not exceed 40% of the value of its assets.

Many of the stipulations of Article 17 also specifically address counterparty concentration risk. For example:

- The aggregate risk exposure to the same counterparty of an MMF stemming from OTC derivative transactions which fulfil the conditions set out in Article 13 of MMFR shall not exceed 5 % of the assets of the MMF.

- The aggregate amount of cash provided to the same counterparty of an MMF in reverse repurchase agreements shall not exceed 15% of the assets of the MMF.

This prescriptive regulation therefore helps to ensure that MMFs remain truly diversified, especially in comparison to bank deposits.

Source: www.legislation.gov.uk/eur/2017/1131/article/17

How MMFs Deliver Throughout Monetary Cycles

Whether interest rates are rising or falling, MMFs are competitive with other short-term investment options:

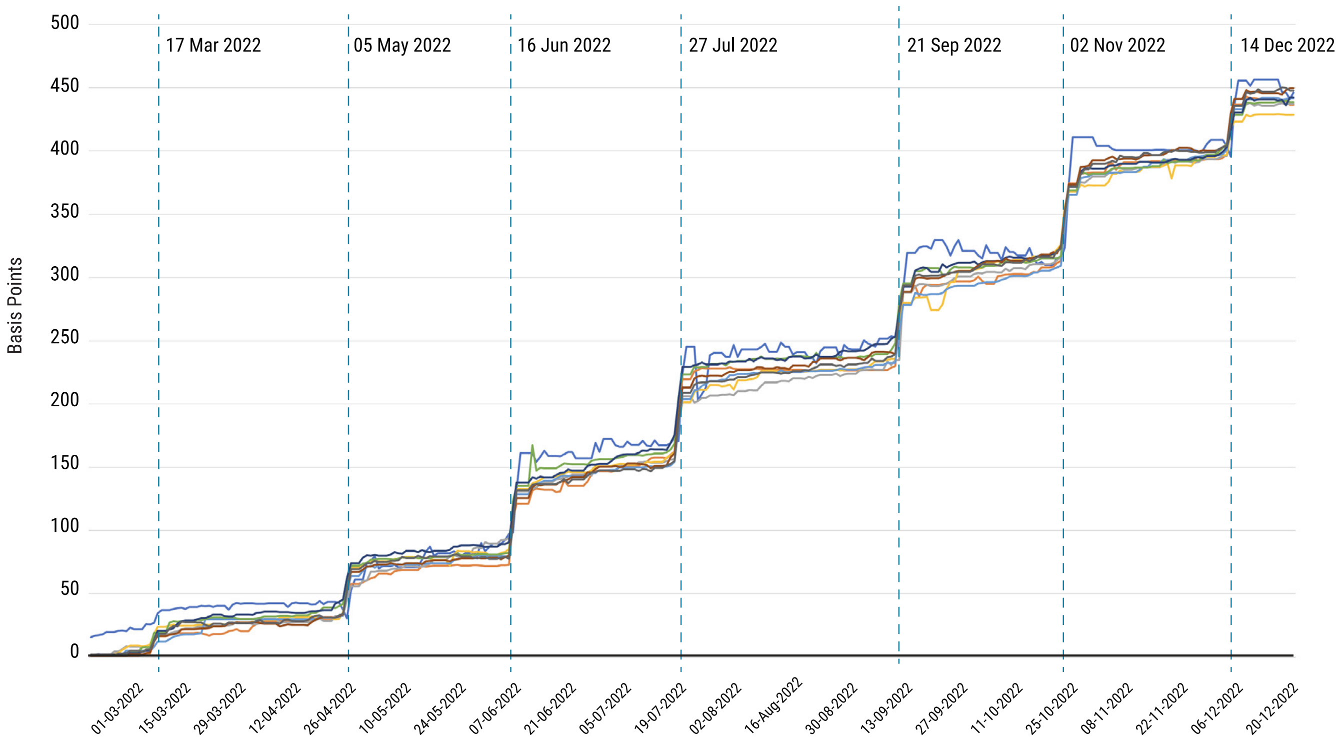
- **Rising rates**. When rates are on the way up, MMFs typically reset to the new rate quickly, meaning that investors see the benefit relatively rapidly. What's more, fund managers proactively manage their portfolios to maximum returns. They do this by dramatically reducing the WAM of the investment portfolio – potentially halving it from 60 to 30 days. This enables cash to be reinvested on a monthly basis, so that all interest rate rises can be captured and passed on.

  Since MMFs can deliver upside in any monetary cycle (as the chart on the following page illustrates), they are an ideal bedrock for a stable investment strategy. One that does not rely on making too many tactical shifts to avoid investment underperformance, but rather works in harmony with the macro environment and the company's wider growth goals.

- **Falling rates**. The ability to alter the WAM works in an MMF's favour both ways. So, when rates fall, fund managers can buy longer-dated securities to slow down the impact of any rate cut. And by changing the composition of the portfolio with longer dated holdings, MMFs can offer more attractive yields than short-term bank deposits, which automatically reset to the current 'market' interest rate.

- **Stable rates.** MMFs perform in-line with other short-term investment products when rates are flat, given the portfolio manager's ability to find the highest yielding

TOP 10 YIELDING USD OFFSHORE FUNDS ON ICD PORTAL



As of 31-Dec-2022 | iMoney Net Data

bonds to incorporate into the funds' portfolio. The added benefit is the embedded risk mitigation that comes in the way that MMFs are structured, given that holdings are a bundle of highly liquid government and debt securities as compared to the single credit exposure of the bank or other counterparty.

Irrespective of bank moves, MMFs offer investors the benefits of a proactively managed portfolio of instruments – that is, the flexibility portfolio managers have to monitor maturity structures, manage risk, and analyse credit to maximise returns while offering same day liquidity.

> *“MMFs offer investors the benefits of a proactively managed portfolio of instruments – that is, the flexibility portfolio managers have to monitor maturity structures, manage risk, and analyse credit to maximise returns while offering same day liquidity.”*

MAXIMISING RETURNS | CHAPTER 3

Portals in Treasury's Tech Stack

Making MMF Investment Even Easier

Short-term investment portals offer products and tools all in one place, making it convenient for investors to trade these instruments. An independent short-term investment portal does not own any of its own products, nor is it bank-owned. It is essentially an electronic 'fund supermarket', providing investors with a convenient means of finding and investing in multiple MMFs and other short-term investments. Its counterpart, the single-bank portal offers its own products and may offer some of its competitors' products as well.

An independent portal offers comprehensive market coverage, and thus discovery, through a single point of access. ICD Portal, for example, provides access to more than 450 investment products from the market's 40 fund providers.

The fund selection offered through a single-bank portal, on the other hand, may be limited by self-interest. An independent portal not only provides the investor the freedom to determine who they share their investor data with, it also provides institutional investors unbiased access to the market, operational efficiency, and robust risk mitigation.

After all, in a fractious market, treasury teams need timely information across all their investments in one place – to track performance and move money in and out of different vehicles as required. This is much easier with an independent portal than having to collate and analyse disparate data sources (and formats) across a suite of single-bank portals.

Taking control

Even without the urgency of a challenging market, the ability to monitor and manage treasury policy compliance across a varied portfolio is enhanced through an independent portal. This stems from the ability within a portal such as ICD to set and monitor limits, such as credit, currency, counterparty, etc. upon each fund and their underlying holdings within a portfolio.

By setting a maximum invested value, a warning can be triggered if a proposed trade will breach that limit. And users can also be notified when a percentage holding in a fund is breached when other investors put through redemptions that push the percentage held into the compliance red zone.

As discussed in earlier chapters, diversification has always been a key attraction for MMF investors. But by trading across a number of different funds, all of which will have their own individual portfolios of underlying assets comprising different issuers, types, securities, maturities, credit ratings, and ESG criteria, risk is even more readily mitigated.

It's also the case that while investment diversification could be achieved through any MMF portal, independent multi-fund portals are agnostic in terms of funds offered. This ensures that the provider is not trying to promote its own products over others.

Client and fund research

As every treasurer knows, appropriate fund selection is vital to investment success. To assist investors, ICD pools and provides regularly updated static and historical data concerning each fund. This helps unlock valuable knowledge – and only by getting under the hood of what a fund is trying to achieve, and its credit process, will investors pinpoint their best targets. This can be achieved by communicating directly with the funds or asset managers.

The short-term market is home to a number of portal providers. To help investors select, a key point of differentiation will be technology resources. ICD is focused solely on serving the treasury industry, giving it the space and independence to invest at scale. This approach has seen ICD's tech-team expand to represent more than half of its total headcount, with 100% access afforded to the rest of the business to ensure a service that is dedicated to developing and maintaining its portal.

As part of its development programme, rather than offer clients annual or six-monthly major upgrades, ICD engages in two-weekly developmental 'sprints' (an Agile development technique that requires execution of a specific task in a short timescale). While this ensures it will swiftly implement any changes or non-urgent fixes, true sprints are possible only with full 24/7 access to the internal technology team.

In fact, full tech accessibility enables ICD to set itself 'mid-sprint' targets, attending to any technological issues requiring immediate attention. Regular client reviews are thus not only used to train new users but also to update existing users on the latest enhancements. These reviews are augmented by annual client surveys, and a continuous stream of social and educational events designed to gather all feedback and ideas and apply them to new developments.

Meeting investor needs

In the same way that ICD will work to bring on board a new fund where there is client demand, it will build out functionality where it is requested. The platform will then be upgraded at the earliest point. With every client on the same portal version, each upgrade is made available to all that need it. A recent example of this technological agility is the ability for ICD's clients to manage exposures to MMFs using a single currency to control multiple currency funds. Rather than wait for a major upgrade, this functionality was part of a sprint release.

In this instance, having a limit per fund but not being able to specify the currency of that limit required clients to build headroom into their compliance rules. While this ensured they never breached their limits if FX values changed unfavourably, it took too long for clients to ensure their daily limits were met. Now users have the ability to set all limits in their functional currency, so they could control exposures in an EUR MMF using a USD limit, for example.

At the same time, ICD's tech team enabled clients to aggregate fund families. A treasurer investing, for instance, in one fund, using three currencies, and wanting to limit exposure to that single fund, can now set a single-currency limit, exchange the three currencies into the base currency, and have the system aggregate and expose their limits.

Optimising data flows

Even with the latest tools (at zero cost to the treasurer), the efficacy of portal integration with existing corporate systems and processes is a key determinant in portal selection. With this in mind, ICD's tech team has established connectivity and integration with all major TMS providers. Resources are also provided to clients to establish test environments and ensure the success of individual TMS integration.

The flow of data created by technical integration can offer significant value to investors. Within ICD, elements such as yield data are ingested automatically within the system on a daily basis, enabling a TMS to calculate daily dividend earnings. Trade data also flows automatically into the TMS, either using secure file transfer protocol (SFTP) or API technology. Other common integration files, such as end-of-day balance, are made available to investors.

For treasury organisations looking to optimise excess short-term cash, ICD also offers an automated sweep functionality. Within this process, when specified cash parameters are reached, the TMS is instructed to create a trade ticket in ICD.

If the payments module is set up in the TMS, automatic settlement can be established, alternatively ICD has its own auto-pay functionality to create the payment with the relevant bank and settle any purchased trades. All trade data flows back to the TMS – making it a very easy, efficient way to trade, with no human intervention required.

Selection considerations

When it comes to portal selection, it is important that treasurers look closely at portal functionality and to try to assess data accuracy and update frequency. Also worth consideration is the ease with which trades can be placed and whether the trading interface is one they would be happy using on a daily basis.

Treasurers may also wish to explore the depth of reporting and analytics functionality offered by a portal. Does it, for example, provide up-to-date (and time-stamped) fund research, and does it offer a deep dive to the level of underlying counterparties?

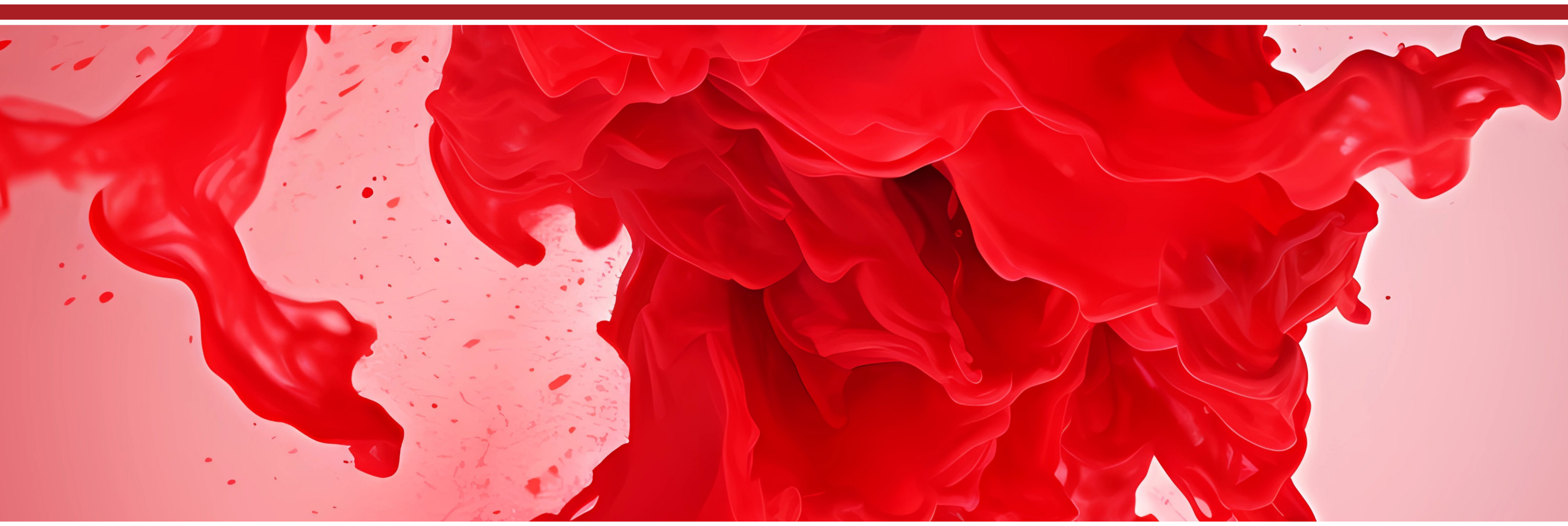
ICD Portal contains data required by investors to inform their daily trading decisions. With data being fed directly from fund providers and rating agencies, users can see all their investment data, complete with underlying exposures, in one place. With the recent upheavals in the banking sector, ICD clients were able to manage their exposures. Similarly with the geopolitical tensions created by Russia's invasion of Ukraine, investors were able to view their regional exposures through all underlying counterparties. Of course, the same insight into counterparties also applies to investors seeking to meet ESG criteria.

Finally, because at any stage an investor's needs may change, it's important to be able to see and research the portal provider's full fund line-up. Without it, investors can't easily make fully informed fund reviews and decisions – and treasurers need 360-degree visibility now more than ever.

KEY ELEMENTS OF AN MMF PORTAL TO CONSIDER

- Degree of independence from asset managers
- Ease of integration with existing tech stack and processes
- Anonymity or exposure on fund and investment sides
- Controllable individual trader and overall fund limits
- Appeal of user interface
- Full fund line-up exposed on the portal
- Live fund performance updates and reporting
- Consolidated reporting e.g. for dividend accruals
- STP including automated sweeping, trading and settlement
- Risk and compliance analytics and reporting e.g. for exposure monitoring
- Fund research at the level of underlying counterparties

"ICD Portal contains data required by investors to inform their daily trading decisions. With data being fed directly from fund providers and rating agencies, users can see all their investment data, complete with underlying exposures, in one place."



Case Studies: ICD In Action

zalando

Challenge
Many people were involved in a complex, highly manual, time-consuming process for trading MMFs. The team also lacked aggregated reporting and counterparty visibility.

Solution
The Zalando team transformed their treasury technology stack from a mix of custom solutions to making SAP S4/HANA the centrepiece. The team partnered with SAP and ICD to streamline their short-term investment process through API integration.

Result
The automated process is saving Zalando the equivalent of one FTE for the time previously spent on manual work, including four-eye checks and postings in accounting.

Tinatin Biganashvili

Team Lead Corporate Solutions, Zalando

“The integration of ICD into Zalando’s SAP treasury stack frees up staff to work on more strategic activities.

Automation really pays off for significant time savings, risk mitigation and reallocation of resources.”

ICD CLICK TO READ THE FULL CASE STUDY

Jonathan Kluding

Business Product Owner, SAP Global Treasury Group, SAP SE

Challenge

SAP SE's Global Treasury Group were already using ICD's investment portal to park their excess cash in short-term instruments, but they were entering transaction data manually into the portal and entering that same information again in the back end of SAP TRM.

Solution

The SAP SE Global Treasury Group chose ICD Portal as its innovation partner to integrate short-term investment capabilities into the SAP Treasury and Risk Management (TRM) solution. With a single sign-on, the SAP-ICD API integration creates an end-to-end workflow for treasury teams to manage liquidity.

Result

The straight-through process enables treasury to eliminate multiple data entries and disrupted workflows. By reducing the number of interfaces, the SAP Global Treasury Group has reduced processing time, cost, and risk. ICD Portal now holds a formal SAP Integration Certification and is offered as a core capability to more than 5,000 SAP Treasury clients globally through the SAP Cloud Marketplace.

"The treasury team is now relieved of 100 hours of manual work annually, and the volume of transactions and additional hours saved will scale as the system is rolled out to additional SAP entities, globally."

ICD CLICK TO READ THE FULL CASE STUDY

Philip Giron

Treasury Manager, Riot Games

"With ICD, the quick execution has freed up a lot of our time, as has the interface which allows for fast research of MMFs. Being a lean team, time is our most valuable resource."

ICD CLICK TO READ THE FULL CASE STUDY

Challenge

Riot Games operates all over the world and collects revenue in various currencies. Due to its structure, revenue and cash go back to its global publishing entities, several of which had built up excess cash. The team's cash management activity was highly manual – they relied on spreadsheets and multiple banking platforms and various statement formats for reporting.

Solution

The Riot Games treasury team implemented Kyriba for global operations, and ICD Portal to focus on automating investments in Europe.

Result

The treasury team streamlined cash management, cutting reporting from three days to an hour, and reduced excess cash globally, working closely with international finance teams, enabling it to increase its return on cash.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