FINDING A HOME FOR YOUR CASH: WHY USE CASH OR LIQUIDITY FUNDS?

The world's major central banks continue to hold their reference rates at historically low levels, with an outlook that suggests little change from that position in the near term. However, investors remain cautious and whilst some confidence may be returning, the search for increased yield continues to be restrained by memories of the 2008 credit crisis and the subsequent collapse of Northern Rock, Bradford & Bingley and the Icelandic banks.

These events cause us all to consider if our savings are safe, against a backdrop where corporate cash is standing at historically high levels and many trustees and treasurers face a daily conundrum about where to house cash deposits, as the search for a 'safe home' continues to exist.

Much of the advice that arose immediately after the 2008 credit crisis spoke about 'spreading your cash' – hence the basis analogy of diversification and spreading risk. Whilst some of this consideration was aligned to the compensation scheme limits in the various jurisdictions for individual investors, there was also a basic view that holding cash across several bank accounts would reduce specific counterparty risk.

Whilst rates have remained at historically low levels for the past six years, some have responded to their need to increase income yield or merely achieve real return (ie. a net positive return after the effect of inflation) and accepted an adjustment in risk profile as they switched into higher yielding asset classes. However, for others their investment policy may still dictate for certain asset values to remain in cash and for all of us, a certain level of near term immediate liquidity does usually tend to exist.

Another solution that stood out post the events of 2008 and continues to provide several benefits for its investors, are pooled cash vehicles or often referred to as 'money market' or 'liquidity funds'. These types of investments have been around for a long time and have steered investors through various peaks and troughs of the individual central bank rate cycle. They aim to preserve capital and achieve returns by investing in a diversified portfolio of money market instruments and can be used in isolation or as part of a wider investment portfolio. Each investor in this type of fund is considered a shareholder and these funds are managed under strict and transparent guidelines that seek the preservation of capital, whilst maintaining liquidity and attracting reasonable yields.

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There are a list of specific reasons as to why these funds offer benefit to certain investors and why they are used by both individual and institutional investors in relation to their cash investment requirements.

1. Diversification

Liquidity funds invest across a range of money market instruments, issuers and sectors to achieve a diversified portfolio and thereby seek to reduce specific concentration risk.

2. Credit risk

Liquidity funds are generally governed by strict parameters around the credit quality into which they can invest, generally taking reference from external credit rating agencies in respect to the choice of underlying investment or issuer. The specific guidelines of a fund should be detailed in its Offering Document or Scheme Particulars.

3. Professional Management

Professional cash management should add a layer of skill and also access to the institutional cash markets that may otherwise not be accessible by an individual or SME. An experienced cash management house will carry out specific analysis of money markets and issuers and operate approved lists that are often the result of a collaboration of their internal investment committee's and credit analysts, and adopt tight guidelines around diversification, duration and credit quality.

4. Ring-fencing of Assets

The assets held within liquidity funds are normally required, by local regulation, to be ring-fenced from the

assets of their appointed Investment Manager, Fund Administrator, Asset Manager and Custodian. This means that in the event of any solvency issues to the parties to the fund, the assets would be held separately and should therefore be protected in accordance with regulatory requirements.

5. Independent Scrutiny

Many liquidity funds now seek independent rating by external credit agencies such as Moody's and Standard & Poor's. In order to achieve such ratings, there is scrutiny over the investment process and ongoing management. In fact, 'AAA rated' money market funds have one of the most conservative and restrictive investment policies of the collective fund universe. In addition, liquidity funds will generally have independent directors, who are separate to the investment management function, an independent trustee and an external audit requirement will tend to be a requirement.

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6. Flexibility

Unlike fixed term deposits, liquidity funds offer flexibility and generally, there is no requirement to commit cash for specific periods of time or redemption penalties.

7. Liquidity

Liquidity funds are designed to maintain high levels of liquidity in order to ensure immediate access to cash by their investors when it is required.

8. Fees

The fees charged to a liquidity fund are transparent and are detailed in the Offering Document or Scheme Particulars to the fund. These type of funds do not normally include fees to subscribe or redeem, allowing more freedom to move in and out of the fund when required.

9. Administrative ease

Liquidity funds aim to provide exposure to a wide range of underlying investments through its diversified portfolio, thus it provides one solution without several account opening processes and numerous accounts statements to administer.

The type of fund structure used for liquidity funds can vary. Generally these funds are established within UCITS or UCITS equivalent structures (such as the Isle of Man Authorised Scheme). However, it is possible to use other fund types depending upon the requirements and the intended target audience of investors. As with any investment decision, a thorough review against individual circumstances is required and a review of the available investment options must be carried out before making an investment decision.

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