MONEY MARKET FUNDS HAVE ENSURED THAT CORPORATE TREASURERS NO LONGER HAVE TO BREAK INTO THEIR EXISTING FIXED-TERM INVESTMENTS WHEN IN NEED OF SHORT-TERM LIQUIDITY. BUT DO THEY OFFER VALUE FOR MONEY, AND WHAT SERVICES SHOULD YOU EXPECT FROM YOUR FUND MANAGER? **PETER KNIGHT** OF THE IMMFA EXPLAINS.

MMFS – A FASTER ROUTE TO YOUR CASH?

The money market fund (MMF) industry is celebrating becoming a $200bn business (see *Figure 1 on page 24*). What makes this achievement so impressive is that it has grown from almost nothing in 1995 and continued to grow through one of the biggest recessions in recent asset management history. It has opened up a whole new client base for the mutual fund manager – namely, the corporate treasurer. Ten years ago, for many companies, the only dealings a treasurer was likely to have with an asset management company would be through the company pension scheme. Today, MMFs have put asset managers at the heart of a company's cashflow management.

Over the years, many articles have been written on the subject, often by asset managers keen to point out the perceived advantages they believe MMFs bring to corporate cash management. Sometimes, articles are written by treasurers explaining how they use these new vehicles to add value to their treasury activities. Both are valid viewpoints. However, the two most frequently-asked questions are often overlooked, namely:

- What do fund managers do?
- What do I get for my money?

Let us look at these questions a little more in-depth and in doing so, hopefully I can provide you with some tips on how to save time and money.

ASSET MANAGER OR BANKER? There is a general lack of understanding of what asset management companies do. I am both an accountant and a treasurer, but when I joined my first asset management group in the mid-1980s it took months, some would say years, to understand what they did and why they did it. One of the most common mistakes treasurers make is to think that asset managers are banks and that the wares they offer are a variation of banking products. This is not true. Bankers and asset managers are fundamentally different. It is true that a number of asset management firms are owned by banks, but do not let this fool you.

The difference between bankers and asset managers can be filtered down to one word – fiduciary.

What you buy from an asset manager is a service, not a product. This 'service' may be packaged and presented to you in a convenient form, such as an MMF, but it is still a service. Asset managers effectively set themselves up as your trusted adviser. They give you access to markets such as short-term debt in the case of MMFs, and then apply their expertise to buy appropriate investments on your behalf.

Many of their obligations to you are set out in law, they cannot have the 'pile them high, sell it cheap – buyer beware' attitude adopted by some bank dealing desks. This is because they have a 'fiduciary duty'.

‘WHAT YOU BUY FROM AN ASSET MANAGER IS A SERVICE, NOT A PRODUCT. THIS ‘SERVICE’ MAY BE PRESENTED IN A CONVENIENT FORM, BUT IT IS STILL A SERVICE’

So you are buying a service when you buy an MMF. For this service, the fund management company will charge a fee. Understanding what service you want will help you decide how much you are willing to pay. I will revisit this point later but first I need to explain what fund managers do.

WHAT ARE FUND MANAGEMENT SERVICES? The fund management industry does have something in common with banking – both try to mystify themselves with jargon. I have a simple rule about this: if I don’t understand it, I won’t buy it – and neither should you.

The two charts in this article sum up what you are purchasing when you buy an MMF. *Figure 2* explains the structure of a fund – it is basically a company with variable capital. When you buy the fund, you become a shareholder. The assets of the company are the portfolio of short-dated debt securities your shareholder funds have allowed the company to purchase.

To run this company, a number of services need to be provided. Some are legal and regulatory, while some relate to the running of the company. They all cost money and, as a shareholder, you are paying for this. One of the services you buy – in fact, the main one – is the service of the fund management company. Basically, a fund management company can be broken down into three main activities, as follows:

- managing the portfolio;
- servicing of the shareholders/clients; and
- sales of shares to new shareholders/clients.

The main value activities to you, as an investor, in MMFs occurs in the management of the money and the servicing of your account.

WHAT DO FUND MANAGERS DO? MMF managers are involved in two main activities:

- credit management; and
- investment of funds.

In my opinion, credit management is the most important activity and the one for which I, as an investor, would not mind paying a reasonable fee.

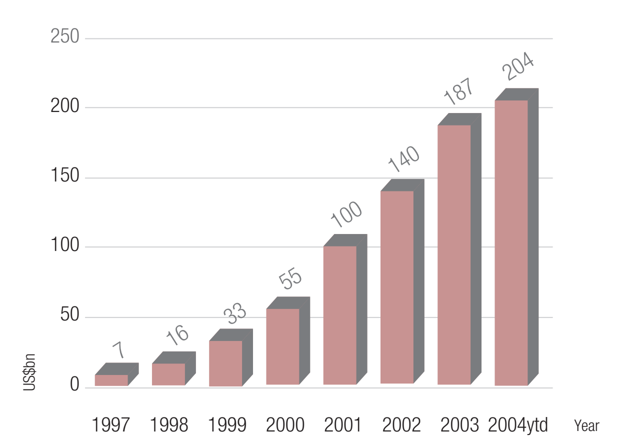
Typically, a money manager would employ a department containing between one and 12 professionally-qualified credit analysts. Their job is to vet every single investment in the MMF. They are usually divided regionally and by industry sector. A credit analyst would make regular visits to every company on his or her list so there is a lot of travel involved in the job. Back in the office, they keep track of quarterly earnings, debt cover, balance sheet restructuring, management changes, regulatory changes, market comment, market rumours, the interest rate environment – the list goes on and on.

Often, large fund management houses have three sets of analysts: short-term debt, long-term debt and equity. These analysts follow the same companies but use different criteria to decide whether or not they are a good buy. Ideally, all three sets of analysts should be sharing information. This is really a specialist job and one out of the reach of nearly all corporate investors.

The investment of money in an MMF, subject to credit approval, is carried out by a specialist team of dealers and fund managers. If you visit the investment floor of a large asset management house it looks very similar to a bank’s trading floor – the usual mass of screens and telephones. The difference is subtle – the process is that of investing, not trading a proprietary book.

Dealers and fund managers usually start around 7am. Many investment houses are global, so the beginning of an investment day for one is the end for another. The day usually starts with a team meeting – what’s going on in the world, what’s on offer in the market, what should we be looking out for?

Figure 1. Money market fund assets under management



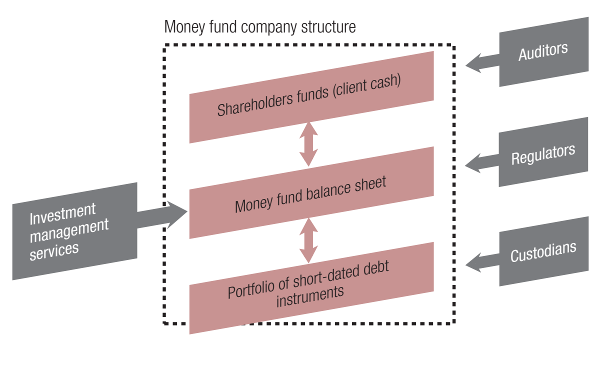
Source: iMoneyNet

Funds are open for business all day, so knowing about large flows in or out of the fund will help the fund manager structure his or her portfolio to optimise the yield.

The buying of the day's investments usually starts early. Experience of the market's liquidity and the availability of certain debt issues will guide the dealers as to when purchases are made – this is why dealing rooms sometimes seem quiet; there is a lot of waiting and searching for the best deal. The biggest value the investment team bring to you, as a shareholder, is their knowledge of where to go to get the best deals in the market. This knowledge is worth a lot of money.

As the day passes, global money fund managers often pass their investment portfolio on to the next regional team. So when the US markets open for business, the US money fund portfolio is passed on to New York or Boston to manage. Fund managers will exploit not just instruments but markets and time zones to maximise the returns they bring to you.

Figure 2. Services provided and charged to the money fund



Source: IMMFA

For European investment teams, the day ends at about 4pm. For currencies, such as sterling and the euro, which have then closed, the accounting teams get busy valuing the portfolio, checking confirmations and ensuring settlements have been made. The true market value of the fund is established and checked to ensure it stays within allowable limits. Compliance teams check to ensure there are no regulatory breaches and the shareholder records are updated to reflect client activity. Finally, the balance sheet is balanced and the fund is ready to open for the next day's trading.

WHAT DO I GET FOR MY MONEY? I hope I have made it clear that when you invest in an investment management product, you are buying a service. By buying an MMF, you are buying a share of the portfolio of investments. The gross return on this portfolio of investments is high, typically Libor plus 0.1%. However, along with this gross return, you are buying a service that costs money.

There are dozens of suppliers of MMFs and they each have their own mix of services:

Core
- Credit analysis service
- Investment service
- Client record-keeping
- Deal-taking and problem-solving

Optional
- Internet portal dealing
- Multi-fund portals
- Automatic cash sweeps
- Portfolio look-through
- Dedicated client support desks, sometimes global 24/7
- Small minimum deal size
- Late cut-off times
- Multi-currencies
- Internet modelling

For these services, fund managers typically charge between 0.1% and 0.2% of the principal invested. If you want to save money then consider the following three points:

- If you buy these services you do not have to replicate the activity yourself – otherwise you are effectively paying twice.
- Don't buy what you don't need. You have to purchase the core activities, but you may be able to save money if you don't require the optional ones.
- Make sure you negotiate. Fees are a percentage of your investment – the larger the investment, the higher the revenue to the investment manager. There is a lot of competition for your money; investment managers can achieve economies of scale with larger stable amounts of money so it is a buyer's market. However, be realistic when negotiating; a supplier that makes a reasonable profit is one which will value your custom.

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The AAA-rated money market fund industry has a trade body – the Institutional Money Market Funds Association (IMMFA). If you want further information about the industry contact IMMFA on 020 7269 4669 or visit its website.