

Spotlight Test: Money Market Funds **Worked Solutions**

Question 1

When making a withdrawal from a UK Money Market Fund the proceeds of the withdrawal can normally be paid into which of the following?

- (a) to any named account with any UK bank
- (b) to any named account with one nominated UK clearing bank
- (c) to only one account with one nominated UK clearing bank
- (d) to only one account with the Money Market Fund's UK relationship bank
- (e) don't know

Answer

The right answer is (c) to only one account with one nominated clearing bank

This is primarily a money laundering prevention measure, but it has internal control benefits for the treasurer.

See The Treasurer May 2003 Money Market Funds – The Treasurer's View

Question 2

Which of the following best reflects the factors considered by rating agencies when evaluating Money Market Funds?

- (a) asset management quality, operational efficiency and investor base
- (b) asset management quality, returns history and operational efficiency
- (c) returns history, operational efficiency and investor base
- (d) returns history, asset management quality and investor base
- (e) don't know

Answer

The right answer is (a) asset management quality, operational efficiency and investor base

Answer (a) is the only one not including 'returns history'. This is not a major factor, as the emphasis for the fund rating is on preservation of capital not on delivering a return. The importance of operational efficiency and the investor base is explained in the article referenced below.

See The Treasurer May 2003 Money Market Funds – A Rating Agency View

Question 3

A large corporate treasury has an investment policy for its short-term funds which emphasises the liquidity of the investment as well as return and safety. Commercial paper, FRNs and Money Market Funds are permitted investments for these short-term funds. What advantages might Money Market Funds be seen to have?

- (a) Money Market Funds *always* show a higher return.
- (b) Money Market Funds are normally traded for same day value.
- (c) Money Market Funds *always* offer better security.
- (d) Money Market Funds have clear documentation.
- (e) don't know.

Answer

The right answer is (b) only Money Market Funds are normally traded for same day value

CP can be traded for same day value, but T+1 or T+2 is more normal. FRNs normally trade on T+3 basis.

See The Treasurer July/August 2003 Money Market Funds – Going with the Flow

Question 4

Theoretically, which is the most appropriate comparison rate when considering the performance of a Money Market Fund?

- (a) 3 month LIBID rate.
- (b) 1 month LIBID rate.
- (c) 7 day LIBID rate.
- (d) overnight interbank bid rate.
- (e) don't know.

Answer

The right answer is (d) overnight interbank bid rate

The overnight rate gives comparable daily liquidity.

See The Treasurer July/August 2003 Money Market Funds – Yield and Performance

Question 5

Which of the following best reflects a typical asset allocation for a Money Market Fund?

- (a) 51% CP; 19% short time deposits; 16% CDs; 14% FRNs.
- (b) 51% short time deposits; 19% FRNs; 16% CP; 14% CDs.
- (c) 51% CDs; 19% FRNs; 16% CP; 14% short time deposits.

- (d) 51% FRNs; 19% CDs; 16% short time deposits; 14% CP.
- (e) don't know.

Answer

The right answer is (a) 51% CP; 19% time deposits; 16% CDs; 14% FRNs

Short time deposits and CDs are highly liquid and will generate primary liquidity for the fund. CP can enhance the overall return, but secondary markets may be thin.

See The Treasurer July/August 2003 Money Market Funds – Going with the Flow

Question 6

Which of the following is likely to gain most yield benefit from investing in Money Market Funds?

- (a) a Local Authority with a total investment of £30M and normal subscription / withdrawal amounts of £0.5M.
- (b) a large corporate treasury with a total investment of £100m equivalent in several currencies and normal subscription / withdrawal amounts of £2M equivalent.
- (c) a small corporate treasury with a total investment of £8M and normal subscription / withdrawal amounts of £75,000.
- (d) a recently-established pension fund with no current pension liabilities but £40M of long-term pension liabilities.
- (e) don't know.

Answer

The right answer is (c) a small corporate treasury with a total investment of £8M and normal subscription / withdrawal amounts of £75,000.

The biggest gain in yield benefit is for those with £10M or less to invest as long as the subscriptions / withdrawals are greater than around £50,000. This because, typically, those with significantly greater sums can approach the LIBID rates which the funds can access.

See The Treasurer May 2003 Money Market Funds – The Treasurer's View