Pension Update

Low rates and money market funds

Background

Money market funds offer safety of capital, liquidity and stability of returns. The strategies invest in government and corporate short-term instruments. Although the principal you invest is safe, the interest rate paid on the cash you invest fluctuates with the market rates.

Prior to 2008 when short term notes (Canadian T-bills) were yielding almost 4.0%, money market funds presented a decent return with very little risk for plan members. Fast forward nine years and that same T-bill is yielding 0.4%, while inflation sits around 1.3%.

Impact on Money Market Funds

Like any investment fund, there are investment management fees and other expenses associated with operating the fund. Although the management fees on money market funds are usually lower than equity or bond funds, there can become a point where the interest earned on these short term instruments is less than the fees and expenses to operate the fund. What was a safe investment steadily earning a small return can now actually produce small negative net returns, even before the eroding effect of inflation.

Implication for Plan Sponsors and Members

DC Plan Sponsors who offer a money market option to their members ought to be aware that the interest earned on money market deposits may not be adequate to cover expenses resulting in a loss of capital. If the money market fund is the default option for plan members who do not select where to allocate their capital, Plan Sponsors may wish to consider another default option.

Members who use the money market fund as a long term savings vehicle may not be aware of the impact on their capital, especially if inflation picks up. The funds are not protected against inflation and short term rates will need to rise for net returns to improve.

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