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Your guide to money market funds

What is a money market fund?

A money market fund (MMF) is a professionally managed, diversified investment vehicle designed to meet short-term cash-management needs or serve as a lower-risk alternative to the volatility of stocks or longer-term bonds. MMFs consist of highly liquid, high-quality money market instruments with the primary objective of providing current income, consistent with liquidity and stability of principal. They offer investors easy access to their cash (same day or next day) and the potential for market-rate income through investments in high-quality short-term debt securities.

Who uses money market funds?

- **Banks, corporations, financial entities, treasurers, insurers, local authorities, charities, universities:** To manage short-term cash needs or as a lower-risk investment during market volatility.
- **Individual investors:** To keep cash liquid for emergencies or near-term purchases.
- **Institutional investors:** To add stability to an overall investment portfolio.
- **Portfolio managers:** To use as a "cash" allocation within longer duration portfolios.

Why use money market funds?

- **Liquidity:** MMFs provide easy access to cash, with withdrawals available the same or next business day.
- **Stability:** They aim to offer a stable investment option, managed by experienced professionals who navigate changing market environments.
- **Current income:** MMFs can benefit from managed exposure to the yield curve, offering competitive yields through investments in high-quality, short-term debt securities.
- **Diversification:** MMFs invest in a variety of short-term debt instruments, spreading risk across different issuers and sectors, which can help mitigate the impact of any single investment's poor performance.

MMFs are suitable for those with a short investment horizon, low tolerance for volatility, or a need for highly liquid investment options. They can also provide liquidity and lower-risk options within a diverse investment portfolio.

Types of money market funds and what they buy

Outside the United States, the Money Market Fund Regulations group funds into two categories: Short-term MMFs or standard MMFs. Each invests in debt securities that are lower risk and liquid.

- **Short-term MMFs** have shorter-dated maturity, life, and term requirements than standard MMFs and are therefore suitable for short-term operating cash, making them more suitable for cash investors looking for an alternative to fixed-rate time deposits.
- **Standard MMFs** are suitable for reserve or strategic cash, which has a slightly longer investment time horizon.

Potential risks and rewards of money market funds

Rewards

Safety
MMFs are generally considered the lowest risk asset class for investors because they are short-term, high-quality investments.

Liquidity
Due to liquidity requirements, and their short-term duration, MMFs can provide daily access to an investor's cash when they want to redeem shares.

Income
Dividends and yields on MMFs are correlated to current market rates (minus fund expenses) and can be accrued daily, paid monthly.

Stability of principal
Stability of principal is a key goal of MMFs. Because of the strict requirements for investment quality, short investment maturities within a highly diversified portfolio, MMFs have historically provided strong preservation of principal to investors.

Risks

Loss of principal
MMFs are investments and are not guaranteed.

Credit
Credit risk refers to the creditworthiness of a bond issuer and its expected ability to repay its debt.

Interest rate
MMFs, while considered low risk investments, are sensitive to moves in market rates and therefore have interest rate risk.

Interest rate risk is the potential for losses in investment value caused by upward moves in market rates.

Government vs prime money market funds

Government MMFs invest primarily in government securities such as treasury bills, government bonds, and repurchase agreements collateralised by these securities. They are highly liquid and carry minimal credit risk, making them attractive to conservative investors. Prime MMFs invest in a broader range of short-term, high-quality debt securities, including commercial paper, certificates of deposit, and corporate bonds. These funds offer higher yields compared to government MMFs but come with slightly higher credit risk.

	Government money market funds	Prime money market funds
Investment Assets	Treasury bills, government securities, repurchase agreements collateralised by government securities.	Commercial paper, certificates of deposit, corporate bonds.
Risk Level	Minimal credit risk.	Slightly higher credit risk.
Liquidity	Highly liquid.	Highly liquid.
Yield	Typically lower yields.	Higher yields.
Investor Type	Conservative investors.	Investors seeking money market returns.

CNAV, LVNAV, and VNAV

All European and UK MMFs must be valued using one of three methodologies: CNAV, LVNAV and VNAV. Each methodology is designed to cater to different risk and return profiles, each offering unique features and benefits.

Type	Description	Investment focus
CNAV (Constant NAV)	Aims to maintain a fixed price per share.	Primarily government securities.
LVNAV (Low Volatility NAV)	Aims to maintain a stable price per share as long as 20 basis point collar is not breached.	Short-term money market instruments and deposits.
VNAV (Variable NAV)	Price per share fluctuates based on market value of underlying assets.	Short-term money market instruments and deposits, with ability to invest in assets with extended maturities.

Money Market Funds Regulation (MMFR)

UK-domiciled MMFs are governed by UK Law and subject to UK MMFR, while European-domiciled MMFs are governed by EU Law and subject to EU MMFR.[1] These regimes are similar in their controls and limitations on MMFs, though are not identical, having diverged since the UK's departure from the EU. MMFs in both the UK and EU can be structured to be compliant with local UCITS rules.

	Short-term money market funds	Standard VNAV money market funds
Maturity	Typically less than one year and up to 397 days. Individual securities: Max. 397 days. WAM: Max. 60 days. WAL: Max. 120 days.	Can include longer maturities, up to 2 years. Individual securities: Longer maturities permitted. WAM: Max. 182 days. WAL: Max. 365 days.
Investment assets	High-quality, short-term debt instruments, cash and cash equivalents.	High-quality debt instruments, including longer-term securities.
Instruments	Treasury bills, certificates of deposit, commercial paper, bank deposits, repurchase agreements, short term bonds and floating rate notes.	Treasury bills, certificates of deposit, commercial paper, corporate bonds, floating rate notes and repurchase agreements.
Risk level	Very low risk.	Low risk, but slightly higher than short-term MMFs.
Liquidity	Highly liquid. Minimum daily liquidity requirements: A MMF must have at least 10% of its assets invested in "daily liquid assets," generally meaning securities that can be turned into cash in one day. Minimum weekly liquidity requirements: A MMF must have at least 30% of its total assets invested in "weekly liquid assets," generally meaning securities that can be turned into cash within one business week (five days). Weekly liquid assets include daily liquid assets.	Highly liquid, but may have slightly longer settlement times. Daily liquidity: Min. 7.5%. Weekly liquidity: Min. 15%.
Yield	Lower yields.	Potentially higher yields.
Investor type	Conservative investors seeking a same-day access home for short term cash.	Investors seeking a balance between stability and potentially higher returns.

	Short-term money market funds	Standard VNAV money market funds
Quality	High-quality "eligible" money market instruments, including: - Government and agency instruments. - Eligible securitisations and Asset-Backed Commercial Papers (ABCP). - Deposits with credit institutions. - Financial derivatives. - Repurchase and reverse repurchase agreements. - Units or shares of other MMFs.	Same as short-term MMFs.
Settlement	T+0 or T+1.	Typically T+1.
Diversification	A MMF's diversification requirements are designed to mitigate portfolio risk by spreading that risk among many issuers, ensuring that no single issuer poses a significant risk to the overall portfolio. Funds are generally required to invest no more than: - 5% in an individual issuer. - 10% in any one deposit taker. - 15% in a reverse repo provider. Note: Diversification requirements exclude cash, cash items, securities issued or guaranteed by governments or government agencies, and repurchase agreements collateralised by government securities.	Same as short-term MMFs.
Asset valuation	**CNAV & LVNAV funds – Amortised cost** Fund assets are valued at their purchase price, adjusted for amortisation of any premium or discount over the remaining life of the asset. For LVNAV funds, assets with maturities >75 days are valued using the Mark-to-market method, where asset values are based on their daily market price, ensuring the NAV reflects real-time market conditions. VNAV Funds – Mark-to-market NAV.	Mark-to-market (MTM) NAV.

Put your cash to work in a money market fund

MMFs can be a valuable addition to your portfolio, whether you use your cash daily or invest it for the longer term. MMFs can offer a competitive yield while providing a liquid, diversified, and high-quality investment. Investors benefit from easy access to their cash, with withdrawals available the same or next business day, and enjoy the lower levels of risk associated with these funds. Managed by experienced investment professionals, MMFs navigate changing market environments to help you maximise the potential of your cash.

For more information on Federated Hermes' liquidity solutions, visit: www.hermes-investment.com/liquidity

Glossary:

Constant NAV (CNAV) A type of MMF that aims to maintain a fixed price per share, typically $1.00.

Daily liquid assets Securities that can be converted into cash within one business day. MMFs must maintain a minimum percentage of assets in daily liquid assets.

Diversification The practice of spreading investments across various issuers to reduce risk. MMFs have specific diversification requirements to mitigate portfolio risk.

Duration A measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates, typically expressed in years.

Government money market fund A MMF that invests primarily in government securities, such as treasury bills and government bonds, offering minimal credit risk and high liquidity.

Liquidity The ease with which assets can be converted into cash. MMFs are required to hold a certain percentage of assets in highly liquid securities to meet shareholder redemptions.

Low Volatility NAV (LVNAV) A type of MMF that aims to maintain a stable price per share as long as the MTM price remains within a 20 basis point collar.

Mark-to-market (MTM) Mark-to-Market (MTM) NAV means valuing a fund's assets based on their current market prices, ensuring the NAV reflects real-time market conditions.

Money market fund (MMF) A professionally managed investment vehicle that invests in high-quality, short-term debt securities and aims to provide liquidity, stability, and current income.

Net Asset Value (NAV) The per-share value of a MMF, calculated by dividing the total value of the fund's assets by the number of shares outstanding in compliance with the MMFR.

Prime money market fund A MMF that invests in a broader range of short-term, high-quality debt securities, including commercial paper and corporate bonds, offering higher yields but slightly higher credit risk.

Repurchase agreement (Repo) A short-term agreement to sell securities and repurchase them at a later date, often used by MMFs to manage liquidity.

Reverse repurchase agreement (Reverse Repo) A short-term agreement to buy securities and sell them back at a later date, used by MMFs to manage liquidity.

Variable NAV (VNAV) A type of MMF where the price per share fluctuates based on the market value of the underlying assets.

Weighted Average Life (WAL) The average time until the securities held in a MMF are scheduled to be repaid or would be repaid upon demand by the fund.

Weighted Average Maturity (WAM) The average time to maturity of all the debt securities within a MMF, typically measured in days.

Weekly liquid assets Securities that can be converted into cash within one business week (five days). MMFs must maintain a minimum percentage of assets in weekly liquid assets.

Yield curve A graph that plots the yields (interest rates) of bonds with equal credit quality but differing maturity dates, showing the relationship between interest rates and the time to maturity.

[1] EU MMF Regulation – EU Regulation 2017/1131 on money market funds and all implementing legislation and regulation (as amended).
UK MMF Regulation – EU MMF Regulation as it had effect on 31 December 2020 as incorporated into UK domestic law by the EUWA and amended by The Money Market Funds (Amendment) (EU Exit) Regulations 2019 (as amended by the Financial Services (Miscellaneous) (Amendment) (EU Exit) (No.3) Regulations 2019/1390) and the Financial Services (Miscellaneous) (Amendment) (EU Exit) Regulations 2019.

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Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns and, where possible, to contribute to positive outcomes that benefit the wider world.

Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by five decades of experience
- **Private markets:** private equity, private credit, real estate and infrastructure
- **Stewardship:** corporate engagement, proxy voting and policy advocacy

For more information, visit **www.hermes-investment.com** or connect with us on social media: