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Adding security to cash sweep without sacrificing liquidity or yield

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Whether it is used for liquidity, diversification or for opportunistic investing, cash continues to be a vital component in a diversified portfolio. However, large cash balances can create a drag on returns, increasing the risk of not meeting financial goals. While there have been ways to increase yield, they usually generated more risk for the portfolio. Regulatory reform has added complexity to the landscape for money funds. The possibility of fees, gates and a floating net asset value (NAV) has impacted the willingness to use some fund options. The result is potential yield impacts causing further challenges for financial intermediaries, such as trust organizations, who as fiduciaries are searching for the highest possible yield with the least amount of risk. This uncertainty is causing some organizations to rethink their approach to cash management.

What are the options?

While most investing is done with traditional money market fund sweep vehicles that provide the necessary liquidity, there have been shifts in the utilization of these funds. Most of these money market fund sweep options now focus exclusively on Government or Treasury options, due to the impact of regulation with some use of Short-Term Investment Funds (STIFs). Products in these categories have proven to be viable options for many investment portfolios. However, as with any investment product, there are times when they may not be the best fit, leaving investment managers seeking alternatives.

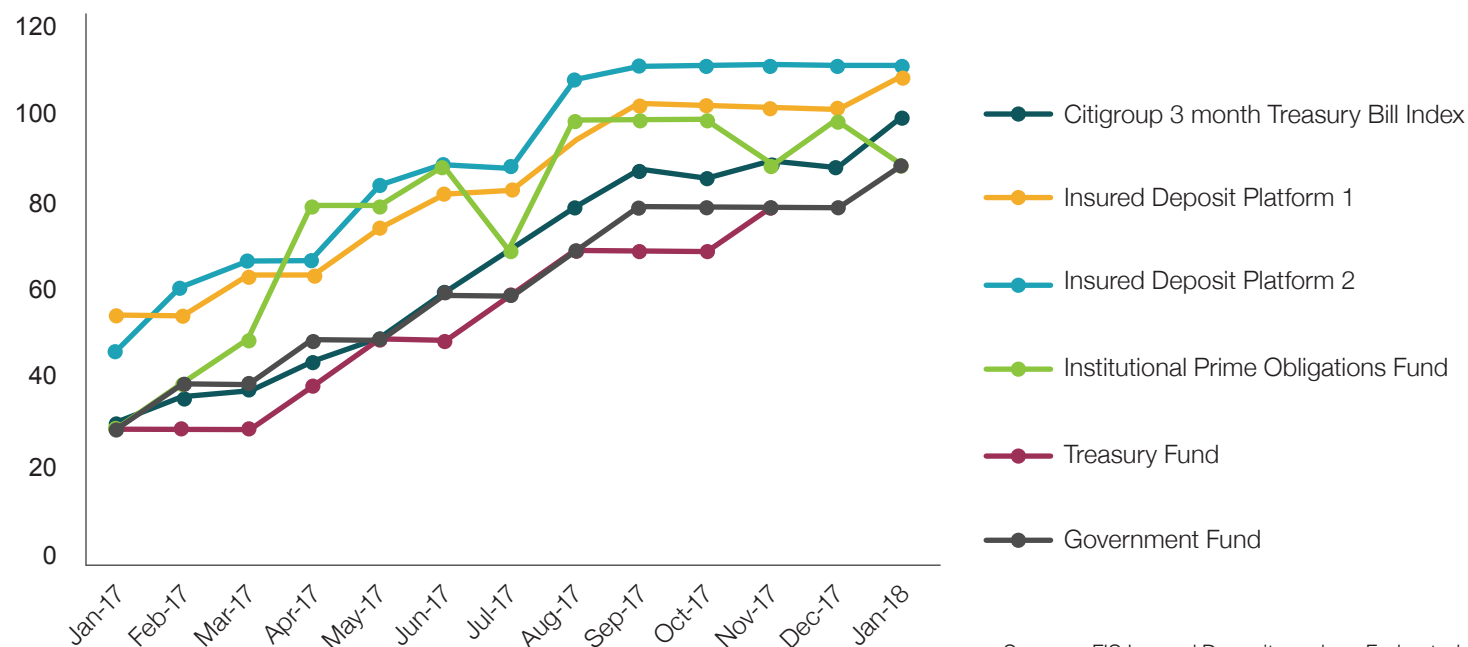
One option that has gained recent traction with trust banks and trust companies is Federal Deposit Insurance Corporation (FDIC) Insured Deposit Programs, a tool that has been widely used in the past by broker-dealers. At the core of the solution are the relationships developed between the program administrator and a network of approved insured institutions who provide investors with the opportunity to qualify for extended FDIC, typically using Demand Deposit Accounts or Money Market Deposit Accounts. Relying on proprietary technology, these programs allocate funds to the participating institutions while ensuring that deposits do not exceed the maximum limit for FDIC insurance coverage. Programs may also require an automated solution to ensure compliance with Regulation D. The main benefit to this product is the ability to gain a higher yield while offering same-day liquidity and higher security through extended FDIC insurance.

What do the numbers look like?

A review of monthly returns for 2017 (Fig. A) shows two FDIC-insured products returned a comparable return to traditional products and a popular index, matching or beating both in almost every month. The above average performance, combined with the benefit of FDIC insurance, provides a strong case for using this type of product, making them more popular with leading providers on a year-over-year basis.

It is clear that no one single product fits all the needs for investing of cash. Advisors have a fiduciary responsibility to select the most appropriate product for the portfolio. What is important to note is there are options to consider when searching for security, liquidity and yield.

Figure 1: Monthly money fund returns (in bps)



Sources: FIS Insured Deposit vendors; Federated

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Past performance is not an indicator of future returns

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About Mike Tropeano, CFA

Mike Tropeano is a solution architect in the Wealth & Retirement group at FIS. He is responsible for designing client-centric solutions based on the client's requirements and FIS' suite of products and partners. He has more than 20 years of experience in financial services experience with 15 years of focus in the private wealth and trust area. He joined FIS in 2017. Mike holds a BSBA from Boston University with a concentration in Accounting, an MBA from Bentley University with a concentration in Finance, is a Chartered Financial Analyst (CFA) and a member of the Boston Security Analyst Society.



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