



March 22, 2019

# Government Investment Officers Association Presentation: Cash Management



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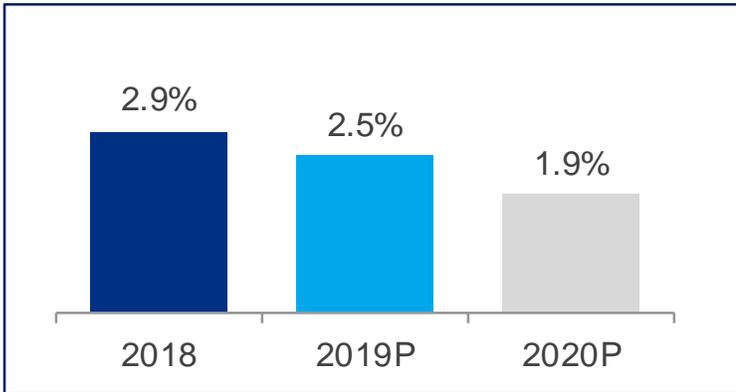
# 1. Market Conditions



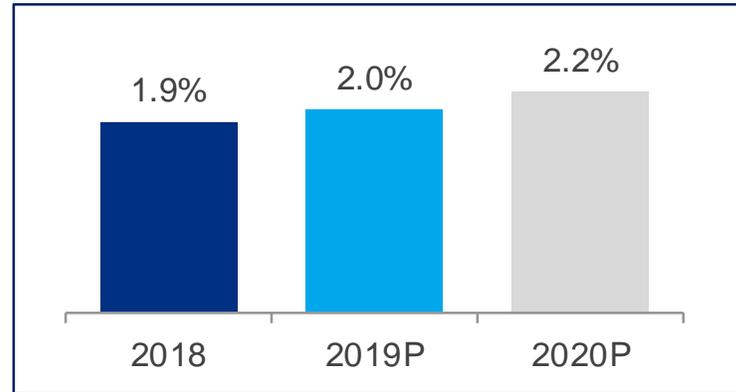
# U.S. Macroeconomic Outlook

Futures markets are pricing in an approximate 19% chance of a Fed cut by the end of 2019.

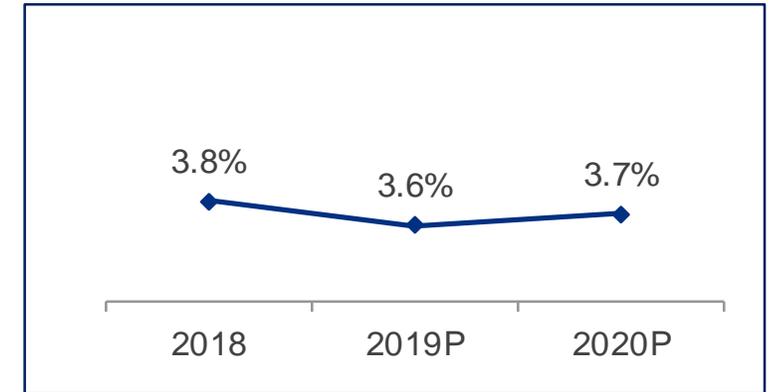
Despite healthy GDP,



stable inflation



and sustained low unemployment,

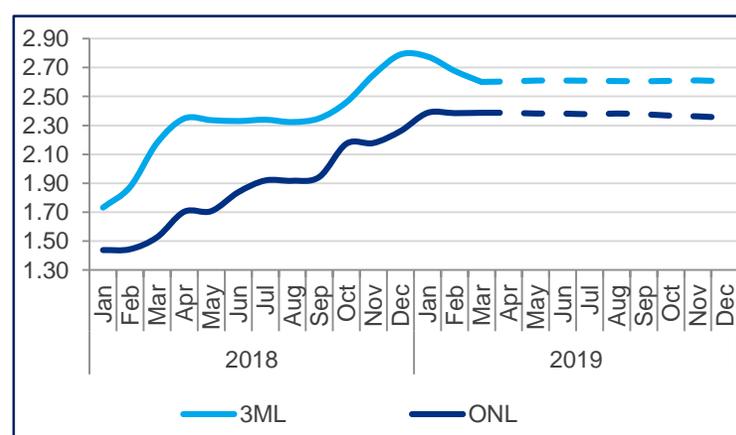


Futures markets are pricing in 81% chance of zero rate hikes in 2019.

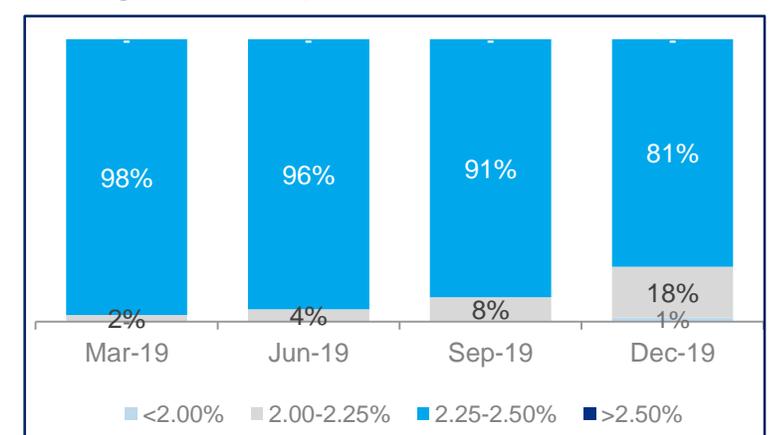
S&P 500 Historical Price



O/N and 3M LIBOR Forward Rates



Fed Target Rate Expectations

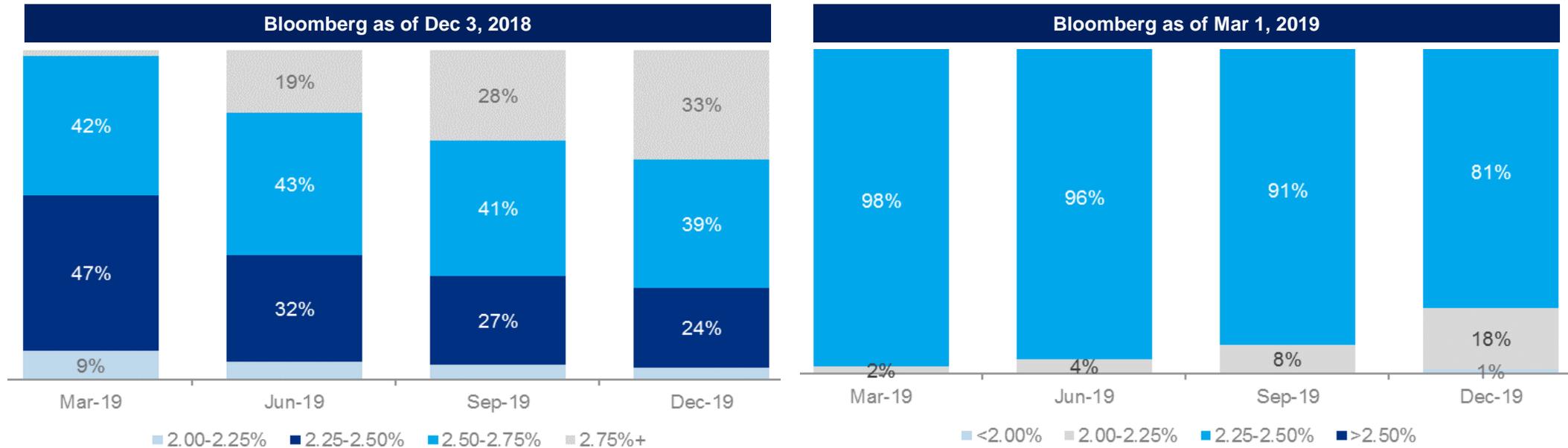


## 2. Federal Reserve Policy Considerations



# Federal Reserve Updates

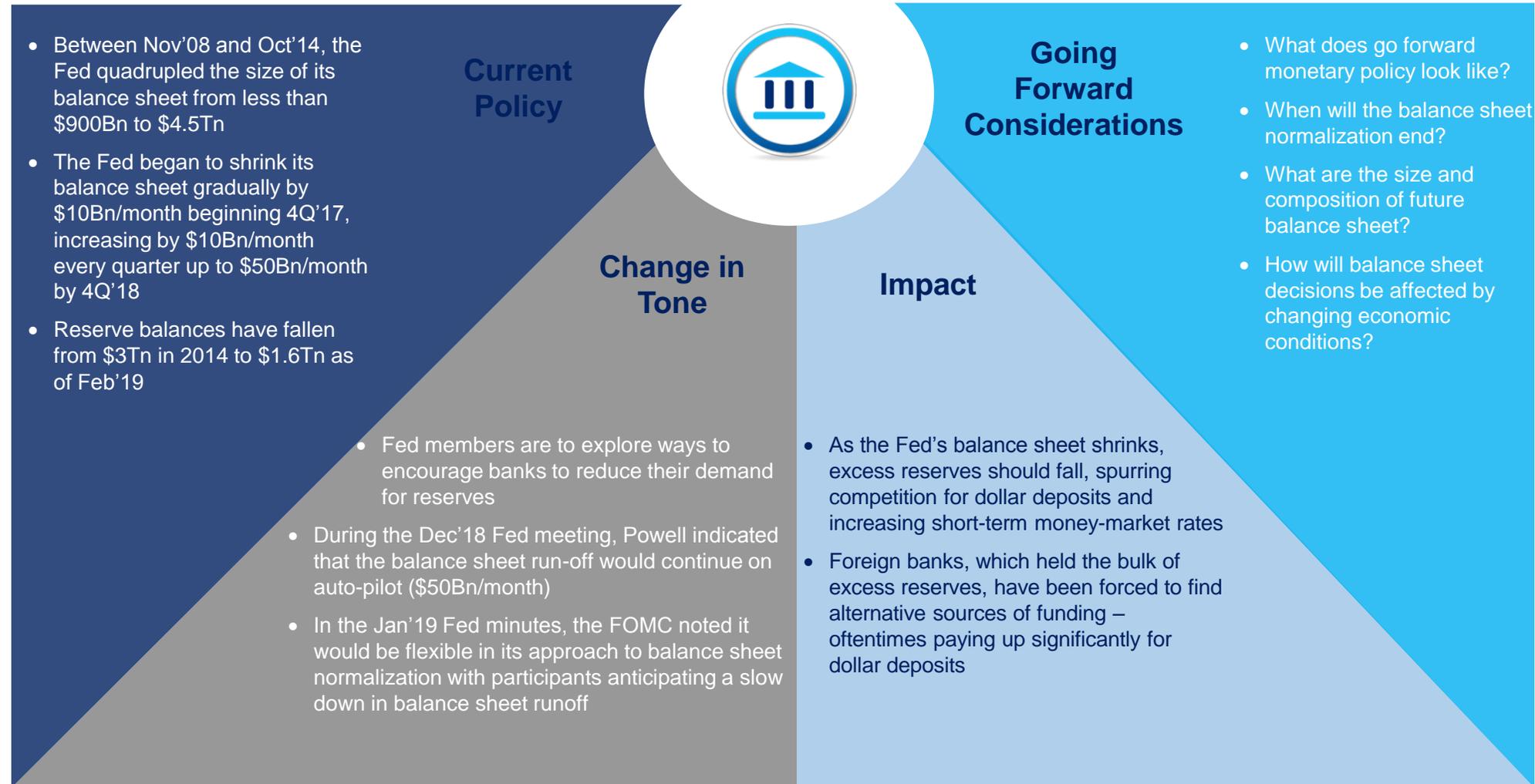
Fed suggests further interest-rate increases will depend on incoming data easing concerns about near-term risks on the US economy.



- Previous estimates of **two rate hikes** in 2019 have changed drastically as Fed continues to weigh various headwinds to US growth
- Fed removed reference to **“some further gradual increases”** from its statement and indicated that it will be **“patient”** on any future adjustments
- Jerome Powell confirms central bank’s balance sheet unwinding to end in 2019, stopping reduction of bank reserves and **increasing supply of U.S. Treasuries to market**, further indicating a **slow down in rate increases**

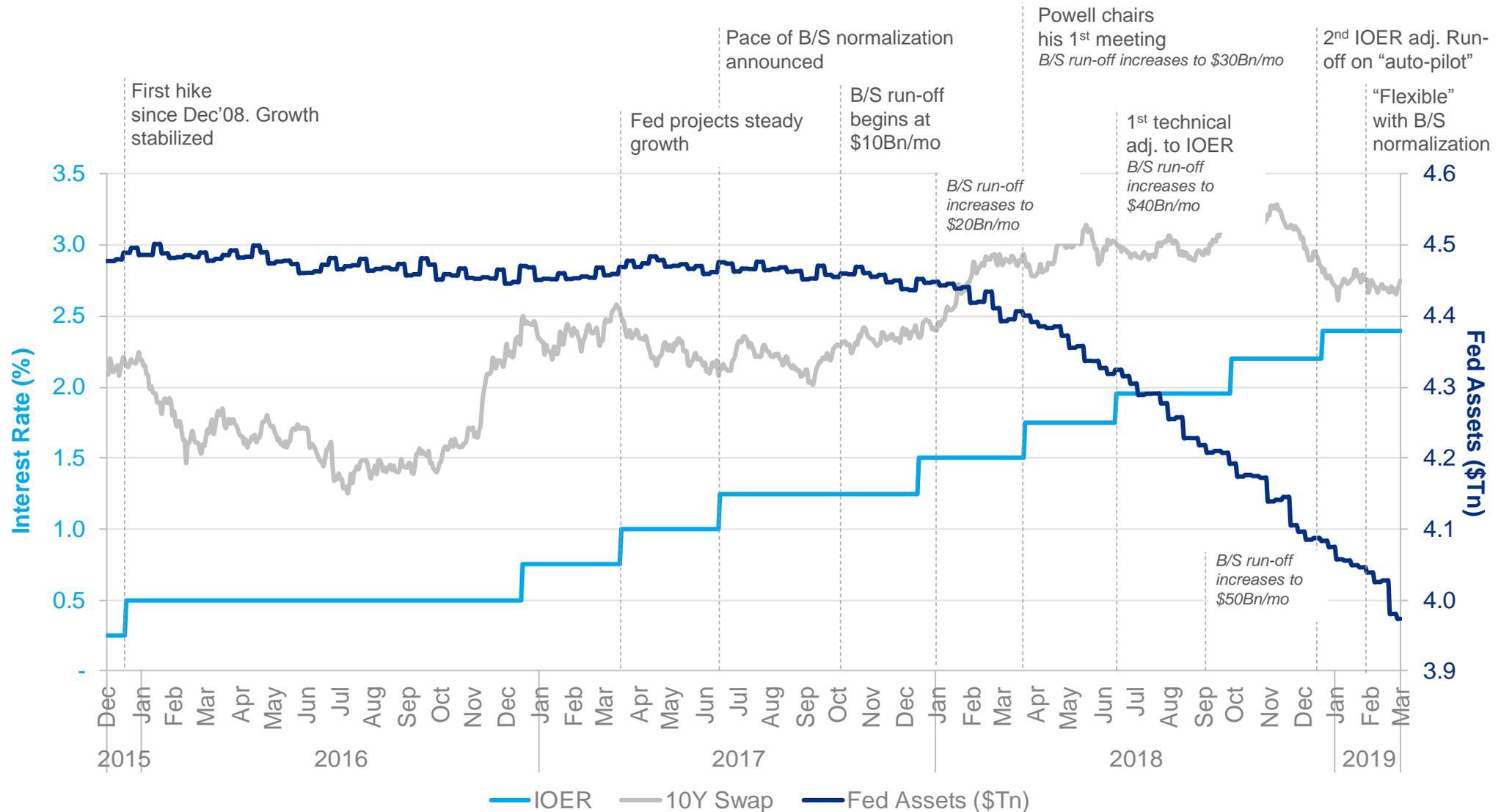
# Changes in Fed Balance Sheet and Impact

After the Fed signaled that interest rates would remain steady, investors are focusing on how the Fed will use the balance sheet as a tool for monetary policy.



# Timeline of Fed Policy

The Fed uses several tools to achieve its monetary policy goals in response to economic conditions.



# Negative Rate Fed Policy Considerations

Negative interest rates may be a go forward Fed policy consideration.

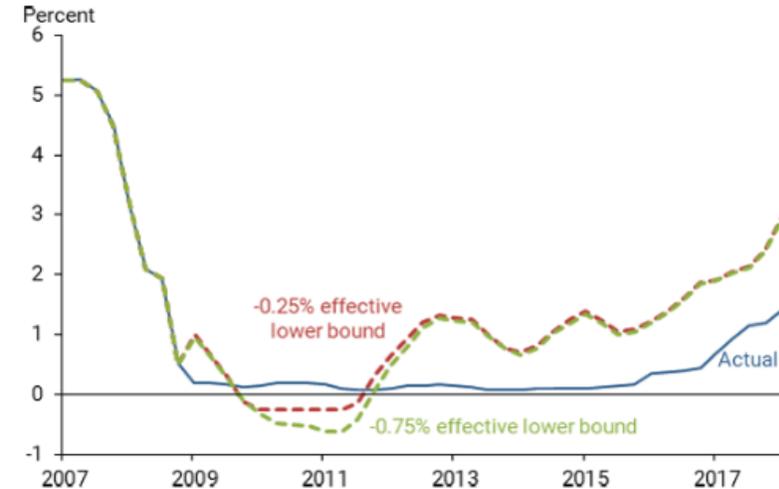
## Federal Reserve Bank of San Francisco

- Recently published letter indicates negative rate policy may have sped up economic recovery
- How negative is too negative?

## What Would be the Impact?

- Possible expedited recovery
- Limited projected impact long term
- With less room to cut, negative rates may be necessary

### Actual and Projected Fed Funds



### Actual and Projected Output Gap



Source: Federal Reserve Bank of San Francisco

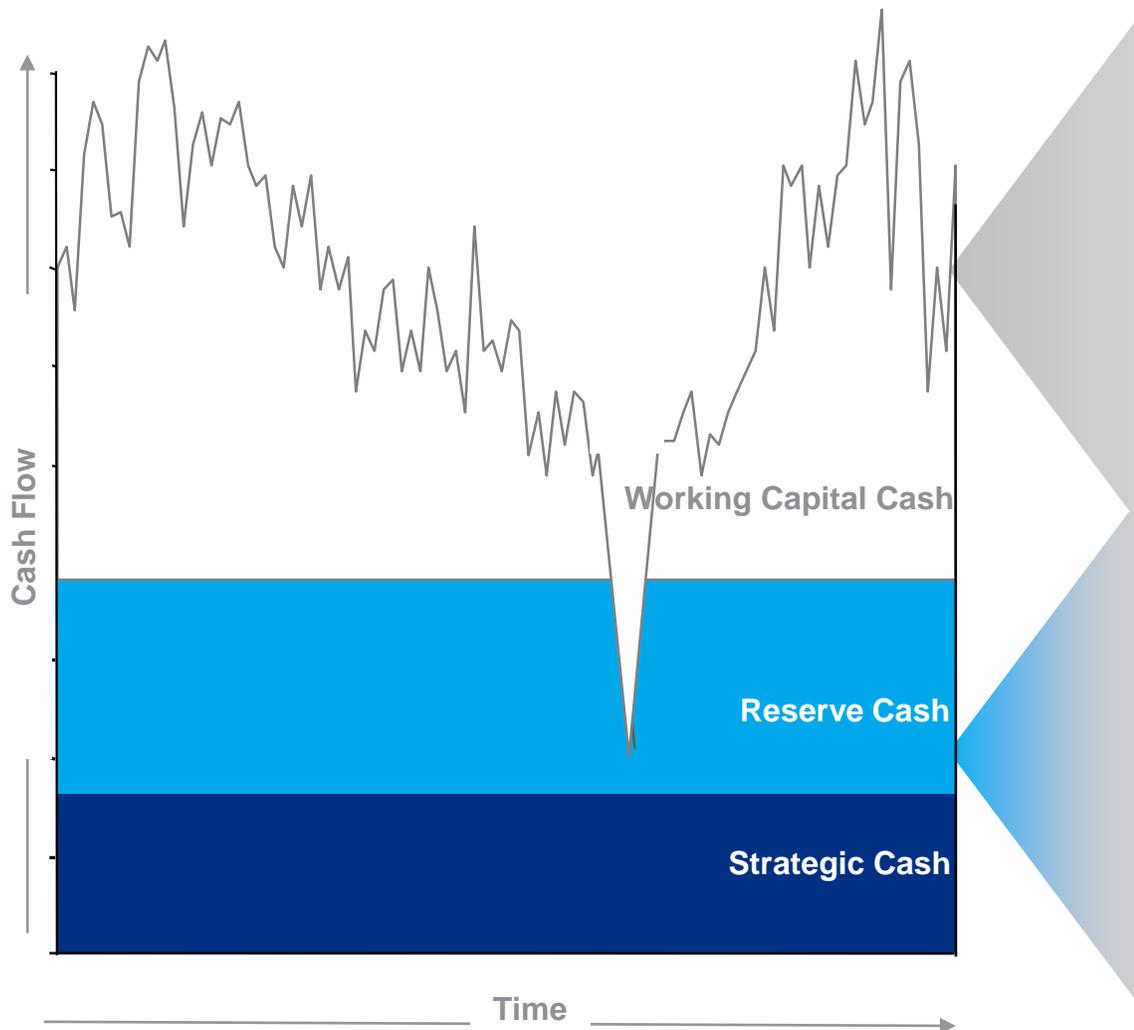
### 3. Liquidity Management and Products



# Short Term Deposit and Investment Options

Segmenting your cash portfolio to maximize yield, while ensuring ample liquidity and safety of principal, remains as important as ever.

## Cash Management Segmentation Example



**Earnings Credit Rate (ECR)** - Compensation method where clients earn **soft-dollar credits** on balances held in non-interest bearing accounts to **offset certain banking fees**

**Interest Bearing Demand Deposit Account (IBDDA)** - Operating account that **earns hard dollar interest** in exchange for full liquidity

**Money Market Funds (MMF)** - Diversified portfolios of high-quality, **short-term money market instruments** that provide same-day liquidity

**Time Deposit (TD)** - Higher yielding, **fixed rate** deposits placed for a stated amount and for a **specific period of time** ranging from overnight to five years, allowing clients to earn enhanced yield on cash that does not require daily liquidity

Source: AFP 2018 Annual Survey

# Deposit and Investment Product Spectrum

Cash Management efficiency is increasingly dependent on proactive deposit management via structures that align with the regulatory landscape.

## Day-to-Day Operating/Working Capital Cash

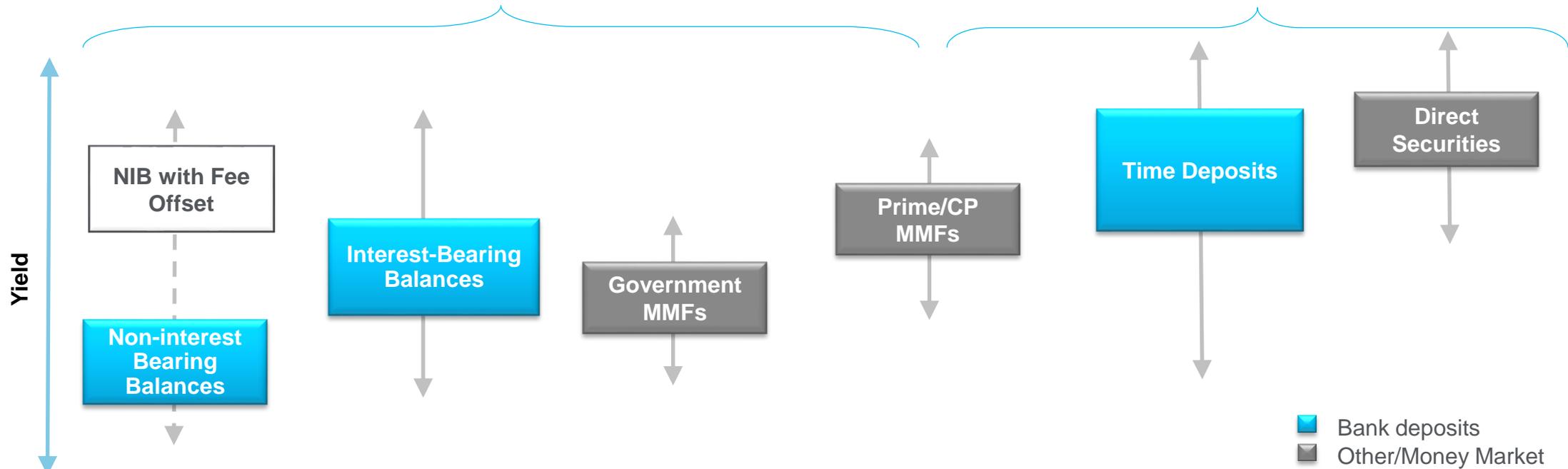
- Consolidated transaction activity with **bank deposit allocation**
- Use MMFs to **further diversify counterparty exposures**

## Non-Operating/Reserve Cash

- Consider **31+ day maturity tranche bank deposits** for excess, non-operating balances
- **Extend usage of non-bank instruments** including Direct Securities

### More Suitable for Day-to-Day Operating /Working Capital Cash

### More Suitable for Non-Operating/Reserve Cash



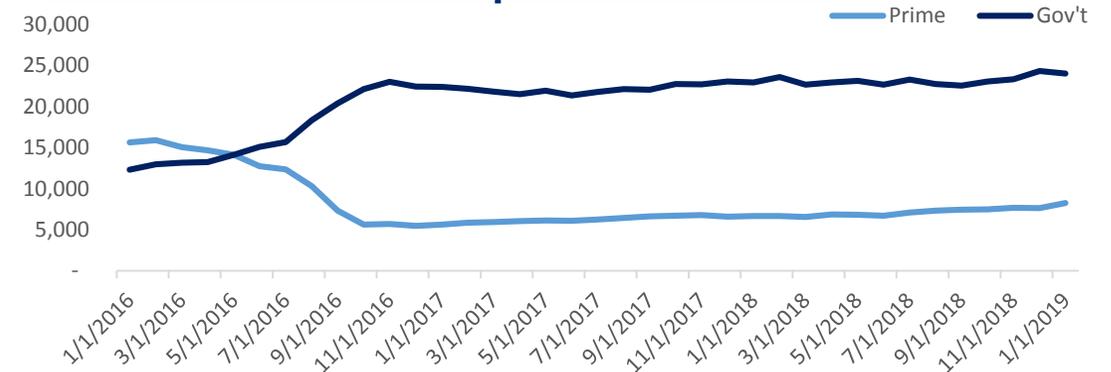
# Money Market Funds (MMFs)

Money Market Funds are an efficient method of investing in a diversified portfolio of high-quality, short-term instruments while providing daily liquidity.

## Money Market Fund Landscape

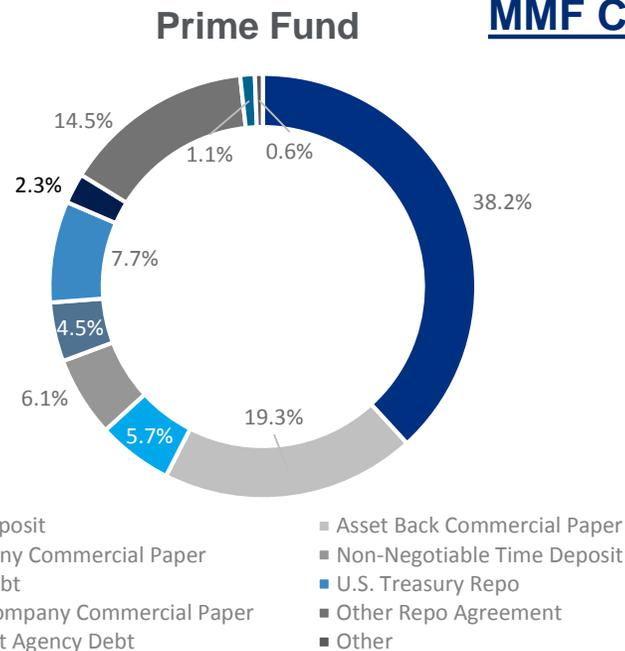
- MMF reform caused significant outflows from Prime funds as a result of floating NAV and gates and fees
- Money is beginning to flow back to Prime as a result of yield pick up of ~25bps
- Increased product offerings including private funds and funds focused on Women Business Enterprises, Minority Owned Businesses and Service Disabled Veteran Owned Businesses

## Investor Action in Response to Reform

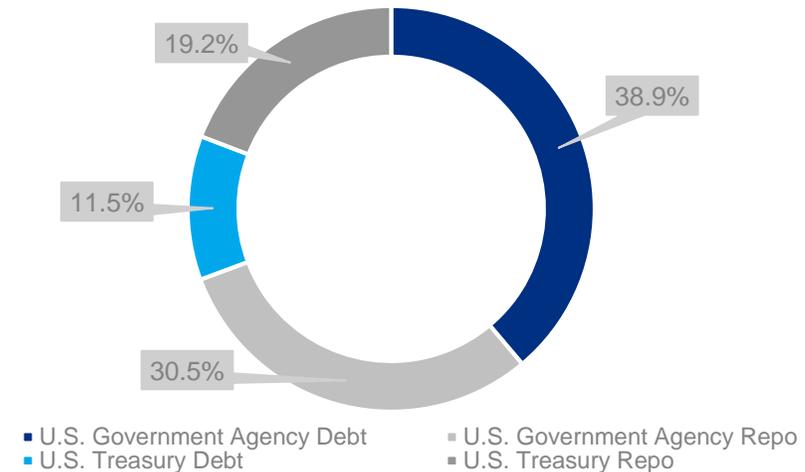


Source: SEC Form N-MFP2, OFR Analysis

## MMF Composition



## Government Fund

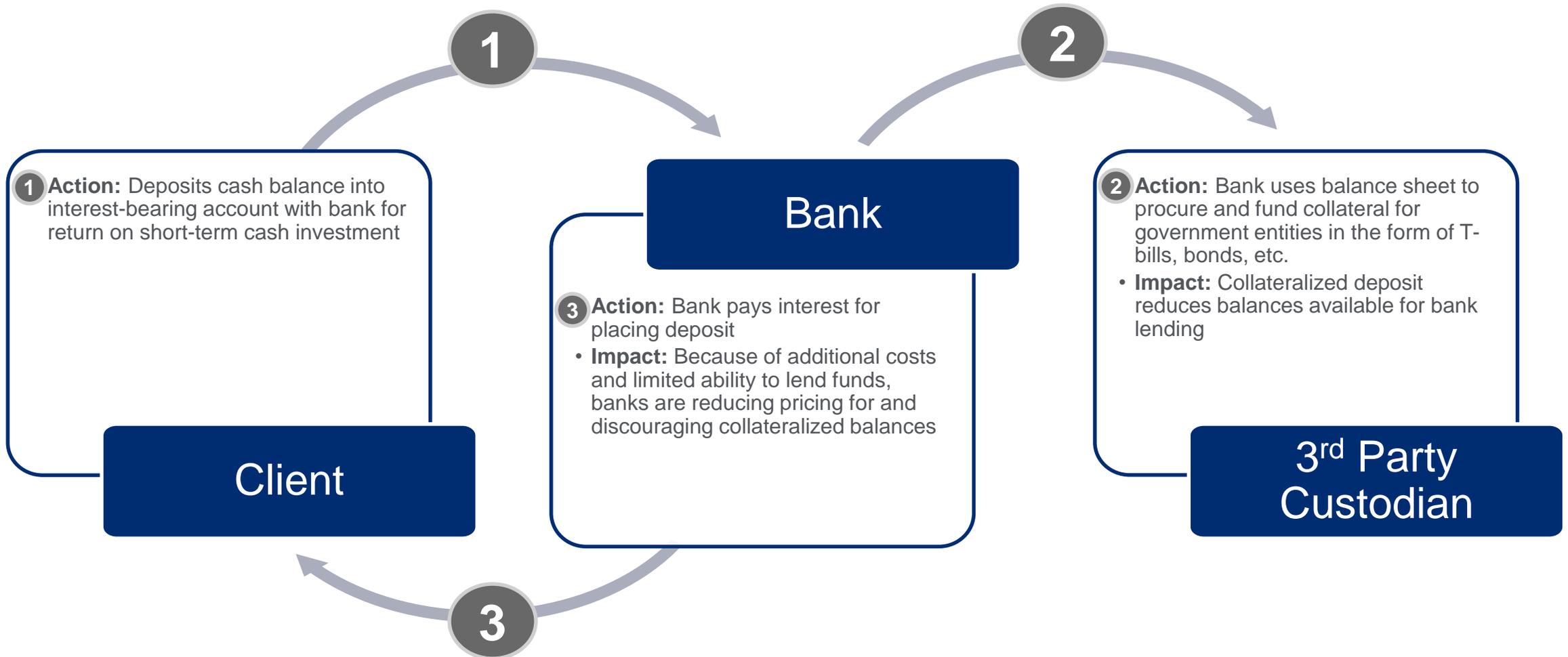


## 4. Collateral



# Collateralized Deposit Lifecycle

The majority of State & Local Bank Deposits require collateralization as per investment guidelines. The safety of public funds is the foremost objective in public fund management.



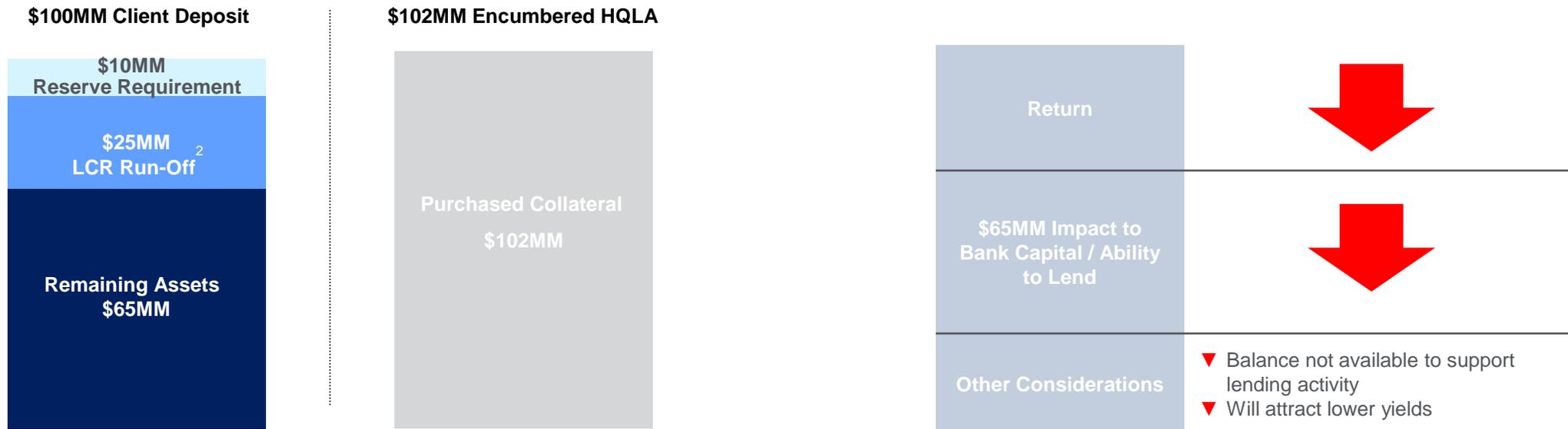
# Collateralized Balances Overview

Bank deposits continue to be the most prevalent short-term cash investment for U.S. government entities.

## Current Collateral Requirements

- Government investment policies typically dictate that banks are **required to post collateral** at a percentage of deposits (100%-110%)
- The most common forms of collateral are **Treasuries, Municipal Securities, or Letters of Credit**
- Securities must be posted as long as funds remain in the account

## Collateralized Deposit on Bank Balance Sheet<sup>1</sup>

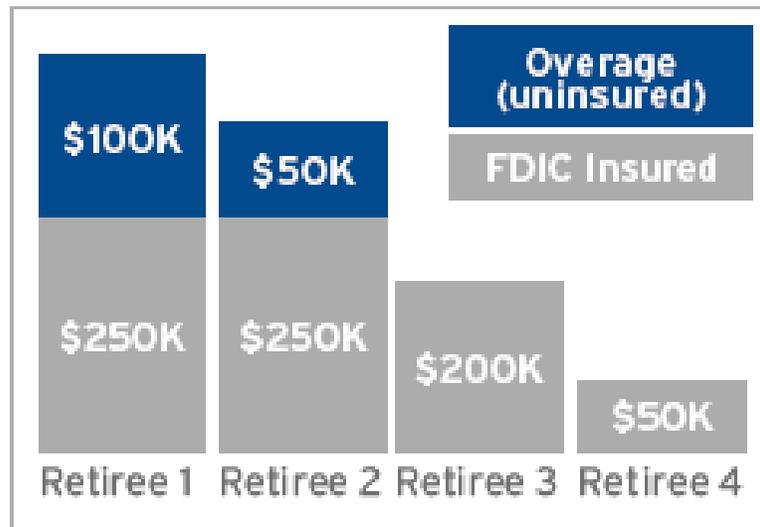


# Alternatives to Collateralization

Alternatives to collateralized deposits can provide yield and greater flexibility.

## For Benefit Of (FBO) Accounts

- FBO account structures provide **increased FDIC coverage** for entities or funds that hold cash **on behalf** of multiple entities or individuals
- FDIC insurance eligibility of up to **\$250,000 per depositor per bank**
- Employee retirement systems, pension plans, and other savings plan serve as use cases for FBO accounts



## Government Money Market Funds

- Rule 2a-7(a)(16) from SEC defines Government MMF as “money market funds that invests **99.5% or more** of its total assets in cash, government securities, and/or repurchase agreements that are **collateralized by cash or government securities**”

*“... may invest in the obligations, either directly or in the form of securities or other interests in investment company... if the [portfolio] is limited to United States government obligations and repurchase agreements fully collateralized by United States government<sup>1</sup>”*

## 5. Q&A

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