

# Best Practices in Cash Investing

## *Perspective Across States*

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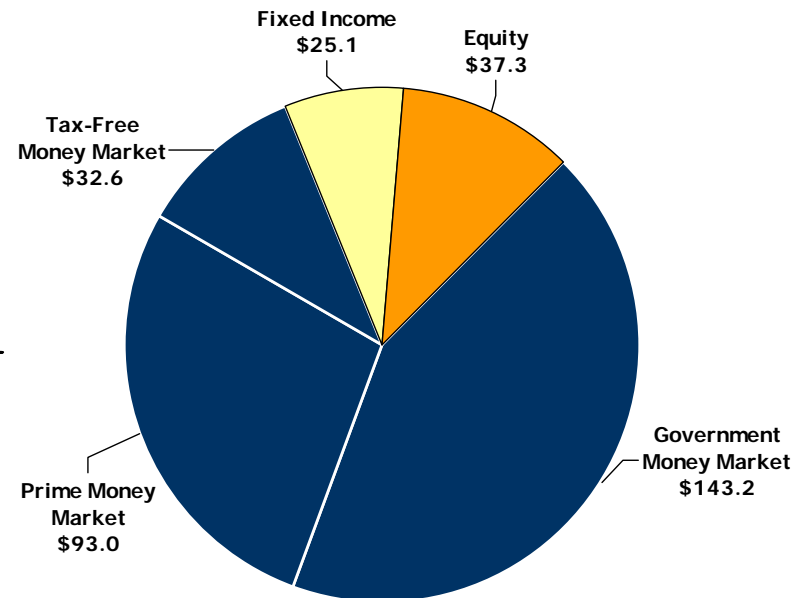
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08-28183 (8/08)



# Federated Liquidity Management

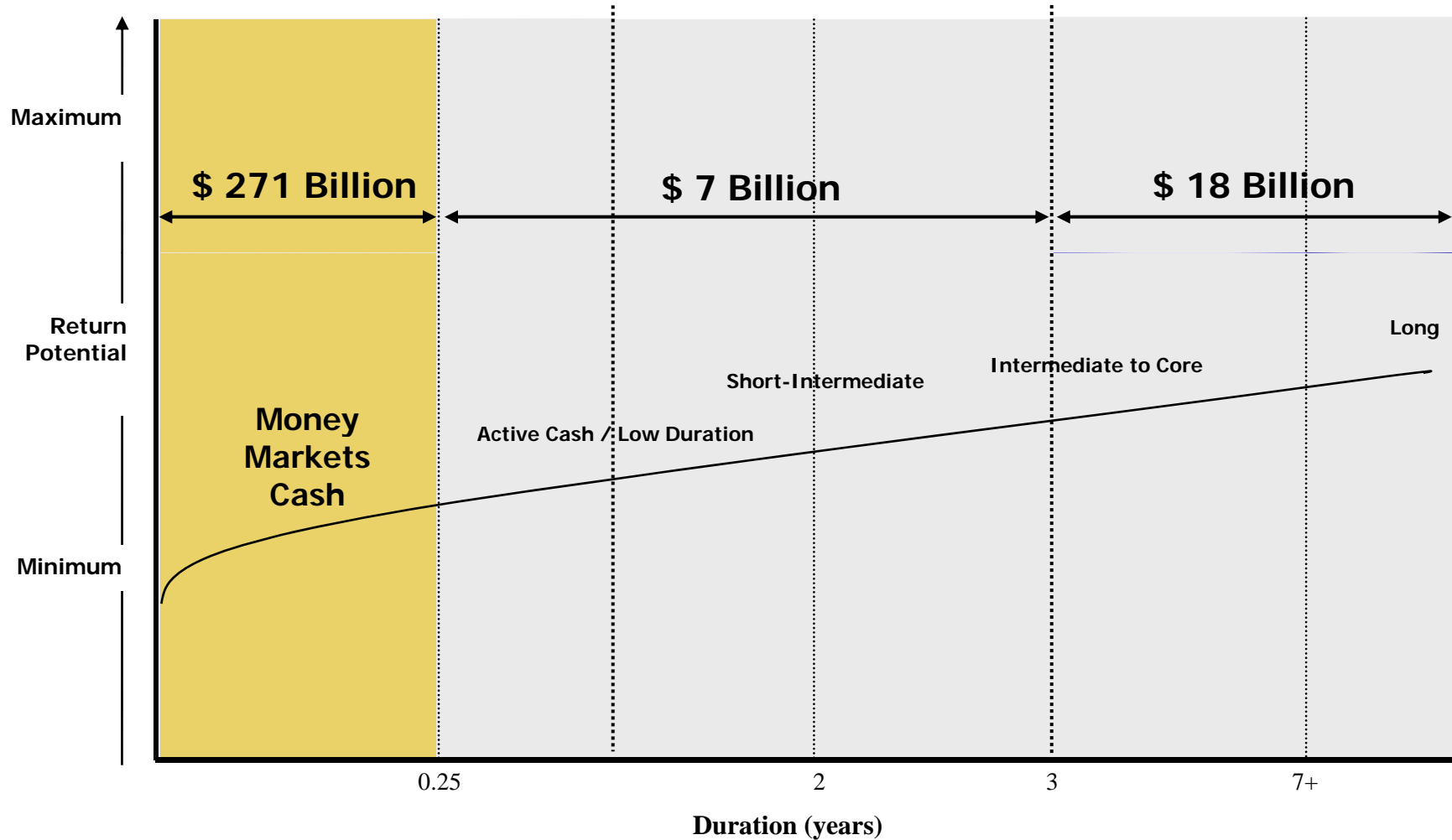
- More than \$333 billion in Total Assets Under Management
  - \$37 billion in Equities
  - \$25 billion in Fixed Income

- **\$271 billion in Money Markets**
  - Including \$35b in LGIPs
- **55 Money Market Portfolios**
  - 22 AAAM portfolios (\$165 billion)



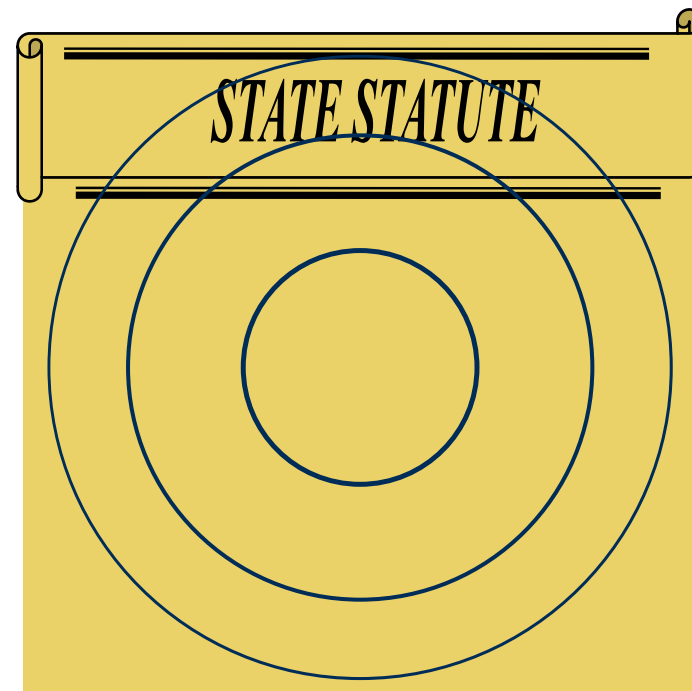
*Assets are as of 6/30/08.*

# Federated Spanning the Yield Curve



# Review of Your Investment Policy and State Statute

- Policy congruent with actual use of the pool of money
- Eliminate unnecessary gaps between investment policy and State statute
- Examine legislative change to forge best practices



# Certificates of Deposit

## *State Statute*

A certificate of deposit is an authorized investment under this subchapter if the certificate is issued by a state or national bank domiciled in this state, a savings bank domiciled in this state, or a state or federal credit union domiciled in this state and is guaranteed or insured by the Federal Deposit Insurance Corporation or its successor or the National Credit Union Share Insurance Fund or its successor

## *Suggested Enhancement:*

CDs are better viewed for inclusion in a portfolio not as depository instruments but as credit instruments whose value is determined by analyzing the creditworthiness of the issuer.



Potential

**8-10 bps.**

# Commercial Paper: 180 days vs. 270 days

## *State Statute*

**Commercial paper is an authorized investment if the commercial paper:**

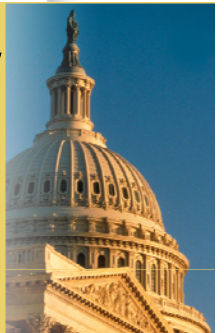
*(1) has a maturity of 180 days or less; and*

*(2) is rated not less than*

*A-1 or P-1 or an equivalent rating by at least two nationally recognized credit rating agencies...*

## *Suggested Enhancement:*

Commercial paper is issued with a stated maturity of 270 days. Requiring lesser time frames for holding until maturity significantly precludes advantageous purchasing opportunities.



Potential

**2-3 bps.**

# Commercial Paper: Registered vs. Unregistered

## *State Statute*

Commercial paper registered under the Securities Act of 1933 (the "Act"), known as "3(a)3 paper" is permissible in percentage allocations specified in the accompanying diversification standards.

## *Suggested Enhancement:*

So long as the investing entity is an accredited investor, purchasing 4(2) paper (unregistered paper) is typically more desirable in terms of its supply, trading patterns, and yield.



Potential

**2-3 bps.**

# Asset Backed Commercial Paper and Notes

## *State Statute*

Asset Backed Commercial Paper must be limited to 15% of the portfolio, must mature within 90 days, and be A-1/P-1 rated. Asset-Backed Notes are not permitted.

## *Suggested Enhancement:*

Allowing for both ABCP and asset backed notes offers better yield potential than Commercial Paper and Corporate Notes alone and provides diversification. These security types could comprise up to 25% of portfolio with permissible stated maturities of 270 days on ABCP and 397 days on asset backed notes.



Potential

**4-5 bps.**

# VRDNs and Floaters: Book to Reset or Maturity

## *State Statute*

Variable and floating rate securities must be booked to final maturity when determining the average maturity of the pool.

## *Suggested Enhancement:*

Incorporating provisions which allow the final stated maturity to be shortened based on interest rate adjustments and demand features enables more effective use of these securities and allows for interest rate risk to be managed more proficiently, all at higher yield potential without correlating increases in interest rate risk.



Potential

**7-11 bps.**

# Repurchase Agreement Collateral

## *State Statute*

Repurchase agreements must be collateralized by Treasury and agency securities.

## *Suggested Enhancement:*

Allowing for slightly more expanded collateral types, such as agency mortgages, optimizes flexibility of the pool to seek out most advantageous repurchase agreements and can add incremental value to yield.



Potential

**0.5-1 bps.**

# What Your State Statute Might Reveal

INSTRUMENT	STATUTE REQUIREMENTS	SUGGESTED ENHANCEMENTS	POTENTIAL YIELD ADVANTAGE
CDs	Must be domiciled in your state Guaranteed or insured by FDIC Secured by obligations	Better viewed as credit instrument Value determined by analyzing creditworthiness of issuer	8-10 bps.
Commercial Paper	Maturity of 180 days or less Rated not less than A-1 or P-1 or equivalent by at least two NRSROs	Maturity of 270 days Holding for a shorter period could hinder purchase opportunities	2-3 bps.
Commercial Paper (Registered)	Is permissible in percentage allocations specified in diversification standards	If investing entity is accredited investor, unregistered paper is more desirable	2-3 bps.
Asset Backed Commercial Paper	Limited to 15% Mature within 90 days Rated A-1/P-1 No Asset-Backed Notes	ABCP & ABN offer increased yield potential than CP and CN alone Additional diversification Comprise up to 25% Maturities of 270 days ABCP & 397 on ABN	4-5 bps.
Variable and Floating Rate Securities	Booked to final maturity when determining average maturity of pool	Shorter final stated maturity based on interest rate adjustments and demand features; can allow for lower interest rate risk	7-11 bps.
Repurchase Agreements	Collateralized by Treasury and agency securities	Expand to include agency mortgages to optimize flexibility Potential to add incremental yield	0.5 -1 bps.

# The Power of Incremental Basis Point Outperformance

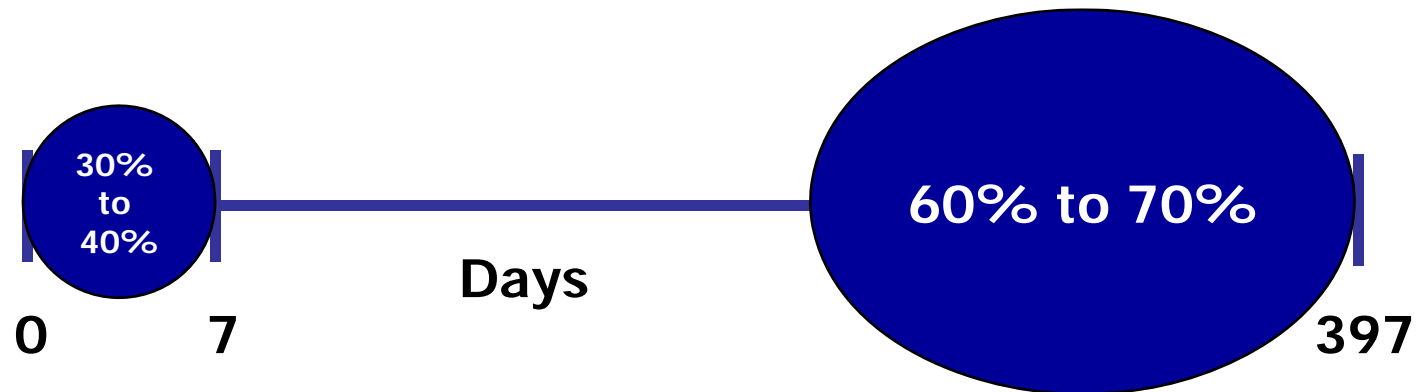
**\$100 million X .0010 = \$100K**

**\$500 million X .0010 = \$500K**

*This is for illustrative purposes only and does not represent any specific security.*

# Portfolio Construction

## Value-added through Barbelled Portfolio Structure



- Repo
- Time Deposits
- Variable Rate Instruments

- Commercial Paper
- Bank Instruments
- Asset-Backed Securities
- Corporate Notes

# Solid Investment Policy at the Foundation

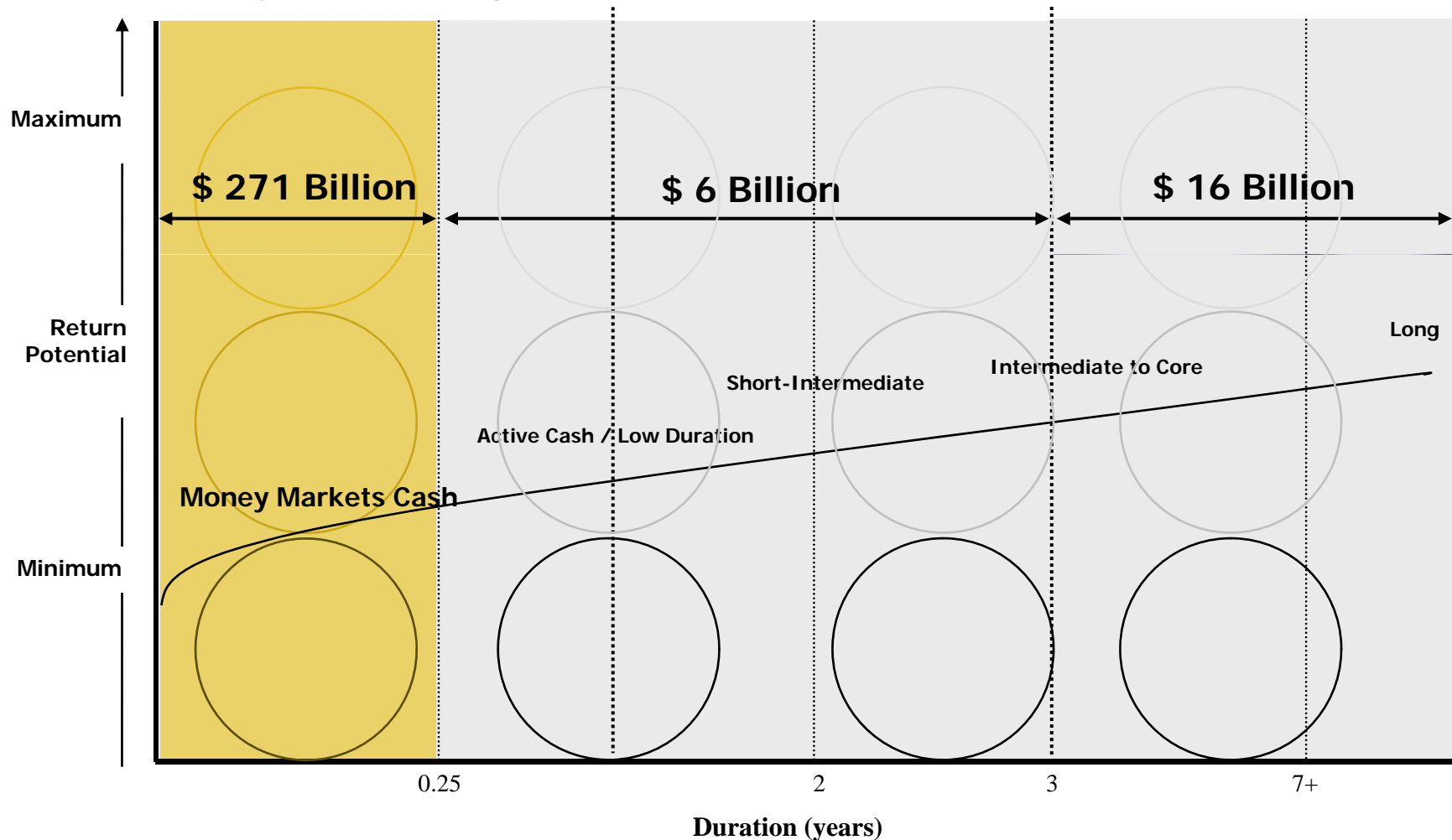
## Legal List Approach

- A list of authorized investments:
  - Risk controls defined by “can do” “don’t do”
  - Demands continuous updates by legislature
  - Generally addresses final maturities
  - Does not necessarily address diversification

## Guideline-Based Approach

- “Best Practice” environment:
  - Risk limiting provisions
  - Defines eligible securities
  - Addresses maturity at the security and portfolio level for interest rate risk
  - Addresses portfolio diversification

# Build a suite of portfolios to accomplish the Treasury's full gamut of investment needs



# Governance & Surveillance

- Identify within each investment pool the situations that would constitute a material event
- Develop escalation procedures for material events and stick to them
- A thorough risk management process should be in place over all portfolios, **including cash**
- Ongoing monitoring
- Ongoing surveillance through proprietary credit work or outsourcing

# Disclosure

An investment in the security is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the issuer seeks to preserve the value of an investment at \$1.00 per share, it is possible to lose money by investing in the security.

**Past performance is no guarantee of future results.**