Managing cash investment portfolios

86%
of respondents say preserving principal is their top priority.

75%
do not plan to change their current selection of permissible investments.

51%
regularly measure portfolio performance against an external benchmark.

44%
of companies have the Board providing oversight of the investment management program.

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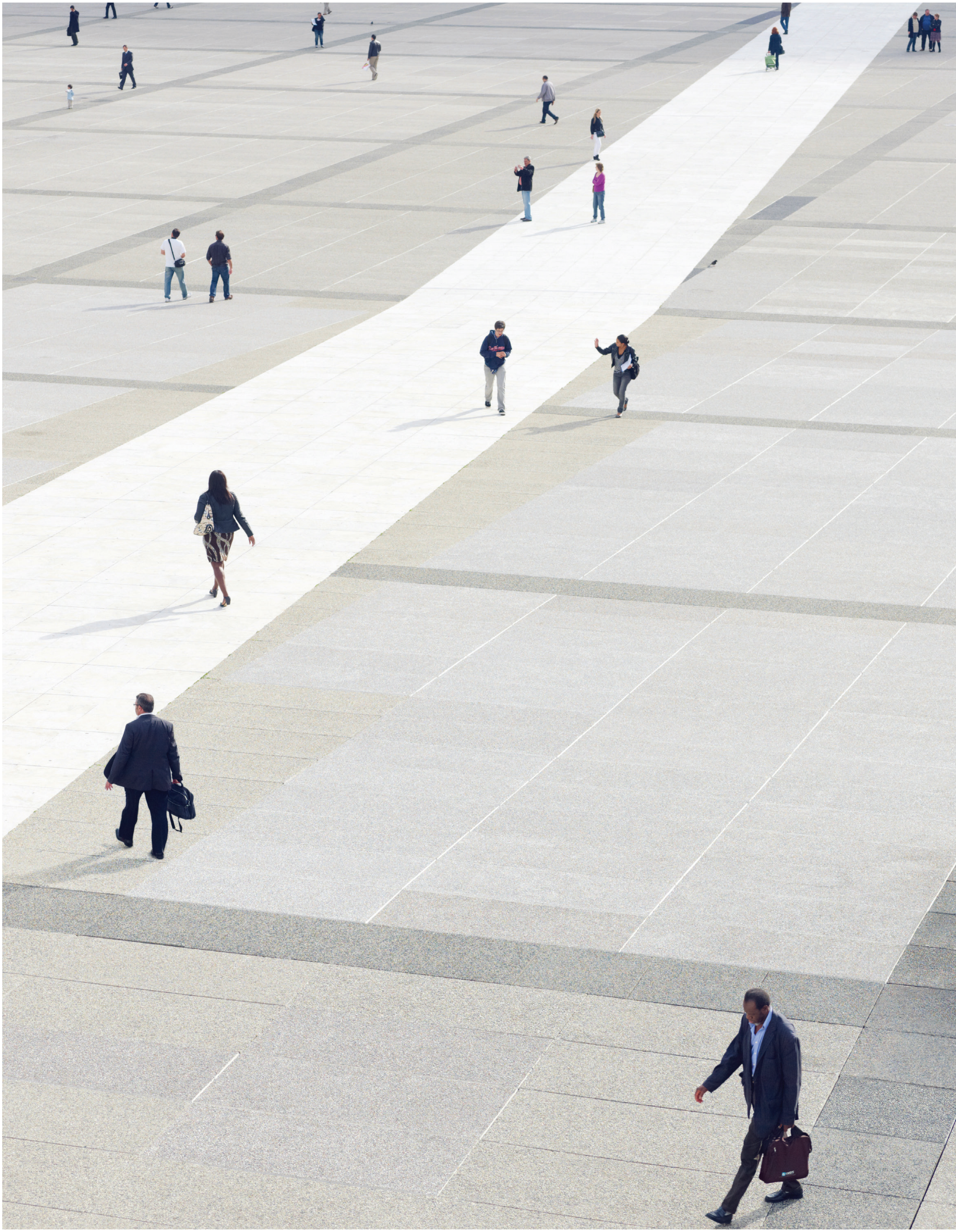
Contents



Introduction

In the wake of the financial crisis and amidst continued tepid global economic growth and historically low borrowing rates, companies have amassed large amounts of cash on their balance sheets, including substantial amounts outside of the US. Over the past two years, we have noted a great deal of interest among our clients in how to invest their excess cash, given the current interest rate environment, the challenges of repatriation and potential regulation that could make some popular investment vehicles less attractive. Many of our clients want to know how their peers are tackling these and other challenges, and to learn about leading practices in corporate investment management programs.

To address these questions, PwC conducted a survey of senior treasury and financial professionals. The 92 respondents to our survey represented a broad mix of industries as well as company and portfolio sizes. Annual revenues ranged from less than USD $500 million (17% of respondents) to $5-$10 billion (9%). Almost two-thirds of respondents reported revenues of at least $1 billion. Investment portfolio sizes ranged from less than $250 million to more than $1 billion. Roughly two-thirds of respondent companies are public, one-third are private, and the vast majority were US-based.

Our goals in conducting the survey were to identify trends in corporate cash investment management practices, share leading practices with respondents, and highlight potential opportunities for improvement. We hope that the survey findings, and our observations, will serve as a useful tool to help you promote some of your own practices, strengthen your approach to cash investment, and increase the overall effectiveness of your investment management program.

Summary findings and observations

- **Portfolio risk profile:** More than five years after the start of the financial crisis, companies continue to employ very conservative cash investment objectives and strategies. This was perhaps the most significant, and most surprising, finding of our survey given the level of interest we have heard from our clients in improving portfolio performance.

  As cash has become a more significant percentage of investment portfolios, we have observed that many companies are searching for ways to increase yield. But the results of our survey suggest that relatively few companies are taking action to pursue higher yields by expanding the range of investment instruments, extending maturity, or taking on more credit risk.

- **Investment strategy:** Portfolios remain heavily weighted toward vehicles with short durations, often below the maturity levels that corporate policies permit. And while companies may want to seek higher yields, the majority of respondents said they do not expect to lower their credit rating standards or expand the range of permissible investments in order to do so.

Almost 50% of companies do not have a formal performance management framework in place.

- **Performance management:** Almost half of companies participating in our survey do not have a formal performance management framework in place. Companies that do have a framework in place may be using it more for compliance and reporting purposes than for tracking deviations from expected performance and taking measures to improve their portfolio performance.

- **Technology and tools:** Spreadsheets remain the primary tool used to capture trades and manage investment programs. These findings suggest there is an opportunity for companies to build the business case to purchase systems and tools to increase automation, enable straight-through-processing, and ultimately, improve analytical capabilities in order to make better investment decisions.

- **External investment managers:** More than four in ten respondents use external investment managers for at least a portion of their portfolios, most commonly in order to access expertise in specific asset classes, sectors, and/or markets. Among companies that use external managers, the vast majority do not plan to change the number of firms they use, or the percentage of their portfolios they allocate to these firms, over the next 12 months.

  As the number of external managers grows, so does the difficulty of monitoring their performance and identifying all of the fees associated with their services. For these reasons, companies using more than two or three firms may want to consider consolidating their relationships or implementing automated tools to aggregate investment positions, monitor compliance with investment guidelines and measure performance of investment managers.

Portfolio composition

Portfolio growth

The financial crisis drove many companies to stockpile cash to ensure liquidity in the event of another crisis. As a result, cash as a percentage of total assets on corporate balance sheets has been rising since 2008. Three-quarters of survey respondents said that cash increased or remained the same as a percentage of total assets in the past 12 months. Only 22% said the composition of cash on their balance sheets had declined.

Percentage of cash to remain stable

It's worth noting that companies have continued to increase their cash portfolios even as the economy has improved. That said, survey results suggest that this trend may be ebbing as almost three quarters of respondents said that they expect their cash portfolios to remain at current levels or decline over the next 12 months. Of those that expect cash balances to increase, most attribute this to increasing operating cash flows. Among those expecting a decline, the most common reason cited was business acquisitions. Certainly, the recent sharp increase in deal volume supports this view.

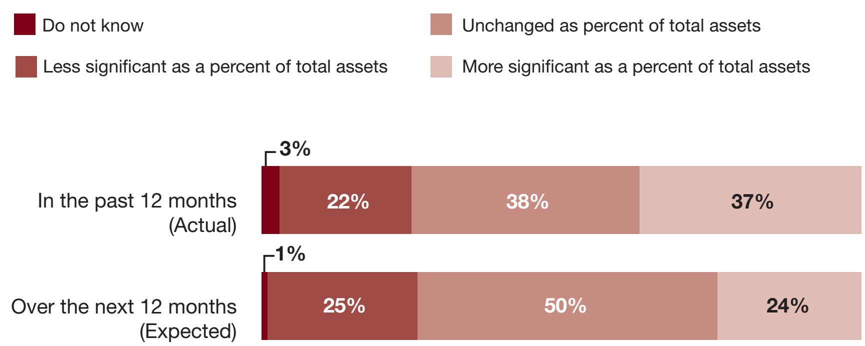
One reason for the healthy amounts of cash on corporate balance sheets is simply that companies are generating more cash in an improving economy, and may be setting aside some of that cash for acquisitions. Ultimately, how much cash to retain on the balance sheet is a company-specific decision based on the company's growth prospects, risk profile and investor expectations. However, the increase may also reflect a longer-term, structural change in capital allocation and financing strategies. Stung by the experience of the financial crisis, some companies, particularly those with aggressive growth plans and largely intangible asset bases, have made a conscious choice to hold larger amounts of cash to manage liquidity risk in the event of another credit contraction. To some extent, excess cash on the balance sheet may represent an increased cost of doing business in the post-crisis era as well as a natural outcome of tax planning strategies for multi-national companies.

Need for more focus on performance

The trend of stockpiling cash may be easing, but cash is likely to remain a significant portion of companies' total assets for the foreseeable future. As the financial crisis recedes into the past, we expect to see more focus on enhancing the return on cash investments. With cash continuing to represent a significant portion of many asset portfolios, companies must achieve higher returns on this asset to avoid dampening overall company performance.

Almost four in ten respondents reported that 25% or more of their cash is invested outside of the US.

Change in size of investment portfolio



Geographic distribution

Growth of non-US portfolios

As investment portfolios have grown, the proportion of cash assets held abroad has grown significantly as a percentage of the overall portfolio for many US companies. Overseas cash is estimated at $947 billion, or 58% of current total cash, up from Moody's estimate of $840 billion last year.[1]

Our survey confirmed this prominent trend. Almost four in ten respondents reported that 25% or more of their cash is invested outside of the US, and one in four indicated that at least half of their cash is invested abroad.

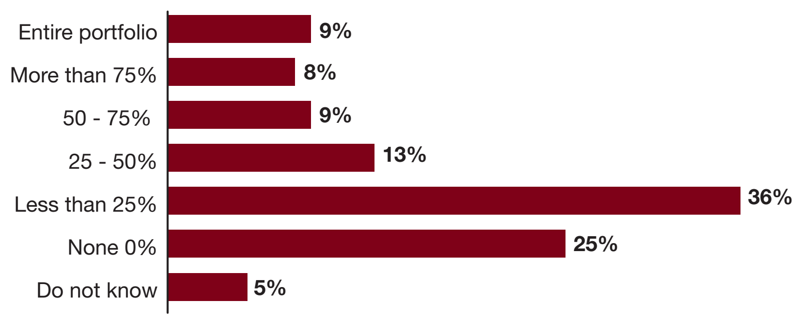
[1] https://www.moodys.com/research/Moodys-US-non-financial-corporates-cash-pile-grows-led-by--PR_296106

Repatriation challenges

The main reason for holding cash abroad is the tax burden related to repatriation of foreign-sourced earnings; this reason was cited by almost two-thirds of respondents who have non-US portfolios. Other reasons include diversification and overseas operations that require holding cash abroad.

Absent tax reform, which we believe is unlikely in the near future, we expect companies to continue maintaining large international investment portfolios over the long term, particularly for the largest, multi-national companies.

As a percent of your overall portfolio, how much is invested outside the US?



Governance and policy

More than one-fourth of responding companies have an investment committee and 14% have a finance committee providing oversight.

Board oversight

Less than half of survey respondents indicated that their Board of Directors provide oversight over their investment programs. Given the amount of cash on corporate balance sheets, we would have expected the Board to be more engaged in investment management. It seems that the level of Board oversight may not have kept pace with the growing significance of cash investments.

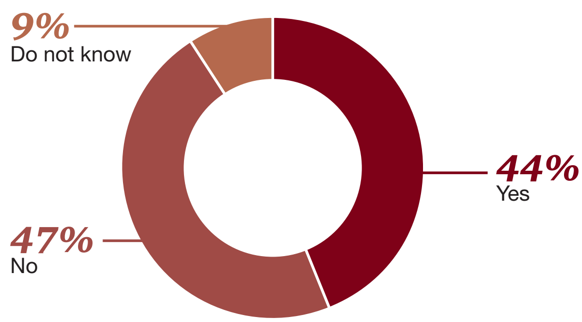
According to the survey, Board reviews are most commonly performed quarterly (58%) or annually (18%). In these reviews, Boards focus mainly on policy compliance, performance and investment strategy, and asset allocation.

For companies with formal, Board-level oversight, this function is most commonly performed by the audit committee. This may suggest that in these companies, the focus of oversight is more on compliance and financial reporting than on strategy and performance. That said, it is worth noting that more than one-fourth of responding companies have an investment committee and 14% have a finance committee providing oversight. Though our survey did not specifically ask the question of oversight committee charters, it is reasonable to suggest that in companies with investment or finance committees, monitoring investment strategy and performance is likely a priority.

Board oversight is leading practice

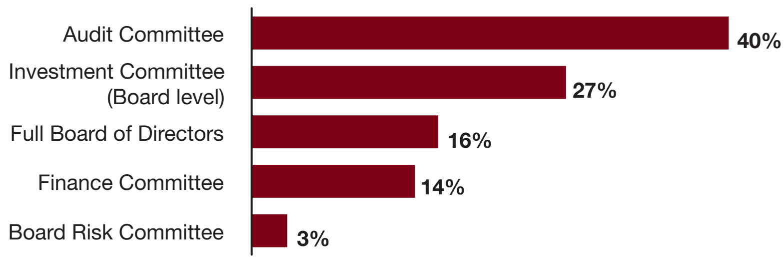
Formal Board oversight over investment programs is a leading practice. At a minimum, investment policy and guidelines should be approved by the Board, or a committee of the Board. (Among our survey respondents, the vast majority has defined investment policies, and more than two-thirds say the policy is approved by the Board.)

Board of Directors provide oversight for investment program



The nature and frequency of the Board's involvement beyond this should depend on the significance of cash as a percentage of total assets on the balance sheet. The greater the percentage of cash (and thus the greater the significance of portfolio risk and performance), the more involved the Board should be in overseeing performance management and decisions around investment strategy. In addition, the Board should be included in periodic discussions with management about how to maintain a robust investment management program.

Board committee provides investment program oversight



Investment strategy

Objectives

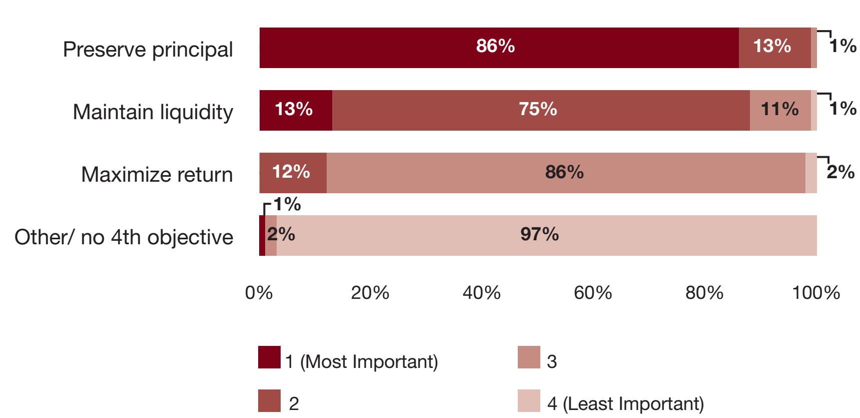
For the vast majority of companies responding to our survey, preserving principal is the primary investment objective, followed closely by maintaining liquidity. For most companies surveyed, maximizing return is a distant third priority. A few companies mentioned diversification as a fourth objective.

Weighing the balance between risk and return

The fact that companies remain focused on safety is not surprising, but as cash becomes a larger and more significant corporate asset, addressing performance risk becomes more important. If this risk is not adequately managed in a cash portfolio, it could dampen the overall return on assets, so it is important for companies to strike the right balance between risk and return objectives. In our view, in many companies there may be an opportunity to take on additional risk (and earn incremental return) while still achieving objectives around safety and liquidity.

We believe there is an opportunity for substantive discussions between management and Boards about the benefits of enhancing their investment strategies. Initiating those discussions and obtaining input from a broader stakeholder group will enable management to gain a better understanding of the company's liability profile as well as planning decisions that could impact cash (e.g., business expansion, extraordinary dividend payments). This in turn will help organizations to make more informed cash investment decisions.

Primary investment objectives



Permitted instruments

Money market funds, Treasury bills, term deposits, and overnight sweep accounts are the most common permissible instruments for cash investments, across sectors. While money market funds top the list of instruments, proposed regulatory changes under consideration may make such funds less liquid and require companies to reconsider their historical reliance on these investments as a primary liquidity and investment management alternative.

A small number of companies (13%) plan to expand their list of permissible investment instruments in 2014.

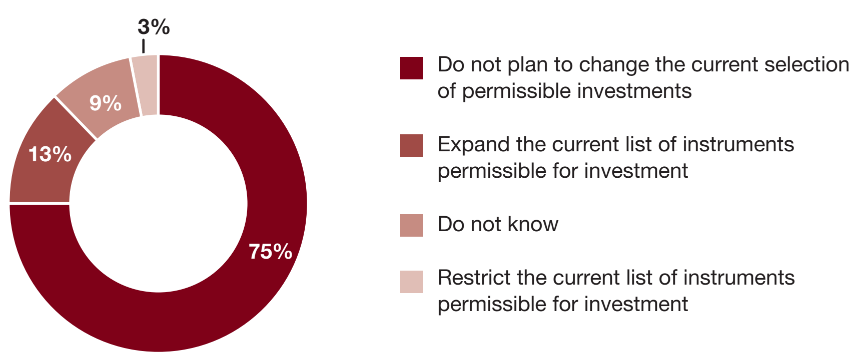
Few plan on expanding options

A small number of companies (13%) plan to expand their list of permissible investment instruments in 2014.

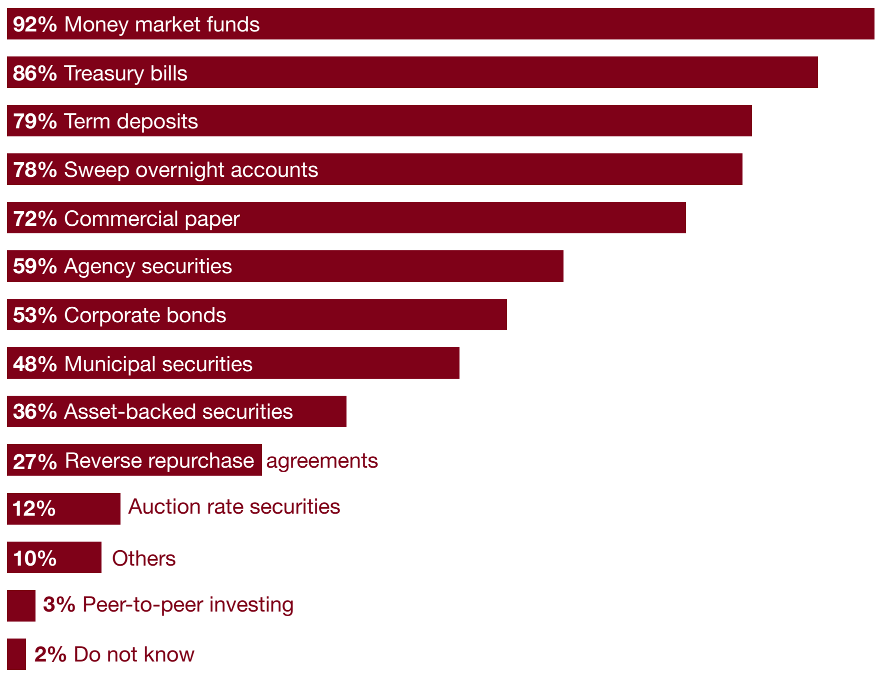
In our view, the most likely reason that most companies have no plans to modify their investment policies to expand the array of options is that many policies already afford more flexibility than is currently being utilized. Many policies in existence today were put in place before the financial crisis, when many companies had higher investment risk appetites. After the crisis, some companies prohibited the use of certain riskier instruments, but did so by simply changing their strategies and did not revise their policies to reflect the new, lower risk appetite implicit in the strategy refinements. Put differently, policies may not require revision to accommodate potential changes in strategy because they may simply be outdated.

Among companies that do plan to expand the range of permissible investment options in the coming year, the most often mentioned options were corporate bonds and commercial paper. In addition, a minority of respondents showed an interest in peer-to-peer ("P2P") financing. Anecdotally, we have also begun to see some interest in P2P financing from companies that want to improve yield and for banks looking for new sources of income. Under Basel III, banks will have to start making assumptions about the stability and levels of each deposit type. Accepting certain liquid investments on their balance sheets could increase their capital requirements. By contrast, facilitating P2P lending across corporates could generate a new revenue stream for banks without consuming regulatory capital.

In the next 12 months, you plan to revise your investment policy to:



Instruments permitted for investments (select all applicable)

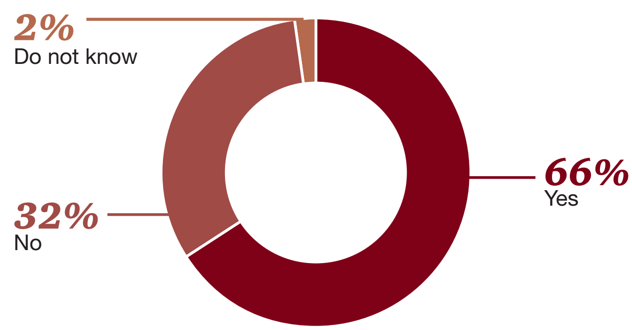


Portfolio segmentation

Surprisingly, less than one third of companies participating in our survey segment their portfolios based on different investment objectives and strategies. Among those that do, portfolios are divided into two or three sub-segments, and the majority of these sub-portfolios (75%) are segmented according to duration or credit risk.

While formal portfolio segmentation does not appear to be widely practiced, it could be a useful approach for some companies. In particular, non-US cash portfolios or ones that are expected to be held for an extended period may warrant different objectives and strategies than domestic portfolios held primarily to meet short-term liquidity needs. Depending on the overall size of the portfolio, it may be beneficial to develop multiple portfolio segments based on expected use of cash and time horizon such as portfolio segments for daily operating cash, medium term liquidity, longer-term, strategic investment portfolios, assets within insurance captives, etc. The key to making such investment portfolio segmentation decisions is to closely link the investment portfolio structure, objectives and strategy formulation to business requirements and the overall corporate and financing strategy. Further, treasurers that have greater visibility into business planning and financing activities as well as the liability profile of the company make more informed decisions about how to segment their portfolios, improve returns, and optimize the use of cash.

Have you segmented your investment portfolio into sub-portfolios with different investment objectives and strategies?



> *Around 25% of respondents accept credit ratings of BBB+/-*

Investment risk

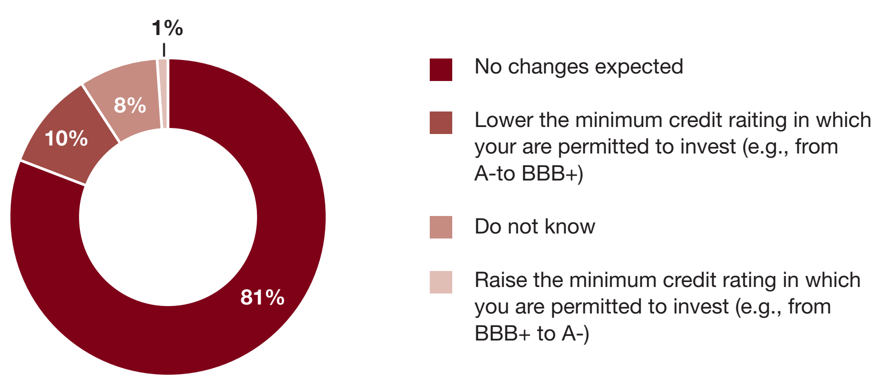
Credit ratings

Consistent with their stated objectives, the vast majority of companies surveyed have a limited tolerance for credit risk, and few plan on relaxing their high standards. The majority of respondents set a minimum credit rating of A- or better.

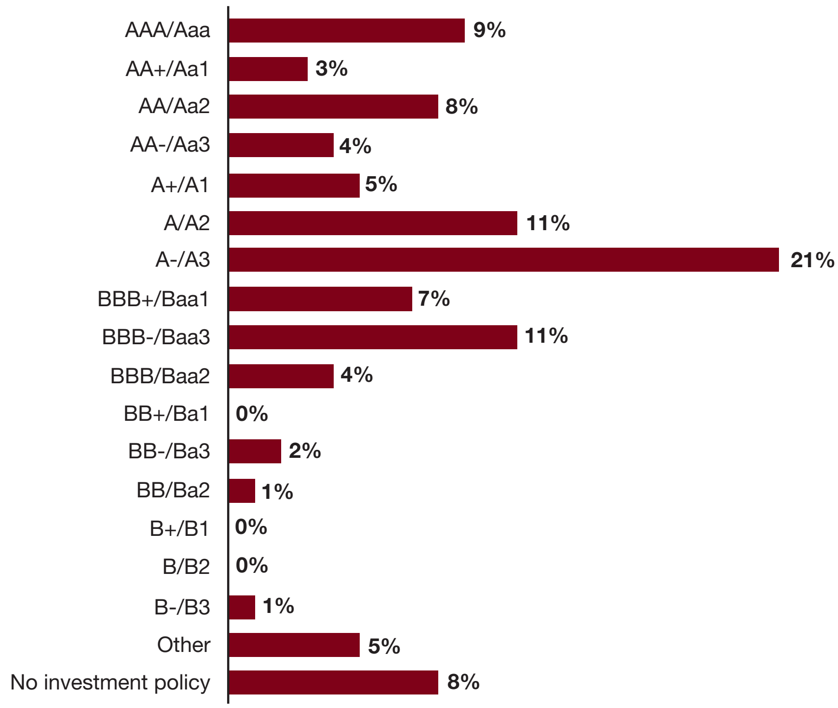
However, there is some evidence that credit restrictions are loosening. Around 25% of respondents accept credit ratings of BBB+/-, and 10% say they expect to lower their minimum acceptable ratings in the coming year, potentially signaling a willingness to accept somewhat more risk in pursuit of higher returns.

We have observed that many large companies are interested in expanding their range of allowable investments. For these companies, an in-depth analysis of risk and return might serve as a basis for adding a limited amount of credit risk to improve the performance of their portfolios.

In the next 12 months your company expects to:



Lowest credit rating permissible, per investment policy



Duration

Another measure of portfolio risk is the average maturity of investments. By this measure, more than half of companies surveyed are investing their cash in a conservative fashion with weighted average maturity of their portfolios less than six months. By contrast, only 21% of companies have policies in place that restrict them to such short-term investment strategies. Thus a significant number of companies could take on longer-term investments without requiring a change in policy.

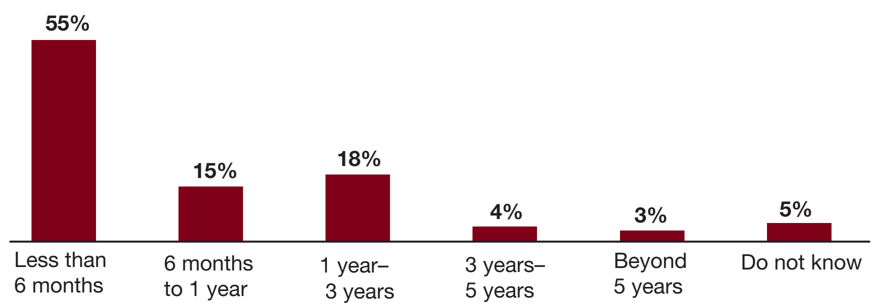
Continuing focus on the short term

Why aren't companies investing their cash for the longer term? Based on our experience and discussions with clients, the main reasons are the low interest rate environment and flat yield curve as well as uncertainty around the macroeconomic environment and the direction of monetary policy, both of which could impact the yield curve.

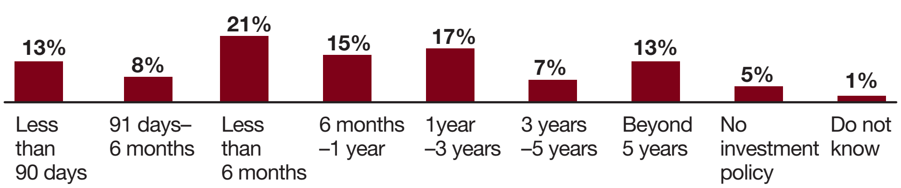
Many companies are in a "wait and see" mode, trying to assess where interest rates are headed before pursuing longer-term changes in interest rate stance. In some cases, companies may prefer short-term investments because they have inadequate cash forecasting tools, or no tools at all, making it difficult to determine how far into the future they can prudently invest their excess cash.

In our view, implementing tools and processes to improve cash forecasting are key enablers for any company to improve its investment function. This becomes more important as expected changes in the monetary policy may lead to higher investment yields available in the market.

Approximate weighted average maturity of portfolio



Maximum maturity permitted for any investment, per investment policy



Performance management

Frequency of evaluation

Nearly half of companies reported that they do not regularly review the performance of their investment portfolios. This was one of the more surprising findings of the survey. In our view, the key reason for the widespread lack of performance measurement is that, in the aftermath of the financial crisis, as noted above, companies continued to focus more on preserving capital and maintaining liquidity than improving performance. The results also may indicate that, while management has begun to focus on performance, the tools to manage performance, such as benchmarking and analytical models, are not yet in place.

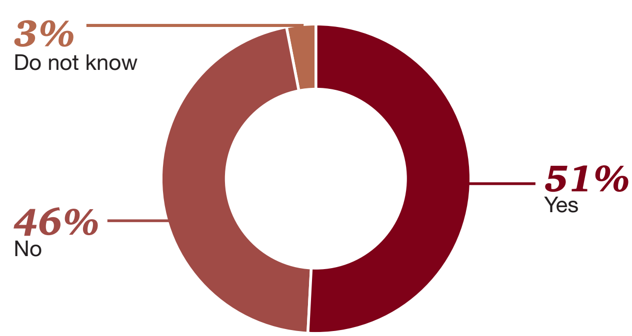
Of respondents who do evaluate performance, most use a market index or a market interest rate as the benchmark. Indexes used include the 3-month, 6-month, and one-year Treasury rates; indices compiled by specific banks; LIBOR; and in a few cases S&P 500. Of those who benchmark their performance, about 60% do so monthly. Roughly 23% benchmark quarterly, which may indicate that performance is being measured for compliance or reporting purposes rather than a useful tool to enhance performance.

The tools to manage performance, such as benchmarking and analytical models, are not yet in place.

A driver of strategy, policy, and internal investment

Robust performance measurement is a clear leading practice and a basis for modifications to strategy and policy, and for further investment in the investment management function. In our view, companies should measure and benchmark their performance regardless of investment objectives or strategy, or whether portfolios are managed internally or externally. As cash portfolios grow in size and significance, it becomes increasingly important to monitor performance to ensure that the organization is making the most of one of its key assets.

Do you regularly benchmark the performance of your investment portfolio against an external benchmark?



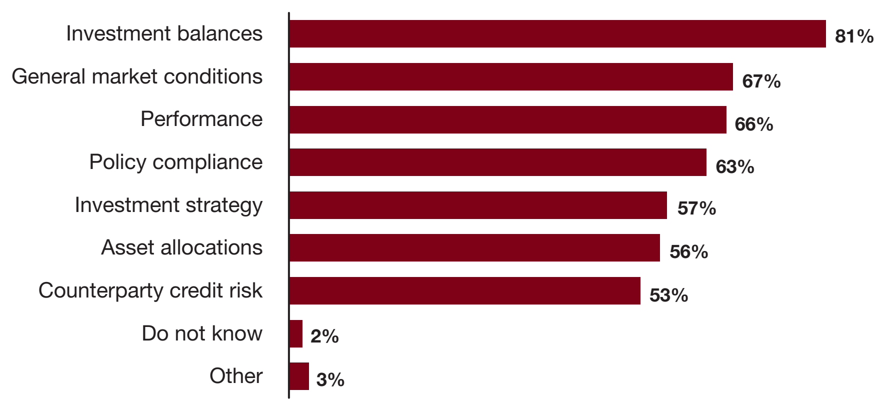
Dimensions of evaluation

Among those companies that report on investment management activities, the most common reporting element is investment balances, followed by general market conditions. Performance rounds out the list of the top three management concerns. A few years ago, after the financial crisis, the rankings likely would have differed, with counterparty risk near or at the top of the list followed closely by market value.

We found it somewhat surprising that investment strategy is ranked only fifth. If management is becoming more concerned about performance, we would expect companies to focus more on the investment strategy in reviewing their investments as, in theory, strategy drives performance.

Overall, the results suggest that some management focus areas that companies adopted during the financial crisis may be changing.

In performing its oversight role, management primarily reviews the following (select all that apply):



Technology

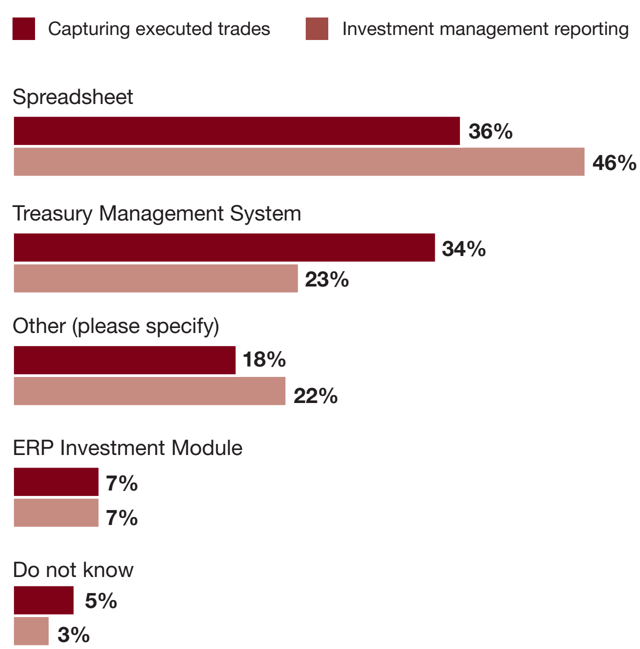
Despite advancements in treasury technology in recent years, the survey revealed that spreadsheets are still the primary tool used for capturing trades and reporting investment portfolio activities. The majority of those who said they use tools other than spreadsheets generally use treasury management systems (“TMS”) for trade capture and reporting.

Many companies are beginning to assess alternative tools they can use to manage their growing or evolving portfolios. We have heard a number of clients express interest in implementing treasury management systems to increase visibility into their cash assets, but the evolution toward TMS has been slow. In fact, spreadsheets are still widely used to manage many aspects of treasury operations, and our survey confirms that companies are not taking advantage of all the technology available to them.

The case for automation

As cash portfolios continue to grow, so does the need to manage these assets effectively and efficiently. Automating the investment management function can help companies to manage their cash more strategically. Potential benefits of automation include richer analysis, better visibility into the cash across regions, and enhanced reporting. Increased automation of investment activities can also enable straight-through-processing, enabling seamless integration with investment brokers, trading platforms and custodians as well as “downstream” with transaction settlement and financial reporting. A thorough assessment of the “end-to-end” process costs and benefits of further automation may help to make a broader business case for investing in treasury technology.

Tools used in investment activity



External investment managers

More than four in ten respondents use external investment managers for at least a portion of their portfolios.

Prevalence

More than four in ten respondents use external investment managers for at least a portion of their portfolios. Of this group, the majority use two or three external managers and allocate more than half of the portfolio to these firms.

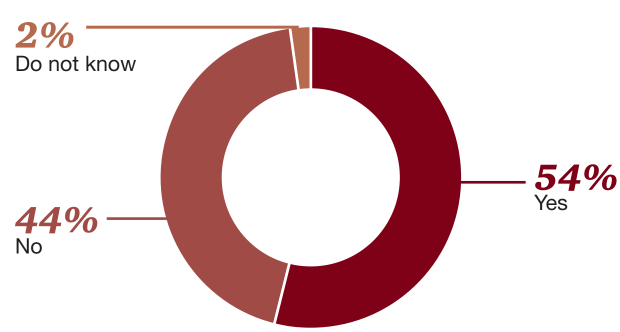
Among companies using external investment managers, 84% plan to use the same number of firms and 74% plan to allocate the same percentage of their portfolios to these firms over the next 12 months.

Choosing the right number of external managers

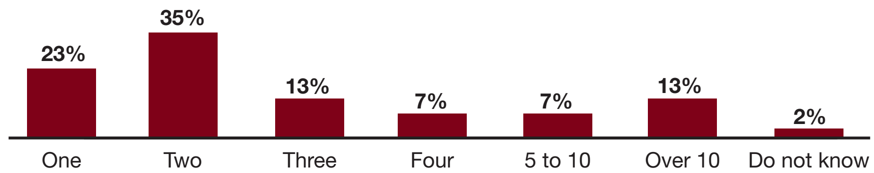
How many external managers should a company retain? The answer varies depending on the company, portfolio and objectives. For a small company with a limited portfolio and a simple investment strategy, the incremental value of adding a second manager may not be great. But for a large company with a complex portfolio that includes multiple asset classes and a significant number of alternative investments, the value proposition of incremental managers is clearer.

While there may be a business case for using multiple external investment managers, as the number of managers grows, it becomes more difficult to monitor their performance and to identify and manage the costs of their services. In our experience, companies often lack full visibility into the true cost of external investment managers. For these reasons, companies that use more than two or three external investment managers may want to reassess their needs and consider consolidating portfolio management across fewer firms. In addition, regular review of the performance of external managers and periodic rotation are good practices.

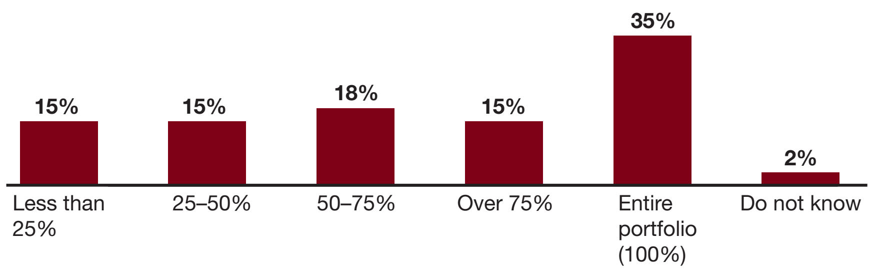
Do you use external investment managers?



Number of external investment managers (firms)



Percent of portfolio managed by external investment manager(s)



Almost half of companies surveyed have just one full-time employee allocated to managing the investment portfolio, and 23% have none.

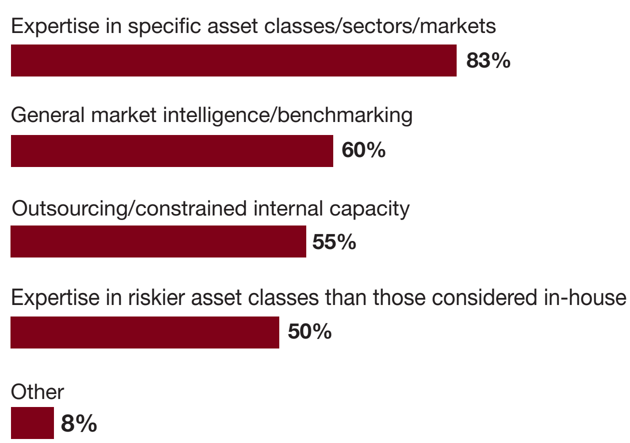
Value proposition

The most common reason why companies use external investment managers is to access expertise in specific asset classes, sectors, and/or markets. Many companies also use external managers to gain market intelligence or fill gaps in internal resources (almost half of the companies we surveyed have just one full-time employee allocated to managing the investment portfolio, and 23% have none). Half of those who report using external managers do so to gain access to expertise in higher-risk or less-liquid asset classes.

Strategic use of external managers

Companies that are using external managers may want to evaluate whether they are gaining as much value from these relationships as they could. As portfolios grow, external managers should be used more strategically. For instance, companies that are looking to expand their investment alternatives should consider the use of external firms that can manage the more sophisticated or riskier investments they may wish to add to their portfolios. Companies that utilize external managers strictly for market intelligence might explore whether more cost-effective alternatives are available. Considering the conservative nature of most portfolios, there may be an opportunity for companies to reduce cost by in-sourcing more management of the investment management function. Insourcing could also help to support the business case for investing in treasury automation or internal management capabilities.

Purpose of using external investment managers (select all that apply):



Conclusion

Cash investment portfolios have grown substantially in recent years, but with business confidence rising, the increasing influence of active investors and the increase in deal activity, the rate of this recent growth is expected to slow. Absent tax reform though, it is likely that many companies will maintain significant non-US portfolios for some time to come.

Despite the rapid growth in cash portfolios and an interest on the part of many companies in increasing yield, remnants of the financial crisis remain, as companies continue to orient their cash portfolios toward minimizing risk. Despite the current posture at many companies, we see opportunities for companies to pursue improved investment portfolio performance while maintaining the appropriate focus on safety of principal and maintenance of adequate liquidity. By engaging executive management and Boards around objectives and risk appetite, enhancing performance measurement systems and strengthening risk analysis, companies could expand their investment choices, taking on somewhat more risk, extending the duration of investments, and slightly lowering their credit standards in order to increase yields.

As cash portfolios grow, companies can also use external investment managers strategically, to manage more sophisticated and less-liquid investments. Considering the conservative nature of most portfolios, there also may be an opportunity to reduce cost by insourcing management of more short-term, highly-liquid investments.

Managing cash portfolios effectively requires a sound infrastructure, including the right tools and technology. Despite advances in treasury technology, the infrastructure to support investment management remains largely manual; even most large companies still rely on spreadsheets to capture trades and manage their investment portfolios. Increasing portfolio risk, stronger program governance, better performance management, and insourcing of some of the investment management function may serve to strengthen the business case for investing in treasury technology.

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