

Cash Management and Short-Term Investing

Washington State Treasurer's Office

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In Washington, the Treasurer's office:

- Is responsible for the safety of tax payer funds;
- Manages cash flow of all major state accounts with deposits, withdrawals and transfers that totaled nearly \$469 billion last year.
- Invests the state's operating cash in safe short-term instruments that preserve the ability to access funds.
- Issues and manages the state's debt.
- Provides financial and policy direction on various boards including the State Investment Board, the State Finance Committee, and the Public Deposit Protection Commission

Treasury Management Goal

Use Cash Efficiently

- Provide Liquidity
 - Meet Current / Future Financial Obligations
- Optimize Cash Resources
 - Minimize Holdings of Non-Earning Cash Balances
 - Safely Invest Excess Balances
- Maintain Investments
 - Meet Short and Longer Term Needs
 - Preserve Principal, Ensure Liquidity, then Return on Investment

Managing the Cash Flow for the State Requires the Office of the State Treasurer (OST) to:

- Handle financial transactions that receive money collected by all state agencies and pool it in a single bank account.
- Serve as intermediary between state agencies and financial institutions through master agreements that provide economies of scale that save the state money on banking services.

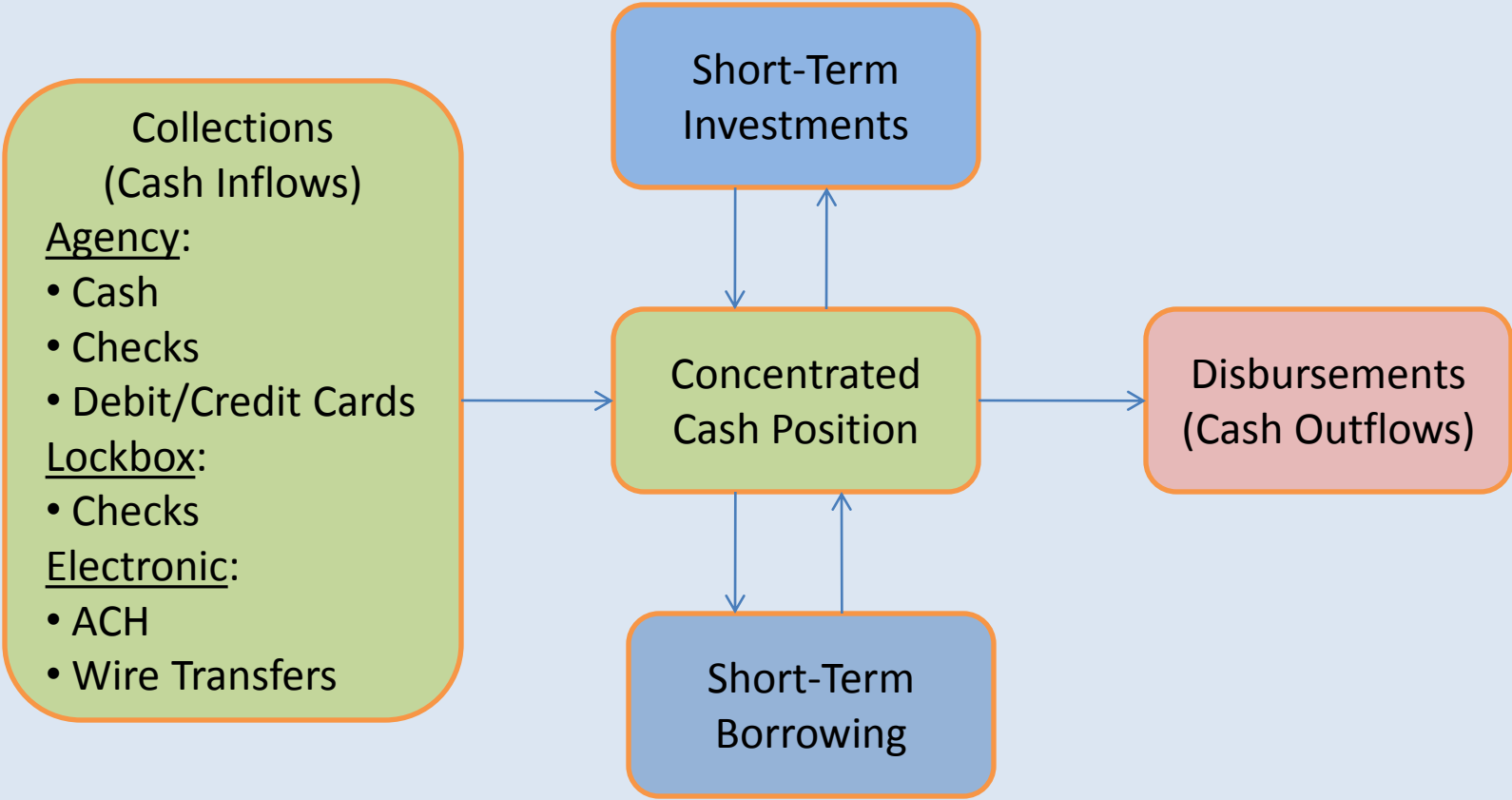
Statutory Environment

- In 1993, the legislature passed the Cash Management Act (CMA) to:
 - Obtain efficient management of the state’s cash;
 - Combine state cash for investment purposes; and
 - Revise policies and procedures so the state could create cost effective cash management contracts.
- In 2010, at the Treasurer’s request, the legislature improved the CMA by combining all state funds managed by the Treasurer for purposes of investment, deposit, redeposit and cash balances.

Key Results of the Cash Management Act

- Establish master agreements for financial services
- Find economies of scale to drive down costs.
- Replace cumbersome inter-fund lending with fund accounting within a large cash pool
 - Accounts in surplus earn interest while accounts in temporary cash deficit pay interest at same rates.

Cash Inflows & Outflows



Main Elements of Cash Management

- Collection
- Disbursements
- Concentration
- Cash Flow Forecasting
- Investment
- Safety and Security of Public Funds

Primary Goals of Cash Management

- Speed Up Inflows (Collections)
- Control Outflows (Disbursements)
- Minimize Net Cost of Process (Concentration)
- Manage Liquidity
 - Meet Daily Obligations
 - Reduce Opportunity Cost (Holding Excess Cash)

Cash Managers Hand Off Responsibility to Investment Managers by:

Preparing Collections For Future Disbursement

- Central or Master (Concentration) Account
- Transfer Funds From Outlying Locations / Banks
- Enables Funds to Be Managed Efficiently and Effectively
- Facilitates Daily Liquidity Management
- Invest Larger Amounts – Potentially Increasing Interest Income

Investment Managers Hand Off Responsibility to Cash Managers when Funds are Disbursed

- Primary Issue = Control
 - Ensuring Disbursements Made Exactly As Requested
- Wire / ACH
 - Vendor Payments
 - Intergovernmental Payments
- Direct Deposit – Low Cost / Certainty of Timing
 - Payroll / Expense Reimbursements
 - Retirement Payments
- Purchasing / Procurement Cards (P-Cards)
 - Small Dollar Purchases (Supplies)

Effective Cash Flow Forecasting Means Better Management of Cash and Investments

- Estimate cash receipts and disbursements during period
- Optimized use of funds – Minimize Excess Balances
- Ensure sufficient liquidity to meet disbursement needs
- Helps identify maximum maturity limits
- Helps identify core funds available for longer term investing
- Mitigate need to borrow or liquidate securities

Cash Flow Forecasts

- Involve all departments to measure all flows
- Use historical data to measure cyclical nature for receipts and disbursements
- Receipts = expected inflows + investment maturities
- Disbursements = regular expenditures (payroll) + non-repetitive expenditures
- Expect fluctuations
- Updated regularly for changes in revenues and expenditures

OST Investment Program

Two Separate Pools

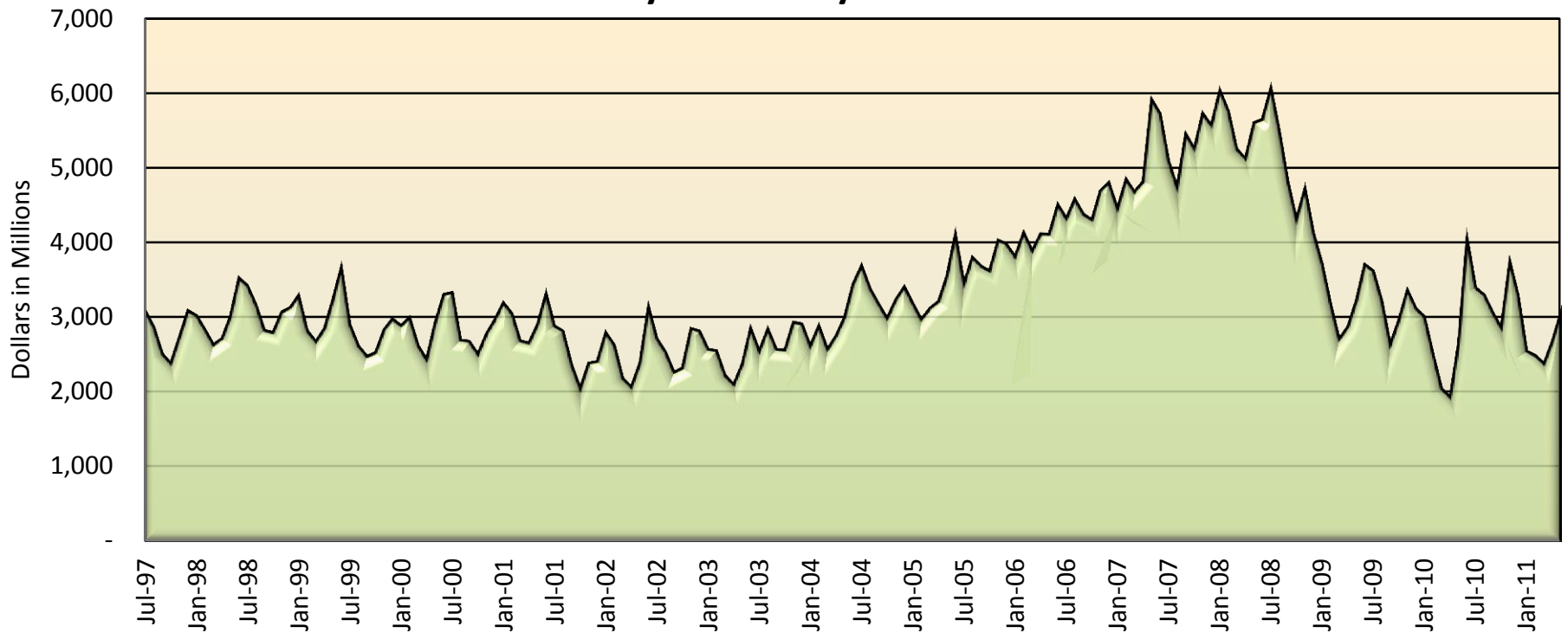
- Local Government Investment Pool (LGIP)
 - 100% voluntary / 100% liquidity
 - Constant share price
 - Runs like a SEC Rule 2(a)-7 money market fund
- State Treasury
 - 100% mandatory / 100% liquidity but only to meet cash flows
 - Constant share price
 - Beyond 2(a)-7 parameters

Treasury Pool

Investment of Temporary Surplus Balances

- Objectives, in priority order
 1. Safety of principal
 2. Liquidity to meet agency cash requirements
 3. Yield
- An important source of revenue
 - 10-year total of over \$2.5 Billion
- Investment policy defines the parameters
 - Sets the boundaries between conflicting objectives of safety, liquidity, and yield

Month-End Actual Balance Treasury & Treasurer's Trust July 1997- May 2011



- Significant, volatile cash flow makes it difficult to:
 - Effectively manage portfolio duration
 - Establish a meaningful performance benchmark
 - Provide effective oversight of the portfolio manager

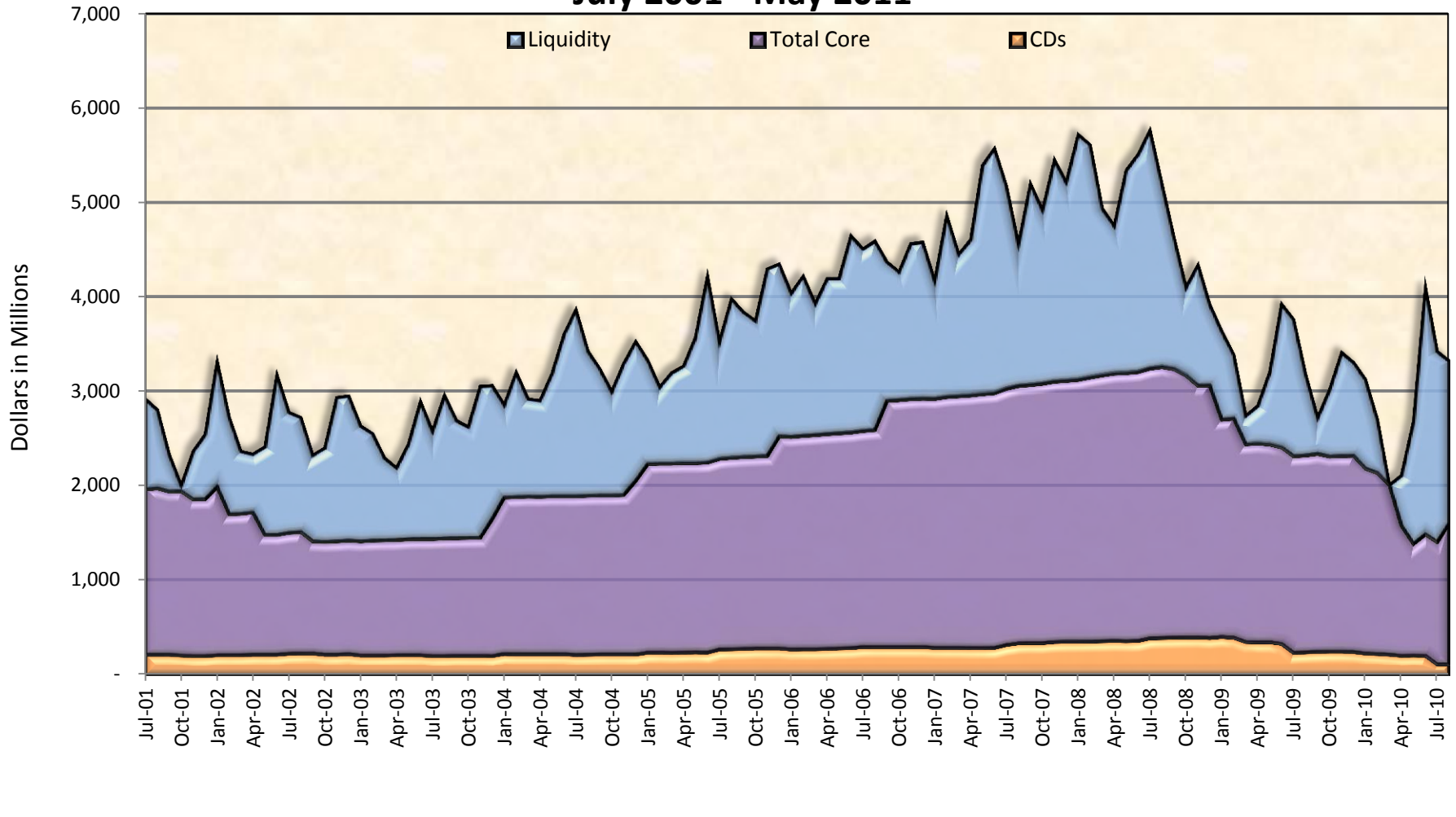
Solution: Subdivide the Treasury Pool into Two Portfolios

- “Liquidity” Portfolio:
 - Size ranges from \$0.2 - \$2 Billion
 - Responsible for all cash requirements
 - Manages cash for the core portfolio
 - Follows 2a-7 investment guidelines
 - Valid performance benchmarks
 - Creates cushion against unforeseen cash flows

Solution: Subdivide the Portfolio

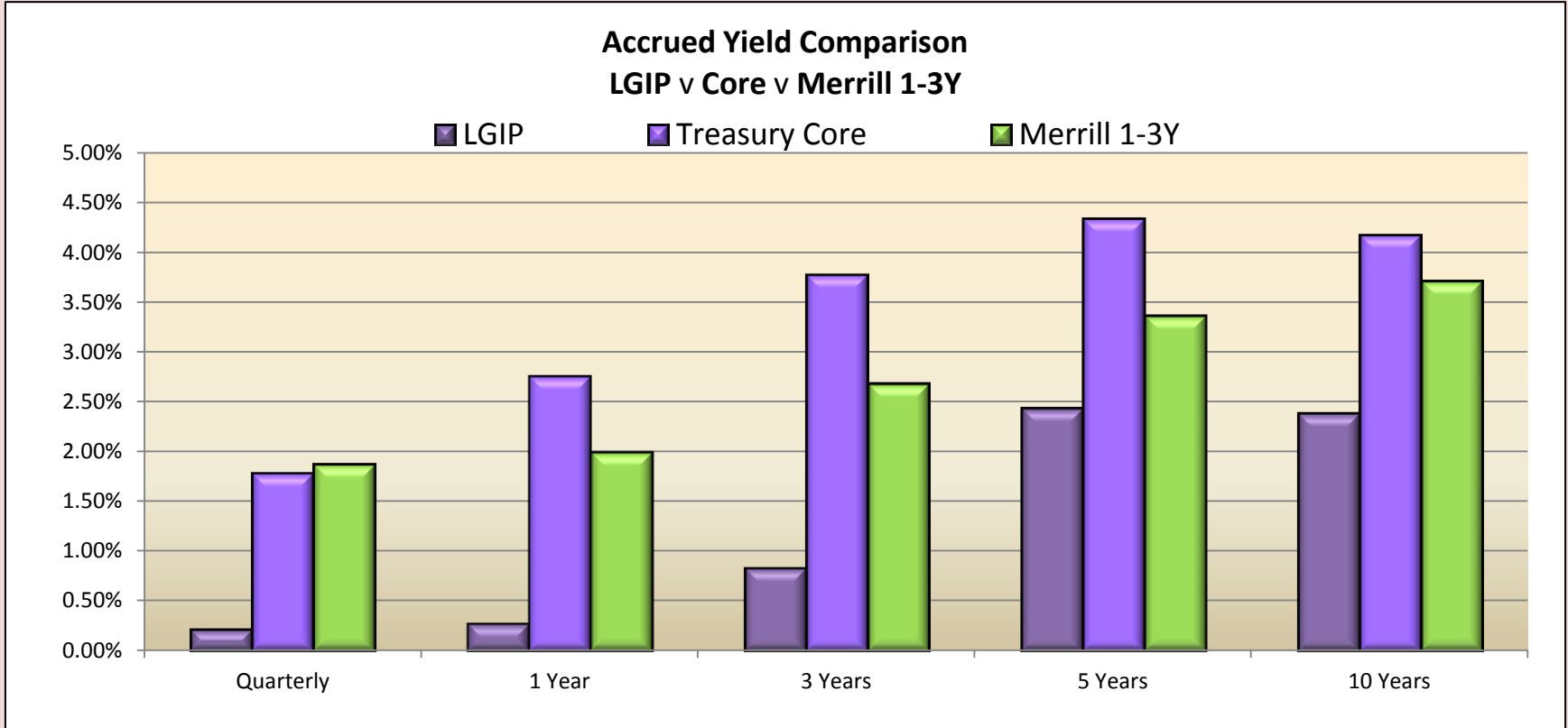
- Enhanced Cash “Core” Portfolio
 - Sole focus is fixed income investing
 - Managers relieved of cash flow considerations
 - STIF/Liquidity available for cash investing
 - Improved accountability and oversight
 - Valid performance benchmarks
 - Merrill 1-3 Year Govt/Agency Index (total return)
 - Blended Ladder (Earnings yield)

Treasury & Treasurer's Trust Actual Balance by Portfolio July 2001 - May 2011



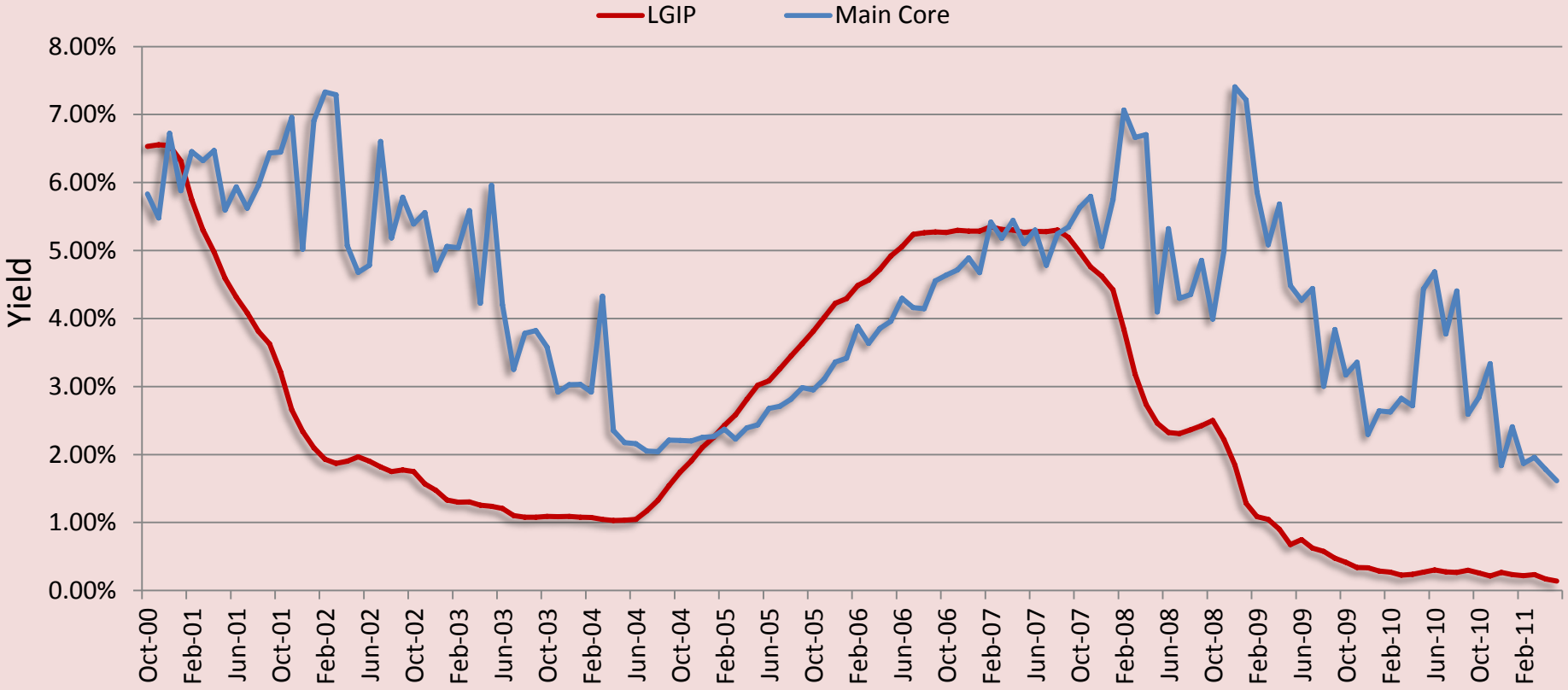
Accrued Yield Comparison: State Core Portfolio, LGIP and Benchmark

	Quarterly	1 Year	3 Years	5 Years	10 Years
LGIP	0.217%	0.27%	0.83%	2.43%	2.38%
Treasury Core	1.785%	2.76%	3.78%	4.34%	4.18%
Merrill 1-3Y	1.871%	1.99%	2.68%	3.36%	3.71%



Washington Treasury Returns

LGIP vs. Treasury Core
Accrued Yield



Questions?

Additional Information – Cash Management

Payment Systems and Procedures

Manage Collection & Disbursement Functions

- Cash Systems: Currency & Coin
 - Safeguarded Until Transported To Bank
- Paper Systems: Checks / Warrants
- Electronic Systems:
 - Wire Transfers
 - Automated Clearing House (ACH) Transactions
 - Bankcards: Credit or Debit
 - Image Deposits of Paper Items (Remote Deposit)

Collection Goals

- Reduce Paper-Related Float As Much As Possible
- Timely collection of receipts (Opportunity Cost)
 - Uncollected Funds Cannot Be Invested or Used
- Efficient handling of cash and checks
 - In-House or Lockbox Service Provider
- Deposit receipts timely (same day or next day)
- Acceptance of Electronic Payments via Automatic bank debit, Internet, or Telephone

Cash Management Contracts Administered by OST

Lockbox

- Master Agreement with 3rd Party (Bank)
- Expedites collection of paper-based payments
- Improves cash flow by reducing processing time between mail delivery and depositing of payments
- Available to any agencies accepting large numbers of paper checks
- Competitively Bid Every 4 to 7 Years

Lockbox Systems

- 3rd Party Receives and Processes Payments
- Advantages:
 - Mail Float Reduced: Use Unique Postal Code
 - Processing Float Reduced
 - Efficient Processing
 - Economies of Scale
 - Lower Per-Unit Processing
 - High Levels of Security / Segregation of Duties
 - Uninterrupted Service

Cash Management Contracts Administered by OST

Master Depository Agreements

- Agreements with Various Banks Statewide
- Available To State Agencies Authorized by state Office of Financial Management (OFM) to Have Local Bank Account Outside The Treasury
- Banks Are All FDIC and PDPC Qualified
- Fees Kept Static for Two Year Contract Periods

Cash Management Contracts Administered by OST

Merchant Bankcard Services

- Master Agreement with Bank for Processing Merchant Card Transactions
 - VISA/MasterCard
 - PIN Debit
- Separate Agreements with American Express and Discover
- Competitively Bid Every 4 to 7 Years

Cash Management Contracts Administered by the OST

State Concentration Account

- Main Bank Account for Treasury/Treasury Trust
- Includes All Banking Services Needed By State, for the Collection and Disbursement of State Money
- Includes Provisions for Collecting and Disbursing Funds Electronically
- Competitively Bid Every 4 to 7 Years

Electronic Systems Goals

- Faster Deposit of Funds (Collection Speed)
- Predictability of Settlement Timing (Cash Flows)
- Accelerated Availability of Funds
- Flexibility of Directing Payments to Any Account
- Ease of Transmitting Customer Remittance Information
- Reduced Risk of Fraud
 - Less Cash / Check Handling

Bankcards

- From a Fee Perspective, Most Expensive Option for Collecting Funds.
- Costs Can Range From 1% to 4% On Average of Total Collection.
- Reward Cards and Business Cards Cost Merchants More Than Standard Cards.
- Sometimes Difficult To Pass Fees on to Customers

Comparison of Transaction Costs

Bankcards vs ACH

Bankcards

\$100 Transaction

Interchange	\$1.43
Assessment	\$0.09
Discount	\$0.08
Processor	<u>\$0.10</u>
TOTAL	\$1.70

Total for 50,000 transactions:

\$85,125

ACH

\$100 Transaction

Bank Fee for ACH	\$0.025
TOTAL	<u>\$0.025</u>

Total for 50,000 transactions:

\$1,250

New Banking Services: Converting Checks to Images

Remote Deposit Service (RDS)

- Deposit Paper Checks Electronically
- Scan / Transmit Images To Bank
- Reduce Processing Float
- Improves Availability of Funds



New Banking Services:

Cash Pay Cards

- Alternative to checks/warrants
- Sold as a Payroll Card Solution, but can be used to disburse any funds, not just payroll
- Good for agencies with “unbanked” clients/workers
- Can be used as ATM card anywhere VISA / MC is accepted
- If managed properly, no fee to recipients

Additional Information – Local Government Investment Pool

Washington LGIP

- Created by legislation in 1986 – separate from state treasury, local funds never co-mingled with state
- Open to all local governmental entities in the state
 - Voluntary participation
 - As of 2010, state can invest in LGIP, but LGIP cannot come into state
 - As of 2010, tribal governments can invest their governmental funds
- 100% liquidity daily by 10 am
 - No restrictions on transaction size or balances
- 450 participants
 - All 39 counties
 - All cities > 10,000
 - PUDs, Ports, transit agencies, higher ed, tribes, etc.

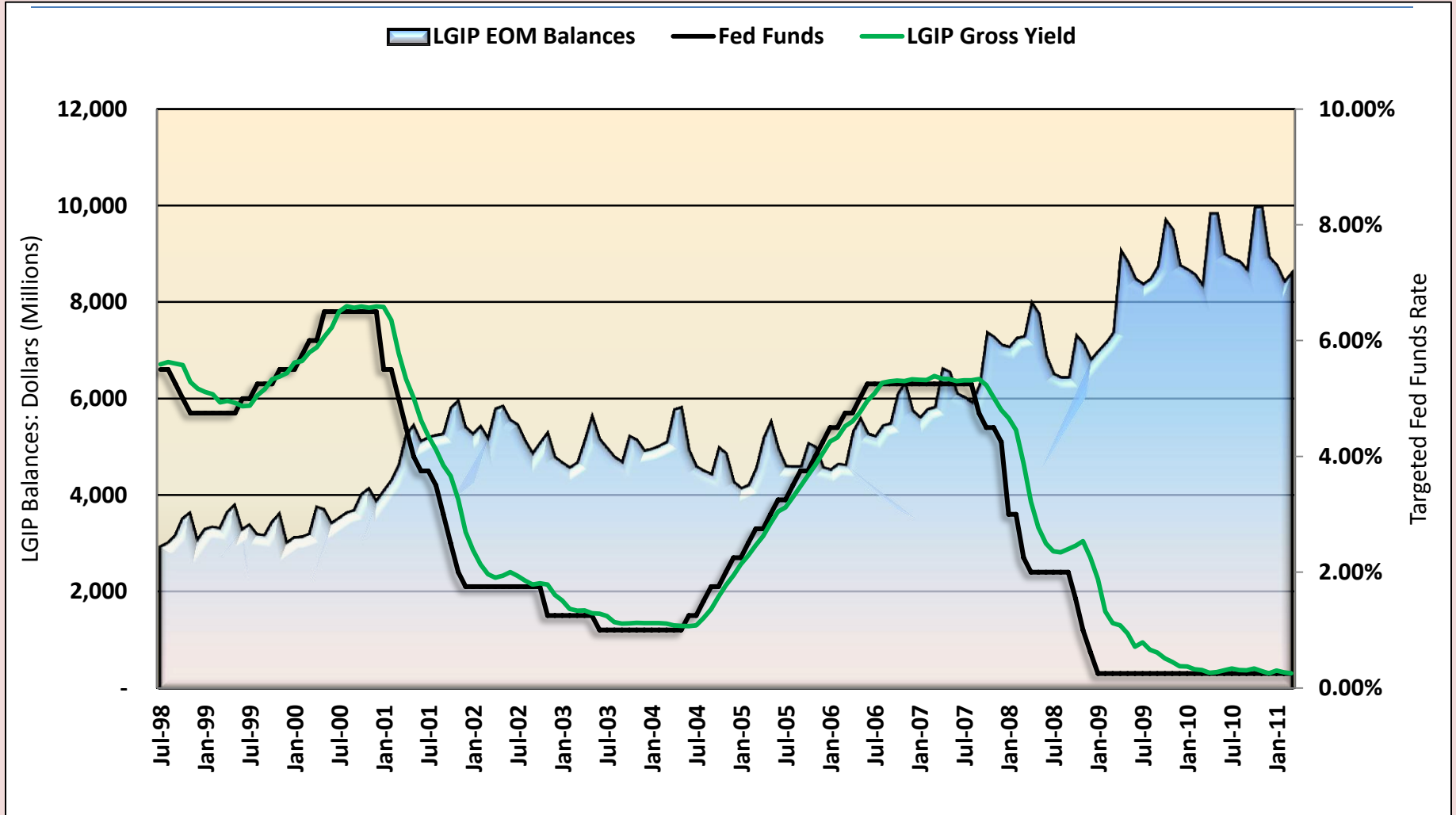
Washington LGIP

- Objective: Provide a safe, liquid, short-term investment vehicle for local governments
 - Patterned after private sector 2a-7 money market funds
 - Benchmark: net and gross yields of the iMoneyNet Government and Agency group of funds
- Fee = 3.5 basis points
- By statute can only charge what it costs to run the LGIP
 - Fee includes all direct and indirect costs
- Net Fee < 1 bp for last several years
 - Net Fee in 2010 was 0.69 bp, with balance of fee rebated back to participants

Washington LGIP

- All aspects of LGIP done by OST staff
 - Administration
 - Portfolio management
 - Accounting
 - IT: System and Support
- Audited annually by outside firm
- Transactions may be done:
 - On-line
 - By phone

Washington LGIP: Yield and Balance History



LGIP Holdings

May 31, 2011

