Understanding the

Cash Management Investment Policy Statement

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Guide Your Liquidity Strategies with a Cash Management Investment Policy Statement

Companies are continuously working to balance their desire for safety and liquidity against a competitive return. Company cash balances have been on the rise in the U.S. since the late 2000's, most recently spiking due to the COVID-19 pandemic as companies built up cash holdings to protect against global disruptions. Evolving market dynamics make managing cash more complex than ever.

Rising corporate cash holdings and short-term investment levels have positioned organizations to expand investment policies to optimize cash. A Cash Management Investment Policy Statement (Cash Management IPS) provides a tactical approach to accomplishing this goal.

What is a Cash Management IPS?

A Cash Management IPS defines an organization's cash portfolio goals and risk tolerance to guide their short-term investment strategies and allocation decisions. An effective policy statement provides financial transparency and allows organizations to swiftly take advantage of new opportunities due to changes in markets, industries, the economy, or their corporate cash position.

A comprehensive, well-defined Cash Management IPS allows organizations to:

- Set guidelines for cash investment strategies to preserve capital, maintain liquidity, mitigate risk, and maximize income on investments.
- Thoroughly define risk tolerance and cash portfolio goals to capitalize on investment opportunities when they arise.
- Clearly communicate the internal or external parties responsible for managing the company's cash portfolio, as well as the policy itself.

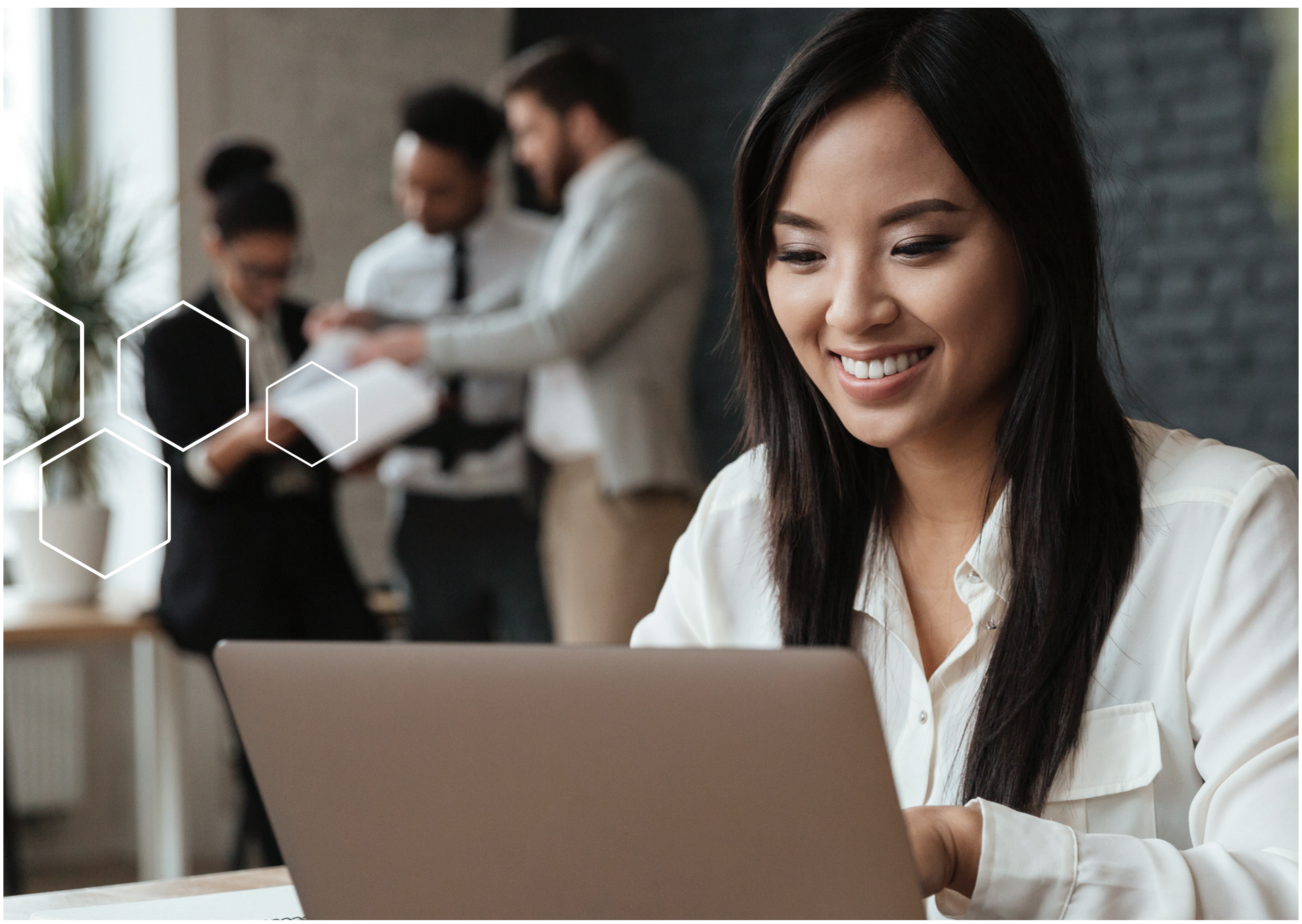
A Cash Management IPS helps companies understand their cash needs and make more informed investment and allocation decisions for their Operational, Reserve, and Strategic cash positions.

Why Should Companies Consider a Cash Management IPS?

There are practical reasons to retain a policy document that sets in writing your organization's cash portfolio goals.

The process of developing this policy requires companies to carefully consider their cash management strategies and hold themselves accountable to those constraints and goals. A thoughtful Cash Management IPS ensures all stakeholders are informed of and knowledgeable about how the company intends to invest its cash balances, permissible products, the allowable risks for investments, and the parties responsible for implementing the policy.

Market, economy, and industry shifts all present new investment opportunities or risks. Established guidelines also allow cash managers to act quickly without needing additional input or exposing their portfolio to more risk than the company has determined is acceptable. Working within established portfolio goals and risk parameters outlined by the policy should result in fewer surprises, less missed opportunities, and better investment outcomes.



What Are the Elements of a Cash Management IPS?

Every organization's Cash Management IPS will differ based on their unique needs. However, the components below are commonly present in most policy statements. The next section will delve deeper into each component.

Policy Objective

- Clearly communicates the goals of the organization's short-term investment strategy.
- Defines the organization's cash flow needs, risk tolerance, and benchmark requirements.

Permissible Vehicles and Product Guidelines

- Defines the types of products and investments allowable under the policy.
- Outlines investment restrictions and considerations.

Risk Management

- Defines credit quality limits on investments and providers.
- Defines exposure limits on any one product or investment type or product provider.
- Defines restrictions on realized gains and losses.

Governance

- Defines the persons responsible for managing the cash portfolio.
- Determines which stakeholders are responsible for creating, reviewing, and revising the policy.
- Sets cadence for investment policy review, as well as parameters for reviews outside this regular cycle.

Benchmark and Reporting

- Identifies metrics for performance and risk measurement.
- Defines communication expectations.

Policy Objective

The policy objective section is where your company includes its cash portfolio goals. Understanding your company's needs is the first step to developing these objectives.

Cash Needs

Begin by assessing your organization's liquidity needs. The purpose of this endeavor is to understand how and when the company will need cash. Proper forecasting should also account as best as possible for shifts in your markets and the industry within which you operate.

Consider cash flow needs for everything, whether regular day-to-day operational costs, periodic needs for planned (taxes or dividend payments) or unplanned (emergency) expenditures, or unassigned funds for future endeavors. Then, after forecasting those cash needs, you can segment your cash portfolio. Cash segmentation is a useful way to visualize the amount of cash you require as well as create purposeful objectives for each segment.

As operating cash is tied to treasury management activities, it is traditionally managed through bank deposit products. Reserve and Strategic Cash segments generally include a mix of bank product and investment solutions.

After estimating the funds you will likely require in each segment, you can begin assessing the amount you'll need to remain fully liquid and how much you are willing to invest in short-term opportunities.

Considerations for Defining Objectives

What are your company's operational and financial needs?

What do you want to accomplish with your short-term investments?

How much liquidity do you need to maintain to avoid risk?

How much risk are you willing to accept in your cash portfolio to meet objectives?

Do your goals align with potential needs in the future, such as facility changes, company growth, and industry changes?

<3 months

Operating Cash

Daily operations and reserve for emergencies

3-12 months

Reserve Cash

Cash for periodic needs – taxes, dividends, R&D, etc. and other intermediate term planned or unplanned expenditures

>12 months

Strategic Cash

Reserves that might or might not have future targeted uses

Risk Tolerance

Investments are not without risk. There are numerous types of risk — credit risk, interest rate risk, currency risk, loss of purchasing power due to inflation, etc. — and your organization will need to consider its liquidity needs alongside the potential risks to determine which products and investments are a good fit.

Each cash segment has its own priorities and therefore will have its own acceptable level of risk. Committing these decisions to writing in the Cash Management IPS keeps all stakeholders in alignment. There should be no question about which investment opportunities are appropriate for each segment based on their level of risk.

Cash Portfolio Objectives

It is recommended to strike a balance between creating cash portfolio objectives specific enough to guide allocation decisions but also flexible enough to allow those in charge of cash management to make fast decisions to pivot if presented with a new investment opportunity or reallocate to a better yielding alternative.

Since your organization already segments its cash between Operating, Reserve, and Strategic needs, it makes sense to set multiple objectives for your portfolio. For example, your organization might set a goal to meet forecasted cash needs within your Operating cash segment and exceed investment benchmark returns with Strategic cash funds.

You will likely have multiple objectives. The Cash Management IPS should prioritize them based on defined risk and expected return to guide investments.

Investment Guidelines and Risk Management

This section of your Cash Management IPS defines the types of products allowed for each segment of your cash portfolio. Generally, it will include a list of approved products and short-term investments, as well as restrictions on investments based on any number of factors. Plan to revisit and revise these guidelines regularly to account for market changes.

Credit Quality Limits

Credit ratings provide insight into the level of risk a product, such as a fixed income security, carries so it is critical to include credit quality limits in your Cash Management IPS. These limits should specify the minimum acceptable credit rating for instruments that carry credit quality ratings, such as money market mutual funds or fixed income securities. They should also encompass both credit limits on specific securities and the minimum average credit quality of the entire portfolio.

Some organizations might also include limits on their bank's credit quality in their Cash Management IPS. Similar to how products are rated on their level of risk, financial institutions receive credit ratings based on their likelihood to default on debts. Your organization can set limits on your bank's credit rating to further mitigate risk.

Credit rating agencies do not always assign the same credit rating to a security. The Cash Management IPS should determine how those executing on the cash management directives should handle these split rating situations.

Considerations for Investment Guidelines

What, if any, restrictions does your company have on realized gains/losses?

How will you handle securities with split credit ratings?

What is your preferred investment duration strategy for each segment within your portfolio?

How much diversification do you desire in your investment portfolio?

How will DEI and ESG considerations affect your allowable investments?

Credit ratings can change at any time, so it's also useful to include a provision in this section to determine the appropriate course of action if an investment's rating changes or falls below the acceptable credit limit.

Restrictions

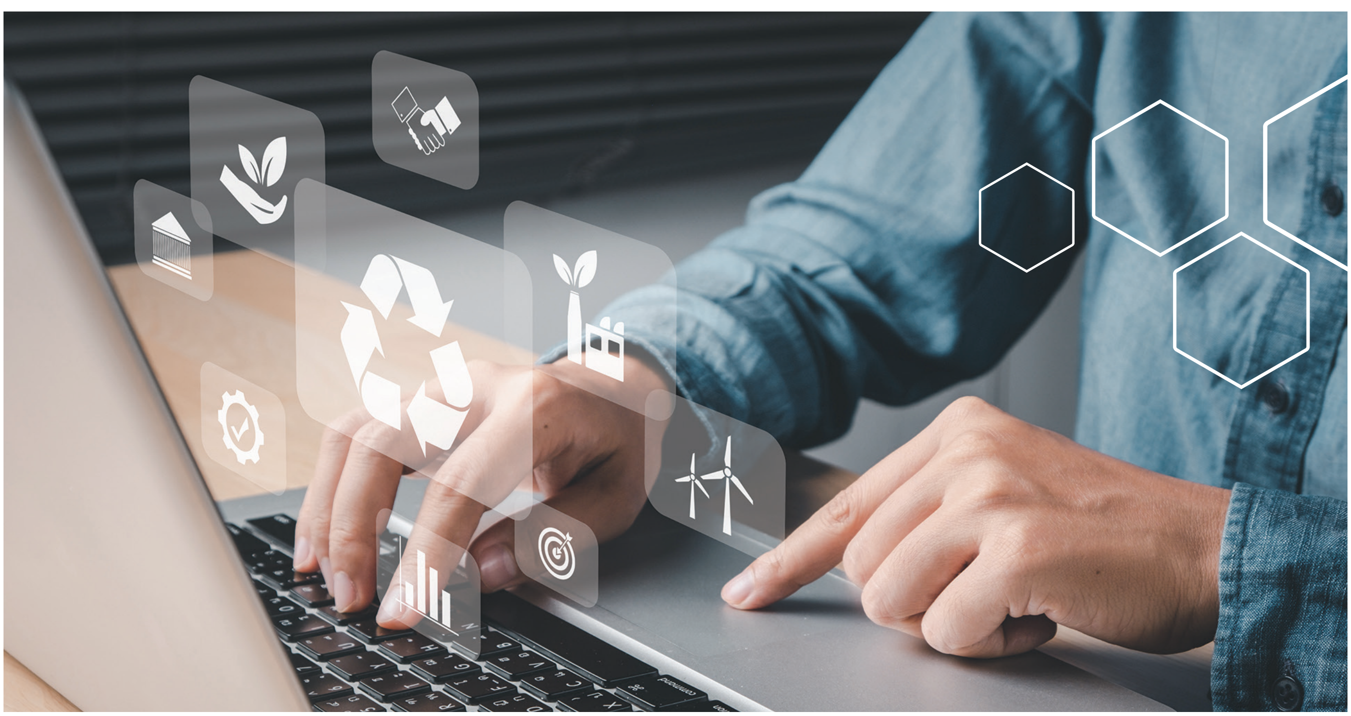
In addition to determining acceptable investments, a Cash Management IPS can include restrictions on allocation decisions, whether exposure restrictions on a single bank or limits on the size of a balance sheet. Legal and regulatory factors can influence these restrictions. Maximum duration or maturity limits could also be included, as well as diversification targets. Organizations also might decide not to invest in certain sectors that go against their principles or values.

ESG and DEI Considerations

Certain organizations opt for Environmental, Social, and Governance (ESG) and Diversity, Equity, and Inclusion (DEI) investments.

ESG investing is a "socially responsible" practice that considers financial returns as well as environmental, social, or governance impact. An organization might purposefully choose securities whose issuers boast green initiatives or support fair labor practices, for example.

Investing based on a company's DEI practices considers the actions issuers have taken or are committing to in order to ensure diversity, equity, and inclusion. An issuer's transparency into hiring practices, composition of workforce, and pay structure could play a role in this. For example, an organization might opt to invest with issuers who have greater diversity in their workforce or who have voiced a commitment to implementing more diversity-focused recruiting practices. If your organization has ESG or DEI considerations for investments, outline them here.



Governance

The governance section of a Cash Management IPS clearly states the persons responsible for managing, reviewing, and implementing the strategies outlined in the document. Every stakeholder involved should be aligned on the guidelines set forth in the policy statement to avoid miscommunication, confusion, or concerns about the handling of cash portfolio products and investments.

Roles and Responsibilities

Typically, the Cash Management IPS will be drafted by your organization's CFO and treasury management team, then reviewed by the CEO and board of directors. This group of stakeholders would also be involved in reviewing and approving adjustments to the policy on a regular basis.

Your organization will also need to decide who will be responsible for executing the cash management policy. It might make sense for your organization to assign this role to the group responsible for managing all cash segments, or it might be better for this responsibility to be handled by a person or group in another area. Every circumstance is different.

Policy Review and Revisions

Your organization might already have a drafted Cash Management IPS, but it is important to remember this statement is not a static document. Circumstances within your business and industry change and the economy shifts – all these situations affect your cash management and investment strategies

So, how often should you review or update your Cash Management IPS? There is no right answer. Review cadence varies from company to company, though once a year is most common.

Considerations for Governance

Who will be responsible for maintaining your organization's Cash Management IPS?

How frequently will your policy be reviewed?

Who is involved in the review process? Who gets final say in changes?

Will your cash portfolio be managed internally or externally?

What qualifications will you require of an external investment manager?

Changes to your cash portfolio, growth opportunities, interest rates, and investment strategies could all dramatically impact your cash-investment strategies. An abundance of strategic cash reserves could prompt credit-quality limit changes, whereas supply chain issues due to geopolitical events could alter operating cash needs. Reviewing on an annual or biennial basis ensures your Cash Management IPS includes updated information about your company and its evolving needs.

Certain types of events might trigger a policy review outside of this cadence, such as major market shifts, geopolitical events, or emergency cash needs. It can be helpful to define which events might spark this type of review to ensure all stakeholders are prepared for the possibility.

Benchmarks and Reporting

Benchmarks in a Cash Management IPS measure the performance of your cash portfolio compared to your defined investment objectives. These benchmarks should be measurable, easy to understand, and reflect the investment goals outlined in this statement.

Although your strategies might shift as markets change or you invest in new opportunities, the metrics themselves shouldn't change. Keep your performance metrics consistent year over year so you can gain meaningful, long-term data on your performance and risk strategies.

This section in your Cash Management IPS should also define who is responsible for reporting on performance and communicating those metrics with necessary stakeholders. While data on portfolio performance should be available on demand, it might make sense to task a person with preparing and disseminating weekly, monthly, and quarterly reports.

Considerations for Benchmarking

What metrics are most appropriate to measure the performance of your portfolio?

Do your benchmarks accurately reflect your cash portfolio objectives?

How often will your portfolio performance be communicated? And by whom?

Conclusion

An effective Cash Management IPS provides financial transparency and allows organizations to strategically plan short-term investments alongside cash flow needs. Each component of the policy requires thoughtful discussion among stakeholders and careful considerations of financial obligations and business growth objectives. With this policy in place, organizations can be better situated to make confident investment decisions to minimize risk and maximize returns.

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