

Dealing with Today's Rising Rate Environment

“Been There, Done That” No Longer Applies

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How is the current market and rate environment different?

What does it mean for cash managers?

Re-introduced and evolving investment choices

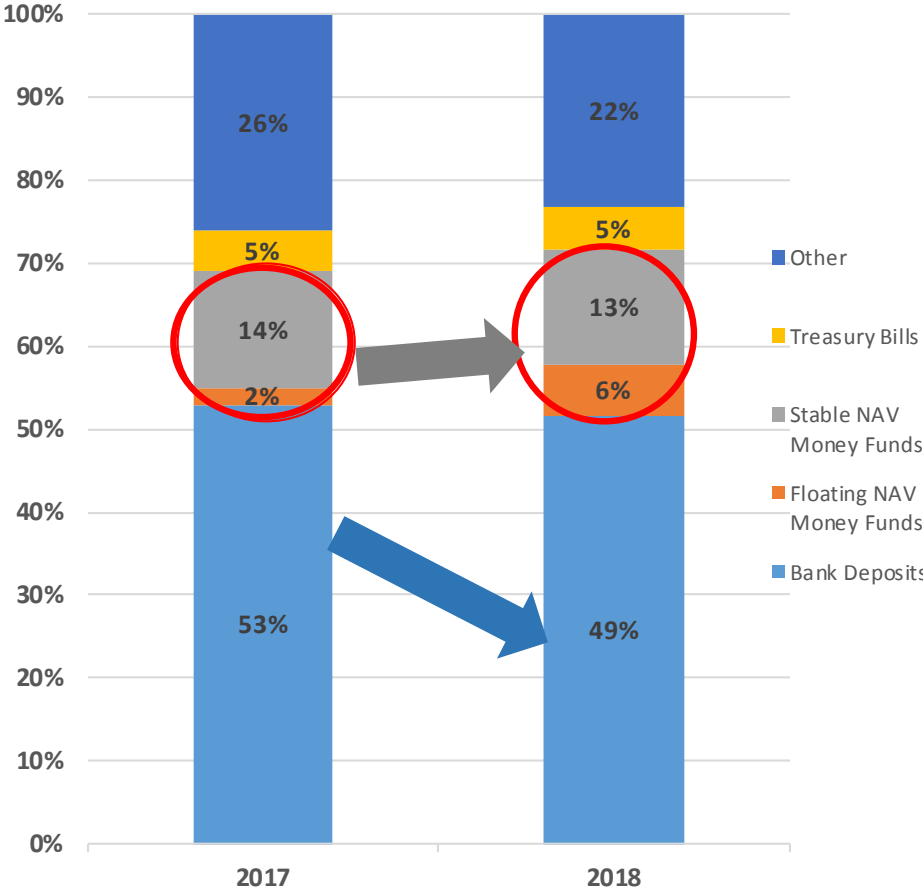
Cash segmentation and liquidity strategy

How is the Current Environment Different?



- Excess cash sitting on the sidelines, as rate environment transitions from historical lows
- Banks' approach to deposits evolved as legislation changed
- The Federal Reserve and European Bank adjust policies as the economy improves and inflation moves toward targeted percentage
- Lessons learned from the financial crisis have the potential to change investment behaviors
- Many financial professionals were not part of the workforce during the last rising rate environment
- Some foreign currencies currently have a negative interest rate
- Investment companies have developed a plethora of new short-term investment options

Allocation of Short-Term Investment Vehicles



Data Source: 2018 AFP@Liquidity Survey



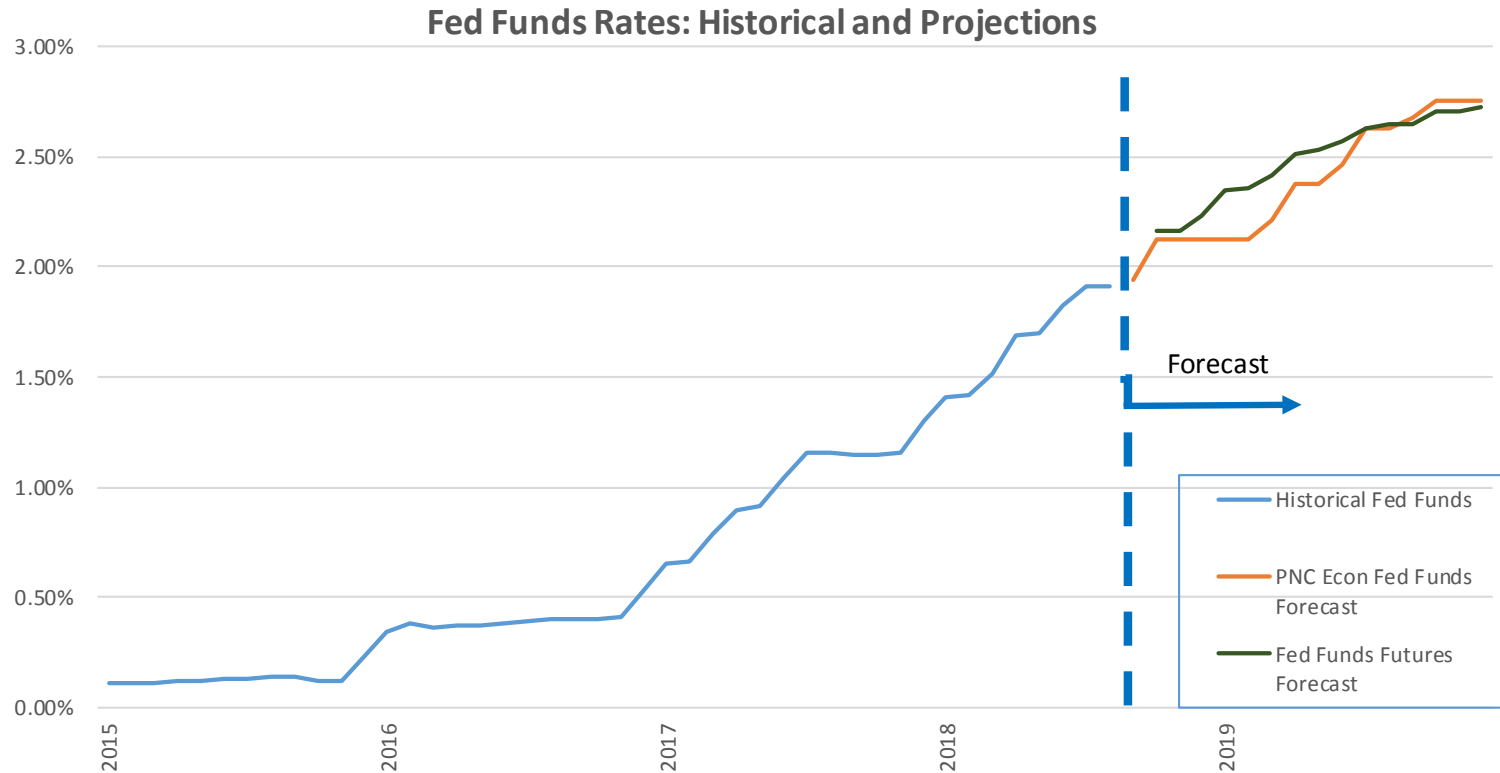
Federal Reserve

- Job market continues improvement: August's unemployment rate at 3.9% and continued improvements in wage growth
- Inflation increased slightly this year, near the 2% target
- Rate hike to 2.25% expected in September, potentially a December hike as well



European Central Bank

- Current accommodative policy to provide monetary stimulus
- Quantitative easing to end in December
- Slow employment, wages, and GDP growth
- First rate increase not likely to occur until mid-2019



Data sources: www.cmegroup.com, www.pnc.com/en/about-pnc/media/economic-reports.html

- Market expects gradual, measured increases
- “Normalized” rate environment looks much different than last time. Per market expectations, rates will not reach pre-2008 levels any time soon

Short-Term Cash Environment: Historical View vs. Future Outlook

Flat Rate Environment

- Cash levels at all time highs – lack of attractive short-term investment options
- Corporates “hoarding” cash - minimal expenditures, slow growth
- Potential repatriation of cash back to U.S.
- Rate environment – most rates near zero with no opportunity cost
- Financial regulation and its impact on liquidity options

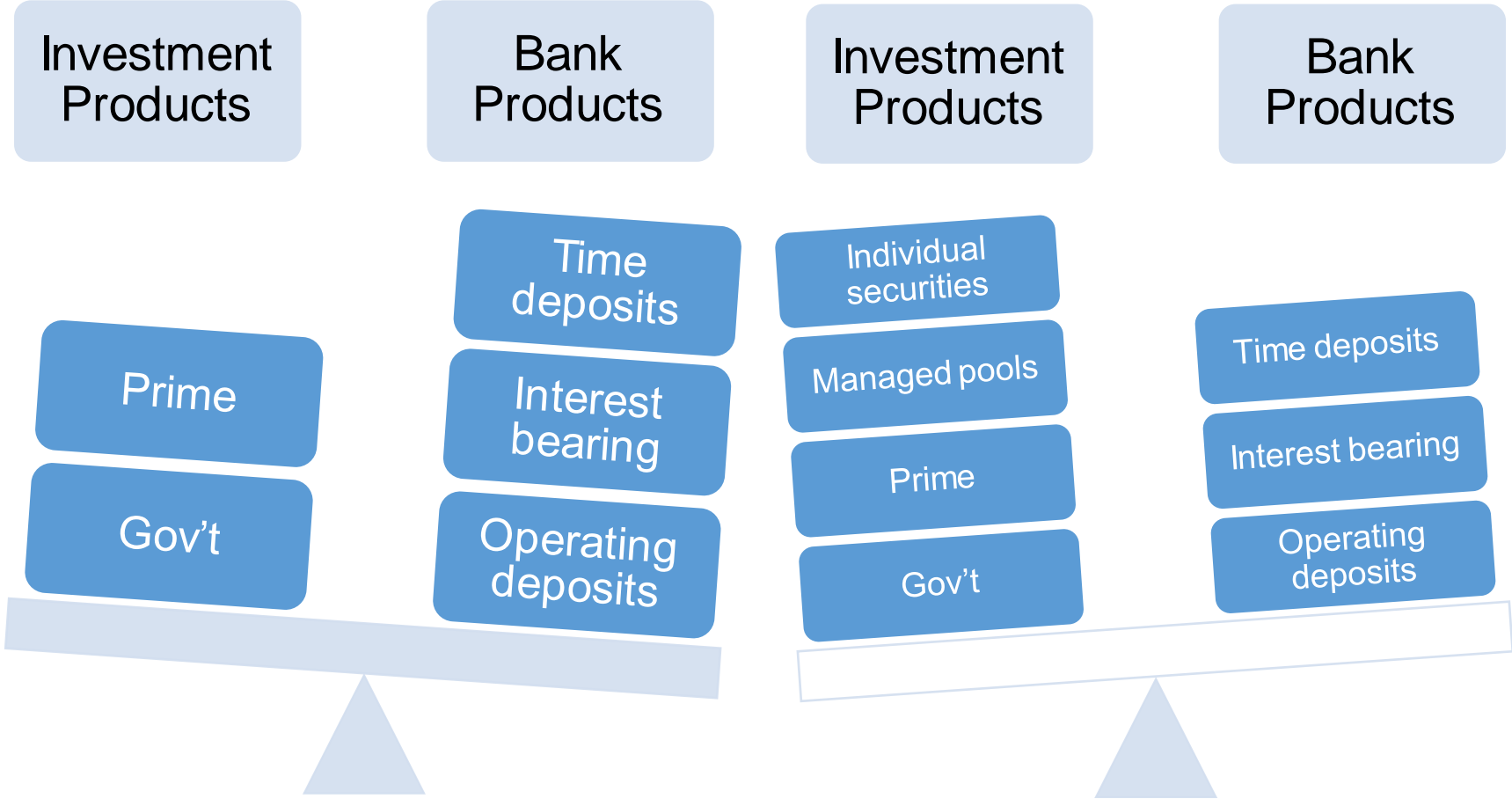
Rising Rate Environment

- Cash levels at all time highs - not likely to rise further
- Excess cash generated from operations expected to be deployed
- Tax reform expected to drive cash repatriation
- Rate environment - rising rates provide attractive investment alternatives
- Regulation and its impact

Rising Interest Rates Create Competition

2015

2018



Regulatory Changes Influence Banks' Views of Deposits

- Deposits tied to an entity's operating business provide highest value
- Deposit valuation varies based on client type and transaction activity
- Banks will compete for the most valuable deposits
- Competition among banks will increase as alternative investment options become more attractive



Repeal Reg Q

Interest-Bearing
Checking

“Hybrid” Checking
(Earnings Credit and Interest)

Relevance of Sweep
to investments

Basel III LCR

Banks define valuable
deposits by client type
and activity

Accelerated or
“Evergreen” Maturity/
CDs

“Notice”
accounts

Repo Sweep
elimination

MMF Reform

Floating NAV funds
fees & gates

Ultra short bond funds

Separately Managed
Accounts

Exchange traded
funds

Elimination of Prime
fund sweeps

What Does This Mean for Cash Managers and Treasurers?

- Changing environment may prompt need to review and update investment policy
- Renewed focus on the risk and return of allowable investments
- Closer management and allocation of operating, reserve and strategic cash
- Prepare for shift in liquidity needs. Increased capital expenditure, M&A activity, repatriation, changes to lending approach likely outcomes of changing environment
- Understand re-introduced and emerging short-term investment products

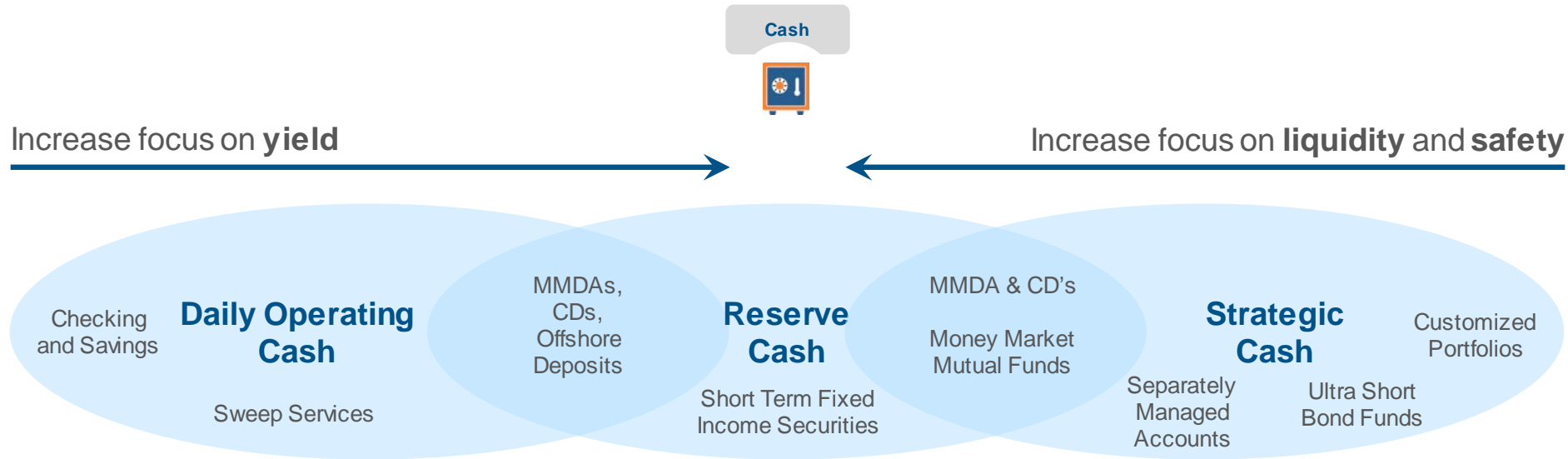
- Key elements of an investment policy
 - Investment objectives
 - Risk tolerance
 - Time horizon
 - Permissible investment types
 - Asset allocation
 - Investment performance metrics

- Potential changes in a rising rate environment
 - Counterparty limits and due diligence
 - Acceptance or restriction of investments with floating NAV and liquidity fees and gates
 - Allocation among bank deposits and other liquidity alternatives given cash segmentation
 - Acceptance of emerging investment products
 - Priority of risk vs. return



Liquidity Continuum

Options Driven by Cash Segmentation



Daily Operating Cash is needed to support daily operations

- Short term in duration
- Safety primary objective
- Passively managed

Reserve Cash serves as a cushion for unforeseen events

- Up to 1 year duration
- Liquidity primary objective
- Actively or passively managed

Strategic Cash is reserved for a particular duration and purpose

- Up to 2+ years duration
- Yield primary objective
- Actively managed

Determining Appropriate Cash Segmentation

Cash Management Style and Investment Considerations

Cash Characteristics (purpose and term)

The intended use of excess cash and a sense of when the funds will be needed are critical in determining an appropriate liquidity management solution

Key things to consider

- Balance predictability and perceived term
- Liquidity requirements
- Intended use of cash



Cash Management Style

Each company has unique preferences for managing liquidity. An appropriate solution will align with the cash manager's stylistic preferences.

Key things to consider

- Active, passive or outsourced
- Level of sophistication
- Time and staffing available
- Knowledge of investment alternatives



Investment Policy, Risk Tolerance, Tax Status

All cash managers must also consider the risk, diversification, and tax implications of the liquidity management solutions they employ.

Key things to consider

- Permissible investment options
- Diversification requirements
- Risk tolerance
- Tax status
- Interest rate risk



▪ WHY?

- Rising rates introduce opportunity to utilize varied and relevant liquidity options
- Client demand for products similar to those available before the financial crisis

▪ WHAT?

- Re-emerging Options
 - Investment sweeps
 - Money market funds
 - Separately managed accounts
- Evolving Options
 - Interest-bearing and “hybrid” checking
 - Ultra-short bond funds
 - Private structures
 - FNAV money market funds

▪ WHEN?

NOW is the time to consider myriad liquidity options within a short-term investment strategy

“Been There Done That” Does Not Apply: A Call To Action

- Revisit investment policy
 - Review annually at a minimum
 - How does the policy address interest rate risk
 - Does the policy consider new and re-emerging investment products

- Evaluate and re-calibrate cash segmentation approach
 - Greater relevance in a rising rate environment
 - Cash segmentation can influence investment duration as well as investment priorities of liquidity, safety, and yield

- Understand the solutions you will use and employ sufficient expertise
 - Seek continued education and knowledge of short-term investment options
 - Meet with investment and banking advisors
 - Pay attention to market and rate conditions
 - Use knowledge and investment strategies to employ effective cash forecasting



QUESTIONS??

