

# AFP<sup>®</sup> Annual Conference



November 7-10, 2010 | San Antonio

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## Money Fund Selection with Limited Treasury Resources

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# Company Background

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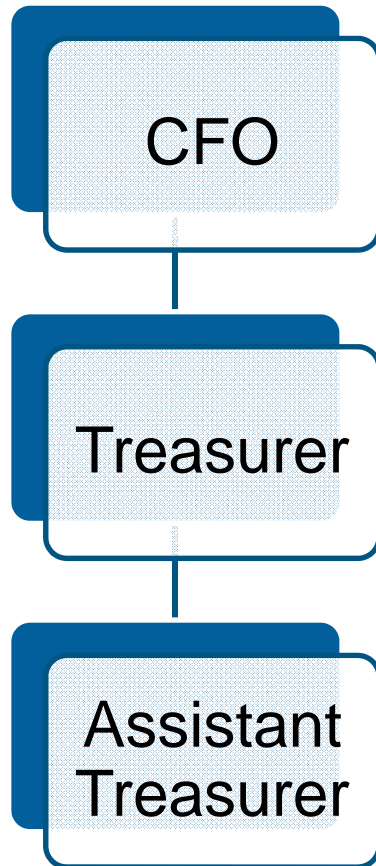
- Overview

- HQ in Atlanta, GA
- Consumer ISP
  - 1.9 million subscribers, broadband & dial-up
- Additional businesses
  - SME telecom services
  - Hosting
  - Content & Advertising
- ~590 FTE

- Financial Highlights

- ~\$600 million LTM Revenue
- ~\$935 million market cap
- \$740 million cash Q2 '10
- \$484 million net cash Q2 '10
- ~\$15 million FCF/mo
- ~\$70 million annual dividend
- Most receivables from credit cards
- Most payables EFT
- “Annuity-like” cash flow

# Treasury Organization & Policy



## Portfolio Strategy Overview

- Strategic Cash - \$250 million
- Reserve Cash - \$100 million
- Operating Cash - \$50 million
- “Ready Strategic” - \$350 million



\$400 million designated to be invested in money funds

2010 AFP Liquidity Survey suggests that 25-30% of corporate cash is invested in money market funds

# Alternatives to Money Funds

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- “Do-it-yourself”
  - Build your own money market fund effectively to 2a-7 standards, managed by internal portfolio managers
  - Cost tradeoff: Third party fund manager fees vs. People and systems costs
  - Need critical mass
- “Do-it-for-me”
  - Engage adviser to manage separate account to 2a-7 standards

# Money Market Fund Selection: Problem Statement

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- Objective
  - Minimizing risk is the highest priority as stated in Investment Policy
    - Board and Senior Management view risk through lens of 2008 collapse
  - Risk should be viewed by individual fund and across funds
  - Given low yield environment, cost management is critical

How to minimize risk across portfolio given limited internal resources?

- Maximize access to information
    - Leverage outside resources as much as possible
    - Choose advisers and portals that provide quality data and analysis
    - Distribute funds among advisers to solicit a variety of viewpoints
  - Use the information efficiently
    - Constant attention to the small things
    - Find the right people and keep them engaged
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# Money Market Fund Selection: Considerations

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- Iterative Process
  - Internal changes can lead to change in policy
  - External changes can create or highlight risks and opportunities
  - Portfolio and tools should be flexible enough to move on opportunities/away from risks as soon as they are identified
- Investment Policy Compliance
  - Asset selection
  - Concentration issues
- Regulatory Changes
  - Adoption of new SEC rules should homogenize both risk and return
  - New rules authorize fund's Board to suspend redemptions; formerly required an SEC order
  - Shadow NAV disclosure allows investors 'behind the curtain', but it may not be actionable – half of portfolio is likely to have matured by the time of disclosure

# Money Market Fund Selection: Information Sources

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- Regular discussion with Relationship Managers
  - Differing views on the market
  - Differing views on each other's portfolio strategy
  - Differing information on particular investments
  - When possible, meet with Portfolio Managers
- Third Party Research
  - Online research through portal managers for each fund
  - Independent research
- Reporting
  - Online access to information:
    - Holdings
    - Cross-holdings
    - Performance
    - Credit ratings
    - Policy Compliance
  - Reporting on concentration and other policy compliance requirements

# Money Market Fund Selection: Fund Evaluation

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- Initial Screen
  - Fund size
  - High-level sponsor review
  - Yield outliers
  - Management
  - Relationship with channel
  - High-level review of holdings
- Deeper Dive
  - Credit review of holdings
  - Cross-holdings review
  - WAM/SWAM
  - Deep sponsor review
  - Shareholder risk



# Case Study - Enhanced Cash Funds

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- Background
  - MMF-like product that extended WAM slightly past traditional 2a-7 funds
  - Utilized by investors to generate an additional 15-30 bps over MMF yields
- Timeline
  - During the credit crunch of 2007, increased focus on CDOs, SIVs and other structured products led EarthLink to speak with all of its relationship managers to gauge potential indirect exposure to these asset classes through its fund investments
  - Phone call with portfolio managers resulted in few answers, more questions
  - We decided to pull all investments in fund in favor of a 100% Treasury fund
  - 4 weeks later, the fund closed and was liquidated with a payout of <\$1.00
- Lessons Learned
  - Review underlying securities, Question PM's, Demand satisfactory answers, Don't be afraid to pull assets, Beware short institutional memories

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**Dissecting Prime Institutional  
Money Funds:  
How to Conduct a Deeper Level  
of Due Diligence**

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# Disclosure Statement

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# About Capital Advisors Group

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Founded in 1991, Capital Advisors Group is an SEC-registered investment advisor based in Newton, MA

CAG provides fee-based, separate account cash investment management for corporate treasury functions and other institutional accounts

Approximately \$7 billion assets under management and 270 institutional clients nationwide

\* Client statistics as of 3/31/10

# A Fresh Perspective on Money Funds

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- An investment pool regulated by the SEC
  - **Commingled Assets**
- Advisor appointed by the Board of Directors makes all key decisions
  - **Agency Problem**
- Receives special exemptions to disregard market value of assets
  - **Transparency of Risk**
- Similar to bank deposit accounts in utility, but without FDIC insurance
  - **Competitive Pressures**

# Fundamental Risks of Money Funds

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## **Credit Risk: Fund Price < \$1.00/share**

- Rising interest rates
- Credit losses
- Expenses exceed income
- Large redemptions/ runs

## **Liquidity Risk: Halted Redemption**

- Cash-outs > Cash-ins
- Net cash-outs > Available cash
- Can't sell assets to satisfy shortfalls in time without losses

# Fund Troubles in History

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## Two Known Cases

**1994:** Community Bankers U.S. Government MMF

**2008:** The Reserve Primary Fund

## Numerous Near Misses

**1989:** Integrated Resources

**1990:** Mortgage & Realty Trust

**1994:** Orange County, CA

**1997:** Mercury Finance

**2001:** The California energy crisis (PG&E and SoCalEd)

**2007:** Mortgage SLNs, CDOs, SIVs, monoline-wrapped bonds

**2008:** Bear Stearns, Lehman Brothers

**No. Funds “breaking the buck” sans sponsor support (Moody’s)**

Prior to Lehman: 146 out of 776, Post Lehman: 62 (36 U.S.)

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# Lack of Differentiation in Ratings

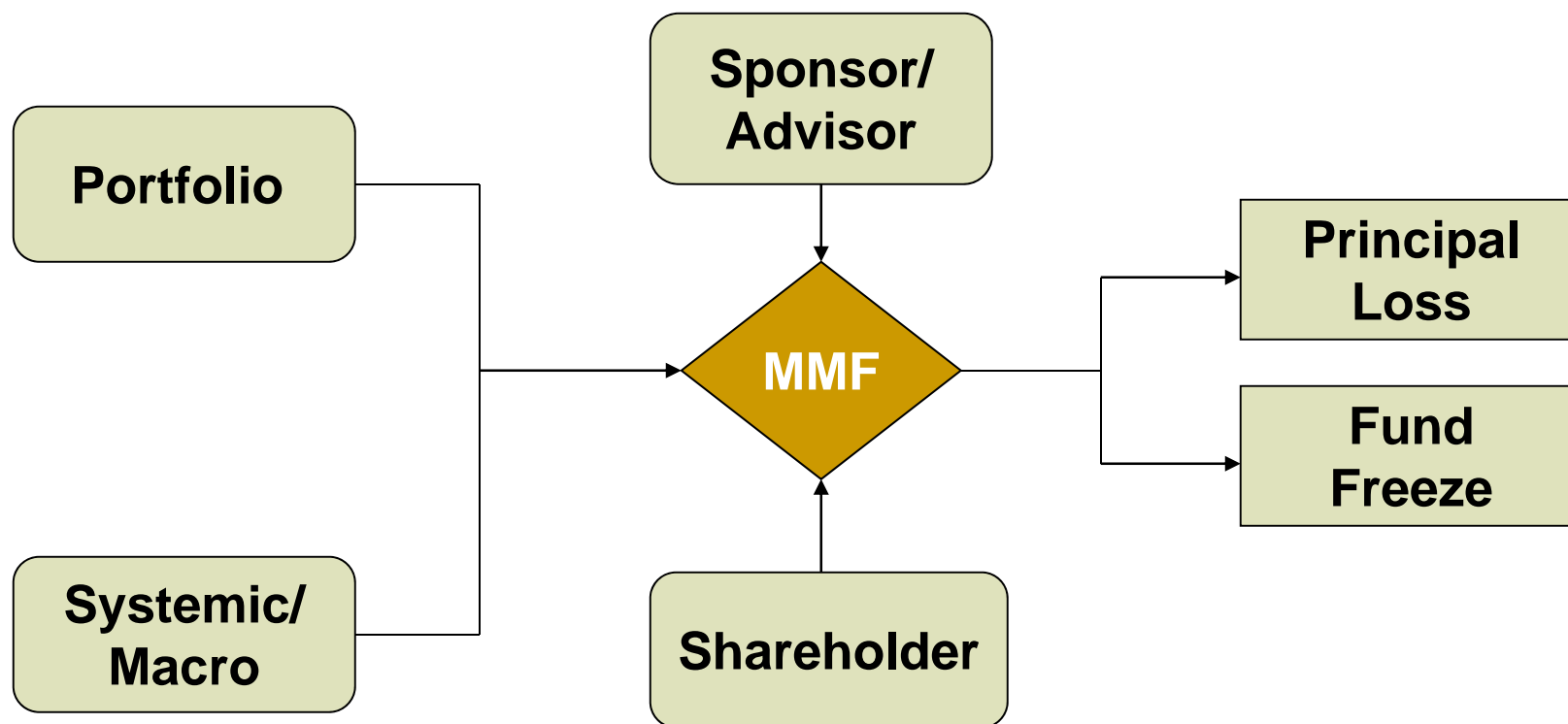
Characteristics of 15 of the largest AAA-rated prime institutional money market funds:

Portfolio Characteristic	Low	High
Weighted Average Maturity	19 days	48 days
Weighted Average Life	22 days	121 days
Overnight Liquidity (% of portfolio)	13%	64%
7-day Liquidity (% of portfolio)	30%	68%
Asset-backed Exposure (% of portfolio)	0%	31%
Floating Rate Notes (% of portfolio)	0%	32%
Non-traditional Repos (% of portfolio)	0%	12%

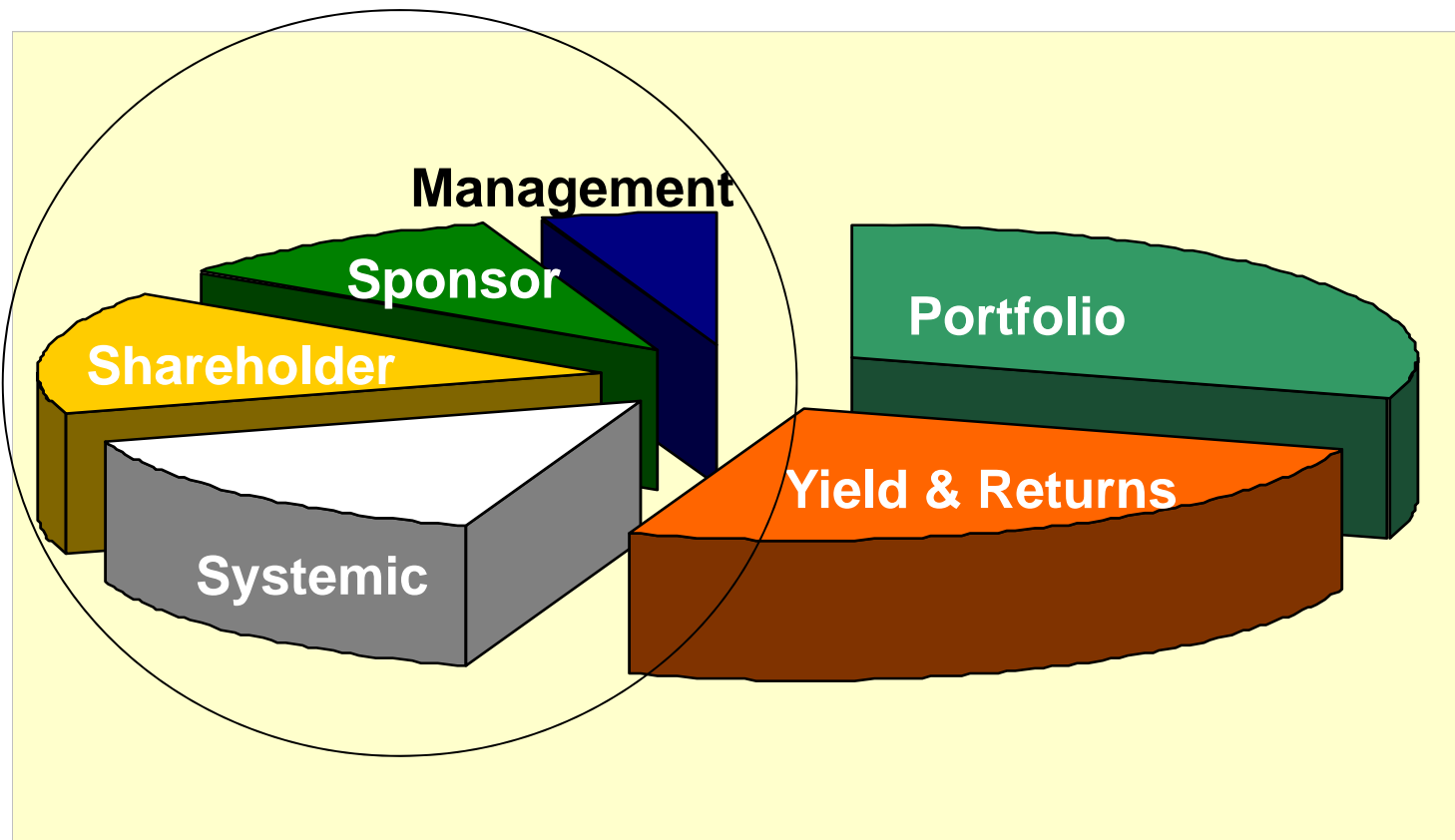
*\*Data source: Capital Advisors Group proprietary research as of 7/30/2010.*



# An Analytical Risk Framework

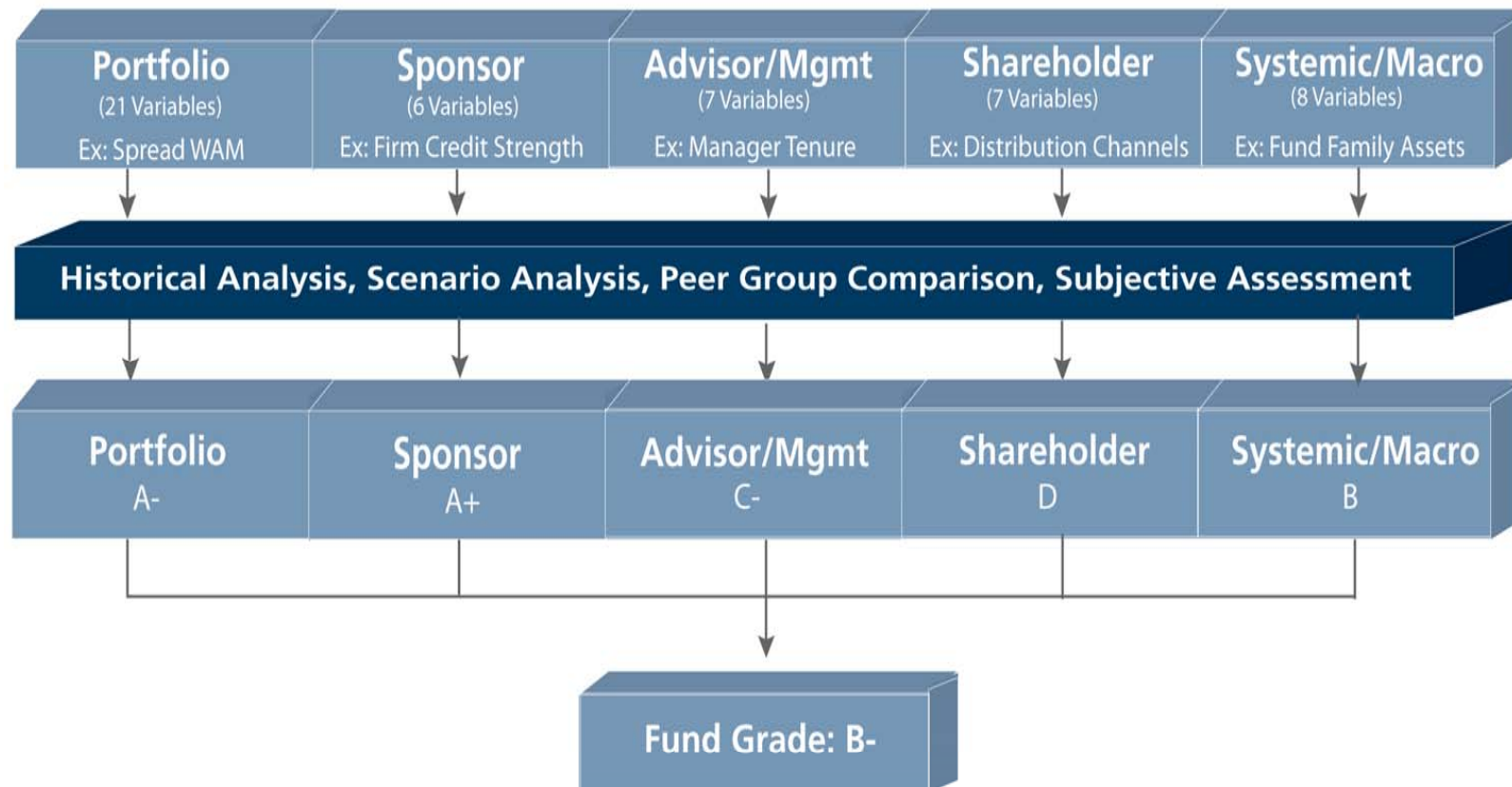


# Conventional Due Diligence Overlooks Major Risk Categories



# Scoring Process: How We Do It

## Risk Categories of Each Fund



# Relevant Risk Factors

## Portfolio

- WAM history
- Maturity schedule
- % of riskier assets
- Counter party risk

## Sponsor/Advisor

- Credit process
- Track record
- Liquidity, profitability, solvency
- Business cyclical
- Size of fund relative to firm
- History of support
- Resources & flexibility
- Commitment to the business

## Shareholder

- Stickiness of fund assets
- Retail vs. institutional holders
- Distribution channels (portals)
- Peak fund flow analysis
- Incentive programs (fee waivers)

## Systemic/Macro

- Government support/guarantees
- Investor confidence
- Fear & greed
- Fund transparency
- Asset migration trends
- Regulatory changes

# Example – Top 5 Issuers

Unsecured CP Issuer

- + Debt from Subsidiaries
- + Sponsored ABCP/SPVs
- + CD/TD/YCD
- + Repo Counterparty Exposure
- + Debt backed by bank LOCs

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= Exposure in one “Economic” Issuer

Fund	%*
A	34%
B	29%
C	44%
D	37%
E	21%

\* CAG data based on publicly disclosed holdings as of 7/30/10.

# Addressing Information Asymmetry

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## Examples of Challenges to Investors

- Stated vs. final maturities (partially solved by 2a-7)
- Economic issuers (credit & liquidity-linked entities)
- Support entity and nature of support for muni debt
- Repo counterparties & collateral information
- Shareholder information
- Support agreements with sponsors

## Analytical Solution

- “Investments from outside in” approach

# Dispersion Revealed by Research

## Sample Scores of Large AAA-rated Prime Money Market Funds \*

	Fund A	Fund B	Fund C	Fund D
Description	Bank Sponsored	Bank Sponsored	Bank Sponsored	Bank Sponsored
WAL	B+	A-	A	A
Repo Risk	A-	D	A-	A-
Structure	B+	B-	C+	A-
Management	A-	B-	B+	B
Shareholder	B-	B-	C+	A-
<b>Overall Score</b>	<b>B+</b>	<b>B</b>	<b>B-</b>	<b>A-</b>

\* CAG data based on publicly disclosed holdings as of 7/30/10.

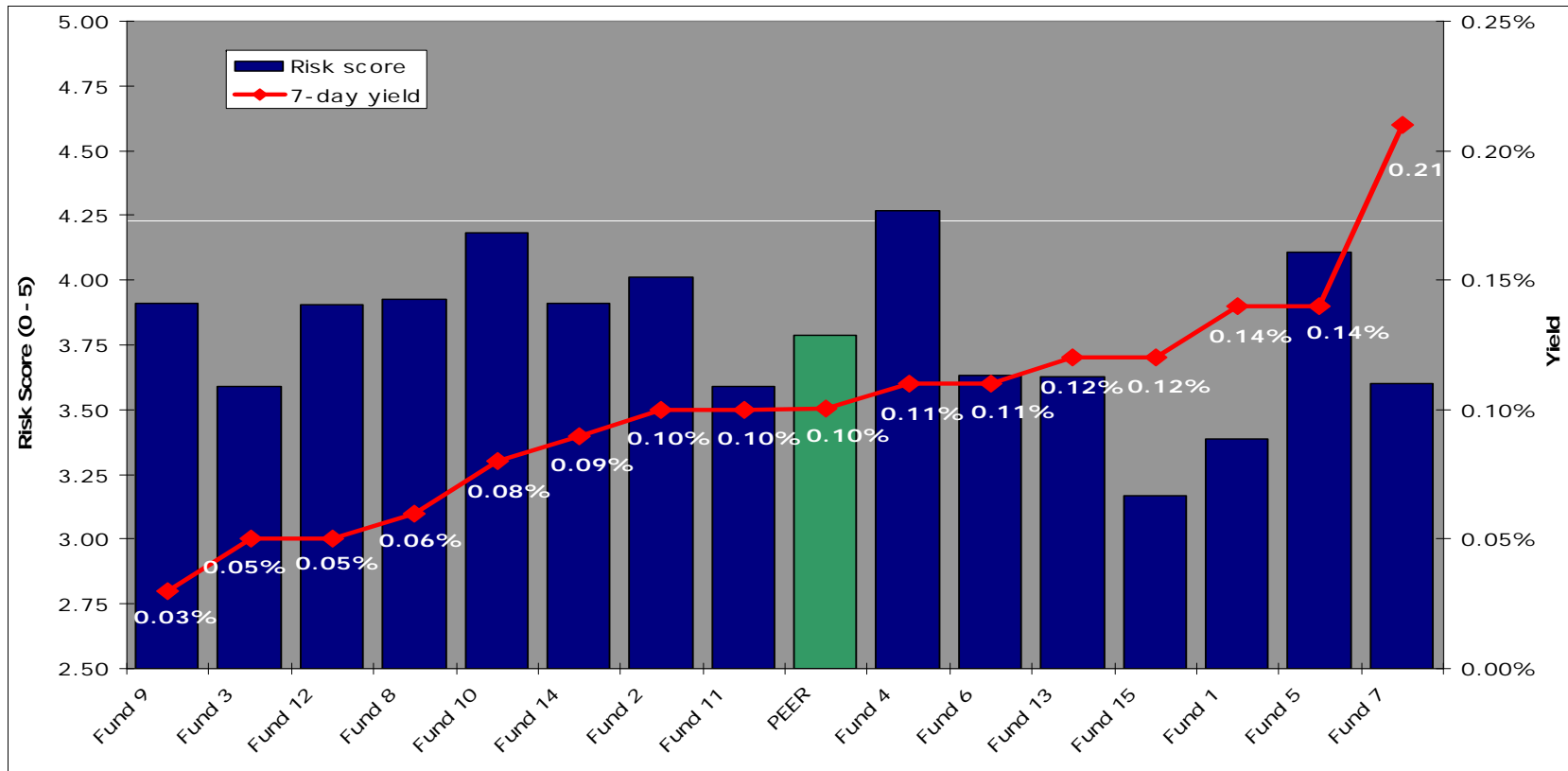
# Further Details – Evaluation Matrix

LETTER GRADES:		1/31/2010							
100%		B+	B	A-	B	A-	A-	B	B
		PEER	Fund 1	Fund 2	Fund 3	Fund 4	Fund 5	Fund 6	Fund 7
100%	PORTFOLIO	A-	A-	A-	A-	A-	A-	A-	B+
20%	WAM	A	A-	A	A-	A	A	A	A
10%	SPREAD WAM	B+	A-	B-	A-	A	A-	A	B-
40%	DIVERSIFICATION	A-	A-	A-	A-	A-	A-	B+	A-
15%	STRUCTURAL COMPLEXITY	A-	B+	A	B+	A	A-	A-	A-
15%	REPO & COUNTERPARTY	B+	A-	A	B-	A	A	A-	D
100%	YIELD & RETURN	B	A	A-	C-	B	A-	A-	A
	SPONSOR	B	C	A-	B+	A	A	C-	B-
100%	ADVISOR/ MANAGEMENT	B	B+	A-	C+	A	A-	B+	B-
	SHAREHOLDER	B	C+	B-	B	A-	B	B+	B+
100%	SYSTEMIC/MACRO	B-	C+	B+	C+	B	B-	B+	B+

\* CAG data based on publicly disclosed holdings as of 1/31/10.



# Practical Application of Information



\* CAG data based on publicly disclosed holdings as of 7/30/10.

# Conclusion: How to Choose the Right Prime Money Fund

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- Portfolio – WAM, WAL, diversification, structure, counterparty
- Sponsor – Financial wherewithal and systemic status
- Manager – Track record in managing credit/rates cycles turns
- Shareholder – Retail/institutional mix, portal use, bank relationships
- Macro – The trend may not be your friend
- Yield/performance – Avoid top yielding funds

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## Q&A

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