Managing Institutional Cash, Asset Pools, and Reserves

It is common for businesses and nonprofit organizations to have large asset pools, like cash or operating reserves, that aren’t yet designated for a specific goal or need. Often, these asset pools have been set aside as rainy-day funds and have grown over time beyond their necessary size. Properly managed, these pools can swell to be a source of capital growth for an organization, but a surprising number of institutional asset pools (IAPs) remain highly conservative when they could be growing.

Typically, IAPs are managed by either an organization’s internal investment committee or a third-party advisor. In both scenarios, the portfolio manager aims to maximize earning power so that the asset pools are not losing value or simply sitting stagnant without growth.

For example, consider a privately owned business that has recently accumulated quite a bit of cash after two consecutive quarters of strong sales. The owners want to keep the money accessible to the company but are also interested in taking advantage of a current market dip to grow their assets over time. In this case, they may choose to manage the funds themselves, investing in stocks, bonds, and other assets of their own choosing, or assign management to an independent advisor.

Depending on the type of organization and the state in which it operates, each institution may or may not be subject to legal regulations regarding fiduciary responsibilities. But even if the organization falls outside the legal definition of a fiduciary, companies still have an ethical responsibility to their constituents to manage assets prudently, says Grant Verhaeghe, CAPTRUST senior director of institutional portfolios.

“Any person who works as a steward of an organization’s assets should be thinking about and learning best practices for institutional asset pool management,” Verhaeghe says. For institutions that use an internal investment committee for asset management, here are some best practices to consider.

Consider Investment

When considering whether to invest institutional asset pools, there is no one-size-fits-all threshold or standard investment strategy, says Verhaeghe. “Depending on the organization’s unique goals and liquidity needs, each one will use these pools differently and have different objectives,” he says.

Eric Bailey, head of CAPTRUST’s endowment and foundation practice, agrees: “The threshold will be different for every organization, but in general, if you think your organization could be earning a material amount of money through investment, then it’s a good idea to talk about investment strategies so you can put existing IAPs to work.”

For example, Bailey says, imagine a business has $10 million sitting on its balance sheet in a variety of places, earning zero dollars. Through strategic investment, the business could potentially earn a 4 percent return—or $400,000—an amount that could make a material difference to its annual profit-and-loss statement. “The company could then deploy those earnings on a discretionary basis,” he says, “for instance, as bonuses in client services or by hiring more people.”

What’s key is understanding both the upside potential and risks involved in IAP investment so that the organization can make informed decisions with appropriate short- and long-term perspectives.

Account for Time Horizons

Another best practice for IAP management is to consider time horizons for invested assets, or how quickly you might need to deploy the capital. Some asset pools will need to be spent in the next month; others in the next one to three years; and still others can sit in waiting for a longer period. Which asset pools will be good candidates for investment depends on the organization’s cash-flow needs and vulnerabilities.

As Bailey says, “One of the keys to managing IAPs is matching the money to the right time horizon to create the right investment strategy.”

A nonprofit, he says, may need a larger rainy-day fund of liquid assets that are easily accessible and safely stored, just in case donations diminish or the organization doesn’t receive a particular grant they were used to receiving. “These reserves are typically managed conservatively, with capital preservation at center of mind,” says Bailey. “They need to be liquid, safe, and readily available. But asset pools with longer time horizons may be good options for a little more risk, and you may potentially see a higher rate of return.”

Manage Risk

Evaluating how much risk to take with your IAPs depends on how a market decline would affect your organization both now and in the long-term future. Again, each institution will be unique. “The important piece is to fully consider the implications of potential growth or potential loss before you make IAP investment decisions," says Bailey.

For example, Bailey says, consider a healthcare organization—a hospital that has issued municipal bonds to upgrade its equipment. The bond underwriters give the hospital a credit rating based on its debt, and the hospital will have debt covenants it must meet. "If investments drop too far in value because of a market decline, the hospital can be downgraded by credit rating agencies. This downgrade could cost the organization additional interest expense in future bond issuances or make their bonds less desirable," he says.

A publicly traded company, on the other hand, will need to consider how investment gains and losses may impact its quarterly earnings statements and, therefore, its stock value.

"Investments on a balance sheet are naturally going to go up and down over time," Bailey says, "and those changes will flow through to impact other areas of the organization. The critical element is understanding what areas will be impacted and how so that you can make the best possible decisions."

At times, an investment committee or financial advisor may be managing institutional assets that have liabilities attached. In this case, Verhaeghe recommends organizations create risk models that explain the conditions under which it may be appropriate to take risk, and when it is not. Factors to consider include when the money will be needed, what the expected return will be, and how much risk the organization is able and willing to take.

Document the Process

"Regardless of whether the organization is considered a fiduciary, it's a good idea to follow a sound process around your investment decisions and document each step," says Verhaeghe. "That way, if anyone ever asks questions about what you chose or why you chose it, you have the answers."

These answers may include articulating the organization's financial needs, goals, and vulnerabilities; documenting practices in an investment policy statement; gathering regular reporting statements; or revisiting goals as the facts and circumstances change over time, Verhaeghe says.

"No two institutions are the same," says Bailey, "There are dozens of different variables that will impact how each organization should be investing." For instance, whereas a retirement plan will have a long-term time horizon and specific goal as it relates to each participant or beneficiary, a small, privately owned business may have the goal to maintain purchasing power of its operating reserves and potentially grow that purchasing power over time.

By following these practices, organizations that are independently managing their IAPs can deliver on their fiduciary responsibilities, whether legally mandated or not. However, for organizations that want assistance, managing institutional asset pools is an easy add-on to a trusted relationship with an existing financial advisor. Whichever path these institutions choose, they can be sure they are engaging in healthy financial practices to ensure long-term viability and, potentially, a healthy return as well.