Association for
Financial Professionals®

2008 AFP Liquidity Survey

Report of Survey Results

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2008 AFP Liquidity Survey

Introduction

Two years ago, the Association for Financial Professionals (AFP) released its inaugural *Liquidity Survey*. That report indicated that many organizations generated historically high levels of cash flow resulting from a sustained period of strong earnings growth. Last year's follow-up survey confirmed similar trends. In addition, the findings of both surveys revealed a perceived dearth of opportunities for investing in new projects or acquisitions. Some cash-rich organizations were using their stockpile of cash to fuel a surge in share repurchases while others were building cash as they sought long-term business opportunities to fuel organizational growth.

The 2006 and 2007 surveys also showed that many organizations were diversifying their short-term investment portfolios beyond traditional vehicles to improve the return on investments. These other instruments included repurchase agreements, agency securities, Eurodollar deposits, asset-backed securities, auction rate securities and variable rate demand notes.

But in the past year, a lot has changed. Economic conditions in the U.S. and abroad have slowed significantly from the past two years due to the downturn in the U.S. housing sector which impacted consumer demand and hit credit markets particularly hard. In the face of turbulent market conditions, investment vehicles that previously had been safe havens for short-term investments were raising concerns in many organizations.

Symbolic of the market volatility was the systemic failure of the auction-rate securities (ARS) market. A number of organizations held ARS in their short-term investment portfolios because these instruments provided an above-average rate of return with what had been a relatively low level of risk. Many organizations believed, incorrectly, that dealers would support the auctions if bidders failed to materialize. The failure of the ARS market left a number of organizations with investments in their short-term investment portfolio that were illiquid. As a result of ARS market failure and overall market volatility, organizations kept a greater proportion of their short-term investments in safe and liquid vehicles. This "flight to quality" manifested itself in the return to bank deposits, treasury bills and money market funds as favorite investment choices during the Spring of 2008.

In May 2008, the Association for Financial Professionals conducted an updated *Liquidity Survey* to provide financial professionals with an understanding of how organizations currently manage their short-term portfolios, and to measure the impact of the elimination of cash equivalents on organizations. The 342 responses to that survey are the basis of this report.

The Research Department of the Association for Financial Professionals, which designed the survey questionnaire, analyzed the survey results and wrote/edited the report, is solely responsible for the content of this report.

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Key Findings

Key findings of the *2008 AFP Liquidity Survey* include:

- Organizations are nearly equally split in whether they held more, less or the same balances of cash and short-term investments in May 2008 than they had six months earlier.
  - In May 2008, 37 percent of organizations held a larger U.S. cash and short-term investment balance than six months earlier.
    - Twenty-nine percent of organizations carried a smaller cash and short-term investments balance compared to six months earlier, while 34 percent of organizations report no significant change in their short-term investment balances.
    - Organizations that are net borrowers and those with non-investment grade credit ratings are more likely to have reduced their cash holdings than those that are net investors and those with investment grade ratings.
  - Twenty-nine percent of organizations that have non-U.S. cash and short-term investment balances indicate that these balances have increased over the same six months.
- A third of financial professionals expect their organizations to increase their U.S. short-term cash and investments balances over the next 12 months
  - Seventeen percent of organizations expect to decrease their U.S. short-term balances over the next year while half expect little significant change.
  - Fifty-six percent of organizations with balances of non-U.S. cash and short-term investments indicate that they intend to maintain these balances at current levels over the next year.
- Nineteen percent of organizations do not have a written policy that outlines acceptable short-term investment policies.
- In reaction to slowing business conditions and volatility in the financial markets, organizations moved to a more conservative investment strategy over the past 12 months.
  - Eighty percent of organizations that have investment policies have reviewed them in the past year in response to market conditions.
  - Overall, the minimum credit quality required has risen relative to recent years as organizations continue to invest in instruments with very short maturities.
  - Virtually all organizations permit the use of bank deposits and treasury bills as short-term investment vehicles.
  - Overall, organizations' policies allow for the use of an average of 4.0 short-term investment vehicles in addition to bank deposits and treasury bills. Participants in the *2007 AFP Liquidity Survey* permitted an average of 6.4 short-term investment vehicles in addition to bank deposits and treasury bills.
  - Eighty-two percent of organizations permit the use of money market mutual funds while 66 percent of organizations permit the use of commercial paper.
  - The permitted use of a number of investment vehicles declined significantly over the past 12 months.
    - Auction-rate securities (18 percent versus 33 percent in 2007);
    - Variable rate demand notes (17 percent versus 25 percent in 2007);
    - Enhanced cash total return vehicles (15 percent versus 22 percent).

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- Even if their investment policies allow for the use of a large number of investment vehicles, most organizations have remained conservative in the number of vehicles actually used. On average, organizations use 2.4 investment vehicles for their cash and short-term investments balance compared to 2.7 investment vehicles in the *2007 AFP Liquidity Survey*.
  - As a result of weak economic conditions and turmoil in the credit markets, organizations place nearly three-quarters (on average) of their short-term investments in three safe and liquid investment vehicles: bank deposits, money market mutual funds and treasury bills. In the 2007 Survey, just under 60 percent of short-term investments were placed in the same instruments.
  - The use of commercial paper, repurchase agreements, and auction-rate securities in short-term portfolios dropped significantly over the past year.
- Twenty-five percent of organizations use an electronic, multi-family trading portal to execute at least some of their short-term investment transactions.
  - Organizations using trading portals execute an average of 80 percent of their money market mutual fund transactions through those portals. Two years ago, only 69 percent of such transactions were executed through portals.
- An overwhelming majority of organizations that invested in auction-rate securities over the past four years believed that dealers would support the auctions should bidders fail to materialize.
  - Sixty-nine percent of organizations that invested in ARS over the past four years indicate that dealer support had been implied.
  - Seventeen percent of organizations that invested in ARS over the past four years indicate that dealer support had been explicitly promised to them.

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Holdings of Cash and Short-Term Investments

Organizations are more likely to have made a substantial change to their balances of cash and short-term investments over the past six months than they had in recent years. The percentage of organizations that increased their U.S. and non-U.S. holdings of cash and short-term investments is nearly the same as a year earlier, but the percentage of organizations that decreased these types of holdings is significantly greater compared to that reported in last year's survey.

Thirty-seven percent of organizations held larger balances of U.S. cash and short-term investments in May 2008 than they carried in late 2007. Twenty-nine percent are carrying smaller cash and short-term investment balances, while 34 percent of organizations report no significant change in their short-term investment balances. In the *2007 AFP Liquidity Survey,* 36 percent of organizations reported that they carried larger cash and short-term balances over the previous year, while 18 percent reported carrying smaller balances.

Net investors are far more likely than net borrowers to have increased their U.S. cash holdings since late 2007 (48 percent versus 26 percent). Conversely, net borrowers are more likely to have decreased their cash holdings than are net investors (38 percent versus 23 percent). While similar percentages of organizations with either investment grade or non-investment grade ratings have increased their cash and short-term investment balances over the previous six months, organizations with non-investment grade credit ratings are significantly more likely to have decreased their cash holdings. This could be an effect from tighter credit conditions especially for those organizations with non-investment grade ratings. Thirty-nine percent of organizations with non-investment grade credit ratings have decreased their cash and short-term investments balances compared to 25 percent of investment grade organizations that report having done the same.

Twenty-nine percent of organizations that have non-U.S. cash and short-term investment balances indicate that these balances had increased over the six months between November 2007 and May 2008. Just over half (52 percent) of these organizations indicate little significant change in their non-U.S. cash balances, while 19 percent of these organizations report smaller non-U.S. balances.

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Change in Cash and Short-term Investment Balances Over the Past Six Months
(Percentage Distribution)

		All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
U.S.	Much larger	11%	11%	12%	8%	14%	11%	13%
	Somewhat larger	26	26	25	18	34	27	26
	No significant change	34	33	31	36	28	37	22
	Somewhat smaller	16	15	17	18	13	16	14
	Much smaller	13	15	15	20	10	9	25
Non-U.S.	Much larger	7%	6%	10%	7%	8%	9%	2%
	Somewhat larger	22	20	19	22	18	17	27
	No significant change	52	56	51	48	57	58	44
	Somewhat smaller	10	10	9	14	6	7	15
	Much smaller	9	8	11	9	11	9	12

Half of organizations plan on maintaining their current strategy of holding onto cash in the near term. Organizations that *do* expect to change their strategy report that they are more likely to increase their cash and short-term investment balances rather than decrease them.

A third of financial professionals anticipate their organizations will increase their U.S. cash and short-term investment balances over the next 12 months. By comparison, 17 percent of organizations expect their organizations to decrease their U.S. short-term balances over the next year while 50 percent expect little significant change. Unlike the trends found in the *2007* survey, the percentage of organizations expecting to increase their cash and short-term investment balances over the next year differs significantly by borrower versus investor status or the organization's credit rating. While 39 percent of organizations that are net investors expect to increase their cash holdings over the next year, just a quarter of net borrowers expect to do the same. Further, 31 percent of respondents from organizations with non-investment grade credit ratings expect to decrease their cash holdings over the next 12 months, compared to just 15 percent of investment grade organizations that expect to do so.

A majority of organizations with non-U.S. cash and short-term investment balances intend to maintain these balances at current levels over the next year. Thirty-one percent of these organizations expect their balances of cash and short-term investments to grow over the next 12 months, while another 13 percent expect these balances to decrease. Fifty-six percent expect little change in their non-U.S. cash balances.

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Expected Change in Cash and Short-term Investment Balances over the Next Year
(Percentage Distribution)

		All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
U.S.	Larger	33%	33%	32%	25%	39%	31%	30%
	About the same	50	46	51	56	41	54	39
	Smaller	17	21	17	19	20	15	31
Non-U.S.	Larger	31	27	29	24	33	26	26
	About the same	56	54	63	59	59	66	53
	Smaller	13	19	8	17	8	8	21

Investment Policies

Most organizations have a written document that defines their policies for short-term investments. Written cash investment policies outline the acceptable investment vehicles and the percentage of an organization's portfolio that may be invested in those vehicles, along with the maximum maturity allowed and the minimum credit rating necessary for each investment vehicle. Maintaining a written investment policy is considered a best practice and often is used as part of an organization's efforts to comply with regulations under Sarbanes-Oxley. More recently, a number of organizations have reviewed their written investment policies in response to the turmoil in the credit markets over the past year.

Eighty-one percent of organizations have a written document that outlines the organization's policies on cash investments. But the likelihood of an organization having such a written guideline is more pronounced among large organizations, those that are net investors and those with investment grade ratings. Significant percentages of smaller organizations, along with those that are net borrowers and those with non-investment grade credit ratings do not have a written investment policy. Thirty-five percent of organizations with annual revenues under $1 billion do not have a written cash investment policy compared to just five percent of those with annual revenues greater than $1 billion. Just over a quarter of net borrowers (27 percent) do not have a written cash investment policy while 29 percent of organizations with non-investment grade ratings do not have one.

Organizations with a Written Cash Investment Policy
(Percentage Distribution)

	All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
Has a written cash investment policy	81%	65%	95%	73%	88%	88%	71%
Does not have a written cash investment policy	19	35	5	27	12	12	29

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Organizations change their investment policies due to a variety of factors. Those factors include changes in the financial condition of the organization, changes to the organization's risk tolerance, changes in overall market conditions (such as the fallout from the sub-prime mortgage crisis) and evolving preferences of the Board of Directors or the auditors. Consequently, written investment policies are dynamic documents subject to periodic review to reflect those changes.

Two-thirds of organizations that have written cash investment policies review and update those policies on a regular basis. Of those organizations, 43 percent of organizations review and/or update the policies once a year. Thirteen percent of organizations with written investment policies review/update them even more frequently, some on a quarterly basis. Twelve percent of such organizations update their cash investment policies every two to four years. Organizations that are net investors or whose debt is investment grade update their written cash investment policies more frequently than do other organizations. The frequency of reviewing and/or updating cash investment policies has not changed significantly in recent years.

Frequency of Review/Update of Cash Investment Policy
(Percentage Distribution)

	All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
Once a quarter	5%	5%	5%	2%	8%	6%	4%
Every 6 months	8	10	8	4	13	12	4
Once a year	43	35	51	41	47	44	40
Every 2-4 years	12	8	12	13	8	13	7
Not on a regular basis	32	42	24	40	24	25	45

Eighty percent of organizations with a cash investment policy have reviewed that policy in response to volatile market conditions that faced all investors over the past year. Of the organizations that recently have reviewed their policies, half have made modifications to those policies. Twenty-five percent of organizations have changed the relative priority placed on safety of principal, liquidity and rate of return while 17 percent have altered the permissible investment vehicles.

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Modifications to Cash Investment Policy Over the Past Year
(Percent of Organizations)

	All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
Has not reviewed cash investment policy	20%	29%	12%	28%	13%	17%	25%
Organization has reviewed but not modified its cash investment policy	40	36	44	41	40	39	40
Relative priority placed on safety of principal, liquidity, and return	25	25	23	19	27	26	21
Permissible investment vehicles	17	13	23	13	23	20	16
Maximum maturity	6	5	7	2	10	7	8
Minimum credit rating	5	6	5	4	7	3	8
Other	6	5	7	5	8	6	8

In devising their cash investment policies, most organizations look to balance their desire for safety and liquidity with their desire to generate a competitive rate of return. Still, for most organizations, the most important objective for their cash investment policy is safety of principal. Three-quarters of financial professionals indicate that the primary focus of their organization's cash investment policy is to protect their investment principal. For 23 percent of organizations, the primary objective of cash investment policies is to optimize liquidity.

While it is not particularly surprising that investment policies are primarily focused on safety of principal, there was a significant shift in this view relative to a year ago. Safety of principal is the most important cash investment policy objective for 75 percent of organizations currently, compared to "only" 61 percent of organizations a year ago. At the same time, 15 percent of organizations were more focused on rate of return a year ago, compared to just two percent in the current survey. The turmoil in the credit markets over the past year, including the collapse of the auction-rate securities market, is a major reason for this flight to quality.

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Most Important Cash Investment Policy Objective
(Percent Distribution)

		All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
Currently	Safety of principal	75%	66%	80%	73%	74%	75%	70%
	Liquidity	23	30	18	25	22	21	30
	Return (Yield)	2	4	2	2	4	4	*
One Year Ago	Safety of principal	61%	54%	67%	63%	59%	59%	65%
	Liquidity	24	28	17	23	23	23	24
	Return (Yield)	15	18	16	14	18	18	11

Current Strategy

Whether or not they have a written cash investment policy, most organizations have a list of permissible investment vehicles they can hold in their short-term investment portfolio. Virtually all organizations permit the use of bank deposits and treasury bills as vehicles for short-term investments. In addition, 82 percent of organizations permit the use of money market mutual funds, while 66 percent of organizations allow the use of commercial paper. A majority of organizations also allow investment in agency securities and repurchase agreements (59 and 55 percent, respectively).

Turmoil in the credit markets led a number of organizations to remove certain products from their list of permissible investment vehicles – particularly those investment vehicles that tend to be inconsistent with the "flight to quality" that many organizations took over the past year. In 2007, 33 percent of organizations permitted the use of auction-rate securities—currently, 18 percent do so. Other investment products less likely to be included in organizations' list of permissible investment vehicles include:

- Variable rate demand notes (17 percent versus 25 percent in 2007);
- Enhanced cash total return vehicles (15 percent versus 22 percent in 2007).

On average, organizations permit 4.0 investment vehicles other than bank deposits and treasury bills in their short-term investment portfolio. This represents a significant decline from results in the past two AFP Liquidity Surveys. In the *2007 AFP Liquidity Survey*, organizations' cash investment policies allowed for an average of 6.4 investment vehicles beyond bank deposits and treasury bills. In the 2006 survey, the average was 7.6.

Large organizations permit the use of an average of 4.1 investment vehicles (in addition to bank deposits and treasury bills) for their short-term investments. Large organizations are more likely than smaller ones to allow the use of:

- Commercial paper (68 percent versus 59 percent);
- Eurodollar deposits (59 percent versus 32 percent);
- Asset-backed securities (35 percent versus 25 percent).

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In addition, organizations that are net investors and those with non-investment grade credit ratings permit a greater number of investment vehicles than do those that are net borrowers and those with investment grade credit ratings. Organizations that are net investors allow for the use of an average of 4.3 investment instruments versus 3.6 for net borrowers. Organizations with non-investment grade ratings permit the use of an average 4.4 investment vehicles versus 3.9 for organizations with investment grade ratings.

Permissible Investment Vehicles per Organization's Short-term Investment Policy in Addition to Bank Deposits and Treasury Bills
(Percent of Respondents)

	All Reaponses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade	All Responses (2007 Survey)
Money market mutual funds	82%	75%	88%	83%	83%	83%	87%	76%
Commercial paper	66	59	68	60	68	68	67	69
Agency securities	59	62	56	53	62	62	64	56
Repurchase agreements	55	59	53	50	59	59	58	57
Eurodollar deposits	49	32	59	55	43	53	58	42
Municipal securities	36	41	32	28	40	40	40	38
Asset-backed securities	31	25	35	22	37	37	40	33
Auction-rate securities	18	19	17	14	21	21	19	33
Variable rate demand notes	17	15	18	14	20	20	17	25
Separately managed accounts	17	18	17	12	22	22	15	20
Enhanced cash total return vehicle	15	16	14	17	14	14	17	22
Mean number of permitted investment vehicles*	**4.0**	**3.8**	**4.1**	**3.6**	**4.3**	**3.9**	**4.4**	**6.4**

*- beyond bank deposits and treasury bills

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Cash investment policies frequently dictate the maximum proportion of an organization's cash and short-term investment balances that can be placed in specific investment vehicles. Such policies are meant to minimize risk from exposure to any single class of investment.

At least two-thirds of organizations allow at least half of their cash and short-term investment balances to be placed in bank deposits, money market mutual funds, agency securities and treasury bills. Conversely, nearly half of organizations limit the use of auction-rate securities, asset-backed securities and variable rate demand notes to less than a quarter of their cash balances. Other investment vehicles for which many organizations cap the amount invested in their cash portfolio at 25 percent include municipal notes, commercial paper, and repurchase agreements.

Maximum Allowable Percentage of Short-Term Portfolio That Organizations Can Allocate to Investment Vehicle per Short-term Investment Policy
(Percentage Distribution of Organizations Permitting Investment Vehicle)

	Up to 25% of Portfolio	25-49% of Portfolio	50% or More of Portfolio
Auction-rate securities	58%	15%	27%
Asset-backed securities	57	12	31
Variable rate demand notes	53	17	30
Municipal notes	47	15	38
Commercial paper	45	22	33
Repurchase agreements	44	12	44
Separately managed accounts	37	4	59
Eurodollar deposits	31	9	60
Enhanced cash total return vehicle	30	9	61
Money market mutual funds	25	7	68
Bank deposits	23	5	72
Agency securities	20	16	64
Treasury bills	15	9	76

Cash investment policies also stipulate the maximum maturity length and the minimum credit quality for each type of allowable investment vehicle. For 60 percent of organizations, money market mutual funds (or at least the underlying securities) have a maximum maturity of 90 days or less; 61 percent of organizations cap the maturity of repurchase agreements also at 90 days or less. Conversely, 51 percent of organizations allow separately managed accounts to have a maturity that extends beyond a year—suggesting that most organizations prefer to use outside management to handle their cash investments with a longer-term horizon.

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Maximum Maturity Allowed per Short-Term Investment Policy
(Percentage Distribution of Organizations Permitting Investment Vehicle)

	30 days or less	31-90 days	91-180 days	181-365 days	More than a year
Repurchase agreements	43%	18%	7%	15%	17%
Money market mutual funds	43	17	10	18	12
Bank deposits	37	12	11	20	20
Variable rate demand notes	37	11	20	16	16
Auction-rate securities	35	35	13	4	13
Eurodollar deposits	32	16	18	19	15
Enhanced cash total return vehicle	29	24	6	18	23
Commercial paper	16	21	20	33	10
Treasury bills	13	10	13	31	33
Asset-backed securities	12	14	14	27	33
Separately managed accounts	10	5	24	10	51
Agency securities	9	9	10	22	50
Municipal notes	6	16	20	19	39

Compared to previous *AFP Liquidity Surveys*, financial professionals indicate that their organizations have less taste for risk in 2008. For most investment products, organizations have raised the minimum credit quality required for holding a particular investment vehicle.

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Minimum Credit Quality Required per Short-Term Investment Policy
(Percentage Distribution of Organizations Permitting Investment Vehicle)

	AAA/Aaa A-1+, P-1	AA/Aa A-1+, P-1	A/A A-1, P-1	BBB/Baa A-2, P-2	Not applicable	AAA/Aaa A-1+, P-1 (2007 survey)
Auction-rate securities	58%	*	35%	*	9%	31%
Money market mutual funds	58	16	15	2	9	43
Enhanced cash total return vehicle	47	35	12	*	6	27
Agency securities	45	17	17	1	20	34
Variable rate demand notes	38	10	47	*	5	18
Asset-backed securities	36	29	21	7	7	19
Repurchase agreements	33	28	23	1	15	25
Commercial paper	32	15	42	8	3	23
Eurodollar deposits	31	24	32	1	12	17
Municipal notes	28	22	34	6	10	24
Bank deposits	24	18	29	2	27	21
Separately managed accounts	13	33	29	12	13	14

Organizations place most of their short-term investment portfolio into investment vehicles that have very short maturities. On average, three-quarters of all short-term investment holdings are invested in vehicles with maturities of one month or less. Another 14 percent of short-term investments are held in instruments with maturities of between 31 and 90 days. Organizations that are net investors and those whose credit ratings are investment grade are slightly more likely to hold their short-term investments in instruments with longer maturity horizons. For example, "only" 71 percent of investment holdings of net investor organizations are held in instruments with maturity horizons of less than a month.

Most financial professionals expect their organizations to maintain their current percentage distribution of their short-term investment portfolios in terms of maturity over the next year (81 percent). Twelve percent of organizations expect to lengthen the average maturity of their short-term investment portfolios, while seven percent expect to shorten the average maturity over the next year. In the 2007 survey, a quarter of respondents expected their organizations would lengthen the average maturity of their short-term investment holdings.

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Average Maturity of Organization's Short-Term Investment Portfolio
(Percentage Distribution of Total Portfolio)

	All Responses	Revenues Under $1 billion	Revenues Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
0-30 days	75%	71%	78%	79%	71%	71%	80%
31-90 days	14	14	14	12	16	16	12
91-364 days	6	9	4	6	7	7	5
1 year or more	5	6	4	3	6	6	3
Expectations for change in average maturity of holdings over next year							
Lengthen	12%	12%	11%	4%	18%	14%	8%
Keep the same	81	78	84	88	75	81	80
Shorten	7	10	5	8	7	5	12

The turmoil in financial markets and the overall investment "malaise" has led organizations to move their cash and short-term investment balances into fewer and safer investment vehicles. On average, organizations invest in 2.4 types of vehicles (compared to 2.7 vehicles in the 2007 survey) for their cash and short-term investment balances. Large organizations allocate their cash and short-term investments to an average of 2.5 vehicles compared to 2.3 for small organizations—in 2007, the averages were 2.9 and 2.5 vehicles, respectively—while net investors use an average of 2.6 vehicles compared to 2.2 vehicles for net borrowers.

Organizations place nearly three-quarters of their cash and short-term investment balances among three of these "safer" investment vehicles: money market mutual funds, bank deposits, and treasury bills. This is a significant increase from last year's survey results which showed that organizations placed, on average, just under 60 percent of short-term investments in these same three vehicles. More than 39 percent of cash and short-term investment balances are placed in money market mutual funds (compared to 31 percent a year ago), while a quarter is placed in bank deposits and eight percent in treasury bills (versus 27 and two percent, respectively, a year ago). Overall, organizations have greatly increased their use of cash instruments (i.e., money market mutual funds and bank deposits) over other financial vehicles compared to the results in the last two *AFP Liquidity Surveys*.

Smaller organizations, as well as those that are net borrowers and those with non-investment grade credit ratings, place a greater percentage of their cash and short-term investments in the bank than do large organizations—34.7 percent versus 16.4 percent. Large organizations are more likely than smaller ones to embrace money market mutual funds (46.3 percent versus 32.8 percent). Net borrowers place a third of their short-term investment balances in the bank, while organizations with non-investment grade credit ratings place 28 percent of their short-term investments in bank deposits.

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As organizations have poured money into bank deposits, money market mutual funds and treasury bills, they have been removing funds from more aggressive—and riskier—investment vehicles. A year ago, more than five percent of all short-term investments were made in auction-rate securities (ARS). Currently, the average allocation of short-term investments made in ARS has dropped below one percent. This is likely the result of the failures of thousands of auctions that ultimately sapped the liquidity from this investment vehicle. Over the past year, the use of municipal bonds and variable rate demand notes for short-term investments has all but dissipated. Also experiencing significant declines in usage for short-term investments are:

- Commercial paper (off by 29 percent);
- Repurchase agreements (off by 44 percent);
- Enhanced cash total return vehicles (off by 27 percent);
- Separately managed accounts (off by 55 percent).

Current Allocation of Organizations' Short-Term Investments
(Mean Distribution)

	All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade	All Responses (2007 Survey)
Money market mutual funds	39.4%	32.8%	46.3%	33.8%	46.5%	38.3%	42.1%	30.9%
Bank deposits	25.0	34.7	16.4	33.8	16.9	22.1	27.8	27.1
Treasury bills	8.1	7.8	8.9	8.6	8.1	8.1	9.9	1.9
Commercial paper	6.7	6.1	6.9	5.1	7.1	7.4	5.2	9.4
Eurodollar deposits	6.0	1.8	8.9	7.0	3.8	6.8	4.2	4.6
Agency securities	5.3	5.8	4.1	4.5	5.4	6.8	2.0	3.2
Repurchase agreements	3.5	4.2	2.8	2.8	4.1	2.9	4.8	6.3
Enhanced cash total return vehicle	1.6	1.4	1.9	1.4	1.9	2.0	1.2	2.2
Separately managed accounts	1.5	0.8	2.1	0.5	2.4	2.3	*	3.4
Auction-rate securities	0.9	1.5	0.5	*	1.5	1.1	0.9	5.1
Asset-backed securities	0.7	1.0	*	0.6	0.7	0.5	0.9	1.1
Municipal notes	*	*	*	*	*	0.6	*	1.1
Variable rate demand notes	*	*	*	*	*	*	*	1.5
Other	0.8	1.6	*	0.6	1.0	1.0	0.6	2.1
Mean number of vehicles used	**2.4**	**2.3**	**2.5**	**2.2**	**2.6**	**2.6**	**2.4**	**2.7**

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Multi-Family Trading Portals

Organizations have the option of using an electronic, multi-family trading portal to execute short-term investment transactions. These portals provide organizations an opportunity to more easily facilitate transactions and compare investment choices. In addition, trading portals can lower the costs associated with managing and administering an organization's short-term investments.

A quarter of organizations use an electronic, multi-family trading portal to execute at least a portion of their short-term investment transactions. Large organizations are more likely than smaller ones to use such a portal: 38 percent of large organizations use a multi-family trading portal compared to just ten percent of smaller organizations. The use of multi-family trading portals has increased slightly from a year ago.

Organizations Use of Electronic, Multi-family Trading Portals to Execute Any of its Short-term Investment Transactions
(Percentage Distribution)

	All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
Organization uses electronic, multi-family trading portal	25%	10%	38%	21%	29%	30%	17%
Organization does not use an electronic, multi-family trading portal	75	90	62	79	71	70	83

Organizations that use electronic multi-family trading portals use those portals to transact most of their money market fund transactions. Those organizations using trading portals move an average of 80 percent of their money market mutual fund holdings through these portals, compared to 69 percent two years ago.

Percentage of MMF Holdings Run Through an Electronic, Multi-family Trading Portal
(Organizations that Use Trading Portals)

	All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
2008 Survey	80%	88%	77%	80%	81%	80%	76%
2007 Survey	74%	87%	68%	75%	73%	71%	76%
2006 Survey	69%	67%	76%	76%	72%	76%	67%

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Credit Crisis and Impact on Investment Strategies

In recent years, a number of organizations included auction-rate securities (ARS) as a part of their short-term investment portfolio. ARS are long-term debt instruments with interest rates that are reset through a Dutch auction on a frequent basis—typically between once a week and once a month. Investors found the product particularly attractive in part because the resulting interest rates provided returns greater than those available from AAA-rated money market funds. For corporate investors, ARS also were attractive as the frequent auctions made these investment vehicles liquid.

Twenty-eight percent of survey respondents indicate that their organization invested in ARS over the past four years. Large organizations, those that are net investors and those with investment grade ratings were most likely to have invested in ARS over the past four years.

Organizations Investment in Auction Rate Securities in Past Four Years
(Percentage Distribution)

	All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
My organization did invest in ARS	28%	23%	33%	20%	36%	32%	25%
My organization did not invest in ARS	72	77	67	80	64	68	75

More recently, however, the use of auction-rate securities by organizations in their short-term investment portfolio has decreased. One major reason for the decline in the use of ARS was a reclassification of the instruments on the Statement of Financial Position (i.e., balance sheet). In 2005, several major accounting firms required their clients to reclassify ARS and variable rate demand notes as short-term investments rather than cash equivalents. This reinterpretation of cash equivalents had an impact on organizations' use of these investment vehicles. According to the *2007 AFP Liquidity Survey* report, a third of organizations that were using ARS reduced or eliminated their use of these investment vehicles as a result of the reclassification.

Having even more of an impact was the sub-prime mortgage crisis in late 2007 and early 2008 which led to widespread failure of the ARS market. By February 2008, hundreds of ARS Dutch auctions were failing on a daily basis as investors declined to make bids and dealers refused to act as the bidder of last resort. While the issuers of the ARS instruments were not defaulting on their obligations (if anything, they typically were paying higher interest rates as a result of the failed auctions), holders of these instruments were unable to liquidate their holdings. In essence, their ARS holdings had become long-term (and no longer short-term) investments. A number of corporate holders that have illiquid ARS instruments have had to write down their investments as a result.

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The percentage of organizations that permit investment in and actually hold ARS has declined dramatically in recent years. Three-quarters of organizations that previously had invested in ARS no longer do so because of increased concern on the risks associated with the instruments or because of the changed accounting treatment of the instruments.

Primary Reason for Organizations No Longer Investing in Auction Rate Securities
(Percentage Distribution)

	All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
Increasing concern about risk associated with ARS	59%	44%	67%	63%	59%	51%	72%
Change in accounting treatment (i.e., no longer considered to be a cash equivalent)	15	25	9	12	16	17	7
Change in organization investment policy	10	13	9	13	10	14	*
Other investments offered more attractive return	8	6	9	6	9	9	14
Other	8	12	6	6	6	9	7

One of the reasons for the popularity of ARS as an investment vehicle was the perceived liquidity of the instruments. As long as the weekly/monthly auctions were conducted successfully, the instruments would continue to provide the liquidity desired by the investor. Organizations based their confidence in the liquidity of ARS instruments on the belief that dealers would support the markets regardless of market conditions. However, starting in February 2008, most of the ARS major dealers declined to act as the "bidder of last resort" when auctions failed to produce sufficient bidders.

Eighty-six percent of financial professionals whose organizations held ARS at some point over the past four years reported that they believed that the dealer would support the auctions if bidders failed to materialize. Sixty-nine percent of financial professionals indicate that auction support was implied, while 17 percent report that they were told explicitly that the investment bank would ensure that the auctions would not fail.

Organizations Belief in Dealer Support of ARS Auctions
(Percentage Distribution)

	All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
Bidder support implied	69%	67%	71%	76%	67%	72%	58%
Explicitly told of bidder support	17	17	17	10	21	14	26
My organization was not told of dealer support	14	17	12	14	12	14	16

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Currently, virtually all financial professionals do not expect their organizations will re-enter the ARS market for the foreseeable future. Only six percent of survey respondents believe that their organizations will re-enter the ARS market, should it stabilize, over the next two years.

Organizations Expectations to Re-enter Market for ARS/Increase Holdings of ARS
(Percentage Distribution)

	All Responses	Under $1 billion	Over $1 billion	Net Borrower	Net Investor	Investment Grade	Non-Investment Grade
Do not expect to use ARS as a short-term investment vehicle for the foreseeable future	94%	93%	94%	94%	94%	92%	98%
In the next two years	4	4	4	5	3	5	1
In the next year	2	2	2	*	3	2	1
In the next 6 months	*	1	*	1	*	1	*

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Conclusions

In the six-month period between November 2007 and May 2008, 37 percent of organizations increased their cash and short-term investment holdings, while 29 percent decreased their balances. These findings differ from the two previous *AFP Liquidity Surveys* in which most organizations had either maintained or increased their short-term holdings. In addition, while half of organizations do not expect these balances to change significantly over the next 12 months, a third expect to increase their short-term holdings over the next year. Just 17 percent expect that they will decrease their cash and short-term investment balances.

As the U.S. economy has slowed and credit markets have undergone significant turbulence, organizations have decreased their holdings in a number of investment vehicles over the past year, including commercial paper, repurchase agreements, separately managed accounts and auction-rate securities. The precipitous decline in the use of auction-rate securities as an investment vehicle is the result of two main factors: the reclassification of these investments away from cash equivalents and the widespread auction failures that began during the Winter of 2008. The failures of the auctions came as a surprise to a number of organizations, many of which had been either explicitly or implicitly assured that the dealers would support the auctions and, if necessary, act as the bidder of last resort.

In turn, organizations have moved a greater proportion of their short-term investment portfolio into "safer" more liquid investment vehicles including bank deposits, money market mutual funds and treasury bills. Nearly three-quarters of all short-term investment balances are allocated to these three investment vehicles. This move towards bank deposits, money market mutual funds and treasury bills has occurred as organizations have shifted their short-term investments away from more aggressive investment vehicles. This flight to quality is consistent with the primary cash investment policy objective of most organizations: safety of principal.

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About the Survey

In May 2008, the Association for Financial Professionals conducted a 25-question survey on strategies associated with the management of short-term investments. AFP sent surveys to 3,000 corporate practitioner members and received 286 responses. After adjusting for misdelivered email, the response rate was 10 percent. An additional 55 responses were received from corporate practitioners who are not AFP members. The combined 342 responses are the basis of this report. The survey questionnaire and report were produced by the Research Department of the Association for Financial Professionals, which is solely responsible for the content.

The demographic profile of the survey respondents mirrors that of AFP's membership. The following table summarizes the characteristics of the survey respondents.

Industry Classification
(Percentage Distribution)

Manufacturing	18%
Insurance	10
Retail (including wholesale/distribution)	10
Energy (including utilities)	9
Banking/Financial services	7
Business services/Consulting	6
Construction	6
Health services	6
Non-profit (including education)	6
Government	5
Software/Technology	5
Real estate	4
Telecommunications/Media	4
Hospitality/Travel	2
Transportation	2

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Annual Revenues
(Percentage Distribution)

Under $50 million	9%
$50-99.9 million	5
$100-249.9 million	10
$250-499.9 million	12
$500-999.9 million	10
$1-4.9 billion	31
$5-9.9 billion	7
$10-20 billion	9
Over $20 billion	7
Median	$1.5 billion

Ownership Type
(Percentage Distribution)

Publicly owned	43%
Privately held	40
Non-profit (not-for-profit)	9
Government (or government owned entity)	8

Organization Is a Net Borrower or a Net Investor
(Percentage Distribution)

Net borrower	48%
Net Investor	52

Organization's Credit Ratings
(Percentage Distribution)

Investment grade	66%
Non-investment grade	34

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AFP Research

AFP Research provides financial professionals with proprietary and timely research that drives business performance. The AFP Research team is led by Director of Research and Data Standards, Kevin A. Roth, PhD, who is joined by four research analysts. AFP Research also draws on the knowledge of the Association's members and its subject matter experts in areas that include bank relationship management, risk management, payments, and financial accounting and reporting. Study reports on a variety of topics, including AFP's annual compensation survey, are available online at www.AFPonline.org/research.

About the Association for Financial Professionals

The Association for Financial Professionals (AFP) headquartered in Bethesda, Maryland, supports more than 16,000 individual members from a wide range of industries throughout all stages of their careers in various aspects of treasury and financial management. AFP is the preferred resource for financial professionals for continuing education, financial tools and publications, career development, certifications, research, representation to legislators and regulators, and the development of industry standards.

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