The New look of Liquidity Management in the U.S.

Chastened by Risk, Shaped by Globalization, Enabled by Technology

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For the first time in a decade, corporate liquidity in the U.S. has fallen, by $250 billion. This decline follows six months of intense market turbulence, which began with a crisis in sub-prime mortgages that fueled a credit crisis, and later expanded into the deterioration of money market securities, including enhanced cash funds and auction-rate securities. The general creditworthiness of many commercial banks and brokerages has been questioned as a result of these unsettling events. Corporate Treasurers have begun to scrutinize the underlying instruments of their investments and undertake a flight to quality. Firms are revisiting their investment policies in an effort to 'bulletproof' their Treasury operations and safeguard every dollar.

What happened

Job number one for the corporate Treasurer is to serve as custodian of the company's cash. It's no secret that in recent years, many Treasurers lost sight of that objective and began creating aggressive portfolios to earn better returns on their cash. Unfortunately, it took some fairly visible setbacks to stem such practices.

As mentioned above, corporate liquidity fell for the first time since 1999 as a result of six months of intense turbulence stretching from July 1 2007 to January 1 2008. The $250 billion decline represents 5% of the total market, which stands at $5.25 trillion as of July 1 2008.

While corporate investors did incur some short-term investment losses, the drop in liquidity was largely driven by the need to use excess cash to fund operations. Additionally, the mix of liquidity by investment type notably changed. Corporate investors made dramatic moves to protect their cash. There was a strong flight from commercial paper, auction-rate

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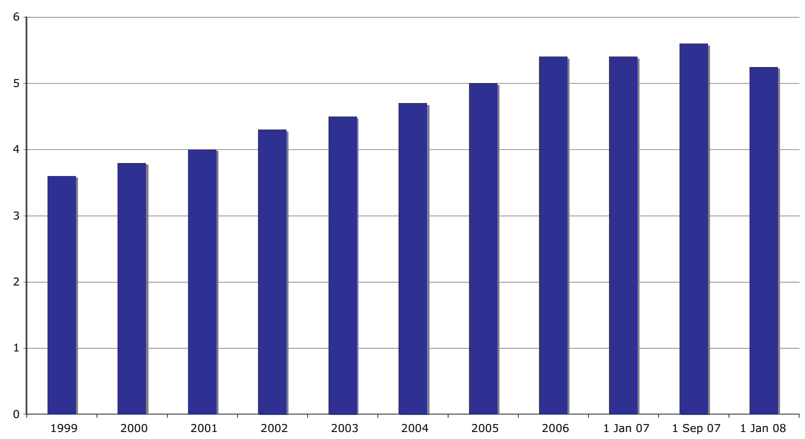
Fig 1 - Total U.S. Liquidity (in $ Trillions) 1999-2008



Liquidity is moving away from high-risk investments toward more traditional, lower-risk instruments.

Fig 2 - Liquidity Levels between July 2007 and January 2008

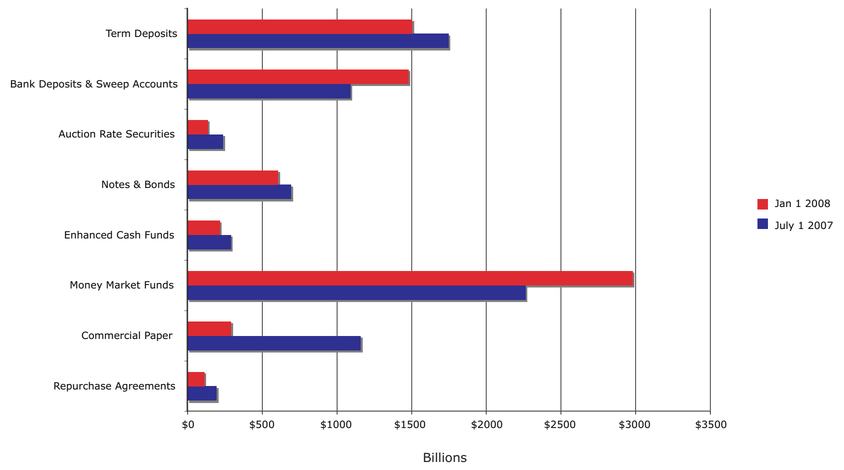
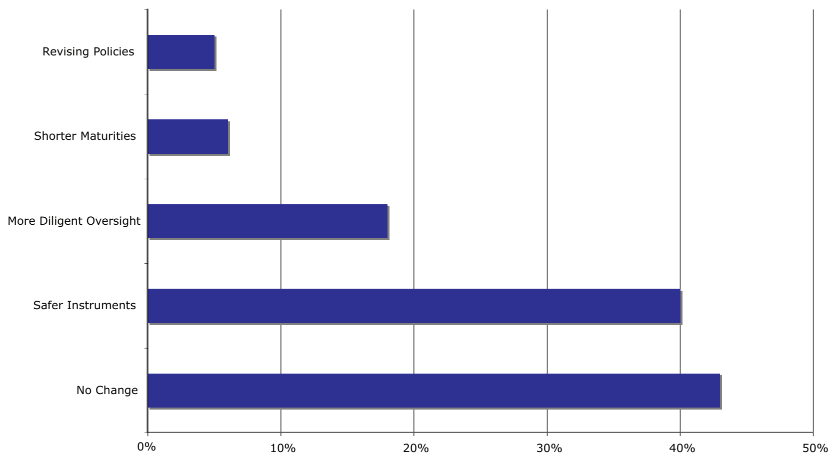


Fig 3 - Changes in Investment Practices



securities and repurchase agreements and a rush to bank deposits and sweep accounts as well as conservative money market funds.

Altogether, treasuries pulled $623 billion out of commercial paper, a staggering 75% drop in commercial paper's share of the investment pie. Those who could find an exit did so and cut auction-rate holdings by $72 billion, a 43% decline. Repurchase Agreements dropped $58 billion, down 42%, while enhanced cash funds tumbled $51 billion, down 25%.

Meanwhile, $474 billion poured into money market funds, raising their share of portfolios by 32%. Bank deposits and sweep accounts gained $279 billion, increasing their share by 36%.

Now we are seeing a much-chastened risk mentality. As a result, liquidity is moving away from high-risk investments toward more traditional, lower-risk instruments. Separately, the low rate environment is spurring treasurers to decrease their holdings in non-interest-bearing bank deposits in favor of time deposits. In a global liquidity market we estimated to comprise approximately USD$12 trillion, these trends naturally entail enormous change and deserve close attention.

Bulletproofing

This flight to quality is occurring in areas beyond investment portfolios. Many treasury organizations are also looking into how they approach their daily operations so as to safeguard every dollar throughout the lifecycle of the financial value chain.

By moving to safer instruments, revising policies and maintaining more diligent oversight, corporations are building processes and procedures that will guard against risk and drastic changes in market conditions. By ensuring the appropriate controls are in place, corporate treasuries are better able to measure, monitor and manage risk, which is effectively 'bulletproofing' the organization against further crises.

'Bulletproofing' has the added benefit of keeping Treasurers focused on their strategic mission to provide value throughout the organization. A 'bulletproof' Treasury is one that has plans in place for when crises occur, which minimizes distractions and protects the organization against risk.

The dust is settling

Going forward, Treasurers note they will be further rebalancing their portfolios. Financial institutions have a tremendous opportunity in the current environment. Banks are viewed as a trusted, safe harbor for corporate cash and are in a position to retain deposits. The related advisory services that come with deposits put banks back in the 'trusted advisor' role once again.

Changes in portfolio composition vary by market segment. Since the turmoil of late 2007, the Large Corporate portfolio is a fairly balanced mix of Bank Deposits and Direct instruments. Mid-Corporate and Middle Market portfolios are more heavily invested in Money Market Funds and Direct Instruments, respectively.

Overall, U.S. portfolios remain relatively conservative, although there has been some movement back to Repurchase Agreements. Additionally, Money Market Funds have grown, especially in the Mid-Corporate segment due to their convenience, diversification and in some cases, attractive yields from the more competitive funds.

Expected changes in instrument balances

Treasurers are planning to shift the composition of their cash in the coming months. Table 1 shows the instruments that ranked highest among Treasurers that plan to increase cash balances by 20% or more.

The decision to direct increased cash to money market funds reflects the current environment. As diversified, highly liquid offerings, Funds offer Treasurers attractive returns while limiting their risk exposure. When making decisions regarding Funds, Treasurers cite Underlying Instruments as their number one concern. This indicates that in the wake of Auction Rate Securities, Enhanced Cash Funds and other instruments that were not properly understood, Treasurers are no longer willing to rely on opinions, but are rigorously assessing the composition of their investments.

Key Treasury Issues

Risk management and liquidity management are the two top concerns of corporate Treasurers across nearly every revenue segment. Close behind is Credit/Funding, which reflects the current tight credit environment.

These results attest to corporate worries about growing exposure to high-risk investments like ARS, the growing difficulties of finding funding after years of tapping easy credit from many sources, and a risk hangover after overindulgence in aggressive investing of cash. Now, companies are struggling to ensure that they are investing their cash wisely, that they can get it back when they need it, and that they understand the risks of the investments they are choosing.

For the first time in a long time, U.S. respondents did not rank Technology among their top three concerns. This may suggest that investment portals and other technology tools are becoming more of a required, core offering and less of a differentiator among providers.

Fig 4 - US Portfolio Mix by Segment

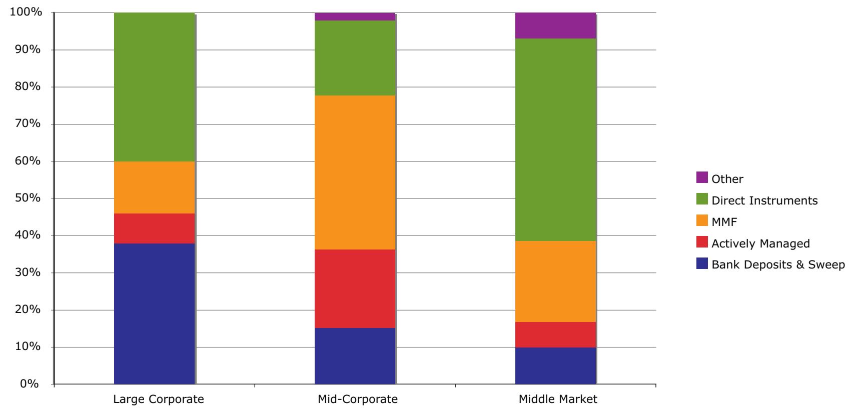


Table 1 - United States - Expected 20% Increase in Balances

Rank	Large Corporate	Mid-Corporate	Middle Market
1	Money Market Mutual Funds	Money Market Mutual Funds	Sweep Accounts
2	Commercial Paper	Sweep Accounts	Money Market Mutual Funds
3	Offshore Deposits	Commercial Paper	Notes/Bonds

As diversified, highly liquid offerings, Funds offer Treasurers attractive returns while limiting their risk exposure.

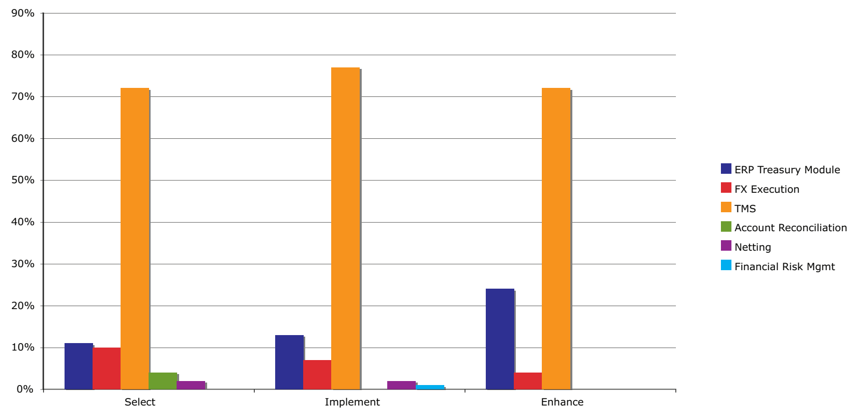
Table 2 - Top MMF Investment Determinates North America

1	Underlying Instruments
2	Offered Through Concentration Bank
3	Size of Fund

Table 3

Rank	Middle Market	Mid-Corporate	Large Corporate
1	Risk Management	Liquidity Management	Liquidity Management
2	Credit/Funding	Risk Management	Risk Management
3	Liquidity Mgmt	Credit/Funding	Credit/Funding

Fig 5 - Treasury Technology Plans for 2009 - US



Technology

Firms in the U.S. plan to address their key risk, liquidity and efficiency concerns through technology. In addition to the strained liquidity environment, there are many market forces at work that make it no surprise that technology is a top initiative for 2009:

1. Increased globalization of firms of all sizes, leading to the rising complexity of managing banking, liquidity and FX risk.
2. An emphasis on liquidity, which has led Treasurers to deploy technology to gain faster and more precise visibility into liquidity across the enterprise.
3. Growing speed of business and increased competition, necessitating that Treasury react quickly to the financial needs of the organization - for instance, the need to quickly raise funding for an unexpected yet important acquisition.
4. Increased responsibility of Treasury. Treasurers are taking on responsibility for a growing number of functions outside of traditional treasury management including corporate finance, tax, investor relations, enterprise risk management (ERM) and insurance.
5. Need for greater efficiency. Although staffing levels increased in 2008, most Treasury units operate small staffs and are being called upon to do "more with less." Technology helps Treasurers automate operational activities while also providing access to critical information needed for strategic initiatives.

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Technology continues to be viewed as a means to improve Treasury processes in addition to gaining greater visibility to cash and mitigation of risk.

Treasury Management Systems (TMS) dominate current plans with a fairly even balance of selection, implementation and enhancement projects on the horizon. ERP Treasury Modules are also in wide use in the U.S., and a large number of enhancement projects are also planned for those applications.

Bank relationship structure

Management of banking relationships has taken on increased importance as corporations improve controls, processes, and liquidity management tools.

Approximately two-thirds of corporations use the same bank as their primary concentration, disbursement and collections provider. This strong majority is driven by the large portion of Middle Market firms in the survey that have only one or two banking relationships.

Banks have a strong motivation to secure a company's concentration business, since it often leads to winning other core treasury management services business and the lion's share of deposits and investments.

Roughly 15% of firms select a dedicated concentration bank. These firms tend to be cash-rich and select their providers based on their liquidity tools and ability to tailor effective concentration structures to the firm's needs.

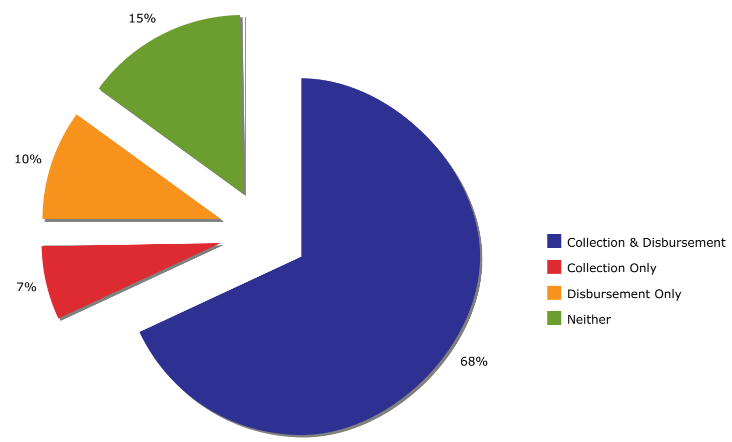
Next steps

Across the country, the strategic role of Treasury continues to grow, driven by globalization and technology. Companies must continue the process of 'bulletproofing' their Treasuries to stay strategic in an increasingly challenging and changing environment.

A well-prepared Treasury will have strong processes, structures and technology that act as an 'armor' which defend the organization from the 'bullets' of market developments, environmental crises, or other threats. 'Bulletproofing' cannot be accomplished overnight, but it is critical to take steps now to minimize the impact of future crises by drawing on the support of expert providers.

For financial services providers, the current liquidity crisis affords providers a rare opportunity to re-address their clients' liquidity with demonstrably safe and secure vehicles for their cash. Virtue now lies with cash preservation versus cash maximization.

Fig 4 - % of Companies Using Concentration Bank for Other Cash Management Services



Research methodology

The content of this article is based on the findings of Treasury Strategies' 2008 Global Corporate Treasury Research Program. The scope of this year's program covers the treasury management practices of 970 corporations across North America, Western Europe and the Asia-Pacific region. Responses were gathered in June 2008 through both telephone interviews and questionnaires.

Respondent Overview

- The 970 respondents were gathered across a variety of revenue segments and industry sectors.
- North American respondents include firms in the US and Canada.
- European respondents include firms located across Western Europe (Belgium, Denmark, France, Germany, Italy, Netherlands, Norway, Luxembourg, Spain, Sweden, Switzerland and the United Kingdom).
- Asia-Pacific firms were drawn from key Treasury centers within the region (Australia, Hong Kong, India, Malaysia and Singapore).

Annual Turnover Segments are defined as follows:

Segment	Annual Turnover
Middle Market	Less than 1 Billion USD
Mid-Corporate	1 to 5 Billion USD
Large Corporate	Over 5 Billion USD

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As a Partner in the Financial Institutions practice of Treasury Strategies, Inc., David Robertson helps financial services providers improve competitive position, client satisfaction and financial returns. He has led the development of many of the firm's proprietary methodologies in deposit engineering, pricing strategies and new product development and is the co-author of Treasury Strategies' groundbreaking whitepaper, 'Treasury 3.0.'