The Repeal of Regulation Q and its Impact on Corporate Sweep Investments

Money Fund Symposium

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Overview of Today's Discussion

- Financial reform is massive, intrusive and global

- Corporate sweep has been a great source of stable balances for the money fund industry

- Reg Q repeal will lead to an overall decline in sweep balances, and additional growth opportunities for the money fund industry

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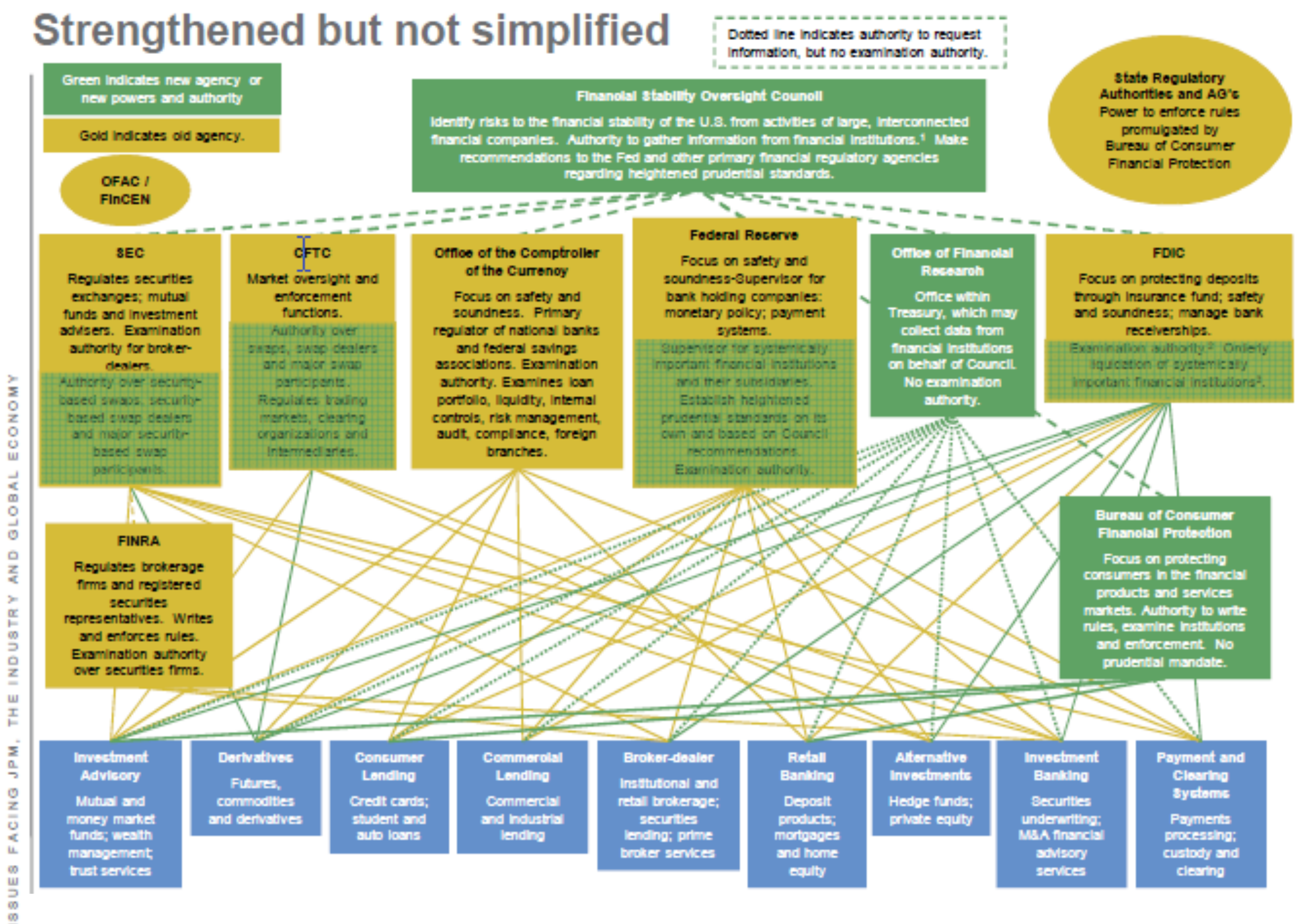
Regulatory Reform: "Strengthened but not Simplified"



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Regulatory Impact – Many New Regs Impact Money Funds

Dodd-Frank - 285 new rules, requires banks to do 92 new studies and issue 44 periodic reports

- **Regulation Q repealed – banks can begin to pay interest on commercial checking deposits**
- FDIC mandates unlimited deposit insurance on all checking/transaction accounts
- FDIC insurance coverage permanently raised from $100,000 to $250,000
  - Should increase the number and total balance of CD's between $100,000 and $250,000
- FDIC deposit insurance assessment methodology was to be based on consolidated assets minus average tangible equity, rather than historical method of total deposits.
  - The FDIC is aware that banks will continue to charge clients for FDIC based on deposit balances

SEC Money Market Fund Rule 2a-7 changed to reduce shareholder/investor investment risk

- Shortened WAM, increased credit quality and overnight liquidity
- Will likely lower the yield

Uncollateralized Daylight Overdrafts will incur fee of 50 bps

- Encourages FI's to minimize Daylight OD's, especially those that are not collateralized

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Regulatory Impact – Many New Regs Impact Money Funds

OTC derivatives market placed under Federal oversight…requires derivatives traders to collateralize their trades

Basel III:

- Requires new standards for Liquidity Coverage Ratio and Net Stable Funding Ratio
- New capital requirements will increase loan pricing and limit banks ability to lend to certain clients
  - Single-product vs. multi-product will have different capital requirements
  - Increased capital requirements plus basing FDIC insurance assessments on assets will drive some lending to ‘non-banks’

H.R. 1834: the Freedom to Invest Act of 2011 – overseas cash repatriation tax holiday

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Financial Impact – A Massive Increase in Costs

Higher interest expense on deposits	Reduced Revenue Streams • Volcker Rule • Potential divestitures
Reduced Fee Income • NSF/Overdrafts • Debit Interchange	Increased cost of compliance & oversight • Human • Systems, tracking and reporting
Increased Fees • Uncollateralized daylight overdrafts • FDIC	Client communication costs
Development costs for new products	Employee training
Reduced value of deposits ("FTP")	Revamped marketing collateral

Increased emphasis on eliminating marginally profitable and unprofitable relationships → Discontinuation of 'Free Checking'

Increased Bank Expenses → Increased Customer Expenses

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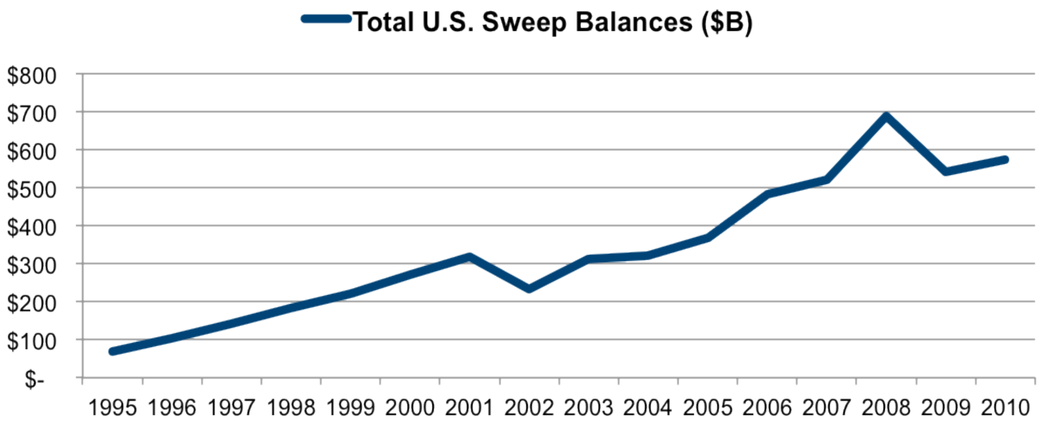
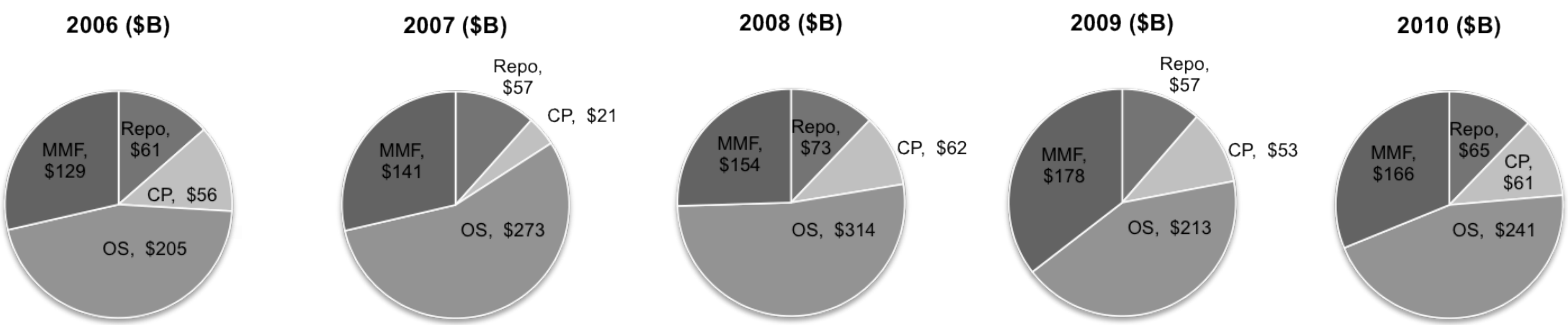
History of Bank Sweep

Launched in the 1990's as a way for banks to provide interest (or dividends) on idle balances without violating Regulation Q



Source: Treasury Strategies' proprietary research; Commercial Deposit/Sweep Study & Global Corporate Liquidity Research
OS = Off-Shore sweeps

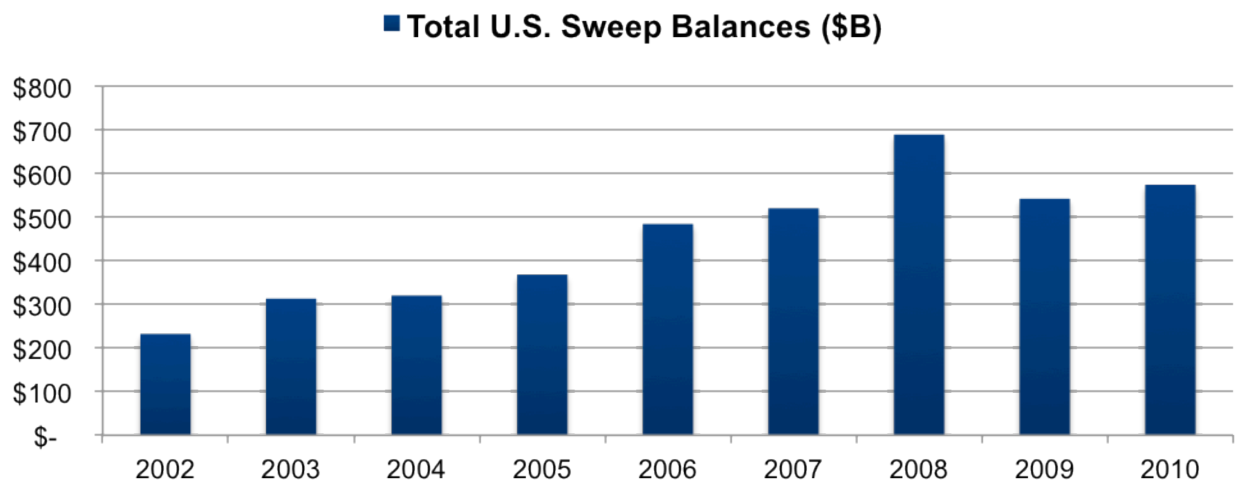
Sweep Balances by Product



Sweep has Historically been a very stable source of Money Fund Balances

Traditional Drivers of Sweep Balances

Key Driver	Comments
Bank Philosophy	On-Balance Sheet vs. Off-Balance Sheet
Client Size	• Large companies tend to leave a lesser percent of total cash balances in a passive sweep investment • Mid-size companies are content with the convenience of sweep
Price Elasticity	• Sweep balances are *generally* not highly price sensitive – Sweep balances suffer dramatic declines during periods of unprecedented low rates – Sweeps were shut off during 2003-04 and 2008-11 as the Fed Funds rate hit 1.00% and 0.25% respectively



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Overview of Regulation Q

- Depression-era regulation that disallowed banks from paying interest on corporate checking accounts

- Its attempted repeal has failed several times, most recently in 2004
  - Incurred a strong negative lobby from the money fund industry and large banks

- Introduced into Dodd-Frank by Congressman Scott Murray in 2010
  - No fanfare or debate…simply included as a single line among Dodd-Frank's 2300 pages
  - Positioned as a benefit to small businesses that will spur job growth

- Has the potential to dramatically reshape the liquidity management landscape
  - Corporate cash is likely to shift away from traditional cash investment vehicles, with more corporate cash being held in bank products
  - European liquidity management model (see next slide)

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Summary: New Regulations Could Drive $1.5T onto Bank Balance Sheets

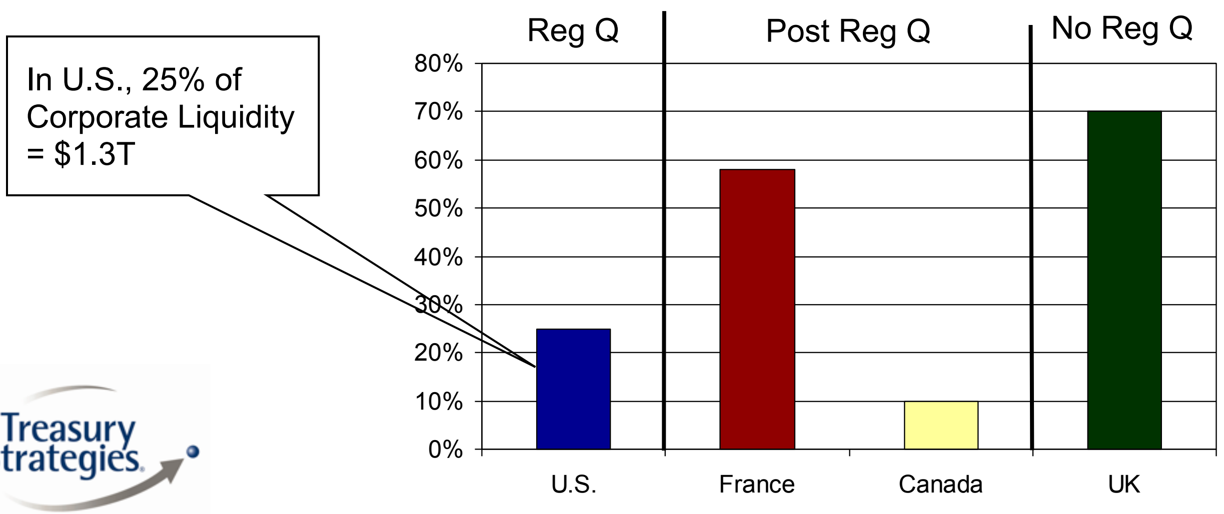
When interest rates rise, we could see an additional $1.5 trillion flow back onto bank balance sheets.

- In other post and non-Reg Q countries, companies can hold as much as 50 - 70% of total liquidity in bank deposits.
- Two current regulations could potentially drive even more liquidity back into the banking system - changes to 2a-7 regulations and collateral requirements for derivatives trading.

Unless loan demand also increases, bank balance sheets will be further constrained to accommodate these deposits.

- Interesting note: Barclays Capital estimates that banks are short $1.7 trillion in core stable funding under the proposed new Basel III requirements.

Percentage of Total Corporate Liquidity Held in Bank Deposits



Source: Treasury Strategies' proprietary research; Commercial Deposit/Sweep Study & Global Corporate Liquidity Research

Bank Deposits Defined as:

- DDA/Current Accounts
- Offshore Deposits
- Time Deposits/CDs
- Savings/MMDAs
- Sweep Off Accounts

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Post Reg Q Repeal, the Primary Purpose of Sweep Changes

Primary Purpose of Sweep	
Old Paradigm	**Post-Reg Q**
• Obtain yield on idle cash balances	• Diversify away from bank risk • Obtain yield in excess of interest-bearing DDA
Predominant Sweep Vehicles	
• Money Funds • Eurodollar Deposits • Repo • Bank Parent Commercial Paper	• Repo (eliminate credit risk) • Money Funds (diversify away from bank risk) • Bank Parent CP (yield enhancement)

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Opportunities to Reposition Money Funds

- Emphasis on diversification
- Emphasis on credit evaluation
- Position as a reservoir for bank excess liquidity
- Position as a tool for 100% visibility of customer cash

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