A quest for quality

NOW IN ITS EIGHTH YEAR, JPMORGAN'S GLOBAL CASH MANAGEMENT SURVEY CONTINUES TO ATTRACT A LARGE NUMBER OF RESPONDENTS, WITH OVER 200 CORPORATE TREASURERS FROM ALL AROUND THE WORLD PROVIDING THEIR VALUABLE COMMENTS FOR THE 2006 REPORT. WITH SUCH A WIDE RANGE OF RESPONDENTS, THE SURVEY – CONDUCTED IN CONJUNCTION WITH THE ACT AND WITH THE SUPPORT OF THE EACT – CONTINUES TO OFFER VALUABLE INSIGHTS INTO HOW THE SHORT-TERM INVESTMENT MANAGEMENT INDUSTRY IS DEVELOPING, THE PRODUCTS THAT TREASURERS ARE CURRENTLY USING, AND THE PERFORMANCE AND SERVICE LEVELS THAT ARE NOW DEMANDED. **ROBERT DEUTSCH** REPORTS.

Executive summary

- Trends that stand out are an increasing focus by treasurers on higher credit ratings and higher yields, and a growing allocation of cash to bank deposits. The expectation is that cash investment management processes will become ever more automated, while many treasurers also predict an increase in cross-border pooling and more consolidation among providers.

The latest cash management survey has been completed by corporate treasurers from around the world, responding on behalf of companies and organisations from many different sectors and industries, and from across the market cap spectrum. An impressively global spread of responses includes treasurers from as far afield as Zimbabwe, Jamaica and India, although the majority work in Europe and North America.

Most respondents are also from large companies with a market capitalisation of more than $500m, while nearly 40% represent mega cap organisations with a market cap of more than $5bn. However, there is also an increase in small-cap responses in the latest survey, perhaps due to the increase in emerging market responses, with 21% of respondents representing smaller companies, up from 16% in the 2005 survey.

DELVING DEEPER The survey questions remain largely the same, so that useful comparisons can be made with the results of previous surveys, although the format and subjects covered continue to evolve. As usual, the questions delve into all areas of the treasury cash management function, including banking relationships, how surplus cash is invested, how cash investment management providers are selected and what expectations treasurers have for returns.

Treasurers also say what they expect the main developments in cash investing will be over the next five years, their concerns for the future, and their opinions on the likely impact of the upcoming

Figure 1. Minimum credit rating required for bank deposits, direct investments and pooled funds

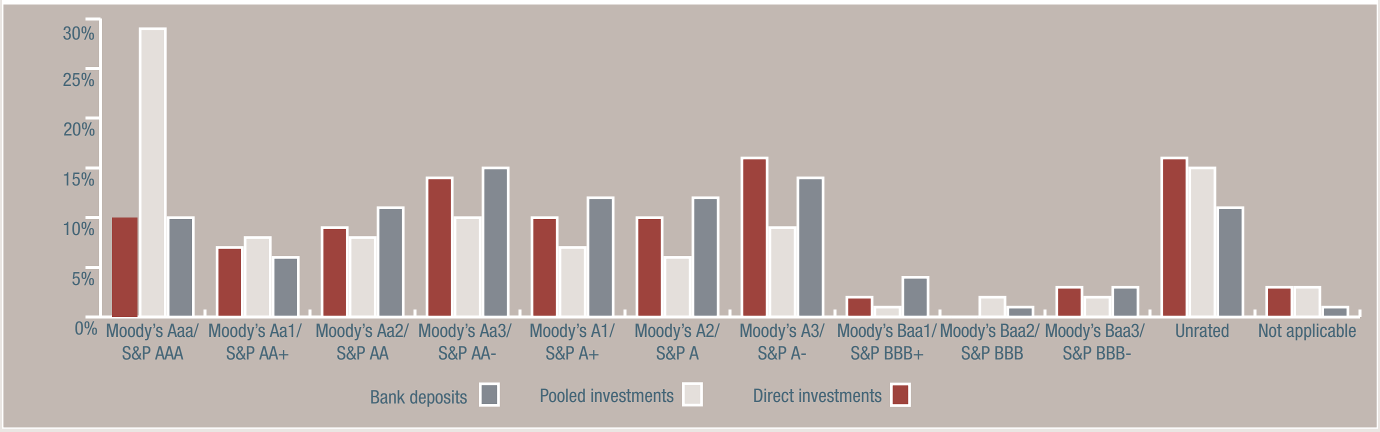


Figure 2. Most desirable characteristics of a pooled investment provider managing surplus cash

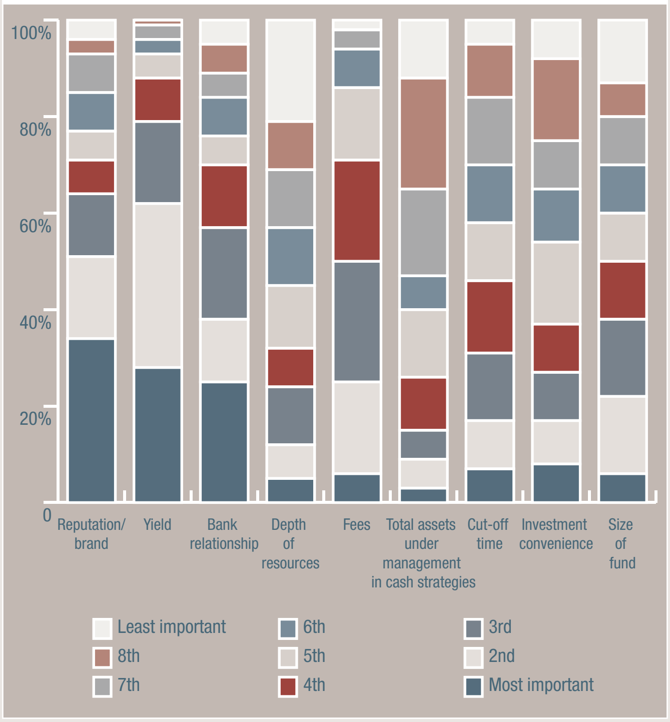
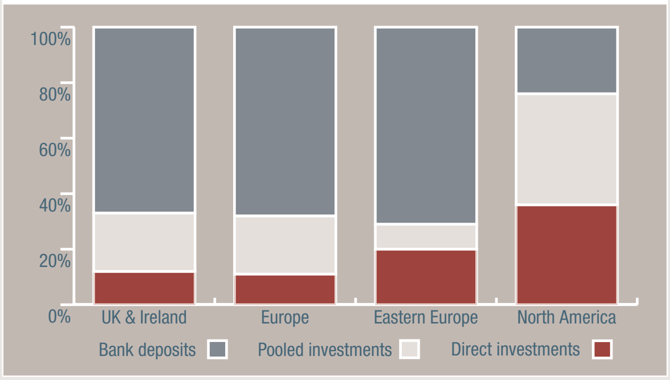


Figure 3. Average percentage allocation to each investment route by region



introduction of the Single Euro Payments Area (SEPA).

The responses to these questions are discussed in more detail below. Some trends that stand out are an increasing focus by treasurers on higher credit ratings and higher yields, and the growing allocation of cash to bank deposits.

SECURITY A major theme that emerges from the survey is security, with treasurers demanding ever-higher credit ratings for their cash investments and only willing to use service providers with the highest creditworthiness and unimpeachable reputations. Very few treasurers are now willing to invest in bank deposits, direct securities or pooled funds with a credit rating of BBB or below (see *Figure 1*).

Pooled fund investors are the most security-conscious, with nearly a third of pooled fund users saying that they only invest in funds with the highest AAA rating. Interestingly, 10% of bank deposit users also say that they require a AAA rating, despite the lack of AAA-rated banks.

Pooled fund investors also say that the most important criteria when selecting a pooled fund provider is the provider's reputation. Again, this emphasis on reputation may also include concerns over the creditworthiness of the provider. Meanwhile, the percentage of treasurers willing to invest in unrated funds has also fallen, from 25% in 2005 to just 15% in the latest survey (see *Figure 2*).

The observed rise in demand for higher credit ratings may be due to rising interest rates, with European and US treasurers now able to achieve good levels of yield even when moving up the credit scale thanks to recent interest rate rises in both regions.

INSTRUMENTS USED TO MANAGE CASH Rising interest rates may also help explain a rise in the usage of bank deposits since the 2005 survey. Again, interest rate increases in Europe and the US during 2006 may have contributed to the rise, as treasurers can get more respectable returns on cash deposits without reducing the quality of their investments or needing to move into pooled funds.

Much of the rise in allocation to deposits and the drop in allocation to pooled investments can also be explained by the higher proportion of smaller company responses in this year's survey. The fact that the 2006 survey contains more responses from countries with more traditional banking models (that is, from parts of Central and Eastern Europe, the Middle East and Africa) as opposed to those from more developed banking systems in Western Europe and the US, may also have contributed (see *Figure 3*).

This trend towards bank deposits is reflected in the fact that the average percentage allocation of treasurers' cash to bank deposits rose from 51% of total cash investments in 2005 to 61% in 2006. Conversely, the use of pooled investments has fallen from an average allocation of 29% last year to the current 22%. However, treasurers using bank deposits are likely to have all their cash in deposits, with no allocation to other investments. When it comes to deposits, it appears to be a case of all or nothing.

Also, bank deposits are much less popular with North American treasurers, who also tend to have a much greater proportion of their cash invested in pooled funds. The greater use of pooled investments in the US is perhaps unsurprising given that US cash investors have traditionally used money market funds rather than bank deposits for their excess cash requirements.

YIELD Remarkably, given the rise in demand for higher credit ratings and the increased use of bank deposits, treasurers' return expectations have actually gone up since the previous survey. Close to half of respondents are now targeting Libor+, compared with about a third of respondents to the 2005 survey.

Treasurers are unwilling to sacrifice credit quality to achieve these returns. Instead, treasurers seeking a higher return are most likely to take duration risk, which is reflected to some degree in the growing popularity of enhanced yield funds, which have a slightly longer average duration than AAA-rated liquidity funds, allowing them to target a higher yield. Treasurers are also willing to accept earlier cut-off times to gain an uplift in yield (see *Figure 4*).

In general, European respondents are more bullish in their return expectations than their UK and North American counterparts. And while UK investors tend to benchmark returns against Libid, investors in European and North America are more likely to use Libor .

MONEY MARKET FUNDS Although pooled fund allocations have in general fallen since the last survey in 2005, the mean portfolio allocation to money market funds among pooled fund investors has risen to 82%, a rise from the 72% recorded in the 2005 survey. Money market funds are also the most popular vehicle across all regions. Interestingly, European treasurers tend to have a higher allocation to money market funds than their US counterparts, while US treasurers are much more likely to use yield-enhanced funds and short-dated funds, as well as other fixed income funds for their surplus cash requirements.

According to our responses, future demand for money market funds is also set to increase further, with 84% of all respondents to the latest survey saying that they are considering using them in future. Enhanced yield funds also look set to increase in popularity, with just under one-third of respondents saying they are considering investing in these products (see *Figure 5*).

WHAT DOES THE FUTURE HOLD? The survey asks treasurers to tell us what they think the main developments in cash management will be over the next five years. One response that crops up many times in the latest survey is that cash investment management processes will become ever more automated, while many treasurers also believe we will see an increase in cross-border pooling and more consolidation among providers. European investors refer repeatedly to regulatory developments, including the impact of SEPA, on their ability to manage cash effectively.

On the subject of the impending introduction of SEPA, the 2006 survey asked treasurers how they thought the new regulatory regime would affect them going forward. While many treasurers believe SEPA will be generally positive, leading to greater efficiency and cost savings and more accuracy, it was also interesting to see that a significant number of respondents, even in Europe, believe the changes will have little or no impact on their operations. Several respondents believe that it will have no impact whatsoever, which is perhaps surprising given SEPA's wide-reaching format.

A theme which emerges from the responses on future industry developments is that automated and internet-based solutions will become the norm for cash management going forward.

Figure 4. Willingness to take risk for higher yields

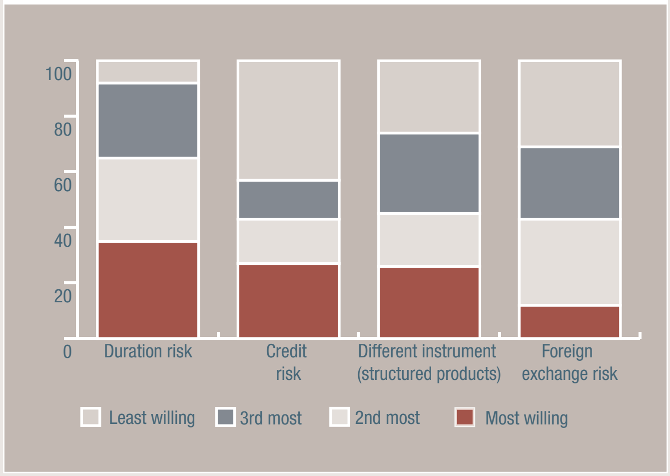
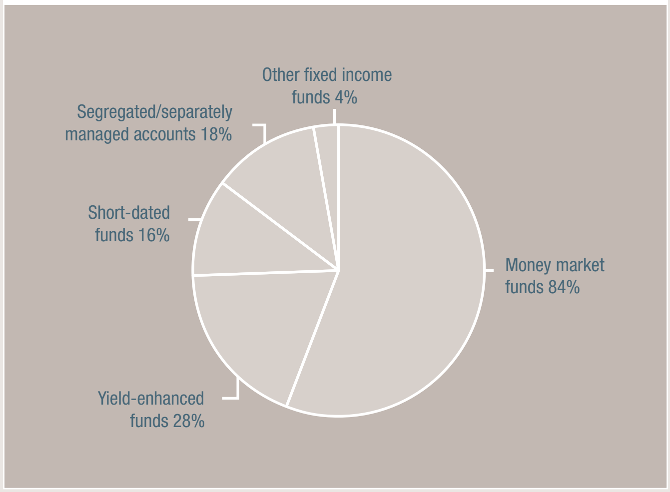


Figure 5. Future investment intentions for pooled funds



On behalf of JPMorgan, I would like to thank everyone who participated in the global cash managements survey, as well as the ACT and the EACT for their ongoing support.

Robert Deutsch is Head of Global Cash at JPMorgan Asset Management.
www.jpmorgan.com

The complete survey can be found on the JPMorgan Asset Management website at: **www.jpmorgan.com/assetmanagement/liquidity**
or on the ACT website at: **www.treasurers.org.**
To obtain a print version of the survey, please contact JPMorgan Asset Management on +44 (0)20 7742 6059.