



# **CASH MANAGEMENT**

The world has changed—  
your investment guidelines  
should too

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FitchRatings

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The fundamental objectives of cash management have not changed. They still remain safety of principal, liquidity and yield. However, the process of managing cash is changing dramatically. Treasurers and cash managers face a daunting set of challenges due to post-crisis regulatory and market changes. They need to not only understand the impact of these challenges, but also to evolve by undertaking a strategic re-assessment of how they manage cash and updating their investment guidelines accordingly.

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## CASH MANAGEMENT CHALLENGES AND WHAT THEY MEAN

<b>CHALLENGE</b>	<b>POTENTIAL IMPACT</b>
<b>MONEY FUND REGULATIONS</b>	
Institutional prime money funds to 'float' NAV and adopt 'fees & gates'; constant NAV government money funds will continue to exist without 'fees & gates'	<ul style="list-style-type: none"> <li>- Potential losses on cash held in prime funds and/or restricted access to liquidity during stress</li> <li>- Lower yields on government funds as demand overwhelms supply</li> </ul>
<b>BASEL III</b>	
Regulations penalize banks for relying on less-stable wholesale short-term funding	<ul style="list-style-type: none"> <li>- Banks to turn away certain corporate deposits</li> <li>- Reduced bank issuance of short-term debt, limiting the supply of high-quality, short-term investments</li> </ul>
<b>ALTERNATIVE CASH MANAGEMENT PRODUCTS</b>	
Money fund regulation is leading asset managers to develop 'alternative' cash management products such as private unregistered funds, short-term bond funds, separately managed accounts and 60-day maximum maturity money funds	<ul style="list-style-type: none"> <li>- Treasurers and cash managers will need to evaluate the new products and update investment guidelines to incorporate these new strategies</li> <li>- Emerging products are not as tightly regulated as traditional money funds, allowing for greater flexibility, but also the potential for greater risk and less transparency</li> </ul>
<b>LOW OR NEGATIVE YIELDS</b>	
Yields in the U.S. remain extremely low and have turned negative in Europe, while the supply of high-quality, short-term securities continues to shrink	<ul style="list-style-type: none"> <li>- Treasury professionals will need to re-think their cash management strategies and policies and better segment cash that does not serve a near-term operational need</li> </ul>
<b>SHIFTS IN RATING AGENCY COVERAGE</b>	
Post-crisis, there has been a material change in the markets covered by the 'big three' rating agencies	<ul style="list-style-type: none"> <li>- Outdated investment guidelines that fail to include all of the 'big three' rating agencies (Fitch, S&amp;P and Moody's) are out of step with market realities and best practices, and unnecessarily restricting cash management options puts your treasury at a competitive disadvantage compared to peers</li> </ul>

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## USE OF RATINGS IN INVESTMENT GUIDELINES

As corporate treasurers update their firms' investment guidelines to reflect the new realities of money fund reform, Basel III, and cash segmentation, the use of ratings in the investment policy also warrants a review. Best practices at industry leaders dictate an approach that takes into account all of the 'big three' global rating agencies (Fitch Ratings, S&P, and Moody's). Legacy investment policies that only rely on one or two rating agencies are out of sync with the market and restrict cash managers from accessing certain segments of the markets.

The use of credit opinions from all three agencies to inform investment decisions is the norm for sophisticated financial players. For example, most long-term institutional investors use the Barclays Capital Aggregate Bond Index (formerly Lehman Aggregate Bond Index) as the benchmark for baseline investment performance.

The same is true in the short-term markets for commercial paper indices such as the Daily Euro Commercial Paper Index, which tracks the daily yield of Euro C.P. issued in Euroclear with A1/P1/F1 ratings.

For inclusion into the index, Barclay's requires that an asset should be "rated investment grade using the middle rating of Fitch Ratings, S&P and Moody's after dropping the highest and lowest available ratings."

Effectively deploying cash holdings has become one of the chief concerns of finance executives, reports Greenwich Associates. Against this backdrop, continued reliance on outdated guidelines leaves the treasury functions of some entities at a competitive disadvantage compared to peers.

## SAMPLE INVESTMENT GUIDELINE LANGUAGE FOR RATINGS

"Investments must be rated A/A/A2 or higher on the long-term scale and/or F-1/A-1/P-1 or higher on the short-term scale by at least two of the three global rating agencies (Fitch Ratings, S&P, or Moody's).

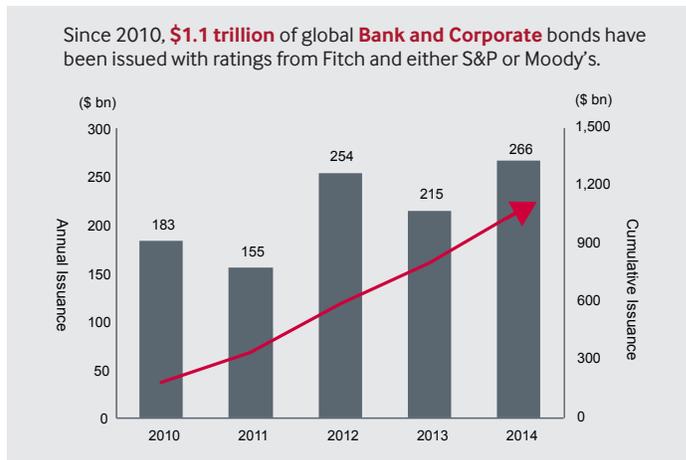
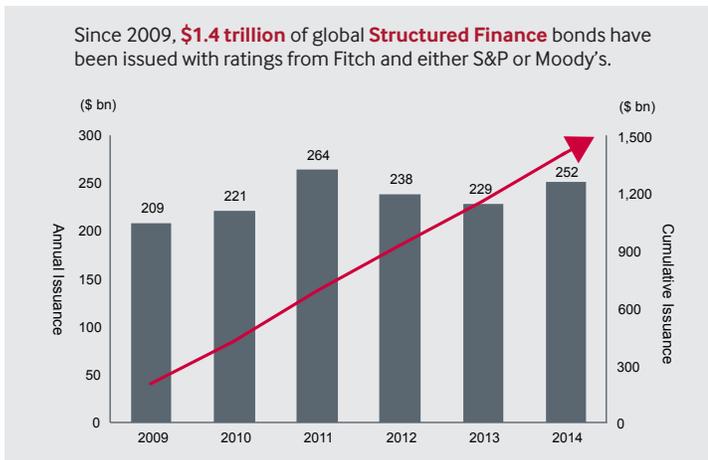
Money market funds and other liquidity products as per this investment policy must be rated equivalent of AAA/AAA/Aaa by at least two of the three global rating agencies (Fitch Ratings, S&P, or Moody's)."

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## THE WORLD HAS CHANGED

The financial crisis fostered major changes in rating coverage by the three major agencies. Now, there is a relatively wide variation of coverage between the agencies in the various segments of the fixed-income market. Banks and Corporates increasingly carry ratings from two of the three global rating agencies.

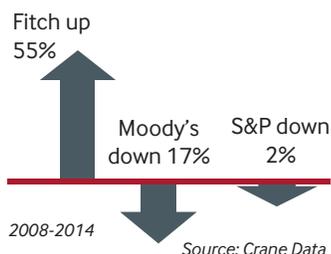


Analysis shows that since 2009, rating coverage of money market funds also has changed considerably. Moody's and S&P's coverage of money funds has declined. During the same period, Fitch Ratings has substantially increased its rating coverage of money market funds.

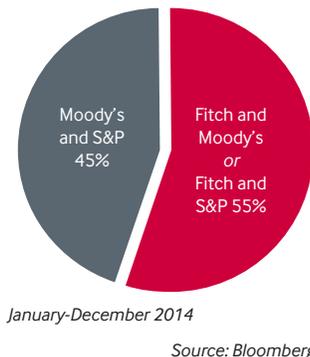
High-quality money market tranches of U.S. asset-backed securities are another example. These instruments are popular with money market fund managers and corporate treasurers seeking high-quality, short-term investment alternatives. 55% of this sector is rated by Fitch and one other rating agency. Therefore, if a corporation's policy excludes Fitch Ratings from their investment guidelines, that investor stands to miss out on a large portion of that market.

As the markets continue evolving, particularly in the area of cash management products, investors should maintain flexibility to account for future changes in cash management products and rating coverage. As asset managers develop new liquidity products like short-term bond funds and private money funds, ratings will be key to these new funds given their lightly regulated nature compared to money funds. Rating coverage of these products may vary by agency. Treasurers should ensure their investment guidelines do not restrict them from evaluating new cash strategies that may be appropriate for their firm's liquidity profile.

### U.S. MONEY FUND RATING LANDSCAPE



### RATINGS COVERAGE OF ABS MONEY MARKET TRANCHEs



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## CONCLUSION: IT'S TIME FOR A PROACTIVE, STRATEGIC UPDATE OF INVESTMENT GUIDELINES

Treasury management best practices call for a senior-level review of investment policies on a regular basis, generally annually. The advent of money fund reform combined with other regulatory and market changes makes these reviews – done in a thoughtful, strategic way – imperative. When performing this review and making changes, it's critical to understand the tectonic shifts that have taken place in order to adapt and position yourself in the best possible way. This includes how you use credit ratings for addressing credit and counterparty risk.

### FOR MORE INFORMATION

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