



INSIGHT REPORT

TREASURY

**HOW IS YOUR CASH BEING IMPACTED
BY REGULATORY CHANGE?**

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Introduction

Now in its fifth year, we're proud to present our 2015 Corporate Cash Investment report, an in-depth study among corporate treasury professionals to explore corporate attitudes to cash investment, investment policies and transaction execution, particularly in the context of major regulatory change in the months ahead. Having now built up five years of data, this report uniquely presents not only the findings from our 2015 survey but also identifies trends and developments over time.

This year, the study involved a representative sample of corporations globally, across all major regions and industries. Forty six percent of respondents were located in North America, with a further 37 percent from Europe. Most of these had a centralized approach to treasury management, with 94 percent of respondent firms having a centralized treasury organization, either globally or regionally, similar to previous studies. Detailed information on respondents is provided in Appendix A.

Key Findings



24%

of respondents hold cash for working capital financing



46%

of respondents say that finding suitable repositories for corporate cash remains the top priority



60%

of respondents anticipate that they will continue to invest in prime MMFs at a similar level once SEC reforms are implemented

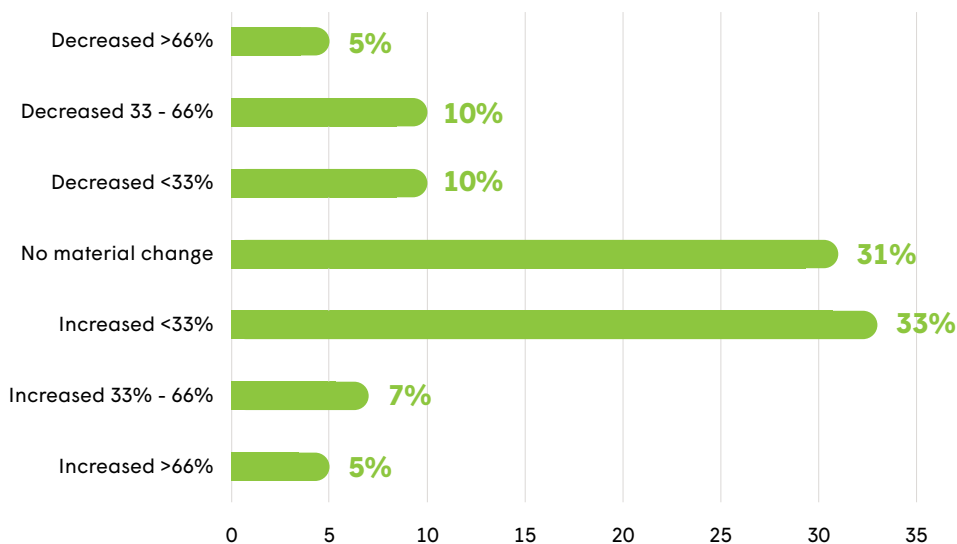
- Corporate cash balances continue to rise strongly in 2015, observed by 45 percent of respondents. Twenty-six percent of those that reported an increase in cash balances noted that these had increased by more than a third.
- Twenty-four percent hold cash for working capital financing, a trend that has been consistent over the past five years. The proportion of companies holding cash to finance capital investment or M&A has continued to increase gradually, from 27 percent in 2013 to 35 percent in 2015.
- Despite high cash balances, we have seen a steady year-over-year decline in the number of companies holding cash as a buffer against dips in revenue, from 17 percent in 2012 to 8 percent in 2015.
- Investment challenges have evolved significantly over the past 12 months. Finding suitable repositories for corporate cash remains the top priority at 46 percent, but while Basel III barely registered a year ago, it is now a key priority for 43 percent of respondents. Money market fund (MMF) reform and the problem of 'trapped' cash are also key issues facing many treasurers.
- Treasurers have become more confident in segmenting their cash into short-term, core and strategic cash, providing more choice of investment instruments with the potential to generate higher returns.
- Sixty percent of treasurers in the U.S. anticipate that they will continue to invest in prime MMFs at a similar level once SEC reforms are implemented in 2016. Thirty-seven percent expect to decrease their holdings, identifying accounting, intraday liquidity and investment policy constraints as the biggest obstacles.
- Treasurers expect to use term deposits (19 percent), commercial paper (15 percent) certificates of deposit (13 percent) and government debt (13 percent) either in addition to, or as a replacement for prime MMFs, although they anticipate using a wide range of instruments. Direct investment has resourcing and risk implications, however, which treasurers will need to address before expanding their investment portfolios.
- For the first time since we launched the study in 2011, use of independent portals has overtaken other dealing methods for short-term cash instruments, including telephone (38 percent) and proprietary portals (21 percent).

What are the Cash Investment Trends in 2015?

How are cash balances changing?

Corporate cash balances have continued to rise in 2015. Between 2012-2014, the proportion of companies that increased their cash balances grew by 6 percent year over year, from 37 percent in 2012 to 49 percent in 2014. In 2015, this has dropped slightly to 45 percent, but even so, the trend remains strong. Twenty-six percent of those that reported an increase in cash balances noted that these had increased by more than a third. This is despite greater market confidence and strong M&A activities in some markets. In contrast, therefore, the proportion of companies that have maintained a 'steady state' in the value of their surplus cash has gradually fallen, from 37 percent in 2012 to 31 percent in 2015.

Figure 1: Change in surplus cash balance over the past 12 months



How much cash do you really need?

Companies hold cash balances for a variety of reasons, as Figure 2 illustrates, with only subtle changes in their relative importance over recent years. As the 2014 report discussed, for example, treasurers had already been building up cash balances in the years leading up to the crisis to fund mergers and acquisitions (M&A) and capital investment, and for working capital reasons. Once the crisis struck, surplus cash became an important ‘buffer’ against revenue shocks and to mitigate liquidity risk.

Although market volatility is high in some markets, which may continue to encourage some corporations to continue holding high levels of surplus cash, as opposed to paying down debt, investing in growth or returning cash to shareholders, an important question is how much cash the company needs, and why? With cash investment becoming more challenging as a result of regulatory changes such as Basel III and MMF reform, and rates still very low or even negative, this cash is not adding significant value to the business. In particular, Basel III will affect the attractiveness of some types of bank deposits, while some corporations may be less comfortable with variable net asset value (NAV) funds compared to constant NAV funds required under new MMF reforms that are coming into effect in the U.S. and planned in Europe.

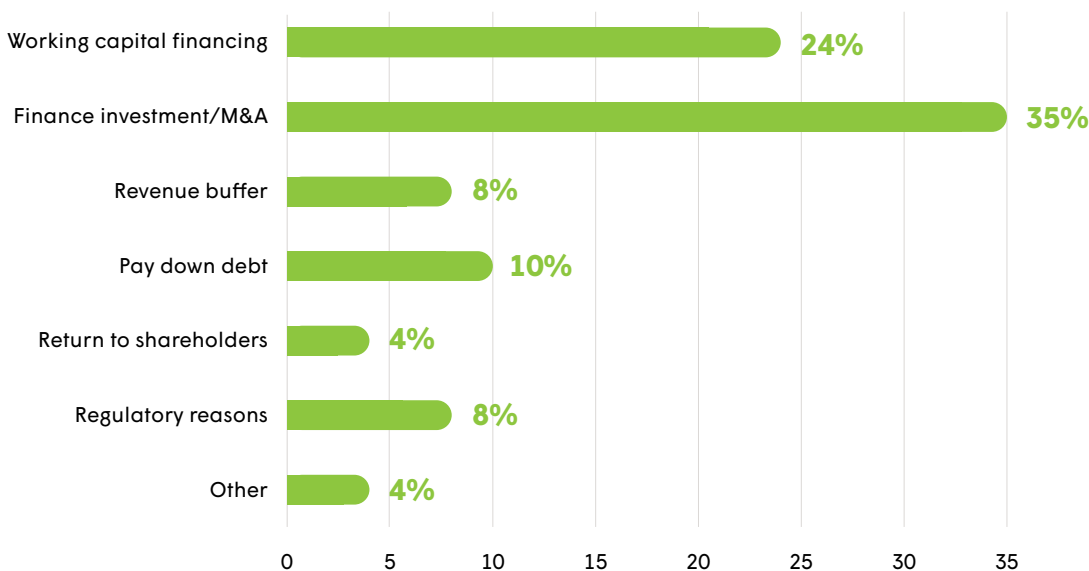
Reasons for holding surplus cash

Twenty four percent noted that cash is required for working capital financing, the same figure as in 2014, with very little variation since 2012. While corporations of all sizes have embarked on initiatives to optimize working capital over recent years, including payables and receivables management, regional and global liquidity programs and alternative financing, these do not yet appear to be reflected in corporate cash levels.

The proportion of companies holding cash to finance capital investment or M&A continues to increase gradually, from 27 percent in 2013 to 35 percent in 2015. This is reflected in the increase in M&A activity that we have witnessed over the past two years, reflecting a shift in corporate confidence. This growing confidence is also illustrated in the steady year-over-year decline in the number of companies holding cash as a buffer against dips in revenue, from 17 percent in 2012 through to 8 percent in 2015.

One growth area in 2015 is the number of companies noting that they hold cash for regulatory purposes (8 percent), specifically those in the financial services and insurance space.

Figure 2: Primary reasons for holding surplus cash



What are your key challenges when investing surplus cash?

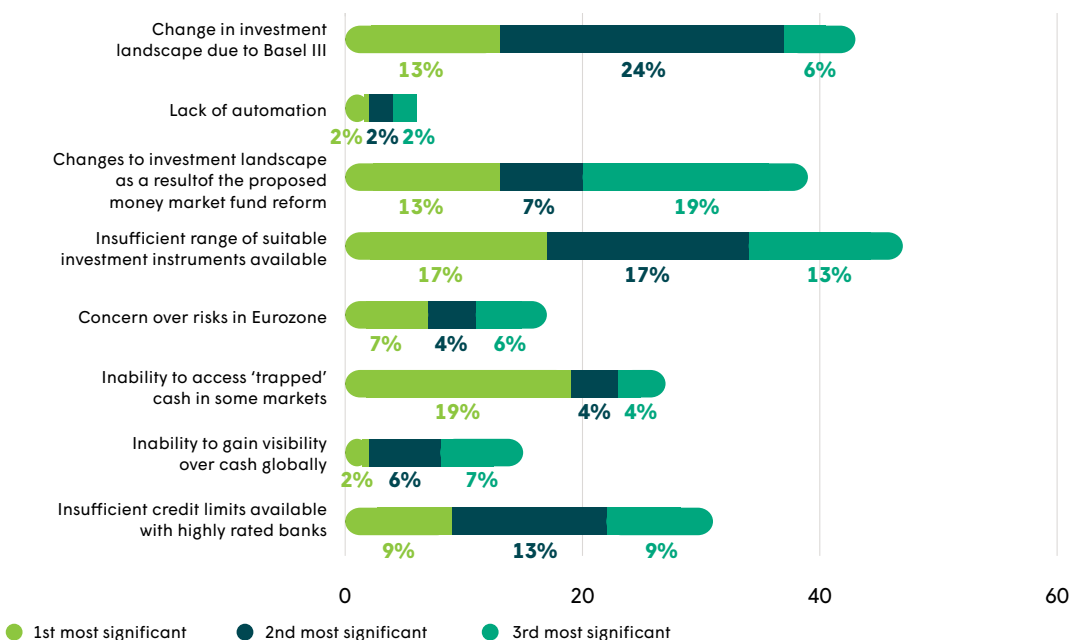
Since our annual study was first undertaken in 2011, the challenges that treasurers are experiencing have evolved significantly. The first key change has been the shift from operational to more strategic concerns. For example, the 2011 results highlighted that cash flow forecasting was corporate treasurers' greatest investment challenge. By 2012, market and regulatory issues had emerged as a stronger priority, including the eurozone crisis and the expiry of Federal Deposit Insurance Corporation (FDIC) guaranteed non-interest bearing accounts. In 2013 and 2014, with some of these issues no longer so immediate, treasurers were most concerned about finding suitable instruments in which to invest, noted by 58 percent of respondents in 2013 and 63 percent in 2014. Unlocking trapped cash held in regulated markets such as China (47 percent in 2013 and 43 percent in 2014) was also a major consideration.

The emergence of Basel III

This year regulatory change is firmly back on the agenda. While finding suitable investment instruments remains the most significant concern, noted by 46 percent as one of their top three challenges, this figure is significantly lower than in 2014. In contrast, Basel III and its impact on corporates' cash investment strategy is now a priority, emphasized by 43 percent of respondents, up from barely 20 percent in 2014 when almost none of the survey participants noted that this was their top issue. Related to this, 31 percent noted that a lack of credit limits with highly rated banks was a challenge. Increasingly, banks are encouraging investors to move deposits off their balance sheets as a result of Basel III, and with many international banks in the US and Europe now close to completing their Basel III implementation, this will continue over the year ahead. Furthermore, while regulators in other regions such as Asia have adopted different interpretations and timelines for Basel III adoption, ultimately all banks will need to comply with these regulations. In the past, if a bank has discouraged an investor from depositing cash, treasurers have typically turned to an alternative bank: however, this is clearly becoming increasingly difficult. The problem has been compounded by credit rating downgrades, so many treasurers now have a smaller panel of approved counterparty banks in which to invest.

At the same time, MMF reform, which will take effect by August 2016 in the U.S., with similar draft regulations now passed in Europe pending implementation, also creates challenges for corporate investors. Thirty-nine percent expressed that MMF reform was one of their top three challenges. One of the implications of these reforms is that investors need to consider the implications of constant NAV instruments on their investment policy, reporting and accounting processes.

Figure 3: Most significant cash investment challenges



The challenge of 'trapped' cash among international treasurers

'Trapped' cash (i.e. cash that cannot be repatriated, typically in emerging markets with capital and/or currency controls) also continues to be a major issue. Although trapped cash affects fewer respondent organizations than regulatory change, depending on their industry and geographic reach, it was identified as the single biggest challenge, up from 17 percent in 2014 to 19 percent in 2015. Although there have been some recent changes in countries such as China that make it easier to leverage surplus liquidity, only a few companies have yet been able to take advantage of these new opportunities. However, the ongoing increase in the proportion of companies doing business in more challenging emerging countries means that trapped cash is likely to continue to be a major issue in the years ahead.

Are you able to invest more widely?

Given the regulatory pressures on treasurers' investment options, a logical response is to revise policies to permit investment in a wider range of instruments. As Figure 4 illustrates, companies have become more confident in recent years in segmenting their cash into balances that are required to fund short-term liquidity requirements, and amounts that can be invested in the longer-term, potentially generating a higher return.

Corporate attitudes to cash security have remained unchanged, but treasurers, and their company boards, have become willing to use liquidity as a lever to access a wider range of instruments, and potentially increase the return on cash.

Figure 4: Changes in corporate cash investment strategy

	2011	2012	2013	2014	2015
Preservation of capital, immediate access to all cash	44%	42%	46%	33%	33%
Preservation of capital, immediate access to some cash, higher yield on strategic cash	45%	38%	35%	38%	40%
Preservation of capital and liquidity as required, optimize yield	17%	26%	23%	28%	28%

What's the likely regulatory impact on your investment choices?

As this study has demonstrated over the past five years, bank deposits and MMFs are treasurers' most popular choices for investing surplus cash. MMFs remain more common in the U.S. and Europe than in other regions, but the use of MMFs in Asia is also growing. For example, in China, rates on MMFs are often higher than deposits, and funds are becoming more consistent with those in the U.S. and Europe, encouraging both domestic and foreign institutional investors.

However, the next 12 months will bring major changes to both deposits and MMFs, compelling treasurers to review their investment policies and processes, and in some cases change the way they invest surplus cash. As discussed earlier, Basel III is already affecting banks' ability and willingness to accept some types of cash onto their balance sheet, particularly in U.S. and Europe, although banks in other regions will also be obliged to implement Basel III requirements in due course.

By August 2016, new SEC reforms will take effect, which require a floating net asset value (NAV) for institutional prime money market funds in the U.S., so daily share prices of these funds will fluctuate, as will the market-based value of fund assets. In addition, MMF boards will have new tools, such as the ability to impose liquidity fees and redemption gates to prevent or limit runs. Other changes include enhanced disclosure requirements, immediate reporting of fund portfolio holdings and improved private liquidity fund reporting, stronger diversification requirements and more stringent stress testing, which will take effect in March 2016.

These changes, particularly the need to maintain a floating NAV, have valuation, accounting, and operational implications for fund managers, and will therefore have a profound impact on the MMF industry. Accounting treatment differs for corporates too, which may require some change to existing systems. Given that there are less than 12 months until the implementation deadline for these reforms, treasurers will need to act now to ensure that their investment policies, accounting methodologies and systems are ready to adapt.

A cohesive global approach

While these rules apply only to MMFs in the U.S., draft regulations in Europe that closely mirror those in the U.S. were passed by the European Parliament in April 2015, with three-way talks now underway with EU member states and the European Commission. Consequently, the issues affecting investors in the U.S. will have similar ramifications in Europe. In other countries too, such as in China, regulators are also reviewing and revising the conditions under which MMFs operate.

Does MMF reform change your view?

Among those that currently invest in prime MMFs in the U.S., the majority (60 percent) anticipate that they will continue to invest in these funds at a similar level to today, although 37 percent anticipate decreasing the level of investment. Accounting considerations (43 percent), intraday limit concerns (30 percent) and the need to revise investment policies (26 percent) were cited as the most important reasons for this. However, as treasurers become more familiar with new instruments and make the necessary revisions to their policies and processes, treasurers' anticipated reduction in their use of MMFs may not materialize in practice.

Government funds are excluded from the requirement to have a floating NAV and given low yields generally, we may see a shift towards these funds, at least in the short term. This appears to be the expectation of many respondents to this study, but the potential to generate additional yield on prime MMFs compared with government funds as interest rates rise in the future may be an incentive to address some of the internal issues and return to prime MMFs. Forty-two percent of respondents indicated that the uplift in rates would need to be only 21 – 34 bps to justify returning to prime MMFs, although the remaining 58 percent would be looking for an additional yield delta of above 35 bps.

In addition, many respondents anticipate diversifying their cash investment portfolio across a wider range of instruments. Treasurers are currently most attracted to term deposits (19 percent), commercial paper (CP, 15 percent) certificates of deposit (CD, 13 percent) and government debt (13 percent). However, the future interest rate environment, availability of assets and treasurers' ability to segment cash will have an impact on these plans. Furthermore, treasurers will need to consider the resource implications of managing their cash assets directly, such as when investing in CP, CDs and repos, as opposed to outsourcing this to a fund manager. Treasurers choosing some of these direct investments will also lose the inherent diversification associated with the use of funds, whether MMFs, bond funds or separately managed accounts.

Figure 5: Anticipated change in MMF investment post-MMF reforms

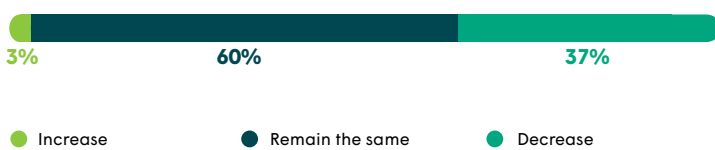
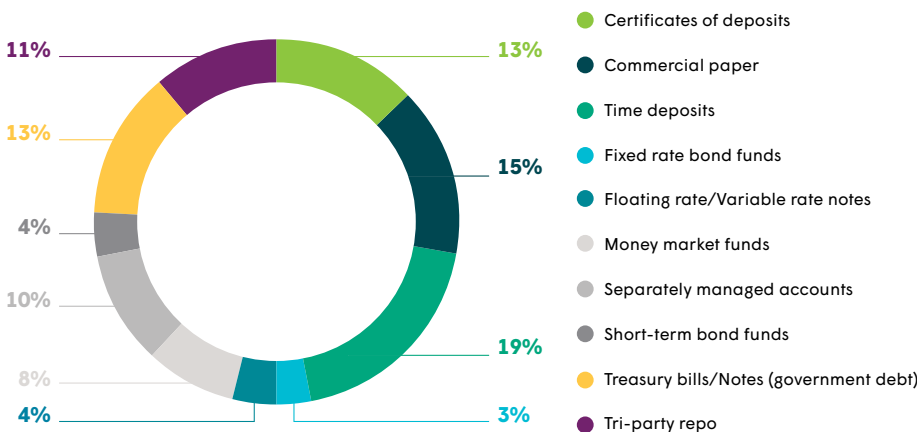


Figure 6: Potential alternatives to prime MMFs



How do you deal short term investments most efficiently?

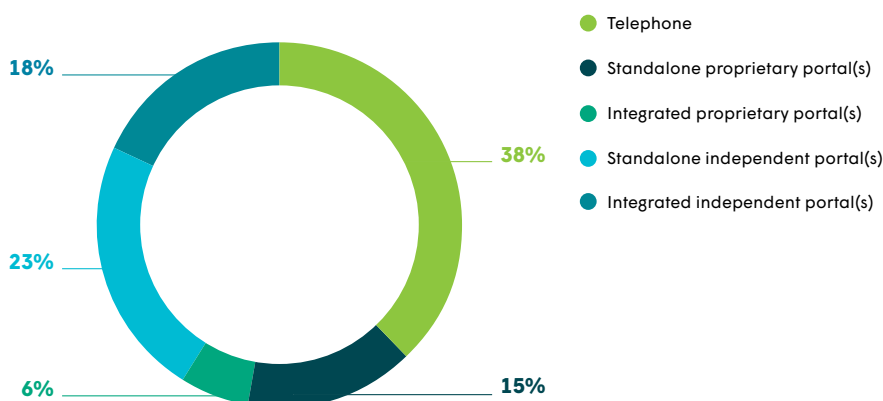
As companies review, and potentially revise their investment policies, they also need to consider how they execute transactions. This year's survey data reveals that the gradual shift towards electronic dealing for more 'vanilla' instruments (e.g. deposits, MMFs, FX spot and forward transactions) that we have observed over recent years has continued. In some cases, this involves using proprietary dealing tools offered by banks, while in others, companies choose to use independent portals to deal with multiple counterparties and funds through a single channel.

However, a significant shift since last year's study is that while the use of proprietary and independent portals was roughly equivalent in 2014, there has been a substantial increase in the use of independent portals in 2015, now

at 41 percent, including those who use these solutions on a standalone basis or integrated with the enterprise resource planning (ERP) or treasury management system (TMS). Consequently, the use of independent, multi-bank portals has now become the most popular means of dealing short-term cash instruments for the first time. However, although the benefits of electronic dealing are well-established, Figure 7 shows that telephone dealing remains popular at 38 percent, a similar proportion to the 2014 study.

Given that such a large proportion of companies are now using electronic dealing, treasurers need to consider how their treasury processes may be affected, and how they will continue to ensure that security and efficiency objectives are achieved, if they opt to expand their cash investment portfolio into instruments that are less often dealt electronically than those they use today.

Figure 7: Methods of transacting short-term cash instruments



Conclusions

As our survey results illustrate, regulatory change, both MMF reforms and the wider implications of Basel III, marks the most important change we have seen in the cash investment space since the global financial crisis. With an unprecedented period of low interest rates, which are now in negative territory in Europe, the value of surplus cash has been negligible over recent years. Even though it seems likely that the Fed will increase USD rates, interest rates across major currencies are likely to remain at very low levels for the foreseeable future. Added to this, with the most common investment choices, namely bank deposits and MMFs under threat, treasurers are now being forced to question why they are holding such large, growing cash balances.

Treasurers have found it increasingly difficult to find suitable repositories for surplus cash, particularly since a number of banks experienced a downgrade in their credit ratings, so treasurers have a smaller pool of banks in which to invest. Basel III and MMF reform are now exacerbating this issue. Basel III will limit banks' appetite for some types of deposits, which will necessarily prompt treasurers to seek alternatives. Many treasurers are also concerned about the shift from constant NAV to variable NAV MMFs, and in some cases, their existing policies and systems do not accommodate these funds. However, this is likely to be a short-term issue rather than prompt a long-term change of corporate behavior. Treasurers value the inherent diversification, credit quality, rigorous criteria and same-day access to liquidity that MMFs offer, and they will continue to offer these benefits post-reform.

Even so, the combination of Basel III and MMF reform are likely to prove a catalyst for treasurers to review their cash investment policy. In particular, treasurers are becoming more adept at forecasting cash flow, and are therefore in a better position to segment their cash balances into short-term, core and strategic cash. Rather than investing all or most of their cash into deposits or MMFs, treasurers can sacrifice same-day liquidity on a portion of their cash in order to access a wider range of instruments, and potentially increase the return on their cash.

As the study demonstrates, treasurers are considering a wide range of instruments, both direct investments and investment funds. While some treasury functions have the resources to invest in the market directly, this is not universally the case. However, treasurers do not need to compromise on the convenience, diversification and credit quality associated with MMFs; rather, they can gain access to a wider range of fund types, including separately managed accounts where their cash balances are of a sufficient size. There are operational benefits too. For example, a growing number and diversity of funds (as well as other short-term cash investments) are supported through independent portals such as FIS' [SGN Short-Term Cash Management portal](#), allowing treasurers to standardize and optimize processes, integration, reporting and analytics without limiting their investment choices.

WHERE DO YOU GO FROM HERE?

Whether you expect to maintain or revise your current investment policy, either by choice or necessity, there are some important steps you need to take.

- First, talk to your banks and fund providers to understand the implications of regulatory change for your business.
- Second, talk to your treasury committee, internal and external audit to check that your policies and processes are consistent with the changing regulatory environment.
- Third, talk to your system providers to make sure that your systems and processes support the full range of instruments that are permitted within your treasury policy.

Appendix A – Respondent Profile

Figure A1. Primary industries

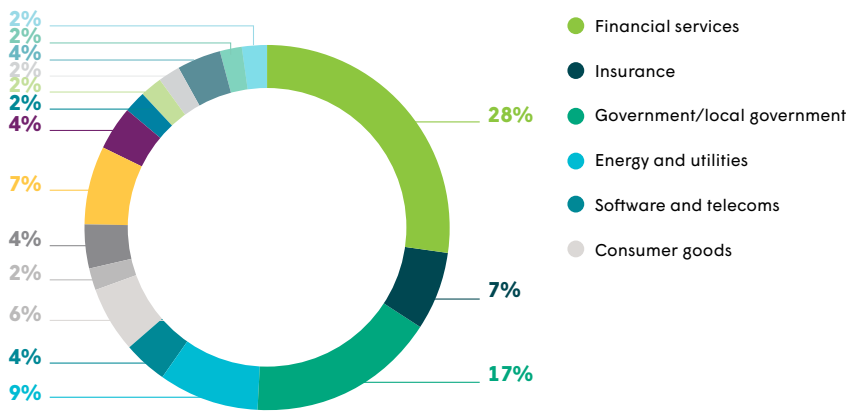


Figure A2. Headquarters of respondent organization

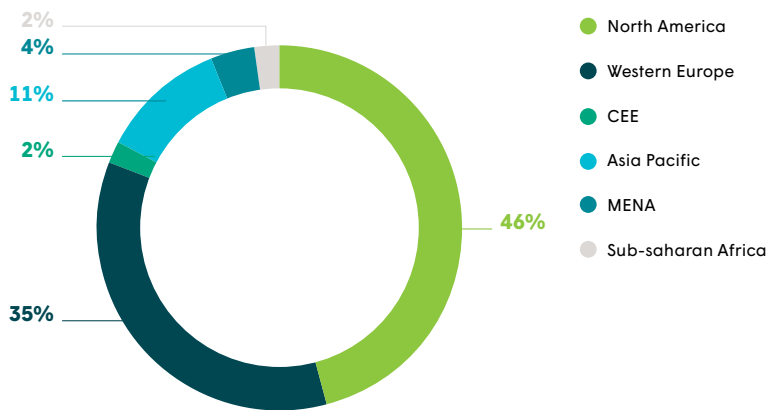


Figure A3. Location of respondent's treasury center

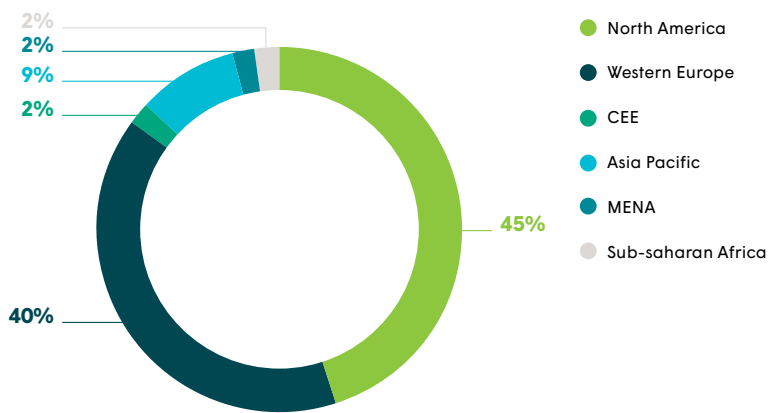
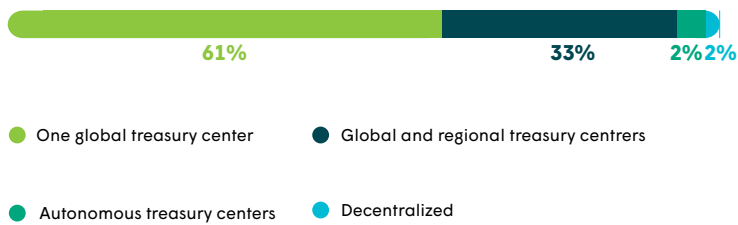


Figure A4. Treasury organization



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