Roger Merritt
Managing Director
Fund & Asset Manager Ratings

Douglas Murray
Managing Director
Global Structured Finance &
Investor Relations

STALE INVESTMENT GUIDELINES LEAD TO MISSED OPPORTUNITIES

Corporate treasurers at many U.S. companies are struggling to find investment options for cash reserves, but are often missing out on high-quality, short-term opportunities simply because their investment guidelines have not evolved with the capital markets.

One area in which this applies is eligible investments and their ratings. Changes in rating agency coverage since 2008 mean that corporations wanting to access the widest variety of cash investments should include all three global rating agencies — Fitch Ratings, S&P and Moody's — in their guidelines. Yet, a number of U.S. corporations have failed to update their policies to include these agencies, limiting their investment choices to a declining pool of eligible assets.

As a result, these corporations have fewer investment options and often earn lower yields on their cash than companies that have updated their guidelines. They may even be forced under their own guidelines to sell assets in response to a particular agency's rating downgrade, crystalizing losses that would otherwise be temporary.

Benefits of Updated Investment Guidelines

Corporate Cash Management Challenges

- Shrinking Investment Universe
- Low Yields
- Risk of Forced Selling
- Regulation (Floating NAVs & Basel III)

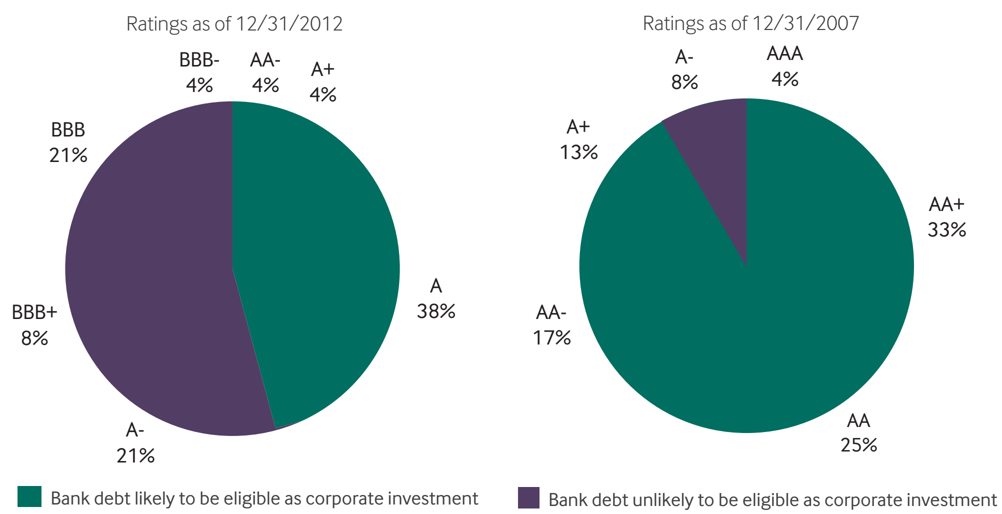
→ Updated Investment Guidelines →

Cash Management Enhancements

- More Investment Options
- Better Cash Utilization
- Flexibility
- Improved Transparency

As the supply of cash investment options falls, maintaining outdated investment policies increasingly puts firms at a competitive disadvantage. Most corporations require cash investments and issuers to hold an 'A' rating or higher. Ratings for the top 25 financial institutions in 2012 compared with those of five years earlier, highlight the diminishing availability of debt to corporations. Banks rated 'A' or higher fell to 46% at the end of 2012, down from 92% in 2007.

Ratings for Top 25 Banks: Investment Universe Shrinks



Credit ratings from all three major rating agencies

Source: FactSet

Effectively deploying cash holdings has become one of the chief concerns of finance executives, reports Greenwich Associates. Therefore, corporate CFOs and treasurers should have more inclusive guidelines to ensure access to a broader range of short-term investment options and achieve greater diversification. This includes incorporating ratings and analysis from all three major agencies.

STALE INVESTMENT GUIDELINES LEAD TO MISSED OPPORTUNITIES

Outdated Guidelines Restrict Cash Investment Opportunities

Investment guidelines at many U.S. corporations reflect an earlier time when reliance on one or two of the major rating agencies was common. This is no longer the case.

The global financial market has fundamentally changed and now it looks to all three global credit rating agencies — Fitch Ratings, S&P and Moody's — for ratings and credit opinions. The rating agencies' coverage of short-term assets has evolved, resulting in a growing diversity of ratings across the investment universe. Accordingly, corporations who have failed to update their guidelines stand to miss out on attractive options for investing their cash.

The use of credit opinions from all three agencies to inform investment decisions is not a new phenomenon. For example, most long-term institutional investors trust the Barclays Capital Aggregate Bond Index (formerly Lehman Aggregate Bond Index) as the benchmark for baseline investment performance. For inclusion into the index, Barclay's requires that an asset should be "rated investment grade using the middle rating of Moody's, S&P, and Fitch Ratings after dropping the highest and lowest available ratings."

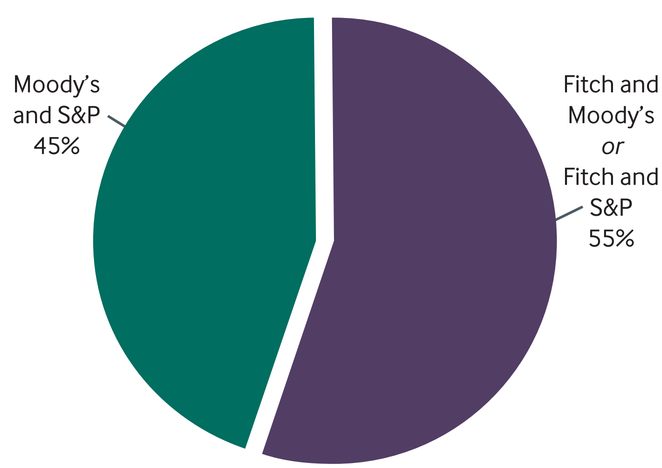
Suggested Corporate Investment Guideline Language — Ratings

"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 three said rating agencies (Fitch Ratings, S&P, or Moody's). Money market funds must be rated equivalent of 'AAA' by at least two of three said rating agencies (Fitch Ratings, S&P, or Moody's)."

The credit crisis only served to reinforce the importance of utilizing many different sources of information to guide investment decisions. A key lesson from the events of 2007-2009 was that an over-reliance on any one opinion or agency was a flawed approach. At the same time, the crisis fostered a change in the coverage of short-term instruments 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.

Money market tranches of U.S. asset-backed securities are a prime example. These instruments have become increasingly popular with some money market fund (MMF) managers and corporate treasurers as they seek higher-yielding, high-quality short-term investment alternatives. Analysis shows that ratings coverage of these instruments is increasingly dispersed across the three leading agencies, with ratings from Fitch Ratings combined with either S&P or Moody's (Fitch Ratings and Moody's OR Fitch Ratings and S&P) encompassing over half of the market. Therefore, if a corporation's policy excludes Fitch Ratings from their investment guidelines, the MMF stands to miss out on approximately 55% of the $18.9 billion ABS money market tranche market.

Missed Opportunities: Ratings Coverage of ABS Money Market Tranches



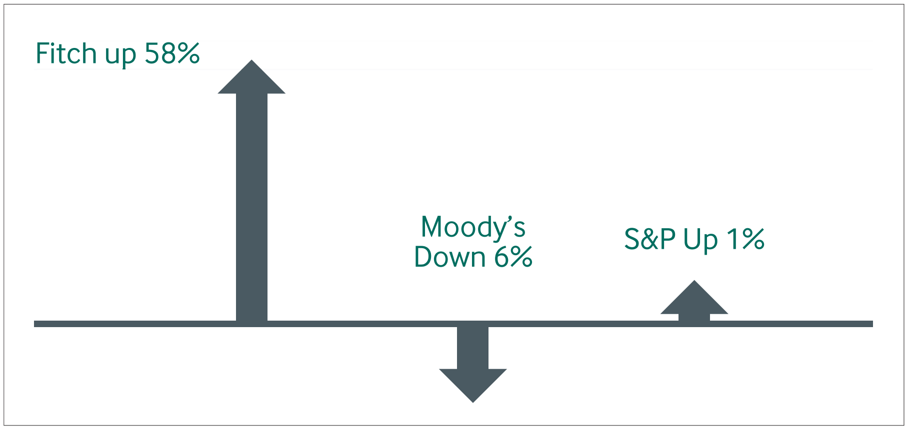
Rating Agency Coverage of U.S. ABS Money Market Tranches by Value (USD)
January-December 2012

Source: Bloomberg

STALE INVESTMENT GUIDELINES LEAD TO MISSED OPPORTUNITIES

The same can be said for rated MMFs, the preferred cash management choice for many corporations. The failure of the Reserve Money Market Fund has led to fundamental changes in the way MMFs are managed and rated. Analysis shows that since 2009, ratings coverage of MMFs has changed considerably. Moody's coverage of money funds has declined and S&P's has stayed virtually flat. During the same period, Fitch Ratings has substantially increased its rating coverage of MMFs (up nearly 60%).

The Dramatic Shift in the U.S. Money Fund Rating Landscape



Change in U.S. Money Fund Ratings (2010 to 2013)

Source: Crane Data

Downgrades Limit Corporations Short-term Investment Options

Since 2008, rating downgrades have had a tangible effect on the amount of cash investment options available to U.S. corporations. As this trend continues, corporations that continue to rely on ratings from one or two agencies put themselves at greater risk of being forced to sell short-term investments or struggling to find eligible investments.

> "By mid-May, 114 European banks and nearly half a dozen U.S. banks [could be downgraded]."
>
> ***– Wall Street Journal, April 2012*** [1]

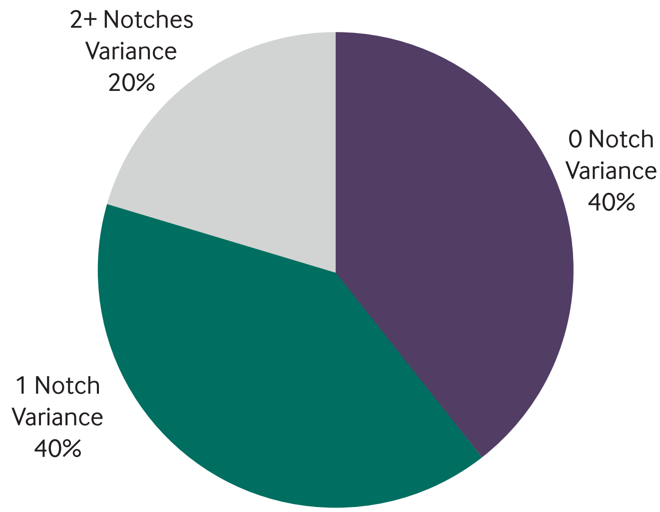
The risk of forced sales is exacerbated by the fact that rating agencies often have differing opinions on the credit quality of specific companies and/or securities. At times, there will be rating opinions that are outliers due to differences in methodology. One agency may have a particularly negative outlook on a sector or company while the two other agencies are positive.

Relying on only one or two agencies clearly can be limiting if one agency assigns a rating that is lower than what is allowed per investment guidelines, especially if the investor and the rest of the market views the issuer as acceptable. In this case, the decision to not invest (or to sell) may not reflect the market's collective view of the issuer's credit quality.

STALE INVESTMENT GUIDELINES LEAD TO MISSED OPPORTUNITIES

How often do ratings vary? The analysis below shows that rating downgrades and upgrades from Fitch Ratings, S&P and Moody's varied for approximately 60% of U.S. corporate debt from 2010-2012. In fact, the ratings varied across the agencies by one notch 40% of the time and by two or more notches 20% of the time. Using a greater diversity of credit opinions provides more flexibility to adapt to changes in rating methodologies or rating outliers.

Rating Opinions Vary, Sometimes Substantially



U.S. Corporate Rating Variance by Number of Notches from 2010-2013

Source: Bloomberg

Ratings can be a valuable input to the investment process, but most agree that one or two ratings should not drive the investment process. For corporations that choose not to update their investment guidelines, lost opportunities may be exacerbated by the possibility of forced asset sales, as uncertainty over the stability of many financial institutions and their ratings persists.

Regulations Are Further Limiting Cash Investment Options

U.S. corporations face a number of regulatory challenges that will further limit their available options for managing cash. In fact, many corporations will be forced to completely re-think their approach to cash management if these regulatory changes are enacted. Investment policies that are overly restrictive are an additional impediment to effective cash management in the current environment.

> "For a large number of institutional investors, the potential of principal loss would preclude floating NAV money market funds from being an internally approved investment alternative."
>
> ***- Association for Financial Professionals, April 2013*** [2]

STALE INVESTMENT GUIDELINES LEAD TO MISSED OPPORTUNITIES

'Floating NAV' and MMF Reform

Among the more controversial of proposed MMF reforms is the introduction of the 'floating NAV' in the U.S. and Europe. If adopted, this would require many MMFs to move away from their constant NAV $1 per share to a variable NAV based on the mark-to-market value of the underlying assets. Many corporations oppose this change as it could restrict the use of MMFs as an attractive cash investment option, offering accounting and tax simplicity.

> "79% of treasurers surveyed would decrease their use of MMFs or discontinue them altogether if MMF NAVs were required to float."
>
> ***- Investment Company Institute and Treasury Strategies, April 2012*** [3]

> "Boeing said that the proposed rule changes could make [MMFs] harder for [it] to use, leaving it with few other options for its $8.3 billion cash hoard, about a quarter of which is invested in such funds."
>
> ***- Wall Street Journal, April 2013*** [4]

Basel III

Basel III's liquidity rules will further limit cash management options by discouraging financial institutions from offering deposits to corporations. One focus of Basel III is getting banks to rely more on longer-term, stable sources of funding rather than short-term, wholesale sources such as corporate deposits. Basel III's liquidity coverage guidelines will require banks to hold a prescribed amount of assets to mitigate the risk of short-term funding shortfalls in a period of market stress. Thus, banks will be less interested in seeking corporate cash deposits.

As MMFs and bank deposits represent two of the top cash investment choices available to corporations, treasurers are significantly concerned about the impact of regulation on their day-to-day operations. A recent Greenwich Associates study[5] reported that 48% of treasurers and cash managers cited regulatory urgency as a major concern for 2013. The same study listed investment of current cash balances as another top concern of financial executives.

Facing the threat of regulation and pressure from CEOs and CFOs to more effectively utilize their cash on hand, corporate treasurers and cash managers will have to be more adept at deploying cash investments across a wider variety of safe, short-term assets.

As the search for short-term investment options hits an all-time high, the continued reliance on outdated guidelines leaves many U.S. corporations at a disadvantage. Those that don't act stand to miss out on investment opportunities that their peers – and competitors – are able to capitalize on.

> "A survey conducted by BlackRock found that 90% of clients would need to amend their investment policy to implement [cash investment options beyond MMFs, such as short bond fund alternatives and separately managed accounts], and many are not yet prepared for change."
>
> ***– Mark Stockley, BlackRock in gtnews, May 2013*** [6]

Conclusion: Update Guidelines to Maximize Opportunity

Many leading corporations in the U.S. and Europe have been proactive in adopting more inclusive investment guidelines that look to a greater variety of credit ratings. The longer that other corporations wait to incorporate ratings from all three agencies, the greater the disadvantage they will face from changes in the fixed-income market.

The variety of credit ratings, research and insight available to corporations has vastly increased. Changing outdated guidelines to incorporate intelligence from all three global rating agencies means wider access to high-quality, short-term assets, higher returns, and greater transparency that enables them to make more informed investment decisions.

"Investment guidelines that are flexible and include all the recognized rating agencies just makes good sense."

- Anthony Carfang, President, Treasury Strategies, April 2013

"We use all three global rating agencies when investing in money market funds and other cash management products. We value the diversity of opinions and the added research and transparency this brings."

- Francois Masquelier, President, Association of Corporate Treasurers of Luxembourg, April 2013

Notes

[1] Shrivastava, Anusha. "Downgrades Could Limit Shrinks for Money Managers." Wall Street Journal. 06 04 2012: n. page.

[2] Money Market Funds Reform. Association for Financial Professionals. Web. 1 June 2013

[3] Treasury Strategies, Inc. , ed. Money Market Fund Regulations: The Voice of the Treasurer. Washington, D.C.: Investment Company Institute, 2012. 11. Print.

[4] Monga, Vipal. "$2.4 Million Looking for Exits: The CFO Report." Wall Street Journal. 30 04 2013: n. page.

[5] "Greenwich Report." *U.S. Corporate Treasurers Seen Opening Their Wallets: Treasury Management Market Pulse*. Stamford, CT: Greenwich Associates, Nov. 2012.

[6] Stockley, Mark. Managing Cash in Challenging Times with Low Interest Rates. gtnews, 13 May 2013. Web. 1 June 2013.

Fitch Ratings

New York
One State Street Plaza
New York, NY 10004
+ 1 212 908 0500
+ 1 800 75 FITCH

London
30 North Colonnade
Canary Wharf
London E14 5GN
+44 20 3530 1000