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Billy Treger
Association for Financial Professionals
301.961.8869

Credit Market Turmoil Sees Flight to Quality by Organizations, according to new AFP Liquidity Survey

Nearly seven out of eight financial professionals that have held auction rate securities believed dealers would support auctions if bidders failed to materialize

June 30, 2008 – Bethesda, MD – In reaction to the credit crisis and recent market turmoil, companies have become increasingly conservative with cash holdings and short-term investments, according to the newly released *2008 AFP Liquidity Survey*. Further, with the collapse of the auction rate securities market, organizations appear to be less focused on securing higher rates of return on short-term investments and more concerned with preserving principal and ensuring access to their cash.

The *2008 AFP Liquidity Survey*, underwritten by Citi's Global Transaction Services unit, examines organizations' holdings of cash and short-term investments, as well as the credit crisis and its impact on investment strategies. Companies' decisions to stockpile cash, or use it for share repurchases or investments in long-term business opportunities, can be seen as important economic indicators.

Organizations are more likely to have made a substantial change to their balances of cash and short-term investments over the past six months than they have in recent years, according to the AFP survey. Thirty-seven percent of organizations responding to the survey reported holding a larger U.S. cash and short-term investment balance in May 2008 than six months earlier. Twenty-nine percent of organizations carried a smaller cash and short-term investments balance compared to six months earlier, while 34 percent of organizations reported no significant change in their short-term investment balances.

According to Jim Kaitz, President and CEO of AFP, "Companies are clearly holding onto cash and making safer investments in this economic climate. Rate of return is taking a back seat to safety of principal as firms look to protect assets, plan for future expenditures, and avoid getting burned in a tight credit market. Stockpiling cash is a sign that businesses are unwilling to invest in acquisitions, capital improvements, and expansion due to uncertainty about economic and business conditions."

"In today's environment, companies are very focused on improving internal cash efficiency and managing liquidity risk," says Elyse Weiner, Managing Director, Global Head of Liquidity and Investments at Citi's Global Transaction Services unit. "The survey shows that treasury departments and investment officers, focused on safeguarding corporate cash assets, are refining policies, practices and processes. At Citi, we are seeing treasury clients integrate global cash, liquidity and investment management processes - for better oversight and decisions, consistent with their organization's liquidity planning and investment policies."

The survey reports that companies have decreased diversification and moved to conservative investment strategies over the past 12 months. On average, organizations place nearly three-quarters of their short-term investments in three safe and liquid investment vehicles: bank deposits, money market mutual funds, and treasury bills. Conversely, this flight to quality has led to decreased use of commercial paper, repurchase agreements, and auction rate securities in short-term portfolios.

There was a significant shift in investment policies toward a primary focus on safety of principal relative to a year ago. Safety of principal was the most important cash investment policy objective for 75 percent of organizations in 2008, compared to 61 percent of organizations a year ago. Twenty-three percent of organizations ranked liquidity as the most important cash investment policy objective, compared to 24 percent a year ago, while at the same time, only two percent of organizations reported a focus on rate of return in 2008, compared to 15 percent of organizations in 2007.

The renewed emphasis on safety of principal and liquidity was triggered by a number of factors related to the credit market turmoil, not the least of which was the collapse of the auction rate securities market. Nearly seven out of eight financial professionals whose organizations held ARS at some point over the past four years reported that they believed that the dealer would support the auctions if bidders failed to materialize. Sixty-nine percent of financial professionals indicated that auction support was implied, while 17 percent reported that they were told explicitly that the dealer would ensure that the auctions would not fail.

A year ago, more than five percent of all short-term investments were made in auction rate securities. Currently, the average allocation of short-term investments made in ARS has dropped below one percent, and when asked about the future of ARS, virtually all financial professionals (94 percent) responded that they do not expect their organizations will re-enter the ARS market in the foreseeable future (i.e. beyond two years).

The use of municipal bonds and variable rate demand notes, as well as other short-term investments, has also decreased significantly.

- Commercial paper (off by 29 percent);
- Repurchase agreements (off by 44 percent);
- Enhanced cash total return vehicles (off by 27 percent);
- Separately managed accounts (off by 55 percent).

On average, organizations permit four investment vehicles beyond bank deposits and treasury bills in their short-term investment portfolios. This represents a significant decline from results in the past two AFP liquidity surveys. In the *2007 AFP Liquidity Survey*, organizations' cash investment policies allowed for an average of 6.4 investment vehicles beyond bank deposits and treasury bills. In the 2006 survey, the average was

7.6. On average, organizations actually invest in 2.4 types of vehicles (compared to 2.7 vehicles in the 2007 survey) for their cash and short-term investment balances.

About the Survey

Each spring, the Association for Financial Professionals surveys financial professionals on strategies associated with the management of short-term investments. The *2008 AFP Liquidity Survey* is based upon the responses from 342 financial professionals (10 percent response rate) from organizations in sectors including manufacturing, insurance, retail, energy, and banking/financial, among others. The survey was underwritten by Citi's Global Transaction Services unit. The survey questionnaire and report were produced by the Research Department of the Association for Financial Professionals, which is solely responsible for the content.

To obtain a complete report of the *2008 AFP Liquidity Survey*, please visit www.AFPonline.org/research.

About AFP

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