Association for
Financial Professionals

AFP SURVEY: REACTION TO THE U.S. CREDIT RATING DOWNGRADE

Key Results

August 2011

AFP Survey: Reaction to the U.S. Credit Rating Downgrade

Four out of five organizations that were holding U.S. Treasury securities on August 5, 2011—the day Standard & Poors (S&P) downgraded its long-term sovereign credit rating on the U.S. from "AAA" to "AA+"—have no intention of changing their holdings as a result of S&P's move. Few of the organizations making a move as a result of the downgrade will be liquidating any part of their current positions, but rather will refrain from future purchases. Access to capital is a greater concern: two out of five organizations anticipate a detrimental impact on the access to and/or cost of capital as a result of S&P's move, with the costs of both debt financing and bank credit being the most affected. But the biggest impact may be on the perception of the U.S. as an investment destination—a quarter of financial professionals view the U.S. as a less desirable investment destination as a result of S&P's downgrade.

These are the findings of a survey of financial professionals conducted by the Association for Financial Professionals (AFP) on August 9th and 10th, just days after S&P made its historic announcement. The five-question survey focused solely on possible impacts on organizations' investment strategies and access to capital—not on the validity of S&P's analysis.

Survey Findings

The *2011 AFP Liquidity Survey* (www.AFPonline.org/liquidity) found that 82 percent of organizations permitted the use of U.S. Treasuries as a part of their short-term investment portfolio. When that survey was conducted in May 2011, organizations held an average of 6.2 percent of their total cash and short-term investment holdings in Treasury bills with another 10.4 percent held in money market mutual funds invested solely in Treasury securities. The decision to include Treasury securities in one's short-term investment holdings is consistent with the primary investment objective of over three-quarters of organizations: safety of principal.

In mid-July, the *AFP Survey: Raising the U.S. Debt Ceiling* (www.AFPonline.org/liquidity) found that 20 percent of organizations that were holding (or at least had recently held) U.S. Treasury securities as a part of their investment portfolios shed some of these holdings during the U.S. debt ceiling debate as concerns grew that the U.S. government could default on its obligations.

That issue was resolved until after the 2012 elections when Congress and the White House reached an agreement to increase the debt ceiling in early August. Nevertheless, 13 percent of organizations investing in U.S. Treasury securities had reduced/liquidated these holdings during the two month period leading up to August 5th. This contrasts to the 79 percent of organizations that had not altered their holdings of U.S. Treasury securities. Eight percent of organizations added to their holdings of U.S. Treasury securities during the two month period leading up to August 5th.

Impact of Debt Ceiling Debate on Corporate Holdings of U.S. Treasuries —Holdings Versus Two Months Earlier

(Percentage Distribution of Organizations that Have Recently Held U.S. Treasuries)

Significantly increased its holdings	Slightly increased its holdings	No significant change to its holdings	Slightly decreased its holdings	Significantly decreased its holdings	Completely liquidated its holdings
2%	6%	79%	7%	4%	2%

During the evening of August 5, 2011, Standard & Poors publicly revealed its decision to lower its sovereign credit rating on the United States. Yet despite the analysis presented by the credit rating agency, most organizations will continue including U.S. Treasury securities as a part of their short-term investment portfolio. Eighty percent of financial professionals from organizations that had held Treasuries on August 5, 2011 indicate that their organizations are not altering their investment strategies regarding U.S. Treasury securities as a result of S&P's decision. Organizations that are reacting to S&P's decision are likely to take a modest action. Fifteen percent of organizations that held U.S. Treasury securities on August 5th plan to maintain current holdings of the securities, but do not plan on adding to these holdings. Only five percent of organizations with U.S. Treasury holdings were shedding some of these holdings as a result of S&P's decision.

In addition to direct holdings of U.S. Treasury securities, S&P's decision also could theoretically impact organizations' holdings of money market funds (MMFs) that are comprised solely of Treasury securities. Yet, only 22 percent of responding financial professionals indicate that their organizations will alter their investment strategies related to pure Treasury MMFs. Fourteen percent of organizations intend to maintain current holdings, but will forgo future purchases. Another seven percent will liquidate at least some of their pure Treasury MMFs holdings as a result of S&P's decision.

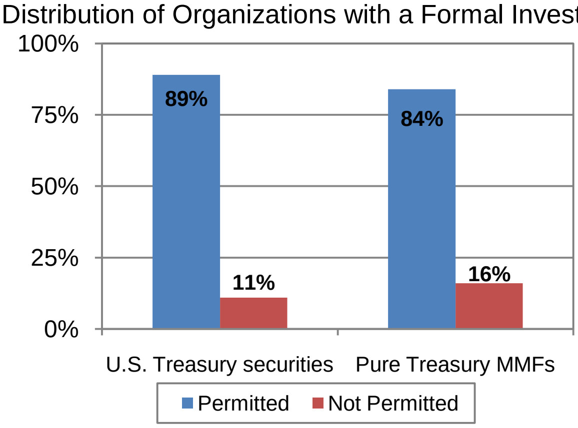
Impact of Standard & Poors' Decision to Lower its Sovereign Credit Rating on the U.S. on Corporate Holdings of U.S. Treasuries and Pure Treasury MMFs
(Percentage Distribution of Organizations that Held U.S. Treasuries on August 5, 2011)

	Organization will liquidate current holdings	Organization will liquidate some, but not all current holdings	Organization will maintain current holdings, but will not add to these holdings	Organization will not alter current investment strategy
U.S. Treasury securities	*	5%	15%	80%
Pure Treasury MMFs	2	5	14	78

According to the *2011 AFP Liquidity Survey*, 79 percent of organizations have a written cash investment policy. These polices enumerate the acceptable investment vehicles and the percentage of an organization's portfolio that may be invested in those vehicles, along with the maximum maturity allowed and the minimum credit rating necessary for each investment vehicle.

One reason why most organizations have not altered their current investment strategies related to U.S. Treasury securities and pure Treasury MMFs is that the downgrade by S&P did not make these vehicles ineligible for inclusion in their short-term investment portfolio. Treasury securities remain a permitted investment vehicle at 89 percent of organizations even when the sovereign credit rating for the U.S. falls below "AAA." Similarly, 84 percent of organizations' investment policies allow for the continued use of pure Treasury MMFs even after the credit rating of the U.S. falls below "AAA."

Organizations Permitted to Hold U.S. Treasury Securities and pure Treasury MMFs in Short-Term Investment Portfolios if the Sovereign Credit Rating for the U.S. Falls Below "AAA"
(Percentage Distribution of Organizations with a Formal Investment Policy)



The pricing of U.S. Treasury securities has a direct impact on both the supply and cost of capital available to businesses. Yields on Treasury securities serve as the risk-free rate-of-return in the pricing of bank credit and other forms of capital, as demonstrated in the recently released AFP report, *Current Trends in Estimating and Applying the Cost of Capital* (www.AFPonline.org/FPA). Should yields on treasury securities, and therefore the risk-free rate, increase as a result of the downgrade of the U.S. government's sovereign debt rating or future legislative disputes that could raise questions about the willingness or ability of the U.S. government to pay its debts, the cost of capital for many businesses could rise sharply with market disruption a possibility. When asked in July about a hypothetical failure of Congress and the White House to reach an agreement to raise the debt limit and a potential default by the U.S. government, 52 percent of respondents to the *AFP Survey: Raising the U.S. Debt Ceiling* had expected a detrimental impact on the access to (and cost of) capital had the agreement not been reached.

Relative to the debt ceiling issue, financial professionals are somewhat less concerned about the impact of S&P's decision to downgrade long-term U.S. debt. Two out of five survey respondents anticipate S&P's decision will have a detrimental impact on either access to and/or cost of capital. The two most widely cited impacts are cost-related: increased cost of debt financing (26 percent) and increase cost of bank credit (20 percent). Less widely cited are:

- Reduced bank credit availability (ten percent)
- Reduced access to debt financing (ten percent)
- Increased cost of raising equity capital (seven percent)
- Reduced ability to raise equity capital (seven percent).

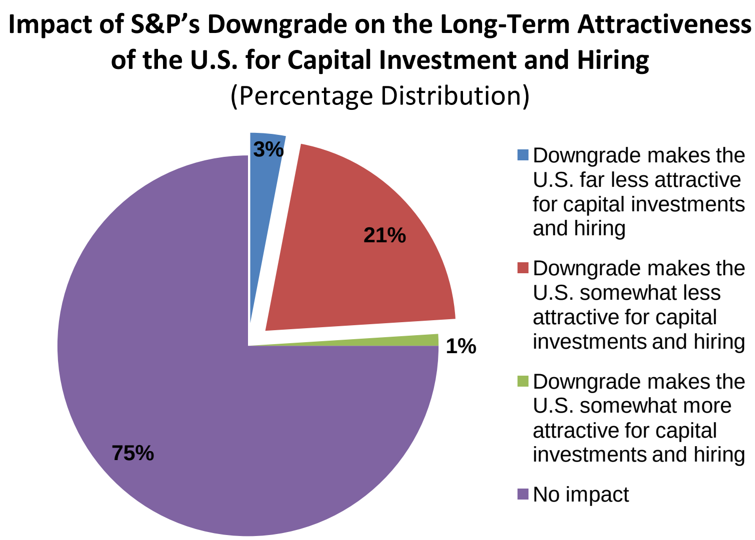
Anticipated Impact of Standard & Poors' Decision to Lower its Sovereign Credit Rating on the U.S. on Organizations' Access to (Cost of) Capital

(Percent of Respondents)

No impact is anticipated	60%
Increased cost of debt financing	26
Increased cost of bank credit	20
Reduced bank credit availability	10
Reduced access to debt financing	10
Increased cost of raising equity capital	7
Reduced ability to raise equity capital	7
Other	2

In addition to potentially impacting investment decisions and access to and the cost of capital, the downgrade of the sovereign credit rating could damage the attractiveness of the U.S. for domestic and foreign direct investment. One in four organizations believe the downgrade of U.S. sovereign debt makes the U.S. a less attractive investment destination. Twenty-one percent of financial professionals indicate that the S&P downgrade of U.S. long-term debt makes the nation "somewhat less attractive" for capital investments and hiring, while another three percent of survey respondents say the downgrade makes the U.S. "far less attractive."

Three-quarters of financial professionals see no impact from S&P's downgrade on the attractiveness of investing and hiring in the U.S.



Conclusions

Despite Standard & Poors' historic announcement that it had lowered its sovereign credit rating on the United States from "AAA" to "AA+," four out of five organizations that had held U.S. Treasury securities on the day of the announcement (August 5th, 2011) have no intention of changing their holdings as a result of S&P's move. This is a clear indication that U.S. Treasury securities remain an acceptable investment option for companies concerned about the safety of their short-term investment portfolios.

But if investment strategies will be unaffected, a significant percentage of financial professionals are concerned about the impact S&P's decision will have on their organizations' access to capital. Forty percent of financial professionals anticipate a detrimental impact on the access and/or cost of capital as a result of S&P's move, with increased costs of debt financing and bank credit being the most likely effects. Further, 24 percent of financial professionals indicate that S&P's move alone makes the U.S. a less attractive destination for capital investments and hiring.

The implication of this last finding is rather serious. *The 2011 AFP Liquidity Survey* found a number of organizations were beginning to utilize their cash holdings to work in growth initiatives; including capital investments, mergers & acquisitions and hiring. If some of these organizations are reversing course because of the S&P decision specifically (and macroeconomic conditions more generally), the state of the two-year old economic recovery may be in a precarious position.

About the Survey

The Research Department of the Association for Financial Professionals surveyed its senior-level members and prospective members on the possible effects the downgrade of Standard & Poors' U.S. sovereign debt rating could have on their organizations. The five-question survey generated 508 responses during the two-day period of August 9 and 10, 2011.

AFP Research

AFP Research provides financial professionals with proprietary and timely research that drives business performance. The AFP Research team is led by Managing Director, Research and Strategic Analysis, Kevin A. Roth, PhD, who is joined by a team of research analysts. AFP Research also draws on the knowledge of the Association's members and its subject matter experts in areas that include bank relationship management, risk management, payments, and financial accounting and reporting.

AFP Research also produces AFP EconWatch, a weekly economic newsletter. Study reports on a variety of topics, including AFP's annual compensation survey, and AFP EconWatch are available online at www.AFPonline.org/research.

Association for Financial Professionals

About the Association for Financial Professionals

The Association for Financial Professionals (AFP) headquartered in Bethesda, Maryland, supports more than 16,000 individual members from a wide range of industries throughout all stages of their careers in various aspects of treasury and financial management. AFP is the preferred resource for financial professionals for continuing education, financial tools and publications, career development, certifications, research, representation to legislators and regulators, and the development of industry standards.

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