Corporate treasurers today find themselves in uncharted and turbulent waters. They’re navigating internal pressures and external forces that are creating deep structural change in the banking industry—and that call for renewed strategies for running efficient global treasury operations. Today, many treasurers are once again embracing the Earnings Credit Rate (ECR) as a practical and versatile way to strengthen corporate income statements and manage liquidity. This value will only increase as banks broaden the range of Earnings Credit-eligible service fees and apply the concept globally across entities, geographies and currencies.
Internal and External Forces Create New Challenges

Treasurers now operate with higher corporate profiles, greater responsibility and more intense scrutiny than ever before. And they face a fast-changing environment that demands agile thinking about a host of complex internal and external variables.

The inside view: cost pressures require new strategies. Faced with tepid global growth, economic uncertainty and persistently low interest rates, treasurers continue to operate under corporate mandates to do more with less. But new performance metrics tied to expense reduction can be especially tough to meet as bank service fees, for example, continue to rise. What’s more, global expansion is challenging already overburdened treasury staff to carefully and economically manage cash positions and investments across currencies, time zones, jurisdictions and multiple bank platforms.

Treasurers must also adhere to internal investment guidelines emphasizing the need for increased liquidity and preservation of principal. In a low interest rate environment, the risks of tying up cash often outweigh the rewards. As a result, Directors are paying closer attention than ever to how much global cash treasurers are holding, what specific instruments they’re investing in and which financial institutions are holding these instruments. Increasingly, cash balances are becoming more challenging to manage as eligible options for cash placement decrease. Investment policies have become increasingly conservative, eliminating many of the investment options used prior to the crisis, and placing stricter balance limits on the remaining options.

Given these factors, treasurers are exploring strategies to offset costs, efficient ways to monitor and manage liquid assets, and safe investment solutions that minimize bank and sovereign risks all while ensuring liquidity.

External factors drive alternative cash strategies. These internal challenges are intensified by complex external factors that are challenging the status quo—and further dictating how treasurers operate. New and emerging regulations are bringing unprecedented structural change to the financial services industry, and treasurers are responding to a new norm characterized by higher service fees and tighter credit.

Treasurers are navigating several US regulatory changes. For example, when the FDIC Transaction Account Guarantee Program expired in 2012, and Regulation Q was repealed in 2011, significant levels of cash could have flowed out of bank deposits. But instead, according to the FDIC Quarterly Banking Profile—2Q 2013, non-interest bearing (NIB) deposits are still almost 70% of all bank deposits in excess of the FDIC standard maximum coverage limit of $250,000 per

The value of earnings credits: Sprint’s view

For Sprint, using earning credits to offset the cost of bank services has been a “win-win,” according to Jennifer Dale, Assistant Treasurer, and offers the company a range of benefits. “If you start with assessing returns, right now earnings credits are giving us better value for our balances,” says Dale. Cost reduction also plays a key role in the company’s use of earnings credits. That is evident in Sprint’s ongoing initiative to apply working capital best practices. That effort has freed up approximately $1 billion since its inception, and the use of earnings credits has been an important part of the initiative. Says Dale, earnings credits are “the gift that keeps on giving,” because they provide the company with ongoing budgetary relief, not just one-time expense reductions.

Sprint is now also using earnings credits to offset credit card acquirer fees. J.P. Morgan recently introduced an earnings credit program for users of Chase Paymentech™, a processor of merchant services. Notes Dale, “We can now use earnings credits to reduce our credit card service fees and interchange costs—an expense control tool that was simply not available before.”
depositor. This reflects treasurers’ continued interest in concentrating assets in DDAs and the value treasurers place on bank deposits.

Treasurers are also preparing for new bank regulations that will reshape and revalue traditional short-term cash positions. The new Basel III global capital adequacy regulations, which are being phased in through 2019, place a significant premium on bank funding through DDA balances linked to operating activity. As a result, bank operating accounts will remain attractive short-term vehicles. The SEC’s proposed additional reforms of institutional Money Market Funds could also affect this traditional vehicle for short-term operating cash.

Together, these variables are causing treasurers to rethink approaches to generate shareholder value. As the regulatory landscape shifts, many treasurers are reevaluating their global banking relationships and are using Earnings Credits derived from overnight DDA balances to unlock the intrinsic value of these relationships.

### Earnings Credits: A Versatile Strategy

As treasurers cope with internal and external forces and reexamine their cash management strategies, many are turning to Earnings Credits as a practical way to address multiple objectives and challenges. Earnings Credits can provide a stable and reliable way to reduce treasury expenses, maximize corporate profits and manage daily liquidity.

**A Hidden Benefit: Maximizing Shareholder Value.** Earnings Credits can also create significant value beyond the treasury budget. Treasurers are using them to improve key financial ratios. Specifically, Earnings Credits can enhance operating margin and potentially increase shareholder value, particularly as compared to traditional interest yielding investments.

Exhibit A demonstrates how Earnings Credits can impact key metrics on an income statement. Using Earnings Credits to lower cash payment for bank service fees can reduce reported Sales General & Administrative (SG&A) expenses directly. Reducing SG&A in turn improves Operating Income, or EBIT, and also impacts key financial ratios such as Operating Margin. For companies heavily leveraged or evaluated based on debt levels, using Earnings Credits to improve ratios such as EBITDA to Interest and Net Debt to EBITDA can provide benefits as well.

### Exhibit A: Sample Income Statement*

ABC Corp. Income Statement — $100,000 ECR vs. $100,000 in interest

<table>
<thead>
<tr>
<th></th>
<th>Traditional Interest</th>
<th>Traditional ECR</th>
<th>Interchange Offset ECR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Revenue</strong></td>
<td>2,000,000</td>
<td>2,000,000</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Cost of Revenue (COGS)</td>
<td>(300,000)</td>
<td>(300,000)</td>
<td>(200,000)</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>1,700,000</td>
<td>1,700,000</td>
<td>1,800,000</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Selling General &amp; Admin</td>
<td>(500,000)</td>
<td>(400,000)</td>
<td>(500,000)</td>
</tr>
<tr>
<td>Total Operating Expenses</td>
<td>500,000</td>
<td>400,000</td>
<td>500,000</td>
</tr>
<tr>
<td><strong>Operating Income or Loss</strong></td>
<td>1,200,000</td>
<td>1,300,000</td>
<td>1,300,000</td>
</tr>
<tr>
<td><strong>Income from Continuing Operations</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Interest Income</td>
<td>100,000</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Tax Expense</td>
<td>(10,000)</td>
<td>(10,000)</td>
<td>(10,000)</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>1,290,000</td>
<td>1,290,000</td>
<td>1,290,000</td>
</tr>
</tbody>
</table>

*Represents sample results for a hypothetical client. Clients are advised to consult with an accounting or financial advisor regarding the potential financial impact of Earnings Credits.

Earnings Credits have a unique impact on key metrics of the income statement compared to traditional interest yielding investments. The impact may vary depending on the fee offset.

As banks expand the types of fees that companies can offset with Earnings Credits, treasurers will have even greater opportunity to strengthen the income statement. For example, many companies book credit card acceptance fees, including interchange, under Cost of Goods Sold (COGS) because these fees tie directly to revenue. By using Earnings Credits to offset these fees and thereby reduce COGS, companies may not only be able to improve Operating Margin; they could boost reported Gross Profit as well. We suggest that clients consult with an accounting or financial advisor about the potential financial impact of Earnings Credits.
Maintaining full liquidity. Earnings credits are also suited to help treasurers maintain and manage daily liquidity so cash is readily available for multiple purposes. In today’s credit-constrained environment, this frequently includes self-funding working capital and capex for operations—a strategy that can help mitigate credit risks and lower the cost of capital. DDA balances are fully liquid bank deposits that are readily accessible throughout the business day and incur no withdrawal penalties or other restrictions. Liquidity is critical to companies with cash forecasting challenges that might have otherwise had to break term deposits and incur fees or wind down investments to meet unexpected working capital needs. Treasury staff can also take advantage of global bank portals, integrated with bank cash management platforms, to easily monitor and control global balances.

For treasurers, there’s a powerful opportunity at hand to rethink and reevaluate global banking relationships to determine which ones deliver the greatest intrinsic value. As they focus on the large pools of liquid assets used to support global operations, treasurers can potentially offset more banking fees by negotiating the Earnings Credit Rate based on DDA balances aggregated across entities, geographies and currencies as well as on the value of the broader banking relationship. Recent research has revealed a trend that is especially relevant to treasurers focused on cost control: companies that use Earnings Credits most aggressively also benefit from lower pricing on their banking services. The combination of internal and external factors is creating a renewed focus on Earnings Credits by treasurers and increased motivation for banks, and bodes well for a versatile solution that marries cost control with liquidity management.

ECR: A New Lever for Banking Relationships

The market factors are driving wider adoption of Earnings Credits—and ushering in a new paradigm for relationships between treasurers and their banks.

Regulations may motivate banks to rebalance the services they provide, rethink the service fees they charge and take a more holistic view of client relationships. As part of this strategy, banks recognize the intrinsic value of Earnings Credits balances toward client ROI, and are investing in new technologies and approaches that encourage client operating deposits. Look for banks to analyze the flow of corporate transactions and peg Earnings Credits to the value of these cash balances. Banks are also creating new services that take advantage of global relationships, including programs that make Earnings Credits a truly global solution for international cash balances—including balances held off-shore for strategic purposes.
Phillip Lindow is responsible for all aspects of the Liquidity business within J.P. Morgan’s Corporate and Investment Bank globally, including business strategy, product management, solutions development, financial management and sales. The business serves clients across all segments and regions.

Before joining J.P. Morgan, Phillip was head of the International Liquidity & Investment Management business for the Royal Bank of Scotland, where he also served as Head of International Cash Management for the Americas. During his 20 year career in financial services Phillip has also served as Head of Global Treasury and Investment Management at ABN AMRO, and has held various management roles at Chase Manhattan Bank and Deutsche Bank.

David Berse is a Senior Liquidity Advisor with J.P. Morgan Treasury Services. In his current role, David provides clients with guidance and advice on maximizing global liquidity through a range of deposit, cash concentration and investment solutions. In addition to working with clients, David is also works closely with product management to develop new liquidity solutions based on client needs. In his 10 years in financial services, he has also held positions in Advisory Services, a consulting team providing guidance to multinational corporations on achieving best-in-class cash management performance.

David holds a B.A. from Rutgers, an MBA from New York University’s Stern School of Business and a CTP certification from the AFP.