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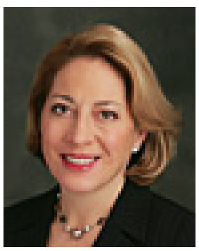
Dodd-Frank's Regulation Q Repeal Requires Review of Short-Term Investment Strategy



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From a corporate treasury perspective, one of the more significant provisions of the new US financial regulatory reform law is the repeal of Regulation Q, which for decades has prohibited the payment of interest on corporate demand deposit accounts.

Regulation Q was instituted in the 1930s as part of the Glass-Steagall Act, the same banking reform law that created the Federal Deposit Insurance Corporation (FDIC). In an effort to reduce risks and provide a level playing field for banks, interest payments on all checking accounts were prohibited, although NOW accounts introduced in the 1970s have enabled payment of interest on consumer checking deposits.

The Dodd-Frank Wall Street Reform and Consumer Protection Act repeals Regulation Q. Beginning July 21, 2011, a year after the financial reform act was signed into law, banks will be allowed to pay interest on corporate checking accounts. As a result, corporate treasury managers will need to re-examine their demand deposit requirements and short-term investment strategies.

Impact on Sweep Accounts

In the Regulation Q era, in order to have excess cash earn interest rather than sit idle in a demand deposit account, many treasury managers have used sweep capabilities offered by their banks. Corporations move excess cash from a checking account to a non-FDIC insured interest-bearing sweep account as the last transaction of the day, and then sweep the funds back into the checking account as the first transaction the following business day. Overnight sweeps have provided treasurers with a combination of earnings capability and full liquidity.

The repeal of Regulation Q will give corporations an additional choice for investing their excess funds — and a reason to re-evaluate their investment mix.

Different investment strategies will be appropriate depending on whether funds represent operating, reserve or strategic cash. Corporations should also follow different cash investment paths depending on the size and sophistication of their treasury management operations. Companies with more extensive operations will want to consider utilizing more vehicles for asset diversification, including money market accounts, alternative sweep vehicles and interest-bearing checking accounts.

With the repeal of Regulation Q, at many banks there will likely be some consolidation of sweep accounts, as well as the new option of a simple interest-bearing checking account. The latter will be the best option for many companies with a limited treasury management staff: An interest-bearing checking account doesn't require a company to manage end-of-day excess cash positions or worry about noninterest-bearing funds, and it limits offshore sweep reconciliation.

Money market instruments and other investment account options may offer greater earning potential but afford less liquidity. They also may carry more risk than demand deposit accounts.

Risk Considerations

While the repeal of Regulation Q means that some checking accounts will pay interest, any amount over $250,000 in an interest-bearing account will not be covered by FDIC insurance. On the other hand, there is no limit to the FDIC insurance coverage for non-interest bearing accounts.

Typically, the higher the interest rate paid, the riskier the investment. So it is important to evaluate any institution in the same way you evaluate all your investment decisions. Pay careful attention to the amount of interest a financial institution offers. If the rate is above prevailing market rates, it should raise a red flag — and the higher the rate is above the prevailing market rate, the bigger the red flag should be.

Deutsche Bank offers seamless integration across our offerings to provide clients with efficient liquidity management alternatives. With the Repeal of Regulation Q, Deutsche Bank will offer interest-bearing accounts for corporate and institutional clients. To determine which liquidity management alternatives you should pursue once the Regulation Q repeal goes into effect this summer, talk to your Deutsche Bank relationship manager.

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