US CDS clearing facility triggers European action

The financial crisis has brought efforts to standardise the credit default swap (CDS) market to a head, after the launch last month by Intercontinental Exchange of a US-based clearing facility, according to analysis group Datamonitor. The launch has forced regulators on this side of the Atlantic to intervene in an effort to set up a European equivalent, as the industry has failed to agree a centralised platform.

Datamonitor said that the financial crisis, and the ensuing collapse of Lehman Brothers underlined the enormity of the CDS market and its unregulated nature – the sector has no fully developed clearing and recovery protocols.

As a result, legislators and regulators are considering some drastic moves, ranging from a legislative push within the EU to establish a clearing facility and, most extreme of all, a bill before the US Congress that would effectively ban most forms of CDS trading.

With a US clearing facility now up and running, the frontrunners for establishing a centralised European platform are NYSE Euronext (through Liffe) and Eurex. However, Datamonitor said there remained much work to be done in the fields of pricing and risk management, as there were many competing tools in the market for determining the requisite levels of margins.

To satisfy regulators, JPMorgan has offered the source code of its own CDS analytical engine to provide a common platform for the proposed new facility.

EU on course to tighten bank regulation

The European parliament will vote this month on a measure to address the global financial crisis by tightening bank oversight and requiring lenders to hold more capital to cover potential losses.

In March, the European parliament's Economic and Monetary Affairs Committee drafted a rule that would force banks to keep a 5% stake in their structured finance deals or give an "unconditional warranty" that they have examined the loans or assets packaged as securities and sold to investors.

The bill "seeks to improve risk management and avoid a repetition of the current banking crisis", said the committee.

ACT warns of financing gap

An in-depth study on the effects of the credit crisis by the ACT has found that prepared treasury teams are still fairly well placed in the capital markets, despite the tough economic conditions.

Siddall: we need to come to terms with new norms

Bacon: more vulnerable firms face tough choices

But the survey, which was based on interviews with more than 40 corporate treasurers from non-financial companies in the FTSE 350, offered few other rays of sunshine.

The study found that typical borrowing margins had risen by up to five times, that companies were unclear on how much appetite banks had for new business, that banks' approval processes were haphazard, and that five to seven-year maturities were generally reducing to only three years when bank facilities were renewed.

Not surprisingly, companies lacking geographical diversity and operating in those industry sectors hardest hit by the recession were finding fundraising particularly expensive and challenging.

Further ahead, refinancing needs will increase in 2010 and 2011 "potentially creating a large financing gap", according to the study.

It is also likely that more corporates will obtain credit ratings so they can access non-bank sources of finance.

ACT deputy president Gerry Bacon said it was evident that more vulnerable companies would have to work hard to secure the investment capital needed, and might be forced to make tough decisions.

"Some bank staff are still stunned," he said, "and these findings show that the impact of the banking crisis goes far beyond funding."

Less expected findings from the survey were that a handful of treasurers still anticipated an improvement in funding conditions in the near future, and that a few banks might be using technical covenant breaches to create "substantial levers" in their favour.

Commenting on the findings, ACT chief executive Stuart Siddall added: "Banking markets have suffered changes, some of which could persist for a generation. We will need to accept the new norms.

"Treasury management has moved up the priority list. All corporates will need to ensure that their finance teams have the necessary skills to meet the treasury management challenges in the future." ■

More on the survey in the May issue.

Corporate tax burden grows

The UK's largest companies collectively contributed £11bn in corporation tax, or almost a quarter of the total corporation tax take, in the year to the end of March 2008.

The figures come from the fourth Total Tax Survey, published by PricewaterhouseCoopers on behalf of the Hundred Group of Finance Directors.

Among the survey's findings is that as well as paying £11bn in corporation tax, the largest companies also pay £12.9bn in other taxes and collected a further £42.6bn of taxes on behalf of the government.

After corporation tax (47%), the biggest drains on companies came from employers' national insurance contributions (20%) and local business rates (14%).

For taxes collected on the government's behalf, the largest amounts were excise duties for fuel, alcohol and tobacco products (41%), employee national insurance contributions and income tax deductions under PAYE (32%).

Although the absolute level of total taxes paid by Hundred Group members fell by 12.4% in the year to March 2008 – and is expected to decrease further in the year just ended as the economic downturn intensifies – the actual cost of tax is going up for many companies as their profits have sharply declined.

Hundred Group chairman Ashley Almanza said; "In this economic climate, the tax burden on large companies needs to be well understood. Taxation levels have an important impact on our ability to compete in a fiercely competitive global economy." ■

Sovereign wealth funds survive investment losses

Despite sustaining major losses on many of their investments, sovereign wealth funds (SWFs) still registered an 18% increase in the value of assets under their management in 2008 to $3.9 trillion, according to a report from International Financial Services London (IFSL).

IFSL's Sovereign Wealth Funds 2009 survey also revealed that another $5.5 trillion was held in other sovereign investment vehicles, such as pension reserve funds, development funds and state-owned corporations' funds, with a further $6.1 trillion in other official foreign exchange reserves.

IFSL said that an inflow of new funds had more than compensated for the losses sustained.

Since the sub-prime crisis began, SWFs, mainly those from Asia, have lost much of the $60bn they had invested in US, Swiss and UK banks. As a result, many have more recently focused on injecting liquidity and helping to revive their own local economies.

The report suggested that the pace of growth in SWFs' assets might slow down over the next few years because of lower commodity prices and the economic downturn, which could slow down the accumulation of foreign exchange reserves.

Even so, IFSL said it still expected total asset value to have doubled to $8 trillion by 2015.

"SWFs have increased their influence on global financial markets since the start of the credit crisis," said Marko Maslakovic, senior economist at IFSL.

"London is an important centre for SWFs, both as a clearing house for transactions and a location from which some funds are managed. The many advantages it offers as a business location should allow it to capture a growing share of this market in the coming years." ■

Pension pledge review urged as deflation looms

With stock markets reaching new six-year lows during February, the pensions accounting deficit of the UK's 200 largest privately sponsored pension schemes widened by £16bn to end the month at £45bn, according to Aon Consulting.

The employee risk and benefits management firm called on the government to review the way in which promises to index pensions are implemented, so that employers can manage the pension burden better.

Abraham: current rules on pension hikes drafted when deflation was not an issue

Aon pointed out that if the prospect of a period of deflation became a reality, then pension schemes would not benefit as they would be unable to reduce pensions being paid.

Yet if inflation returned, schemes would be obliged to pay pension increases, leaving pensioners with a substantial increase in purchasing power but widening scheme deficits even further.

"Flexibility over benefit structures is needed to allow employers to deal with their defined benefit pension promises," said Sarah Abraham, Aon actuary and consultant. "The current rules around pension increases were designed at a time when deflation was not a consideration."

She added: "Although increases to deferred members of a pension scheme allow negative inflation to offset positive inflation, increases to pensions in payment do not have this flexibility. We believe that to review the rules at the time is both a rational and proportionate response." ■

PwC sounds the alarm on pension accounting changes

Proposed changes to the way companies have to express gains and losses in their pension schemes have come under fire from accounting firm PricewaterhouseCoopers.

PwC said the changes would result in "huge volatility" as, for example, daily movements in the equity market would have to go through the profit and loss account.

PwC partner Brian Peters (pictured) said that a company's profits could show huge variance from year to year, regardless of trading performance.

At present, most companies put pension scheme gains and losses through the statement of recognised income and expense or spread the impact over time.

"There is no point imposing a technically robust solution if it is only applicable to pensions and does not include other volatile assets, such as property," said Peters. "We are not opposed to the amendment, but the investor community and businesses alike need consistency to make informed decisions."

Pension pain from quantitative easing

The government's quantitative easing policy will have a detrimental effect on pension schemes in the UK, according to asset management firm Schroders.

Margaret de Valois, actuary and client director at Schroders, said one side effect of quantitative easing would be a fall in gilt yields.

"Actuaries use gilt yields in their calculations to assess pension liabilities," de Valois explained, "and the compounding effect inherent in these calculations means that a fall of 1% in gilt yields can mean up to a 20% increase in the cost of final salary pensions."

Schroders said 20-year gilts had dropped over 70bp since the start of quantitative easing, inflating the Pension Protection Fund's February estimate of pension liabilities in the UK by around £100bn in just one week.

Many pension schemes do not have assets that behave in the same way as liabilities, so the increase in gilt prices will not be big enough to counter the increase in liabilities.

Schemes that have adopted liability-driven investment solutions should be better protected against changes in funding levels due to the rapid fall in yields.

Huge growth forecast for mobile banking

The worldwide number of users of mobile banking and related services is forecast to grow from 20 million in 2008 to 913 million in 2014, according to a study.

The research, by wireless analyst firm Berg Insight, said that in Europe and North America mobile banking would mainly act as an extension of existing online banking, and predicted 110 million users in Europe and 80 million in North America by 2014.

The study tipped Asia Pacific to become the most important regional market, with 65% of the total user base. Mobile banking is also expected to play a key role in bringing financial services to the Middle East and Africa.

Berg also forecast that 5-20% of the international money transfers currently handled by formal or informal agent networks would be carried out using a mobile handset by 2014.

"Mobile handsets are in an excellent position to become the primary digital channel for providers of banking and related financial services on emerging markets," said Berg Insight telecom analyst Marcus Persson.

Sharp fall in UK M&As

UK merger and acquisition (M&A) activity fell by 47% between the first and second halves of 2008, reflecting the worsening global economic outlook as 2008 unfolded, according to a study conducted for accounting and consulting firm PKF.

While there was a flurry of activity in the first half of the year, due mainly to the changes to the UK's capital gains tax regime that took place in April 2008, the collapse of US investment bank Lehman Brothers in September accelerated the loss of confidence already apparent in the market.

The result, said the study, was a 42% drop in deal volumes compared with the same six months of the year in 2007.

While deal value did actually increase by £92.3bn year on year, the rise was down to the government's bailouts of several of the UK's leading banks.

Private equity deals were affected, but private equity houses are adapting to the new face of the market by targeting more defensive niches and focusing on better management of their portfolio companies to preserve and create value.

Laven smells the coffee

Four coffee-related funds, including one for Islamic investors that complies with Shariah law, are being launched by London-based investment management consultancy Laven Partners.

The new funds include two trackers, one long and one short, which will follow the International Coffee Organisation's composite index. Laven's Alpha fund is a total return fund that will manage long/short exposures, while the Eiger Green Coffee fund makes use of Islamic financing methods.

Lussan: working in partnership with Eiger

Jerome de Lavenère Lussan, managing director of Laven Partners, said: "Investing in soft commodities requires an all-encompassing understanding of the industry in which you trade, from crop forecasts to production and distribution. Eiger is offering investors a broad choice in how they access the team's expertise."

Laven is working on the funds in partnership with Eiger Asset Management.

Bart Mauldin, senior investment advisor for Eiger Trading Advisors, said: "There is a strong and growing demand for physical-based commodity funds, particularly within the agricultural sector.

"The tracker funds are designed to give asset allocators a new, highly liquid asset to invest in.

"With the Green Coffee fund we aim to deliver returns of around 12% per annum and the Alpha fund has a targeted return of 15%." ■

Ratings downgrade/upgrade ratio plunges in finance sector

Moody's has confirmed that the financial services industry was the "most troubled sector" in 2008, with defaults from 101 companies. The credit ratings agency forecasts that the figure will hit 300 this year.

Moody's recently published its 22nd annual Corporate Default and Recovery Rates report, which covers the period from 1920 to 2008. It showed that 101 Moody's-rated financial companies defaulted on a total of $238.6bn of bonds and $42.6bn of loans last year.

For the first time since 2003, the number of ratings downgrades (992) exceeded the number of upgrades (268), and so emphatically that it sent the upgrade-to-downgrade ratio plunging to 0.3 compared with 2.0 in 2007. It is the largest decline in the ratio for 39 years.

Moody's also forecast that 2009 could be the year that the speculative-grade default rate exceeds the all-time record level of 15.4% set in the depths of the Great Depression in 1933. Back then, "the speculative-grade market was solely a fallen-angel market comprised exclusively of downgraded investment-grade issuers".

Bust: the speculative-grade default rate is set to hit levels last seen in the Great Depression

The agency observed that in the previous two credit cycles – 1990-91 and 2001-02 – high-yield bond spreads had peaked at roughly 1,000 basis points and were associated with peak speculative-grade default rates of roughly 10-12%.

"If this historical relationship were to hold up this cycle," the Moody's report predicted, "the recent peak of 2,000 basis points in the high-yield spread suggests that speculative-grade default rates could approach 20%." ■