Moody's rules out any more UK bank bailouts

The rapid growth in the UK's public debt burden caused by the "extraordinary support" afforded to the banking system means that further bank bailouts are no longer affordable, according to a report by Moody's.

The ratings agency said that it expected to gradually reduce the extraordinary government support assumptions that it had built into its debt and deposit ratings for each bank since the financial crisis broke, and to return gradually to lower, pre-crisis support assumptions.

How and when this change actually occurs depends on the importance of the bank and the pace of recovery of the UK economy.

A milestone in the process will be the Bank of England raising interest rates to more "normal" long-term levels. Moody's expects that overall it will generally take place over the short-to-medium term, meaning the next one to three years.

"However, there may be some institutions that have not sufficiently improved their standalone strength to offset the phasing out of extraordinary systemic support," the agency noted, adding that their senior debt and deposit ratings could be downgraded as a result. The phasing out of government support is also likely to take longer for the major banks than for smaller institutions.

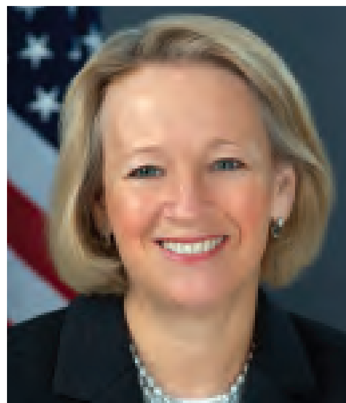
See On Intervention, p10

Bank of England: bailout cupboard now bare

SEC drags its feet on standards convergence

US watchdog the Securities and Exchange Commission has disappointed hopes of an early convergence of global accounting standards.

While the SEC confirmed its stance that the development of global accounting standards would benefit US investors it announced it would not make a final decision about convergence with International Accounting Standards until next year. And the first time that US companies will report under a converged system will be 2015 at the earliest.



Schapiro: discussion only beginning

But the SEC said it was continuing to encourage the convergence of US Generally Accepted Accounting Principles (US GAAP) and International Financial Reporting Standards (IFRS).

"For nearly 30 years, the commission has promoted a single set of high-quality globally accepted accounting standards, which would advance the dual goals of improving financial reporting within the US and reducing country-by-country disparities in financial reporting," said SEC chairman Mary Schapiro. "But supporting this goal is only the beginning of the discussion, not the end."

Nigel Sleigh-Johnson, head of the ICAEW Financial Reporting Faculty, said: "Those looking to the SEC to provide clear leadership in realising the G20 vision of a single set of high-quality global accounting standards may feel that this statement from the SEC fails to provide the reassurance they sought – that the US journey towards an IFRS future is well on track.

"While we warmly welcome the SEC's continuing commitment to this vision, it will only become reality once the US sets out a definitive timeline and deadline for switching to IFRS. The current cautious approach does not offer the much needed certainty required by US companies and the many jurisdictions still in the process of making final decisions about switching to IFRS reporting."

SEC staff are developing a work plan to evaluate what impact the use of IFRS by US companies would have on the US securities market. The SEC said that its objective was to decide by 2011 whether to incorporate IFRS into the US financial reporting system, and if so, when and how to do that. ■

UK leads in pension risk management

The UK's defined benefit (DB) pension scheme sponsors appear further ahead in addressing the key issues with "innovative risk management solutions" than their counterparts in the US and Canada, according to a report by Aon Consulting.

The group's Pension Risk Management Global Survey 2010 found that while North American pension schemes continued to focus on interest rates and equity markets, many in the UK had already tackled the issues and moved on to deal with the more challenging matters of longevity and inflation.

"Historically, the risk management products and solutions available to plan sponsors in the UK have been more advanced than those in the US and Canadian markets," said Andy McKinnell, Aon's investment principal and actuary. "UK schemes have access to pooled fund solutions that simply aren't available in the US or Canada.

"However, globally, current DB plan governance structures do not support rapid implementation of new strategies, and the tendency has been for plan sponsors to take on risk to improve their funded position, although improving funded status is dependent on rising long-term interest rates and strong global equity markets."

Aon added that pension plans on both sides of the Atlantic shared a need to be diligent in measuring and monitoring all risk types, to set an asset mix and investment structure suitable to plan design and individual needs, and to have solid skills and knowledge of risk management best practices.

FTSE 350 'can cope with pension deficits'

Companies in the FTSE 350 are generally well equipped to handle their pension liabilities, a new study has found. However, it has also warned that many are taking major unhedged risks by investing in volatile assets such as equities that could fall in value just as their liabilities rise.

The study, by actuarial consultancy Hymans Robertson, also reported that five major companies – BA, BT, GKN, Interserve and Trinity Mirror – still have a pension deficit that exceeds their entire market capitalisation.

Fortes: risks are unnecessarily large

Royal Bank of Scotland's pensions deficit, at 69% of its stock market valuation, is at least double that of any other UK bank and grew to £11bn by the end of last year.

Hymans Robertson added that while accounting rules meant that corporate pension schemes would show much larger deficits for 2009 than for 2008, the schemes' actual position had not significantly deteriorated.

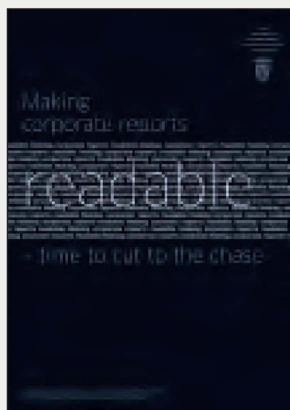
"The good news is that, in spite of these increased deficits, most FTSE 350 companies remain well equipped to deal with their pension liabilities," the study concluded.

The average FTSE 350 pension deficit is around 6% of market capitalisation, compared with 12% a year earlier. A deficit of this magnitude could typically be eradicated with less than a half-year's earnings.

Clive Fortes, head of corporate consulting at Hymans Roberston, suggested that the investment risks taken by many pension schemes should be curbed.

"Large chunks of the FTSE 350 do not have an unmanageable pension problem," he said. "Given that, why would they risk sums equal to a fifth of their market capitalisation?" ■

ICAS makes case for corporate brevity



The annual reports of listed companies are overly complex and focus more on compliance than on providing investors with useful information about the business, says the Institute of Chartered Accountants of Scotland (ICAS).

ICAS's proposed solution, set out in its publication Making Corporate Reports Readable, is that top management should communicate what they see as the most important aspects of the organisation's past performance and future strategy in a maximum of 20 to 30 words.

"It's clear that something radical must be done," said Hugh Shields, chairman of the ICAS corporate reporting taskforce and head of external reporting at Deutsche Bank.

Over the years the annual reports of many businesses have turned into a Frankenstein's monster of information intended for a number of different users. But, at its heart, financial reporting is about effective communication with investors.

"The short form report is not intended to replace the full annual report and financial statements, but would use alternative reporting technologies, such as XBRL [eXtensible Business Reporting Language] to allow the user to access this more detailed information via web links," said Shields. "In effect, the full annual report and financial statements would sit behind the short form report."

ACT Digest

Below is a brief round-up of the issues the ACT has been working on in the last few weeks.

Policy & Technical

■ **Non-bank lending**
Following consultation with members, the ACT has submitted a response to HM Treasury's paper on non-bank lending. The ACT welcomed the initiative and is discussing a multitude of small steps to help promote the availability of debt capital to businesses. Many of the obstacles are based on habitual behaviours, and education and development of standards will be more helpful than extensive legislative programmes.

A lack of competition in the banking sector will increase the costs incurred by mid-tier companies without access to alternative sources. At the Prime Minister's Global Investment Conference in February, ACT chief executive Stuart Siddall raised this point with Alistair Darling, who accepted that competition within the banking sector had to be increased.

■ **Banks too big to fail**
Either regulation is required to ensure that large banks cannot fail or, if they do, that the impact of that failure is not systemically damaging. Healthy and vibrant banks and markets are essential to corporate success.

Visit www.treasurers.org/technical for the latest updates from the ACT policy and technical team.

ACT Middle East

■ **TT draws crowd**
Nasser Saidi, chief economist of DIFC, addressed a packed ***talkingtreasury*** event in Dubai last month (see page 36 for a full report on the event). Over 120 professionals attended – the highest turnout so far – to discuss key challenges facing treasurers in the region.

The next event will take the form of a breakfast briefing in Dubai on 8 April to provide practical guidance and discussion on funding options and techniques for Middle East borrowers.

For more information on ACT Middle East, visit www.actmiddleeast.org

IAS 19 change could hit equity investments

Planned changes to international accounting standards could affect attitudes to pension plan investments, suggests pension consultancy Mercer.

The group said that the proposal under IAS 19 to replace the current form of "expected return on assets" in the pension component of profit and loss could persuade many CFOs to review the investment strategy for their company pension plans.

"This proposal effectively means that, in their profit and loss, companies would no longer be automatically rewarded for taking investment risks through their pension plan assets," said Warren Singer, the group's UK head of pension accounting.

"Currently, a pension plan that is heavily invested in equities will report a higher expected return on assets and a lower pension charge to profit or loss than a plan taking no investment risk, even if the actual return on equities over the accounting period is poor. The proposed change would mean a removal of this incentive for CFOs to support investment in equities."

Mercer said that if the proposed change were applied to the accounts of all sponsors of UK pension schemes, it would wipe about £8.7bn from the annual reported pretax profit or loss based on current asset allocations.

Importers feel devaluation pain

Currency volatility was greater in 2008 than in 2009, according to Moody's.

In a report on currency volatility the credit ratings agency said that while there were swings during 2009 for many currencies, the closing and average rates were not significantly different.

According to Moody's, prolonged devaluation creates operational issues for companies that produce revenue and costs in different currencies – for example, UK retailers that generate sales in sterling but pay for their imports in euros or US dollars.

Also hard hit are emerging market-based companies that have borrowed in US dollars or euros but are servicing and repaying debt from local currency earnings.

Islamic finance comes to terms with hedging

The first worldwide standardised documentation for privately negotiated Islamic derivatives has been launched by the International Swaps and Derivatives Association (ISDA) and the International Islamic Finance Market (IIFM).

The move came in response to growth in the Islamic finance market, which prevents investors from receiving interest payments. Islamic law also prohibits speculation, creating problems for institutions that seek to hedge through swaps, futures or options while continuing to observe religious guidelines.

"Given the growing nature of the Islamic finance industry, the institutions operating on Sharia principles can no longer afford to leave their positions unhedged," said Khalid Hamad, IIFM chairman and executive director of banking supervision for Central Bank of Bahrain.

Robert Pickel, executive vice-chairman of ISDA, added: "Some key hedging products are now becoming common across jurisdictions to mitigate risk. With any derivatives market, you need an active underlying cash market, so growth in Islamic hedging transactions will go hand in hand with the overall growth of Islamic finance." ■

See The Lie of the Land, page 34

Six-point plan to rescue workplace pensions

The Noughties were a "lost decade" for pensions, and the next government should adopt a six-point plan to fix workplace schemes says Ray Martin, investment council chairman for the National Association of Pension Funds (NAPF).

Speaking at NAPF's recent investment conference, Martin outlined the basic steps needed as:

- a reversal of the decision to scrap higher-rate tax relief on pensions contributions;
- a simplification of the reforms to be introduced in 2012, which require all employers to offer a qualifying workplace pension scheme and automatically to enrol eligible staff;
- an extension of the objectives of the Pensions Regulator to include helping foster an environment in which pension schemes can flourish and not solely to defend the Pension Protection Fund;
- a push to ensure that accounting standards are fit for purpose and give transparency to investors while recognising the long-term nature of liabilities; and
- the issue of more long-dated and index-linked gilts to help pension funds match their liabilities more easily.

Martin: regulator needs wider remit

Martin said it was essential that both state and workplace provision of pensions was simple to understand. ■

Meanwhile significant numbers of FTSE 100 companies are looking to fund their pension scheme deficits directly or indirectly with non-cash assets, such as real estate, intellectual property or copyright, says PricewaterhouseCoopers.

PwC estimated that the combined pension deficit of those companies actively looking at non-cash funding could fall by £10bn, which represents around 10% of the £100bn combined FTSE pensions funding deficit.

Under these non-cash funding agreements, assets are paid directly into the pension scheme or used as security payable in the event of default or insolvency. The enhanced security enables trustees to reduce or defer demands for cash contributions from the sponsor. ■