IN BRIEF

The IASB project to replace **IAS 39** is continuing, with frequent board meetings to move the debate on. The IFRS 9 standard on the recognition and measurement of financial instruments has now been published, although financial liabilities has been excluded from its scope. The work on looking at the treatment of own credit risk on liabilities will cease as a free-standing workstream.

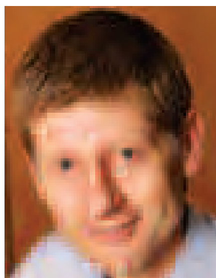
The tightening of credit standards on bank lending in Europe is nearing its end, according to the European Central Bank. The ECB's euro area lending survey of 118 banks was conducted in the second half of September. Credit standards are the criteria that reflect a bank's lending policy. Just 8% of the banks reported tightening compared with 21% in 2009 Q2, but the cumulative tightening since the financial turmoil has not yet gone into reverse and remains very substantial. Companies in the market for bank loans may like to benchmark their banks' attitude to the average revealed in the survey.

Credit rating agencies may be more vulnerable to lawsuits if proposals from the US House of Representatives' Financial Services Committee are enacted. The House has approved a bill to create accountability for credit rating agencies by imposing liability and clarifying the ability of individuals to sue.

In the past credit rating agencies have maintained that their ratings are merely opinions and are therefore protected under the First Amendment on freedom of speech and the press. But recent lawsuits have argued that on structured products the agencies were more involved in the structuring and therefore were in part responsible for the problems.

In September the US Securities and Exchange Commission adopted new rules to reduce the reliance on ratings in other regulations and proposed measures to increase competition and improve standards and transparency. Issuers would be obliged to disclose the rating levels they were awarded while shopping among credit rating companies.

The October Technical Update reported that the IASB had issued an **IAS 19** exposure draft on the discount rate for employee benefits, which would remove the requirement to use government bond rates as the discount rate on pension liabilities when there was no deep and liquid market from which to derive high-quality corporate bond rates. This proposal has now been withdrawn.



INTRODUCTION

By Martin O'Donovan
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There are mixed messages as to whether the relative lack of bank lending is due to reduced supply or reduced demand. The Bank of England's Q3 Credit Conditions survey showed that demand for credit by private non-financial corporations had risen in line with expectations for medium-sized companies, but fallen slightly for larger companies.

But whatever the statistics show, companies should be seeking a diversification of borrowing sources. Little by little new routes into non-bank lending are developing and the new electronic retail bond market from the London Stock Exchange, covered below, might be another nudge in that direction. New players are appearing too, particularly to help mid-sized companies. It will be interesting to see what the market looks like in a year or two.

LSE oils pricing wheels for retail bond investors

The London Stock Exchange's launch of a trading platform for retail investors early in 2010 should give a big boost to the demand for bonds.

Although strong demand from retail investors has been one of the significant features of the bond markets this year, the ability of individuals to invest in small ticket sizes has not been that easy. That should change when the LSE's retail trading platform, initially covering sterling corporate bonds and gilts, is up and running. The system is already in use on the Borsa Italiana, where there is a thriving retail bond market.

The aim is to provide a cost-effective and transparent mechanism for retail price discovery in the secondary sterling markets. Market makers will enter executable two-way quotes and all members will be able to enter tradable orders. Members will be able to execute deals for investors electronically, with straight-through processing through to CREST and a flat per-trade pricing structure offering simplicity and cost efficiency.

APCIMS (Association of Private Client Investment Managers) has reported huge demand for bonds from retail investors and estimates the size of the UK retail bond market in corporates alone to be in the region of £2bn (see the July/August 2009 issue of The Treasurer, page 22). The ready availability of transparent pricing, particularly when it comes to disposing of an investment, should give a major boost to this market segment.

Over 10,000 debt securities are currently admitted to the LSE's markets, but these are available on-exchange for trade reporting only. At launch the LSE hopes to have over 100 existing issues available for electronic retail trading.

This new facility will clearly be of benefit to retail investors by making dealing easier. But it should also be a real help to treasurers as issuers. It will provide a cost-effective mechanism for primary market distribution too, although all the normal Prospectus Directive rules will still apply to the listing particulars.

The requirements for retail-sized denominations are more onerous than issues to professional investors, but the differences are minor compared to the benefits that arise from retail demand (see the July/August 2009 issue of The Treasurer, page 24). ■

Yale's key to finance

For any perpetual students, Yale University offers an open course on the financial markets via the internet, and it's free. Professor Robert Shiller gives 26 lectures covering risk management, portfolio diversification, efficient markets, debt markets, asset classes, options, investment banking and much more, and the site also offers set problems and tests. Alternatively, you can just read them as very interesting articles – the one on behavioural finance is a particularly good read.

http://tinyurl.com/5tprtq

IAS 39 rewrites impairment model

The project to replace the IAS 39 standard on financial instruments has moved into its second part with the issue in early November of the model for assessing impairment on financial assets that are carried at amortised cost.

The aim of the model is to improve the accounting for provisions for losses on loans and the transparency of the credit quality of financial assets. The existing standard uses an incurred loss model whereby loans may be written down (impaired) only when there is evidence that a loan or a portfolio of loans will not be repaid in full. Objective evidence of a trigger event is required, such as significant financial difficulty of the obligor, or the lender granting a concession to the borrower because of the latter's financial difficulties.

The model proposed is based on expected losses. An entity will determine the expected losses on a financial asset when that asset is first obtained, and will recognise contractual interest income less the initial expected losses over the life of the instrument. The expected loss is reassessed each period and the initial effective interest rate is then applied as the discount rate to the probability-weighted future cashflows.

The incurred loss method has been criticised for recognising losses too late. The new proposal is to include the risk of default in the calculation of the interest on a loan right from the outset, with a provision for credit losses built up over time. This is supposed to be a better reflection of the economic interest a lender expects to earn, bearing in mind that part of the contractual interest rate is compensation for the expected losses.

The IASB's exposure draft specifies a detailed breakdown of the interest income and the effects of expected credit losses. The gross contractual interest, the allocation of initial expected losses and the net of these and gains and losses from changes in estimates are to be presented separately in the statement of comprehensive income. In addition there will be disclosures around the inputs and assumptions and the general quality of an entity's financial assets including stress-testing if management prepares this for internal purposes.

The proposed impairment method will also apply to non-interest-bearing assets. The aim is to finalise the standard in 2010, with no mandatory application before 2013. ■

Thumbs up for narrative reporting

The Accounting Standards Board (ASB) has concluded that UK annual reports are getting better although they are still cluttered with unnecessary information.

Most companies, an ASB review said, were providing content above compliance level in their financial reviews, in the description of objectives and strategies, and in the provision of financial key performance indicators (KPIs). However, "immaterial clutter" detracted from important information in the corporate social responsibility (CSR) section and risk reporting.

Just 6% of companies reached best practice levels in risk reporting, and only 38% provided compliant discussion of trends and factors.

The ASB review has been backed up by the publication by Deloitte of its own survey results on the narrative sections in annual reports, which similarly concluded that disclosure was improving. For companies other than investment companies, some of the Deloitte findings were:

- Three areas saw dramatic increases over 2008: 83% (2008: 47%) discussed their capital structure and financing; 68% (2008: 48%) discussed treasury policies; and 47% (2008: 22%) discussed their current and prospective liquidity. In some cases companies were merely reassuring the market about the strength of their financial position. For about a third of companies, relative weaknesses or uncertainties related to their going concern and liquidity positions were discussed.
- Nearly all companies (96%, compared with 89% in 2008) clearly described their principal risks and uncertainties. Companies disclosed eight risks on average.
- And 84% of companies (2008: 77%) clearly identified their KPIs. The average number of KPIs per company was eight, of which five were financial in nature and three non-financial. However, companies performed poorly in explaining the KPIs selected and their link with strategy.

IN BRIEF

The definitions of a **money market fund** (MMF) vary considerably across Europe, depending in some places on local regulation and in others on local trade association terminology. The Committee of European Securities Regulators (CESR) is consulting on a common definition, the main aim of which is improved investor protection.

CESR proposes a two-tiered approach to a definition of European MMFs: short-term MMFs operating a very short weighted average maturity and weighted average life; and longer-term MMFs (which would be required to provide information explaining the impact of the longer duration on the risk profile). In both cases specific disclosure would be required to draw attention to the difference between the MMF and investment in a bank deposit. It should be clear, for example, that an MMF's objective of preserving capital is not a capital guarantee.

The **asset purchase facility** run by the Bank of England has been in place since the start of 2009 to provide support to the funding of UK business and as the vehicle for quantitative easing. By the end of Q3, the amounts purchased were £922m of commercial paper and £1,073m of corporate bonds, with £151,775m of gilts.

On 3 August, the Bank launched a secured commercial paper facility to support the provision of working capital to non-investment grade companies ineligible for the Bank's commercial paper facility. To date there have been no eligible programmes created and consequently no purchases.

A piece in the November Technical Update covered proposed changes to the **Prospectus Directive** and said: "Changes proposed include requirements to keep summaries brief and non-technical and act as an introduction to the prospectus as a whole, being subject to civil liability only if they are misleading, inaccurate or inconsistent when read together with the other parts of the prospectus."

We omitted to add that the proposal intends to add civil liability in respect of the summary if it does not provide key information enabling investors to take informed investment decisions and to compare the securities with other investment products. This further point creates an almost impossible task for prospectuses of being comprehensive but still a summary.