Asset swaps surge sends liability hedging soaring

The third quarter of 2011 saw a significant increase in interest rate hedging by UK pension funds, over 30% above the previous quarter.

This represented approximately £13bn equivalent of liabilities hedged compared with £9.3bn during the previous quarter, the highest quarterly increase since the F&C Liability-Driven Investment (LDI) Survey began in 2008.

Inflation hedging was also up to the highest level seen over the previous six quarters, and up 34% quarter-on-quarter, representing around £9bn of liabilities hedged.

However, according to the survey, outright hedging has been lower than in previous quarters, with the majority of the increase attributable to a rise in asset swap activity.

Alex Soulsby, head of derivative management at F&C, said: "These trades are switches between instruments used for hedging which occur where a scheme takes advantage of higher gilt yields compared with swaps or simply takes profit on an existing position.

"The relationship between swap and gilt yields was especially volatile during the last few months due to rumours about the Bank of England buying gilts. We believe that while outright hedging has remained muted, switches either physically or synthetically will continue to be a major contributor to the total risk traded in LDI."

Since some pension schemes target specific levels of real yield at which to add LDI hedges, the survey also asked the derivatives trading desks at investment banks whether index-linked gilts would reach a real yield of 1% during the next 12 months. The response from the banks was a resoundingly unanimous no.

Soulsby said: "This is a worrying time for pension funds as real yields have steadily fallen over 2011, resulting in a substantial increase in their liabilities.

"In addition some pension funds have targeted market yields that are far from triggering and are reluctant to hedge outright at such historically depressed levels.

"However, in the current uncertain environment there is little prospect of a return to previous levels."

MEPs vote for sovereign debt speculation ban

European MEPs have voted for a regulation to ban short selling and trading in credit default swaps (CDS) in an effort to curb the sovereign debt speculation that last month spread to Italy.

The new rules, which will take effect from November 2012 if formally approved, aim to preserve the powers of the EU financial markets watchdog ESMA. They impose greater transparency and outlaw certain CDS trades to prevent speculation on a country's default.

Among the practices banned is so-called naked CDS trading, where speculators purchase default insurance contracts without owning the related bonds. Purchasing Italian CDS, say, will therefore require the buyer either already to own Italian government bonds or a stake in a sector dependent on the performance of the bonds, such as an Italian bank.

A national authority will be able to lift the ban for up to 12 months if its sovereign debt market ceases to function properly, with the potential option of renewing it for six more months.

Canfin (inset): Parliament has the political will

French MEP Pascal Canfin said: "These rules prove that the EU can act against speculation when the political will is there. This rule will make it impossible to buy CDS for the sole purpose of speculating on a country's default."

Many MEPs pressed for a rule to convert a naked short sale, the riskiest form of short selling, to a normal short sale within a single trading day. The so-called "locate and reserve rule" would have forced traders both to notify from where they planned to borrow the shares and to guarantee that borrowing was possible. The guarantee has been amended to a "reasonable expectation" of being able to borrow.

Reporting requirements will also be stepped up so that national and European supervisors are alerted early to any sizeable short position. ■

Pensions ruling stirs restructuring worries

A recent Court of Appeal ruling in the long-running litigation between the Pensions Regulator, the Pension Protection Fund and the administrators of Nortel and Lehman Brothers has implications for the restructuring of insolvent companies.

The court supported the regulator following a legal challenge to a High Court decision over obligations to members of both groups' pension schemes. It upheld a ruling that where a financial support direction (FSD) is issued after a company goes into insolvency, the cost of complying with the FSD is an expense that ranks ahead of other creditors' claims on the company, including those of banks and other senior lenders.

The decision has deepened concerns that it could make restructuring strategies more difficult for companies with large pension deficits and for other companies in the same corporate group. It is likely to influence how the regulator takes action against insolvent companies and how companies structure their pension scheme.

There could also be regulatory implications for banks and insurers, as the decision effectively gives the claims of pension scheme members priority over those of depositors and policyholders.

Germans admit to finance 'uncertainty'

Most Germans regard a good knowledge of investment and finance as important, but only half believe they are well informed on the subject, a survey suggests.

The findings come from market research firm Forsa, which canvassed the opinions of more than 1,000 German adults for Boerse Stuttgart, Germany's second largest stock exchange, which focuses on derivatives and corporate bonds.

While 84% of respondents agreed that everyone should have an understanding of investment and finance, 52% described themselves as poorly or not at all informed.

Putting financial education on the school curriculum was supported by 73%. Books and magazines were seen as particularly good sources of financial information and were cited by 65%, while 52% said they trusted banks, independent financial advisers, insurers and investment companies. The latter group was particularly strongly represented in the 18–29 age range – 72% regarded banks and insurers as reliable sources of information. Neutral trading institutions such as stock exchanges were cited as good sources of information by one in three of the survey's respondents.

Lammersdorf: education is best protection

"Education is still the best protection for investors," said Boerse Stuttgart's chief executive, Christoph Lammersdorf. "German retail investors have to engage more with their investments and find out what they need to know about asset building and pension provision."

The survey found that 82% of respondents believed that investment issues were overly complex and only 18% felt well informed. ■

For more on corporate bonds, see Retail Therapy, p24

Export credit agency rebrands

The Export Credits Guarantee Department has amended its operating title to UK Export Finance.

The change of name for the UK's export credit agency was announced as part of "the recent launch of a number of new products in support of the government's export drive", with the aim of emphasising that government help is available to help exporters seeking finance.

The newer products are targeted at smaller companies that may be unable to secure all the support they need from private markets. For example, in March the agency announced that the short-term credit insurance scheme would be extended to cover many SMEs.

The name Export Credits Guarantee Department, which is set by Act of Parliament, will continue to be used for all official documents and to provide continuity for existing customers. ■

Businesses fear worst with double dip

Business confidence has slumped to its lowest level since the recession, with the ICAEW/Grant Thornton UK Business Confidence Monitor (BCM) suffering its largest quarterly fall since it began, indicating that the UK economy could contract by as much as 0.2% in Q4 2011.

ICAEW chief executive Michael Izza said: "This quarter's BCM reflects just how rocky things could become. The outlook is increasingly uncertain and businesses are becoming worried about the risk of a double dip recession."

While business confidence has declined in all industries, it has collapsed in the banking, finance and insurance, and property sectors. ■

SWIFT signs up 900th corporate

Following recent new signings SWIFT's corporate treasury user community now extends to 900 corporations, the financial messaging provider has announced.

The network, used by more than 9,700 financial institutions and corporations in 209 countries, said that to simplify on-boarding and implementation of its services it was also offering supporting projects through SWIFT Consulting Services to help with bank operational readiness and streamlining.

Eileen Dignen, managing director, banking initiatives – SWIFT Americas, said: "Corporations are utilising the SWIFT network to gain maximum efficiency from their financial and treasury operations. Together with our community, including banks, corporate and industry partners, we are committed to continue strengthening the value of our offering in the corporate-to-bank space."

Dignen: strengthening SWIFT's value

ACT exam sitting sets new record

The ACT's most recent series of exams, which concluded in October, attracted a record number of entrants. In all, 1,300 students sat a total of 1,741 papers, with 89 centres running exams in a total of 59 countries, also a record number.

The UK, which accounted for 1,177 papers, was followed by the Netherlands (60), South Africa (53), Singapore (45) and Ireland (42). China and Russia each accounted for nine papers and India for seven.

Anti-bribery guide is used for BRICs

Advice for UK commercial organisations on how to trade legitimately in the four fast-growing BRIC (Brazil, Russia, India and China) economies has been published by PwC.

The guide, Responding to the UK Bribery Act 2010, has been produced by PwC in conjunction with the UK-India Business Council, the China-Britain Business Council, the Brazilian Chamber of Commerce for Great Britain and the Russo-British Chamber of Commerce. It follows the introduction of the legislation on 1 July, which affects UK businesses operating in domestic and overseas markets, as well as foreign companies doing business in the UK.

PwC said the report aimed to raise awareness of bribery risks and to offer guidance on how commercial organisations could mitigate risk and protect themselves from the consequences of infringing the Act, such as reputational damage.

Tony Parton, forensic services partner at PwC, said the Act was widely regarded as one of the most stringent anti-bribery laws in the developed world and placed an onus on companies to understand and document the risks they faced as well as to take steps to address them.

"Simply having an anti-bribery policy is not enough. An organisation needs to ensure it has an anti-bribery compliance programme that provides evidence of ongoing and up-to-date controls," he said. "In addition, it must communicate effectively, ensuring a strong ethical culture within an organisation."

He added that implementing an effective anti-bribery programme took time and firms should not underestimate the difficulties of embedding processes and changing cultural norms.

Parton: just having a policy is not enough

Firms struggling with pension auto-enrolment

Around two in three companies are only now beginning to prepare for the introduction on 1 October 2012 of automatic enrolment in workplace pensions, research suggests.

Consulting group Mercer recently surveyed 200 UK companies of all sizes and found 15% either unsure of what the impact of the new requirements on them would be or had not given it any thought. The most common response (61%) was that the company was just starting to consider the issue, while 22% said their plans were further advanced. However, only 1% of companies are already at the implementation stage, with a further 1% almost ready to deliver subject to final regulations.

More than one in four firms (28%) have yet to decide on the policy they will adopt once auto-enrolment commences. Of the remainder, 54% plan either to maintain existing benefit levels for all their workforce or to allow employees a "voluntary upgrade" to a better scale subject to eligibility requirements; 16% expect to maintain current levels of benefit for existing scheme members and to introduce minimum contributions for new hires and auto-enrolled employees.

Brougham: impact on HR/payroll systems

Firms that delay their preparations for auto-enrolment too long could find provider capacity exhausted, said Rachel Brougham, principal and head of Mercer's auto-enrolment initiative. "Provider capacity aside, employers need to consider the significant impact that auto-enrolment will have on HR and payroll systems, and processes too."

More evidence is emerging of the resources needed to implement the changes. Employers may need monthly reviews to ensure the age, remuneration or employment status of each employee is properly considered.

Alan Morahan, principal at Punter Southall, said: "Payroll departments have an important role to play in this but their job needs to be made easier by the introduction of appropriate software to manage such a constantly changing process."

One encouraging sign noted by Brougham was that few employers were planning to level down benefits despite the tough economic environment. "Although that's not to say all current contribution levels are high enough to provide members with a decent income in retirement," she pointed out. "Most pension schemes still have some way to go to reach that goal." ■

France demands inquiry into SAP downgrade gaffe

Ratings agency Standard & Poor's has said it will take steps to avoid any recurrence of the technical error that led to it inadvertently downgrading France's sovereign rating just as the euro zone crisis was deepening.

French bond yields rose sharply on 10 November after an emailed note from S&P to online subscribers signalled a downgrade of its rating for France, of "AAA/A-1+" with a stable outlook. The mistake was quickly discovered and S&P issued a news release within two hours to confirm that the rating remained unchanged.

However, the error angered the French government, which demanded an inquiry by the French financial regulator AMF and the European markets authority ESMA. S&P said it was "co-operating with all relevant authorities to provide full background on the matter". ■