IN BRIEF

Guidelines on transparency and the use of information in the context of the loan market have been published by the LMA (Loan Market Association). Although the law on insider dealing applies only to securities trading there are obvious good practices relevant to trading loans while in possession of confidential information. Good practice will also extend to borrowers themselves in terms of any loan purchases they make, or in ensuring that material information is disclosed promptly to lenders.

The first retail bond issue by a non-financial issuer has been launched by Places for People, one of the UK's largest housing associations, using the London Stock Exchange's Orderbook for Retail Bonds. The bond has a fixed rate of 5%, a maturity of five years and six months, and is designed to be eligible for ISAs and SIPPs. The bonds are tradable in denominations of £100, after an initial minimum investment of £2,000. The issue raised £140m, with Evolution Securities as lead manager and authorised distributor. **See Stores of Wealth, p20**

The government's **Business Growth Fund** is now open for applications. The fund is designed to help expand companies with a turnover of between £10m and £100m. It will provide between £2m and £10m per business in return for a minimum 10% equity stake and a seat on the board for a BGF director. The cash for the £2.5bn fund has been provided by Barclays, HSBC, Lloyds, RBS and Standard Chartered, all working in partnership with the British Bankers Association.

IFRS 10 Consolidated Financial Statements has been issued by the IASB to replace IAS 27 (the old consolidation standard) and SIC 12 Consolidation – Special Purpose Entities. Control is now the sole basis for consolidation and is defined by having all of the following three elements: power over an investee, exposure or rights to variable returns of the investee, and the ability to use power over the investee to affect the investor's returns. It therefore impacts existing accounting where the investor does not have a majority of voting rights but still has control. IFRS 10 as well as the new IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities will be effective for accounting periods beginning on or after 1 January 2013.

INTRODUCTION

By Martin O'Donovan
Deputy policy and technical director

The ACT policy and technical team aims to monitor regulatory developments and, where appropriate, influence the outcomes, if only to remind regulators to consider the unintended impact on non-financial companies operating in the real economy, as we like to call it. Little by little some progress can be made. For instance, on over-the-counter (OTC) regulation, HM Treasury has been putting forward the UK case in the European Council and user-friendly improvements have been made. In early June we even had JP Morgan CEO Jamie Dimon publicly questioning Federal Reserve chairman Ben Bernanke on whether overzealous regulation would stymie an economic rebound. Bernanke acknowledged the point but held that the Fed lacked the quantitative tools to study the net impact of all the regulatory and market changes over the past three years. So – progress in that the issue is at least being recognised, even if we have no answer yet.

Stricter intraday liquidity rules to raise costs

Regulators are tightening up their requirements for bank access to intraday liquidity to settle obligations in payment and settlement systems. Treasurers should be prepared for increased costs or changed processes for payments systems users as a result. Reduced daylight limits, fees for daylight lines or stricter requirements over the timings of payments and receipts are possible.

Banks typically manage their payment flows so that they end the day flat but intraday the liquidity exposures can be huge. The large-value payment and settlement systems, CREST and CHAPS, play a vital role in the UK's financial system. On average, in 2010 over £730bn of transactions were settled every day across the two systems.

In its principles for sound liquidity risk management and supervision, the Basel Committee has identified the issue of intraday liquidity risk and collateral management. In particular, principle 8 advises that: "A bank should actively manage its intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions." The FSA's new liquidity regime will now include intraday liquidity as a key risk driver.

Previously, the collateral used in the payment system was the same as that held as a prudential asset buffer for wider resilience purposes, a practice known as "double duty", so that the cost of intraday liquidity was negligible.

The FSA will now require banks to have an adequate pool of high-quality liquid assets to support intraday needs in both normal and stressed conditions. The FSA could ban using the same assets for two purposes but has decided to continue to allow it as long as the buffer needed is calculated on the basis of the dual purpose.

Increasing the required size of a bank's liquid asset buffer by too much might create incentives for banks to reduce the provision of intraday liquidity in large-value payment systems. Such a change in behaviour could have the undesirable effect of increasing operational risk and credit risk in these systems as the banks try to minimise their liquidity holding requirements and costs.

A recent Bank of England paper on intraday liquidity explores the implications for payment and settlement systems. Operational risk and the cost of addressing it with higher liquidity buffers can be reduced by a variety of mechanisms:

- efficient cashflow management and scheduling, offsetting and queuing algorithms;
- throughput rules, such as CHAPS', which requires 50% of daily settlement flow by noon and 75% by 2.30pm on average each month;
- time-varying tariffs to incentivise early submission through the transaction fees; and
- modifying the collateral eligibility criteria to lower its cost.

The regulators are aiming to lower the opportunity cost of providing intraday liquidity to the stricter rules while maintaining regulatory vigilance, and without undermining the resilience of large-value payment systems. ■

Private sector pension inflation index switch creates lottery

March 2011 saw a rally and lobby of parliament organised by pensioner organisations protesting about the change in the index linking of pensions from the retail prices index (RPI) to the consumer prices index (CPI). Perhaps company shareholders and treasurers should have been out there supporting the change as it must represent one of the biggest immediate boosts to balance sheet values caused by a small change in legislation.

The government itself estimates the benefit to private sector employers that have defined benefit schemes as around £83bn. This includes an estimate for future benefit, the instant benefit to sponsoring employers being just short of £61bn. Both figures represent a very welcome boost to British employers – and are equally bad news for members of pension schemes.

The reason employers are better off is that pensions should rise less and would therefore cost less to pay given that CPI is usually about 0.9% lower than RPI. Why is this?

Some differences in the composition of RPI and CPI are well known. CPI, for example, does not include housing costs such as mortgage interest, buildings insurance or council tax. What is less well known is that a difference in the calculation formula is probably more significant. RPI uses an arithmetic mean while CPI uses a geometric mean. For example, assuming just two items in the index, then if one increases from a base of 100 by 25% and the other decreases by 20%, the new values of the items would be 125 and 80 respectively. The arithmetic mean of these is:

$$\frac{125 + 80}{2} = 102.5$$

On the other hand, the geometric mean is rather less at:

$$\sqrt{(125 \times 80)} = \sqrt{10{,}000} = 100.$$

Views differ as to which is the more appropriate measure of inflation. The Royal Statistical Society has said that while CPI has merits as a macroeconomic indicator, it is not a suitable measure of price inflation as experienced by households. So why change to CPI?

The first move to CPI was made on 22 June 2010 in the Emergency Budget with an announcement that CPI would be used in public sector pensions. The motive was obvious: a lower rate of indexation would result in considerable savings in future government expenditure.

Then on 8 July the pensions minister announced the proposed extension of CPI into private sector pensions. This move was probably to avoid public sector unions arguing that the public sector was being unfairly treated. Consultation was expected in the early autumn of 2010 but only surfaced in December. The proposals identified in consultation were less dramatic than forecast in the summer, with the general principle merely being that if scheme rules specifically referred to RPI indexation, then RPI would continue to apply.

These proposals are likely to become law later this year once the Pensions Bill passes through parliament. The result, however, will be that losses (to members) or gains (to employers) will depend on a choice of words in the scheme's rules which was probably arbitrary.

For example, consider two identical schemes in 1997, when the index linking of pensions was made compulsory. Both schemes wanted to follow the statute and link by reference to the RPI, capped at 5%. The first scheme's lawyers took a shortcut and simply cross-referred to legislation. The second scheme's lawyers perhaps had more time on their hands, and repeated the legislative text in full in the rules.

The intent in both cases might have been the same. However, the rules which cross-refer to legislation now move to CPI while the other rules remain with RPI. The difference could be significant.

While the focus is on pensions in payment, indexation also applies to early leavers. If a member leaves a scheme before retirement, then the pension earned is increased between the date of their leaving service and drawing pension. Again the government envisages a move from RPI to CPI depending on whether the rules expressly refer to RPI or cross-refer to legislation. In practice, however, for the revaluation of deferred pensions, the almost universal practice is to cross-refer to legislation, which means an almost universal move to CPI.

For many schemes, however, it is a lottery, based on historical drafting, as to whether RPI or CPI is to apply to pensions in payment. If RPI applies and management wants to reduce the pension liability by moving to CPI indexation, it would need to alter the scheme rules and that would normally require both the company and trustees to agree. Of course, the trustees are likely to hold that CPI indexation is not in the best interests of the pensioners and so will not consent.

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IASB hedge accounting rewrite takes final shape

The 248 responses to the International Accounting Standards Board's December 2010 exposure draft on hedge accounting show an overall level of strong support for the IASB's proposals. The main positives were the board's overall aim to improve the link between hedge accounting and risk management, the replacement of the 80-125% bright line for effectiveness testing with a principles-based approach, and permitting risk components for non-financial items as hedged items.

The IASB is part-way through its deliberations on hedge accounting but at its regular meetings it has already tentatively approved a number of changes to and confirmation of the proposals it put forward in December.

Fair value

The exposure draft proposed that all fair value hedge gains/losses on the hedging instrument and the hedged item should be recognised in other comprehensive income (OCI) with the ineffective portion transferred to P&L. The IASB now agrees that movements will continue directly through P&L as currently accounted in IAS 39.

The exposure draft proposed that for items that have been hedge-accounted the gain or loss on the hedged item attributable to the hedge risk should be presented as a separate line item in the statement of financial position. The IASB now agrees that the fair value adjustments will be shown in the notes to the accounts.

Equity investments measured at fair value though OCI

The exposure draft proposed prohibiting the designation of financial instruments carried at fair value through other comprehensive income (FVTOCI) as eligible hedged items because the risk exposure being managed did not impact profit or loss as the gains and losses recognised in OCI are never recycled to profit or loss. The board has now decided to permit equity investments designated at FVTOCI as eligible hedged items with any ineffectiveness resulting to be recognised in OCI.

Hedging of layers

Given overwhelming support from respondents for its proposal that a layer component of the nominal amount of an item should be eligible for designation as a hedged item, the board confirmed its proposal to allow layer-based designation of a hedged item (when the item does not include a prepayment option).

Cash instruments as eligible hedging instruments

The exposure draft proposed that financial instruments carried at fair value through profit or loss be eligible hedging instruments. Some respondents requested that cash instruments not designated at fair value through profit or loss (i.e. amortised cost) should also be eligible hedging instruments as they asserted conceptually there was no basis for differentiation. The IASB disagrees and has confirmed its original proposal.

Some respondents noted that for liabilities designated under the fair value option (FVO), the credit component is recognised in profit or loss while other changes in fair value are recognised in OCI.

The board has clarified that liabilities measured at fair value under the FVO with the own credit effect in OCI are not eligible hedging instruments.

Hedging sub-LIBOR cashflows

The exposure draft carried forward the existing hedge accounting guidance from IAS 39 related to designation of portions of items that are larger than the cashflows of the hedged item (commonly referred to as the "sub-LIBOR issue"). The board decided to retain the restriction in the exposure draft when an interest rate floor is in place but to consider ways to further clarify the guidance. ■

Are you being unreasonable?

We have all seen the magic words "such consent not to be unreasonably withheld" appended to the clause requiring borrower consent to a loan transfer, but what is the case law on this? A Clifford Chance briefing, entitled "Are Borrowers Acting Unreasonably When They Withhold Their Consent to Transfers and Assignments by Lenders?", explains all. **http://bit.ly/ky1yyM**

IN BRIEF

Major changes to VAT have been proposed in a green paper from the European Commission. It is still very early days in the consideration of very significant changes but nonetheless the ACT has responded specifically on the ideas for collection and payments. One idea is that customers would split every invoice payment into two destination bank accounts, one for the supplier and one semi-blocked account for the VAT. The ACT has requested further detailed work be carried out – in particular, to consider the impact on a company's cashflow.

Early adoption of prospectus rule changes has been proposed by the UK government. In its response to HM Treasury the ACT welcomed the moves to make capital raising easier for small issues of less than €5m or to fewer than 150 subscribers. A prospectus would be required only beyond these thresholds.

Payments by mobile phone should become easier and safer as the UK Payments Council launches a collaborative project to help participating banks and building societies deliver mobile payments. Within a couple of years customers could be able to send money using only their mobile phone, either by text or via an app or their phone's internet browser. The project focuses on transferring money from one account to another, so customers could pay another person or a business, and differs from recent launches which allow phones with built-in card technology to mimic a contactless card payment.

Lease accounting continues to be subject to IASB redeliberations. While all leases are still on balance sheet, the definition of lease term has changed to the non-cancellable period plus option to extend or terminate if there is "significant economic benefit to exercising". In determining whether there is a significant economic incentive, lessees and lessors should consider contract-based, asset-based and entity-specific factors. All these factors should be considered together and the existence of only one factor does not necessarily signify a significant economic incentive. The IASB has done a U-turn on lessee accounting, going back to the one lessee accounting model and so overruling an earlier decision to have two accounting approaches by lessees.