EU big five win FATCA concessions

A compromise was reached last month between the US and Europe's five main economies over implementation of the US Foreign Account Tax Compliant Act (FATCA), removing some of the onerous provisions for EU financial institutions.

FATCA aims to prevent Americans avoiding tax by concealing their assets outside the US. It originally required foreign funds to enter into an agreement with the US Internal Revenue Service (IRS) to reveal the names of US clients liable for tax – or face hefty penalties if they refused. Under the compromise, businesses in the UK, France, Germany, Italy and Spain will have only to register with the IRS and can report information about clients' tax liability to their country of domicile.

Aileen Barry, director of national tax investigations at law firm DLA Piper, said that HMRC had already been in consultation on the issue and this month's Budget could see new powers introduced enabling it to obtain information on behalf of another revenue authority. However, she added: "This is dependent on reciprocity from the IRS with information on UK taxpayers."

How to recover from a brand trashing

The damage to reputation sustained by six international organisations and what steps they took to restore it are examined in an institute of Business Ethics (IBE) report.

The Recovery of Trust, by Graham Dietz and Nicole Gillespie, reviews the following cases and includes interviews with individuals involved and contemporary media reports:

- Siemens: accused of bribery in 2006;
- Mattel: faced with product recalls in 2007;
- Toyota: product recall crisis in 2009-10;
- BAE Systems: persistent allegations of corruption and bribery in arms deals;
- BBC: phone-in scandals in 2007–08; and
- Severn Trent: found guilty of distorting performance data for the industry regulator.

The IBE added that the report shared insights into the process of organisational trust and asserted the case for a commitment to ethical business practice.

The report can be downloaded at: http://bit.ly/wp96zP

EBA bank target 'will curb lending'

The banking industry will have welcomed the European Banking Authority's announcement in February that the next EU-wide stress test won't be held until next year, says PwC. But it warns that both lending and Europe's economies will suffer in the meantime, with the EBA and national regulators still facing a heavy workload this year as they finalise the latest Capital Requirements Directive (CRD IV), aka Basel III.

The EBA said that banks were looking to strengthen their balance sheets by around €98bn more than demanded and that capital shortfalls were likely to be met primarily through direct capital measures.

PwC director Richard Barfield said: "For the few banks submitting recapitalisation plans to national authorities and the EBA, only a small amount of the improvement in capital ratios is expected to be caused by deleveraging. While the EBA infers that the economic impact will not be great, the 9% target capital ratio by end of June 2012 could have far greater consequences for lending and therefore the economy.

EBA has set a tough 9% capital ratio target

"It is not just reducing assets by deleveraging that will impact the economy. The 9% target also reduces the appetite of these banks – and also those that passed the test – to make new loans. It is important to remember the 9% target is front-running the Basel III timetable for improved capital ratios.

"The majority of actions in the plans focus on directly improving capital levels. Regulators are likely to prefer banks to do this as opposed to changing their models, as it represents an increase in loss absorption capacity rather than refinement to the measurement of credit risk." ■

Haircuts escape crash blame

The role of collateral haircuts in the sale and repurchase agreement (repo) market needs to be better understood, argues a paper from the International Capital Market Association (ICMA).

The study, Haircuts and Initial Margins in the Repo Market, by Richard Comotto of the ICMA Centre, reviews the role of collateral haircuts during the financial crisis of 2007–09.

ICMA defines a haircut as a percentage discount deducted from the market value of a security offered as collateral in a repo to calculate its purchase price. The adjustment is intended to take account of unexpected losses that one party to the repo trade might face in buying, or selling, the security if the other party defaults.

The paper suggests that regulators' fears that haircuts can exacerbate negative market trends is exaggerated, and points out that haircuts changed little during the crisis period. The toxic effects derived much more from the combination of market issuers reducing or withdrawing credit lines, shortening lending periods and narrowing the range of collateral they were ready to accept.

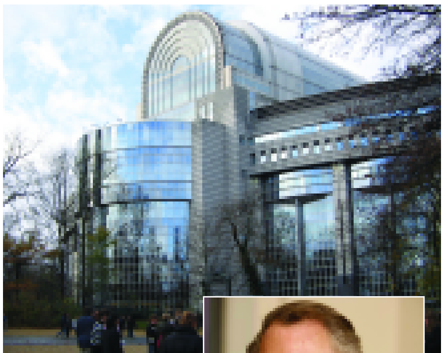
Comotto also points out that data on which studies of structured credit as collateral have been based is largely derived from the US market, and extrapolated to the wider global market without considering their different structures. His paper concludes that there is no evidence to support the argument that haircuts in Europe contributed to the market crisis. ■

A copy of the paper is available from www.icmagroup.org

See Know Your Repo, CMS Spring 2012, p4

Shield real economy from FTT, urges EACT

European Association of Corporate Treasurers chairman Richard Raeburn has outlined widespread concerns over the proposed Financial Transaction Tax (FTT) to the European Parliament.



Raeburn has urged the European Parliament (above) to exempt end-users from the FTT

In a presentation in February to the Committee on Economic and Monetary Affairs (ECON), Raeburn said the EACT strongly supported action to strengthen financial regulation, and acknowledged that the aim of the FTT was to extract "some fiscal compensation for the costs of the financial crisis" and to discourage non-value-added activities in the financial system.

However, he urged the focus be placed on ensuring the financial sector paid the tax rather than allowing it to pass through to the "real economy" of companies, individuals and pension funds. The EACT also sought reassurance that the implementation of FTT would not inadvertently weaken the effectiveness of the new financial regulatory environment.

Raeburn's speech focused on the extent to which the tax, if implemented, would trigger "significant" cost increases and the likelihood that the brunt of these would fall on the real economy.

Clearly such a result would have serious consequences for employment and growth and would also dilute the strength of European financial regulation as companies shifted their transactions to other regions to escape it.

"End-users may react to higher costs by reducing the use of derivatives and by reorganising activities so that their hedging can continue without the direct and indirect cost of FTT," Raeburn pointed out. "We would like to encourage ECON to argue for an end-user exemption from FTT, both in the actual transactions and in the cumulative FTT associated with the activities of the banking system, prior to the end-user transaction." ■

Speculative ratings on the rise

The percentage of companies around the world with speculative-grade ratings rose last year, according to Standard & Poor's.

The ratings agency said that the share of corporate speculative ratings was 44.4% at the end of 2011, compared with 44.1% at the end of June and 43% a year earlier.

The median of all rated entities remained at BBB-, unchanged since the second quarter of 2010, but the share of entities that rated only CCC or lower edged up to 2.5%, from 2.4% a year earlier.

In the fourth quarter, the proportion of global ratings downgrades, at 6.76%, exceeded upgrades at 4.46%.

At 12.3%, Europe had the highest percentage of downgrades, while emerging markets showed the highest proportion of upgrades with 9.5%.

Of the 1,213 European issuers rated by S&P as of 31 December, 890 were investment-grade and 323 speculative-grade; the latter comprised 26.6% of the total against 21.6% a year earlier.

The proportion of European issues designated as investment-grade categories of AAA, AA and A declined from 53.7% a year earlier to 45.8% at the end of 2011. The median rating on European entities was unchanged at BBB+.

In the US, speculative ratings were 48.5%, although this figure was slightly down from the 49.3% recorded the year before, and the median rating was BB+, which is unchanged since the third quarter of 2010. ■

Pension trustees banned for life

The Pensions Regulator has banned three ex-trustees for life, after finding them guilty of "serious and persistent" regulatory breaches.

Robert Hill, Nicholas Halton and Simon Ragg resigned from the Hugh Mackay Retirement Benefits Scheme last October. The regulator said the scheme's funding position had deteriorated so badly that it would almost certainly have to enter the Pension Protection Fund.

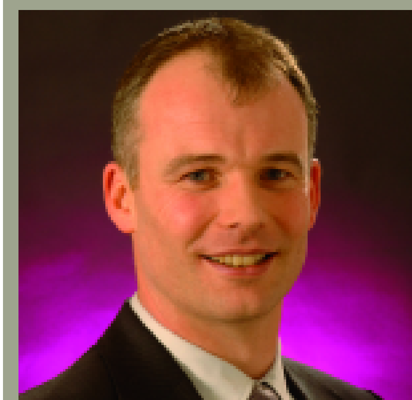
The three trustees were found to have breached investment regulations, employed a dubious valuation process and created a conflict of interest by receiving payments or having a commercial interest in companies that the scheme invested in.

The regulator's investigation also discovered:

- most of the scheme assets were invested directly in property or property-related investments;
- the scheme had bank loans of more than £21m secured on property assets financed by such borrowings; and
- the scheme paid Chartpoint, its sponsoring employer, more than £1.1m for services between 2006 and 2009, with the three trustees receiving salaries and bonuses from the company.

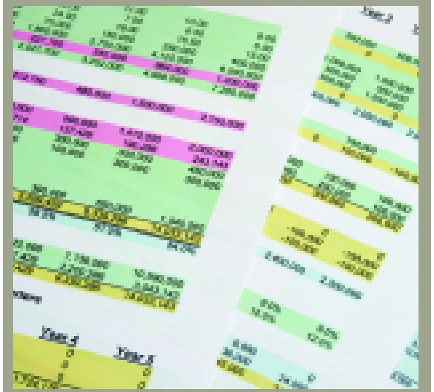
The regulator said the trio's relationship with Chartpoint created serious conflicts of interest, which were not properly managed. In two speculative property deals the scheme bought land for £1.55m, and a commercial building for £8.6m. In both cases, a trustee had a substantial interest in the vendor companies.

The Pensions Regulator's chief executive Bill Galvin said its investigation had "unearthed some of the most worrying examples of mismanagement of a final salary pension scheme that we've seen".



Galvin: worryingly mismanaged scheme

Spreadsheet risk 'still widespread'



Organisations are still exposing themselves to financial and reputational risk because of lax control over their use of spreadsheets, research by Protiviti has found.

The consulting firm polled 100 chartered accountants in December and found that 89% agreed that their company did not do enough to prevent spreadsheet risk and lacked relevant policies and processes to manage it. A similar poll six months earlier had recorded the considerably lower figure of 73%.

Nearly three in four respondents said that no specific department or function had the task of addressing spreadsheet risk; of the remainder, 10% thought responsibility should belong to the finance department, 8% to risk management, 5% to IT and 3% to internal audit.

Protiviti's director of IT consulting Scott Bolderson said that while on the surface the results appeared disappointing they showed an increasing awareness of the issue, with more people starting to understand the scale of the problem. However, the problem threatens to get worse as the amount of data that organisations have to manage steadily increases.

"Our research with clients has shown that 94% of an organisation's spreadsheets will contain errors," Bolderson said.

"Not all of these errors will result in financial loss but organisations won't know without investigating which errors could cause serious issues.

"Regulators are starting to apply more pressure on organisations to address the issue, recognising the level of dependence that many organisations place on calculations in spreadsheets."

CFC revamp to lure businesses to UK

The latest controlled foreign companies (CFC) proposals will make the UK a more attractive destination for international businesses, according to Grant Thornton.

The accountancy group was responding to a recent revision to the draft CFC legislation first outlined in November 2010.

The rules aim to bring into the UK tax net those companies that artificially divert UK profits to low-tax territories or other favourable overseas tax regimes in order to lower their UK tax liabilities. The latest update proposes that the CFC rules should apply to accounting periods beginning or after 1 January 2013.

Grant Thornton said that the most recent changes to the proposed CFC regime showed that the Treasury and HMRC had responded positively to input from industry and tax professionals.

"The changes are very helpful and we have been pushing for them for some time," said Martin Lambert, the group's head of international tax. "I am pleased to see that the government has acknowledged the concerns about the compliance burden the new CFC rules would have placed on taxpayers. The new legislation is great news for overseas companies looking at moving into the UK."

The CBI also called for a simpler way of taxing foreign profits, and a "less complicated" gateway than envisaged in the government's draft legislation on CFCs.

Lambert added: "I am also pleased to see – tucked away in the back of the Treasury and HMRC update document – that foreign finance branches of UK companies may be able to qualify for the full or partial finance company exemption. It is important that finance branches of UK companies can benefit from the finance company exemption in the same way as a foreign subsidiary." ■

Longer lives to deepen deficits

The steady improvement in life expectancy threatens to continue driving up pension scheme liabilities, actuarial consultant Punter Southall has warned.

The latest Office of National Statistics estimates indicate that the mortality rate in England and Wales slowed by 4% in 2011, compared with a 2–3% reduction over the previous 10 years.

Matthews: get scheme data right

If the fall in mortality rates continues at this rate, a man of 65 retiring today could expect to live to the age of 91, compared with the typical current estimate of 88. A 45-year-old would have an extra seven years, and live to 95.

This increase in longevity can equate to an increase of up to 15% in a pension scheme's liabilities, potentially adding up to 50% more to a scheme's deficits.

"Our longevity studies show that socio-economic characteristics of members can make up to 10% difference in scheme funding levels, compared with just using general population data," said Ross Matthews, head of mortality research at Punter Southall.

"Trustees should ensure that they are using the right starting point for their population of members, even if there is some uncertainty surrounding future trends. Both trustees and sponsors need to consider whether or not future uncertainty will have an impact on the security of their scheme. If it does, it could be time to examine derisking strategies such as longevity swaps to see if they are appropriate."