The issues and workload associated with IAS 39 and its implementation will not go away, and many treasury functions will be allocating at least one full-time person to the systems and processes involved. However the publication of the FSA's annual Risk Outlook, featured right, should serve as a reminder to spend some time contemplating the bigger picture. As part of the treasury strategy, perhaps we should be trying to identify the wider threats and opportunities to our firms? Yes, of course we need to reconsider if our hedging strategy can withstand the dollar rate going to 2.0000, but what about terrorist risks and disaster recovery plans, the effects of Basle II on availability and cost of bank credit, the advent of new instruments and markets? The FSA Risk Outlook could be the template to seeing the wood for the trees. Please send your comments on this or any other issues to technical@treasurers.co.uk ■

PENSION

Pension valuations revised

The Faculty and Institute of Actuaries is revising its guidance on valuation reports, known as GN9. The aim is to ensure that sufficient information is provided to enable the current solvency level of a scheme to be understood. When preparing reports for the trustees of defined benefit schemes the actuaries must include a calculation of the solvency of the pension scheme on the basis of a wind-up valuation.

Such a valuation will have to assume that the assets are being invested in a manner that would be done by a wound-up scheme. In these circumstances the scheme would have an investment strategy that minimises the risk of underperformance, namely investment in bonds. On this basis there may be some dramatic effects on the apparent solvency of pension schemes. **www.actuaries.org.uk** ■

RISK

FSA's risk outlook for 2004

The Financial Services Authority (FSA) has published a study and commentary on areas of potential financial risk across the economic, financial, political and social arenas. *The Financial Risk Outlook 2004* presents an interesting and readable overall outlook, including much background data and commentary.

Of particular relevance to treasurers is a very short mention of the use of opaque 'special purpose vehicles'. It explains how their use in the Parmalat case should serve as a reminder to banks and other lenders that they should be especially vigilant where their counterparties are using them in complex structured finance arrangements. This would seem to be a warning to the investment banks that they should in part be taking responsibility for bond issues where they act as sponsors and that accordingly they should not hide behind the usual disclaimers. The consequence could be that the due diligence requirements insisted upon by advising banks could become significantly more onerous and time-consuming.

MAINTAINING CONFIDENCE

The purpose of this publication is for the FSA to review the possible risks and obstacles that may hinder them in their job of maintaining confidence in the UK financial system. They observe that corporate sector credit risks have generally moderated in 2003, but that there are grounds to remain cautious given the burden of significant pension scheme deficits and the build up of household indebtedness. If interest rates rise, the burden of household debt may impact the banking sector directly if credit problems arise, and indirectly indebtedness problems could cause a slowdown in consumer spending and general economic downside effect, thus compounding the problem.

Financial institutions themselves will have to deal with a wave of legal, accounting and regulatory reforms over the next few years, in particular, the EU's Financial Services Action Plan, the change to International Accounting Standards and the move towards a revised capital regime for banks. These reforms will take up considerable management time and may increase cost pressures on firms and exacerbate operational risk.

Beyond this the financial market needs to consider its resilience to deal with terrorist threats, both from physical attack and also from being used for terrorist financing activities. The impression is that the impact of financial crime may still be under-estimated. There will be an increase focus on money laundering by regulators and law enforcement agencies.

NERVOUSNESS

The FSA notes the rapid growth in the credit derivatives market which has allowed the diversification of risk through risk transfers between sectors and individual counterparties. A degree of nervousness is apparent in the FSA since its fear is that there is a major transfer to, and build up of risk in, the insurance sector, through the use of portfolio credit default swaps or credit-linked notes. This is compounded by questions on the reliability of valuation models. Finally it explains the dangers that credit default swaps can be used by traders to influence the price of new bond issues. The strategy involves selling the bond short prior to issuance and buying protection through the use of credit default swaps, helping to reduce the price of the underlying bond. Traders can then hope to make a profit on their short positions.

For those interested in a wider appreciation of the economic conditions in the UK the FSA's report covers many areas from the demographics of an aging population, fraud and identity theft, mortgages and household debt, through to corporate governance, regulation, investment banking, insurance, commodities and hedge funds. A veritable economic and financial handbook.

The full text of *Financial Risk Outlook 2004* can be found at **http://www.fsa.gov.uk/pubs/plan/financial_risk_outlook_2004.pdf** ■

IAS 39

Implementation issues

This standard on financial instruments is set and the emphasis must now be on practical implementation measures. However, as Richard Raeburn mentions on page 62, the ACT has continued to voice concerns at the highest levels. We believe that although the IASB does genuinely recognise the particular difficulties on IAS 39 and will be prepared to give them a thorough consideration, the problem is timing. We have to recognise that while the current standard is not perfect, it would also be far from ideal to abandon or delay a standard which overall is helpful in clarifying an area that has been without formal guidance for too long.

Arising from the most recent ACT meeting with IASB members we were assured that the logic for having different prospective effectiveness testing criteria from the retrospective criteria would be reconsidered at the February IASB meeting. We were delighted to learn that at the 18th February meeting the Board agreed to remove the reference to “almost fully offset” in the prospective effectiveness test with the implication that the 80% to 125% band will apply, as in the case of the retrospective tests.

This might appear a small drafting change but should have major benefits for companies seeking to achieve hedge accounting, particularly in the area of commodities where the hedge and the hedged item do not necessarily move together on a one to one basis.

At this late stage it came to our notice that although highly probable forecast cashflows can be treated as hedged items, if those forecast transactions are between two subsidiaries, a quirk of the wordings meant that they would not qualify for hedge accounting. We received acknowledgement from the IASB that this was not the intent and that a solution would be found.

The major anomaly in IAS 39 which means that hedging net positions via a treasury centre will not qualify for hedge accounting remains outstanding. The ACT has been trying to get the international standard to come in line with the exceptions permitted in US accounting under FAS 138. It is a complex area and the IASB is concerned that if exceptions are allowed it may become a route for abuses to occur. IAS 39 will not be adjusted for the moment but we were reassured that a major review will start almost immediately and our views and suggested drafting were sought as an early contribution to this process. ■ *See also The Treasurer's IAS 39 Roundtable on page 28*

MONEY LAUNDERING

Stringent rules in force

New money laundering regulations published at the end of 2003, came into force on 1 March 2004. The rules now extend beyond the financial services sector and one of the provisions covers ‘the activity of dealing in goods of any description by way of business (including dealing as an auctioneer) whenever a transaction involves accepting a total cash payment of €15,000 or more.’ This activity is defined as that of a ‘high-value dealer’ and means that if your firm engages in any cash transactions over €15,000 you will need to comply with the identification procedures, keep records, give appropriate training, and get registered with the Commissioners of the Customs and Excise by 1 April 2004. Apart from the registration the effective date is 1 March 2004. The monetary limit applies to a single or connected series of transactions. In addition the new regulations also catch ‘relevant businesses’ defined as ‘business services in relation to the formation, operation or management of a company or a trust’. The same registration and identification and recording procedures will apply to these businesses too. ■

BOOK DEBTS

Spectrum case clarifies charges

Judgment has been given in the Spectrum case which clarifies the nature of charges over book debts. It was held that charges over these items are properly categorised as floating charges even if the bank debenture labels them as fixed. In this case the bank was arguing that the charges were fixed and were seeking payments from the liquidator whereas were they to be floating the proceeds would be available to pay preferential creditors. ■

TAXATION

PAYE payments

Effective from May this year, the Inland Revenue changes the rules for payment of PAYE for companies with 250+ staff. Payment must be made by electronic means only, and the due date changes from the 19th to the 22nd of the month. For the first time fines will be introduced for late payers. PAYE is a material cash outflow for most organisations so treasurers may like to check that they have factored this change into their short-term cash forecasts. Employers with 250 or more employees will be required to send their 2004/05, and subsequent, end-of-year returns electronically. ■

FINANCIAL COLLATERAL

New robust arrangements

New arrangements arising from an EU Directive on financial collateral came into force at the end of last year (The Financial Collateral Arrangements (No.2) Regulations 2003). Their aim was to create robust arrangements and to lower the cost of capital in Europe. In essence it will no longer be necessary to register a charge over cash or financial collateral such as bonds. If the specific power is granted in the documentation then no court order for foreclosure is necessary. Provided the collateral is in the possession or control of the holder then the holder or bank may simply take possession and sell the asset. Additional rules to avoid the collateral arrangements from becoming void in an insolvency are also incorporated. The Regulations do not apply to individuals. ■

AUDITING

Exemptions from SMEs

The thresholds in the Companies Act defining small and medium-sized companies and determining which companies are exempt from the requirement to have their accounts audited are being increased. The new thresholds will apply in respect of financial years ending on or after 30 March 2004.

The maximum turnover for small companies will be increased from £2.8m to £5.6m and the balance sheet total from £1.4m to £2.8m. ■

OPTIONS

New LIFFE contract

The London International Financial Futures and Options Exchange (LIFFE) has announced it will offer three-month Eurodollar futures and options contracts beginning 18 March 2004. This is a natural extension of LIFFE's short-term interest contracts which already cover a euro-denominated short-term interest rate contract, Euribor and its sterling, swiss franc and yen equivalents. **www.liffe.com** ■

SECURITISATION

UK market growth

In its annual review of the securitisation market in the UK and Ireland, rating agency Moody's found that issuance in the UK and Ireland increased by 31% to €74.3bn in 2003, and deals for residential mortgage backed securities (RMBS), where transactions by banks and building societies are backed by the loans they make to retail residential customers, contributed the largest share of new business. The contribution from RMBS rose to €50.9bn compared to €28.5bn in 2002.

The rating agency expects continuing interest

in infrastructure whole business securitisation (WBS) deals in 2004, following in the footsteps of previous issues, such as those by Anglian Water and Southern Water Services. But according to Moody's volume in the WBS sector fell to €8.1bn in 2003 from €10.0bn in 2002. ■

ACCOUNTING CHANGES

Lease clarification

The International Financial Reporting Interpretations Committee (IFRIC) has released a draft document to provide further guidance on IAS 17. Determining whether an Arrangement contains a Lease, Draft document D3 examines whether arrangements that do not take the legal form of a lease (eg some take-or-pay contracts) should still be accounted for in accordance with IAS 17.

Kevin Stevenson, IFRIC Chairman, explained that the IFRIC developed the draft Interpretation to deal with questions that have arisen in practice of how to apply IAS standards in some cases. He says: "D3 clarifies that the leasing Standard has wider applicability than simply those agreements specifically described as leases." For example, it proposes that elements of some supply contracts or outsourcing arrangements should be accounted for as leases.

"One important consequence of this will be significantly increased disclosures about these types of transactions, because the disclosures for leases, even operating leases, are reasonably demanding," he adds. "At present there is little required disclosure for these transactions when they are not viewed as leases." The proposal is open for public comment until 19 March 2004. **www.iasb.org**

■ *See also the article on page 28.*

IN BRIEF

- **CashTech Solutions** has launched its next generation platform in India. The TransactCashIn payments module will allow customers to predict and optimise clients' payment requirements and conduct the payment transaction in a manner best suited to the clients' needs, according to CashTech. **www.cash-tech.com**

- **Citigroup Global Transaction Services** has launched a new commercial card reporting feature, Citibank Custom Reporting System, which includes an electronic query tool through which multinational commercial card clients can analyse their corporate spending patterns with the commercial card on a global basis. **www.citigroupgcib.com**

- **EBS**, the electronic dealing service, has launched EBS Live. EBS Live will offer banks a live feed of market data sourced directly from the EBS Spot system – which links more than 2,000 traders and 750 trading floors worldwide – thus minimising the price exposure associated with latency, according to the group. **www.ebs.com**

- **FNX** has developed a structured bonds and emerging debt module for its Sierra system. The module allows users to create fully-customisable structured bonds using multiple asset classes, and has been designed for trading desks using complex structures involving a combination of interest rate, FX and equity. It also supports embedded options that, for example, allow issuers to call them before maturity, according to the group. **www.fnx.com**

- International banking club **IBOS** has relaunched its website to provide more information to corporate clients. The IBOS Association is an international banking alliance made up of 12 member banks and their subsidiaries in the US and Europe that provides corporate clients with cash management services across the two regions. **www.ibosassociation.com**

- The Institutional Money Market Funds Association **IMMFA** has added two new members to its ranks: Mellon Global Investments, which is part of the Mellon Financial Corporation, and Insight Investment Management, which is the asset manager of the Halifax and Bank of Scotland Group (HBOS). IMMFA now has more than 30 members. **www.immfa.org**

WITHOLDING TAX

Broadening scope

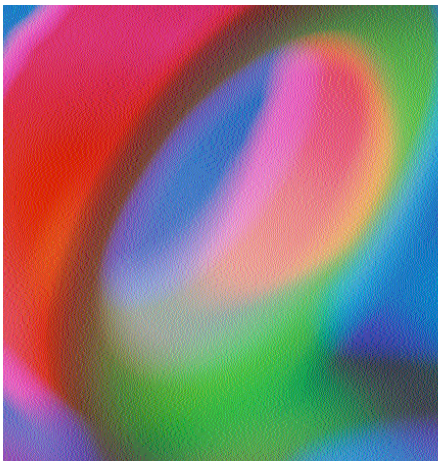
The European Commission proposes to broaden the scope of the EC directive to eliminate withholding tax in the case of payments of interest and royalties between associated companies of different EU Member States. According to the Commission, the changes would see the Directive cover a larger range of companies including the European Company and the European Co-operative Society. The proposal would also get rid of a loophole in that it would not apply to companies that are exempt from tax on interest and royalties received. **http://europa.eu.int**

Clarity

Standard & Poor's has published a report to provide greater clarity to issues surrounding withholding tax in structured finance transactions. The report describes the 'comforts' the rating agency expects to receive when making a transaction. "There is a heightened risk of withholding tax when cash flows across a jurisdictional border," says Julie Lynch Bridson, Standard & Poor's assistant general counsel. "In these instances, the tax authorities in the jurisdiction from which the cash left may require part of that amount to be remitted to it in the form of withholding tax." She says the risk of withholding tax is particularly acute in the European securitisation market, where cash is passed from payers in one country to an SPE issuer in another country. **www.standardandpoors.com**

EU REGULATIONS

Cutting red tape



The European Commission has launched a proposed directive requiring member states to cut administrative burdens and excessive red tape now preventing businesses from offering their services across borders or from opening premises in other member states. The services that would be covered by the proposal make up about 50% of all economic activity in the EU.

The Commission says that many small and medium-sized enterprises (SMEs), who represent the bulk of service providers, are at the moment dissuaded from cross-border expansion. By encouraging cross-border economic activity and boosting competition, such a directive would increase choice, improve quality and bring down prices for consumers and businesses that use services. **http://europa.eu.int**

PERCENTAGES

NO TO SARBANES-OXLEY
European finance professionals are reluctant to follow the lead of the US's Sarbanes-Oxley Act, according to a new report by *GTNews*. Only 48% of Western European respondents agreed that other jurisdictions should adopt similar regulations to Sarbanes-Oxley. A total of 59% of global respondents agreed that Sarbanes-Oxley-style regulations should be implemented in non-US jurisdictions (North America 67%; Asia-Pacific 57%). Respondents also welcomed corporate governance initiatives such as Sarbanes-Oxley as having a positive impact on best practice in the treasury department, but were less confident that such measures would be sufficient to restore investor confidence, the majority of treasury and finance professionals appear to believe that additional measures, such as structural changes at board level, are also required. **www.gtnews.com**

OUTSOURCING TO RISE
According to a survey conducted at Fundtech's second International Client Forum, 53% of banking executives expect to increase their spending on outsourced applications and processing over the next three years. This is consistent with recent research from TowerGroup that projects outsourcing in the payments segment to increase significantly faster than the overall industry with a predicted growth rate of 6.5%. Furthermore, 45% of respondents saw real-time nostro as the initiative with the biggest impact on their business in the long term, and 57% of respondents are planning to use SWIFTNet beyond traditional FIN messages as of 2004/05. **www.fundtech.com**

CASHFLOW AN ISSUE
Small and mid-sized enterprises (SMEs) regularly suffer from cashflow problems as a result of invoice payments being paid late, according to new research from Bank of Scotland Corporate Banking. Around two-thirds (68%) of SMEs in UK have faced restricted cashflow because of late payment and two-fifths (43%) of SMEs have taken legal action against customers for non-payment. Half of businesses wait on average up to 60 days for payment of invoices. One thousand SMEs across the UK. **www.bankofireland.co.uk**

bfinance

FORTHCOMING EVENTS
REGIONAL GROUPS

For more information, contact Anna McGee amcgee@treasurers.co.uk 020 7213 0719. Or visit our website at www.treasurers.org/membership/rgoevents.cfm

London Central Group: The Discreet role of the English Law Trustee *Speakers: Stephen Norton and Richard Rance. 18 March 2004, 18:00. Venue: The Law Debenture Trust Corporation plc, 5th Floor, 100 Wood Street, London EC2V 7EX (nearest tube St Pauls)*

Midlands Group: Treasury Fraud – Managing the risks *05 April 2004 . Venue: Deloitte & Touche, Birmingham*

PENSIONS

Deficit continues

A better year in the equities market has failed to make up the hefty deficit in pension funding for the UK's 100 largest companies based on market capitalisation, according to a report from Watson Wyatt. Increases in the liabilities of pension schemes – as a result of higher inflation expectations and lower corporate bond yields – means the FRS17 deficit for pension funds of FTSE 100 firms totals about £60bn. This is little changed from 12 months ago. The deficit for all UK pension schemes could be as much as double this figure, said the report.

An alternative perspective to view pension scheme funding positions is the shortfall that would be required by employers to fill if they closed the scheme down today and secured the benefits via annuity purchases – the 'buy-out position'. Watson Wyatt estimates the buy-out deficit for FTSE100 companies currently to be £150bn. **www.watsonwyatt.com** *bfinance*

Consultants' review

Recent reports in the US say this could be the year when big investment consultants have some of their working practices reviewed. The relationship between themselves and the fund managers who rely on being recommended to potential pension fund clients is expected to come under examination.

Lori Richards, Director of SEC's office of compliance inspections and examinations, has issued a request for information from a number of major investment consulting firms about their dealings with pension fund clients.

Echoing Paul Myners' 2001 report on the UK investment industry – which highlighted the controversial use of soft commissions (although this was a relationship between fund manager and equity broker) – the SEC is concerned about possible conflicts of interest between pension consultants and fund management firms they work with.

Critics of pension consultants have complained that the billion-dollar industry operates schemes known as 'pay-to-play.' Such a scenario could involve a fund manager paying a consultant through "various hidden means", in return for a recommendation to a pension fund.

Critics say the pension consulting industry in the US lacks transparency and operates under anti-market practices, to the detriment of pension fund clients and smaller consultants. In January a number of firms received letters from SEC requesting information on alleged 'pay-to-play' activities, and stressed full co-operation with SEC's review. **www.sec.gov.** *bfinance*

STRUCTURED FINANCE

Strong performance

European structured finance ratings showed strong overall performance in 2003, and continued to demonstrate stability across most asset classes, according to Standard & Poor's European Structured Finance Ratings group's fourth transition study. Analysts at S&P say the European CMBS market to show a growing pool of seasoned deals in 2003 as a result of strong issuance levels since 2000, and is characterised by signs of innovation and sophistication in new transactions. **www.standardandpoors.com** ■

SOURCES • *bfinance.co.uk* • **The News section was compiled by Denise Bedell • Press releases should be addressed to mhenigan@treasurers.co.uk.**