IN BRIEF

The Office of Fair Trading is to examine **investment banking fees**, according to reports of a speech by its chairman. The OFT has been gathering evidence from investors and issuers who have raised concerns about competition in the wholesale banking market, notably on the level of fees charged for rights issues, which have risen markedly in recent times. The OFT will be seeking voluntary changes rather than heavy-handed regulation.

The Department for Communities and Local Government has issued guidance on **local government investments**. Following the problems encountered by some councils with investments in Icelandic banks, the guidance prompts local authorities to implement a sound policy and process around investing cash. The guidance can be downloaded from: **http://bit.ly/9CJXvY**

The Credit Rating Regulations 2010 will come into force on 7 June 2010, with the FSA designated as the competent UK authority. It will be responsible for enforcing the registration of credit rating agencies, and compliance with various provisions around independence, conflicts of interest, outsourcing, disclosure and presentation of information. Businesses using ratings for the purposes of financial regulation will only be able to use credit ratings from registered credit rating agencies.

Richard North, a former chairman of Woolworths and Britvic and CEO of InterContinental Hotels Group, has been appointed the new **Payments Council** chairman. The Payments Council was set up to ensure that UK payment systems and services meet the need of users, payment service providers and the wider economy.

Setting an end date for **Single Euro Payments Area (SEPA)** migration and the switch from legacy systems is under consideration by the European Commission. The European Association of Corporate Treasurers (EACT), working through the end users committee, supports this aim in principle but makes the point that no final date should be set until some remaining issues over the design of the SEPA products have been resolved, in consultation with end users. In particular, SEPA direct debit is currently insufficiently flexible to meet user needs.

INTRODUCTION

By Martin O'Donovan
ACT assistant director, policy and technical

Winston Churchill was fond of the following quote from Arthur Hugh Clough's poem Say Not the Struggle Naught Availeth: "For while the tired waves, vainly breaking/ Seem here no painful inch to gain/Far back through creeks and inlets making/Comes silent, flooding in, the main." Looking back at your to-do list several months later, it can be encouraging to find how many items can be ticked off. It is the same with the issue of over-the-counter derivatives, where little by little the non-financial corporate community is making progress with the regulators. A sound set of findings from the House of Lords, covered in our main story below, is to be commended, as is the speed with which they have worked, having taken evidence up to early February and reported by the end of March.

OTC reform starts to move the right way

In a report on derivatives, the House of Lords' EU committee has welcomed the European Commission's proposals for central clearing of standardised over-the-counter (OTC) derivatives and greater transparency.

The Lords' report (entitled "The Future Regulation of Derivatives Markets: Is the EU on the Right Track?") follows on from a call for evidence earlier in the year, to which the ACT responded. Indeed, in reaching its conclusions the report quotes from some of the points that were made by the ACT.

The committee observed that the mandatory clearing of all standardised products could increase risk by forcing clearing houses to clear products for which they could not effectively manage the associated risk.

It also accepted that not all derivatives contracts were suitable for standardisation, and that applying capital charges to encourage standardisation (rather than on a basis proportionate to risk) could adversely affect stability and raise the cost of using derivatives to manage risk.

The ACT and EACT had identified the latter point as the new threat to corporate hedging with derivatives. Even if derivatives are exempted from mandatory central clearing and margining, the danger now is that the Basel III proposals, as translated into a new Capital Requirements Directive, could risk weighting non-centrally cleared transactions so heavily as to make them uneconomic and thus represent a backdoor method for forcing central clearing.

The committee pointed out that the use of derivatives by non-financial businesses was inherently less risky as the businesses that use them have a close interest in the value of the underlying assets.

Derivatives play an important role in allowing companies to hedge against risks outside their control and so focus on their core business. The committee argued that the European Commission's proposals could penalise the use of this type of derivative. They welcomed the European Commission's confirmation that it would consider this issue in its impact assessment.

The EU and US proposals for the regulation of OTC derivatives first appeared last summer and at that stage were undiscriminating in calling for the central clearing of all transactions.

It is therefore encouraging for non-financial corporates, which would have been severely and adversely affected by the original OTC proposals, to see a more thoughtful approach being adopted in most quarters. Even though derivatives can be used for speculation, it is now generally accepted that they also have sound economic and commercial benefits and play an important function in the redistribution of risk. ■

Cost of banking pollution

The banking industry is a pollutant, according to Bank of England director Andrew Haldane. In a recent speech, he likened financial systemic risk to a noxious and polluting byproduct that risked endangering innocent bystanders in the wider economy. He went on to provide a detailed assessment of the cost of that systemic risk and the role of regulation and prohibition.

The wealth transfer from the government to the banks as a result of the bailout provides a narrow fiscal interpretation of the cost of the financial crisis. In the UK the direct cost may be less than £20bn, or little more than 1% of GDP. But this underestimates the wider impact on the economy in lost output. A 10% loss of output in the UK translates in money terms to £140bn.

Even this figure is an underestimate since much of the output loss can be expected to persist, and in net present value terms the cost could be a multiple of the static cost, with indicative numbers for the UK coming out between £1.8 trillion and £7.4 trillion. However, this may overestimate the damage caused by banks: others, such as feckless borrowers, are not blameless.

One way of isolating the banks' contribution to systemic risk is to measure the implicit subsidy given to banks by comparing their credit ratings assuming "support" with their "standalone" ratings. Standalone ratings can be between 1.5 and four notches lower, which in yield differences applied to the banks' ratings-sensitive liabilities comes out as an annual subsidy for the top five UK banks of £50bn. This is roughly equal to the UK banks' annual profits prior to the crisis, so it is unrealistic to argue that this should be recouped from the banks themselves.

These assessments can only be a rough guide but the conclusion is that banking pollution is a real and large social problem. The public policy question is how best to tackle it: via capital and liquidity buffer requirements (a form of taxation) or by restricting business activities and splitting up large banks (a prohibition solution)?

Haldane concluded, with a view at odds with the FSA: "It is possible that no amount of capital or liquidity may ever be quite enough. That means banking reform may need to look beyond regulation to the underlying structure of finance." ■

Issuer liability regime extended

HM Treasury has extended the statutory regime for issuer liability. It is the culmination of a process that started with a discussion paper by Paul Davies in March 2007, the central question being should companies, managers or advisers be liable to investors for losses suffered as a result of investment decisions taken on the basis of inaccurate information, and if so to whom should they be liable?

Fraud remains the basis of liability for periodic and ad hoc statements, and negligence for prospectuses, which is why prospectuses are subject to such careful verification.

The scope of the statutory regime will be to cover all information published by the issuer by means of a recognised information service, whether or not the person claiming damages obtains that information from that source.

The statutory regime is extended to include liability where the issuer acts dishonestly in delaying publication of the information.

The new regulations were expected to extend liability to sellers of securities (in addition to the existing rules on acquirers), but the government has gone further and added a new liability for holders of securities. There must be a clear reliance on information published by the issuer in deciding to continue to hold the securities. A distinction is made between active and passive holders of securities; the latter are not entitled to bring an action.

http://www. WEBSITE WATCH

City churches

The City of London has the greatest concentration of church buildings of outstanding quality of anywhere in the country, with no fewer than 42 places of worship situated within the Square Mile. The index on the Friends of the City Churches will lead you to information on each. Why not start with St Stephen Walbrook for a breathtaking Wren dome, the prototype for St Paul's. Go to: **www.london-city-churches.org.uk**

IN BRIEF

▸ The Fitch 2009 global corporate rating transition study reveals the **extent of the global recession**, with 26.7% Fitch-rated global corporate issuers affected by downgrades (up from 20.1% in 2008), and only 4.7% by upgrades. Debilitated financial markets and a deep contraction in economic activity pushed the default rate on Fitch-rated corporate issuers to 2.59%, double the rate of 1.29% recorded in 2008. Meanwhile more optimistic news from Fitch Solutions saw its market implied rating and CDS pricing service, a model-based ratings process, report a 22% decline in its global five-year probability of default rate since the beginning of 2010.

▸ The Bank of England's **credit conditions survey** for the first quarter of 2010 has reported some positive trends. Default rates on lending to private non-financial corporations fell unexpectedly over the first three months of 2010 for medium and large firms and were unchanged for small firms. Loss-given default rates were generally stable. Spreads and fees on corporate lending narrowed for medium and large firms over the three months and widened slightly for small firms. Lenders reported that the amount of credit made available to small firms was little changed but that credit availability had increased for medium and large firms by broadly similar amounts. Over the next three months, lenders expect credit availability to increase for all private non-financial firms, although to a lesser extent for large firms. For large firms, lenders reported that maximum credit lines had increased and that loan covenants were expected to ease over the coming quarter. Tenors on new corporate loans were reported to have increased in Q1 for the first time in more than two years. Lenders anticipated a further lengthening in tenors over the next three months.

▸ The Bank of England provides **short-term liquidity support for the banking system** through its discount window facility by lending gilts against a wide range of collateral in return for a fee. The Bank is consulting on extending the pool of eligible collateral to include portfolios of loans without the need for securitisation. This means that commercial loans to companies can become the backing for emergency liquidity for banks, giving a double benefit to the bank and to the corporate world in the sense of better liquidity on loans. The ACT has welcomed the proposal.