IN BRIEF

A financial transactions tax on share, bond and derivative transactions is an idea under consideration by the European Commission. A 1-5bp tax might seem small but the multiplier effect in a chain of market transactions could become significant. A financial activities tax based on adjusted profits is an alternative and one favoured by the International Monetary Fund to "reduce risk-taking behaviour".

The over-the-counter (OTC) derivatives legislation (known as EMIR) was to have been approved by the Economic and Monetary Affairs committee of the European Parliament in late April, but has been delayed until 24 May. After a plenary vote on 7 June, the regulation will still need to be agreed between the Commission, Parliament and the Council. Surprises, possibly unwelcome, can still be introduced at that late stage.

A new inquiry into credit rating agencies and their influence on sovereign borrowing has been launched by the House of Lords' EU Economic and Financial Affairs and International Trade Sub-Committee. The committee reviews European legislative proposals, which in this case include the suggestion of a European government-run ratings agency, regulatory changes around the rating of sovereign debt, rating agency liability and questions on the issuer pays model. The ACT has already responded to the European Commission – see **www.treasurers.org/node/6674**

Changes to the Prospectus Directive approved in 2010 must be implemented by member states by July 2012. HM Treasury is consulting on early implementation because of the benefit for companies and particularly SMEs of increasing the minimum number of investors for which a prospectus is required from 100 to 150, and raising the prospectus threshold from €2.5m to €5m issue size.

The Payments Council has launched a new accreditation scheme to make sure that companies that offer **sort code validation services** to UK businesses provide regular and up-to-date information. The scheme will help minimise processing errors and delays to businesses that rely on making automated payments via BACS, CHAPS and the Faster Payments Service by inspiring confidence that the information is up to date.

INTRODUCTION

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

Forewarned is forearmed, they say, so I make no apology that from time to time these pages are full of dire warnings of one misconceived legislative initiative or another, such as more strictures on corporate governance from Europe, as explained opposite. But if the political and regulatory environments are going to change, there is no harm in planning early to deal with it. Ideally through individual lobbying efforts, and those of the ACT, we can head off the more damaging ideas. However, the authorities tend to have more stamina than companies do – they persevere for years. So do alert the ACT policy and technical team to any unfavourable proposals you spot and let us know your reactions to the ones we spot.

Government issues Bribery Act guidance

The delayed guidance on the UK Bribery Act 2010 has finally been published, and the Act will come into force on 1 July 2011, making a company liable for the offence of bribery by an employee or someone performing services for the company.

If an organisation can show it had "adequate procedures" in place to prevent bribery, but bribery was still committed, then it will be liable for the lesser offence of failing to prevent bribery. The guidance seems to take a fairly pragmatic and less onerous view of what constitutes "adequate procedures" to prevent bribery, but bear in mind that it does not carry the force of law, so the courts are not bound by it.

Many organisations will face little or no risk of bribery, especially if their business is undertaken primarily in the UK, so the need for procedures may be minimal. However, if an organisation operates overseas, the risks may be higher, and the procedures adopted should be proportionate to that risk.

A corporate can be liable for the corrupt acts of an "associated person". A supplier of services can be an associated person although a supplier of goods will not be. However, the company does not have to look right down through its chain of service subcontractors to check compliance.

A joint venture (JV) entity is not automatically presumed to be associated with its members but members should ensure that they have sufficient audit rights and binding anti-bribery contractual commitments between the JV partners at least for new JV agreements.

As a general proposition, corporate hospitality or promotional expenditure that is proportionate and reasonable and made in good faith is very unlikely to engage the Act.

Facilitation payments – payments to induce officials to perform functions they are obligated to perform anyway – are bribes. The payment of legally required administrative fees or fees for fast-track services are not facilitation payments.

The guidance is based on six principles for bribery prevention, with the key emphasis being on proportionality. Among the other principles are a top-level commitment to anti-bribery, undertaking risk assessments, doing due diligence, communicating your policies and procedures to staff, and monitoring and reviewing your risks and your procedures. ■

Jargon busters
US law firm Latham & Watkins has produced three "books of jargon": on project finance, on corporate and bank finance, and on European capital markets and bank finance. The very full definitions and explanations go beyond a mere glossary and could almost be classed as mini-textbooks on finance. They are even available as an iPhone app. **www.lw.com/BooksOfJargon.aspx**

Lords rap Big Four audit

The Economic Affairs Committee of the House of Lords has published a report highly critical of the "oligopolistic" nature of the auditing market, and the Big Four audit firms in the UK.

Using evidence from the banking crisis, audit firms are accused of having been "disconcertingly complacent" in failing to raise concerns about the state of banks' balance sheets.

Only three of the big firms are active in banking audit, which merely underlines the unacceptable degree of market concentration.

The report does not come out in favour of mandatory joint audits or changes in the ownership structure of audit firms. However, it recommends that FTSE 350 companies should be required to tender their audit contracts every five years. Other recommendations are:

- Audit committees should be required to disclose more information to shareholders about significant issues raised during the audit and the decisions they take.
- Audit committees should also explain the basis of the decision on audit tendering and auditor choice, although investor apathy on auditor choice was noted here.
- The provision of internal audit services, tax advice and advice to risk committees should be prohibited. However, there was no recommendation for a complete ban on non-audit work.
- The Office of Fair Trading (OFT) should examine whether a firm's external auditors should be banned from carrying out any other services for the firm.
- The introduction of International Financial Reporting Standards (IFRS) has lowered audit standards by encouraging a box-ticking mentality and reduced the exercise of auditors' judgement.
- Prudence should be reasserted as the guiding principle of audit.
- There should be regular meetings held between the auditors of financial institutions and the regulators.
- The OFT should conduct a market study of restrictive bank covenants that limit audit to the larger firms.

The Lords committee has called on the OFT to hold a detailed investigation into the audit market with a view to a possible inquiry by the Competition Commission. Possible audit assurance on such matters as risk management, the firm's business model and the business review should be considered.

The committee is clearly concerned about Big Four dominance and would see any move from the Big Four to a Big Three as leading to an unacceptable degree of market concentration that would undermine choice and competition in the audit market. ■

EU trains spotlight on corporate governance

The European Commission has issued a green paper on corporate governance. The paper is based on a review of all companies and was prompted to some extent by the financial crisis and the view that self-regulation was not as effective as it could have been. The consultation aims to stimulate debate on a number of issues such as how to improve the diversity and functioning of boards of directors (including gender mix and possible quotas), directors' pay, the monitoring and enforcement of existing corporate governance codes, and how to enhance the engagement of shareholders.

The green paper says that any risk policy needs to be set from the top, with clearly defined roles and responsibilities throughout the organisation. Given the diversity of situations, it does not seem possible to propose a one-size-fits-all risk management model. Questions are raised about reporting corporate risk appetite to shareholders and including key societal risks in those disclosures.

The chapter on enhancing shareholders' involvement in corporate governance issues reveals major criticism of investors for focusing on short-term goals. Innovations such as high-frequency and automated trading have increased liquidity but shortened shareholding periods. Turnover on the majority of stock exchanges is now running at 150% per year of aggregate market capitalisation, which implies that the average holding period for shares is eight months.

The last chapter of the green paper looks at ways to improve monitoring and enforcement of existing corporate governance codes, focusing in particular on the quality of information provided by companies and the oversight by monitoring bodies. The comply or explain model, as used in the UK, comes under attack for not providing sufficient explanations. As is typical of the EU approach, tighter rules and national monitoring bodies are the implied solution.

IN BRIEF

The disclosure duties for banks advising on swap agreements have been extended in a German court ruling that required Deutsche Bank to pay damages to a customer for breach of its duties when providing advice in relation to a complex interest rate swap agreement. The key point concerned a conflict of interest for the bank. In order to sell on the risk, the bank had structured the swap to the detriment of the customer and should have disclosed this conflict. Although not critical to the case, the court indicated that the bank had not adequately determined the customer's risk profile nor sufficiently disclosed the risk of loss from the instrument.

A merger of treasury management consultancy services has been referred to the Competition Commission by the Office of Fair Trading, following Sector Treasury Services' acquisition of Butlers (ICAP's treasury management consultancy services business). The combined parties would have over 70% of the local authority market, where they supply information and advice on investment and debt management, legal and regulatory compliance, risk assessment, debt and investment accounting, and so on. The OFT is concerned about competition and the high barriers to entry in this market.

The Fitch ratings global default study for 2010 has shown improving economic and credit conditions. Global corporate issuers affected by downgrades fell to 10.6% in 2010 from a recession high of 26.4% in 2009, while upgrades rose to 10.7% of outstanding ratings, up from 4.9% in 2009. The annual default rate on all Fitch-rated issuers fell to 0.49% from 2009's 2.59%. Of note is that all the 2010 defaults were speculative grade-rated credits, resulting in an annual speculative grade default rate of 1.66% in 2010, compared with 8.91% in 2009. Between 1990 and 2010, Fitch's average annual global corporate investment-grade default rate was 0.13%, while across its non-investment grade ratings, the rate was 3.37%. Default rates increase with each incremental movement down the rating scale, but particularly at the boundary from investment grade to non-investment grade where the rate for BBB was 0.24%, whereas at BB it leapt to 1.28%.