IN BRIEF

▸ **The rules on deduction of income tax** from interest are being reviewed for changes. HMRC is consulting on abolishing the concept of yearly interest with the aim of simplifying the tax code. But yearly or short interest benefits from an exemption from the obligation to withhold income tax and is of great convenience within cash pooling or intra-group arrangements. The quoted Eurobond exemption from withholding tax may also be removed for certain intra-group transactions. The ACT will be responding to the consultation, so we would appreciate your feedback to: **technical@treasurers.org**

▸ **Legal entity identifiers** (LEIs) have been flagged by Andy Haldane of the Bank of England as crucial if the financial sector is to keep up with the technology standards commonplace in other industries. At the same time the Financial Stability Board (FSB) has published a note on its work to meet the G20 mandate on the LEI initiative. It has agreed that a 20-character alphanumeric code is a good basis for a global code, and it is continuing to review the reference data that needs to be associated with the identifier. An initial LEI mechanism will begin this summer to enable identification of US swaps, as required by the Dodd-Frank Act.

▸ In the US the **Jumpstart Our Business Startups** (JOBS) Act has been signed into law by the president. The Act is intended to encourage more initial public offerings (IPOs) and capital raising for smaller growth-stage companies by significantly relaxing many of the normal rules. An emerging growth company (EmGroC) is a new category of issuer, which must have had less than $1bn in total annual gross revenues in its last fiscal year.

Under the JOBS Act, emerging growth companies can:

- escape auditor attestation requirements during a transition period;
- solicit certain private offerings with qualified institutional buyers and accredited investors;
- file IPO registration statements confidentially with the SEC;
- present only two years of financial disclosure in the IPO prospectus; and
- have participating underwriters publish research reports.

It is expected that foreign companies of a size to qualify as EmGroCs will be able to benefit from the new regime.

INTRODUCTION

By Matin O'Donovan
Deputy policy and technical director

Within the ACT policy and technical section we spend time reviewing regulatory proposals and providing feedback to the regulators on whether they help or hinder commercial activity in the real economy. By nature I think I must be on optimist: even if the initial proposals look far-fetched, I feel that common sense will in the end prevail. On over-the-counter derivative regulation, much has been achieved and a reasonable exemption from clearing is included for non-financial companies. The exact parameters of the exemption have yet to be set by ESMA, as described on page 09, but once again I believe we will get to a reasonable end point. For some of my ACT colleagues, this is too optimistic too soon. We shall see.

Europe limbers up for shadow banking controls

The European Commission has issued a green paper reviewing the role of the shadow banking sector, the benefits it provides and the possible threats it might cause to financial stability.

For corporate treasurers, changes to the money market fund (MMF) industry would be one area that might directly affect them and their companies. Although no specific changes are proposed it is known that regulators believe that constant net asset value funds should not exist, since they cannot truly guarantee to maintain price stability.

In the past there have been suggestions that constant funds should convert to variable net asset value funds or take risk-mitigating measures such as delaying redemption payments, increasing the capital held by the provider/sponsor firm, credit risk insurance, or creating a reserve funded by reducing the daily yield paid to shareholders.

The Commission defines shadow banking entities as those operating outside the regular banking system but engaging in the following bank-like activities:

- accepting funding with deposit-like characteristics;
- performing maturity and/or liquidity transformation;
- undergoing credit risk transfer; and
- using direct or indirect financial leverage.

The Financial Stability Board (FSB) has estimated the size of the global shadow banking system at around €46 trillion in 2010, up from €21 trillion in 2002. This represents 25–30% of the total financial system, and half the size of bank assets. Shadow banking entities include:

- special purpose entities which perform liquidity and/or maturity transformation – for example, securitisation vehicles such as ABCP (asset-backed commercial paper) conduits;
- MMFs and other types of investment funds or products with deposit-like characteristics, which make them vulnerable to massive redemptions (runs); and
- investment funds that provide credit or are leveraged.

Some regulators and banking supervisors regard shadow banking as dangerous and in need of tighter regulation, but even so it is recognised that shadow banking activities are a useful part of the financial system:

- they provide alternatives to bank deposits for investors;
- they channel resources towards specific needs more efficiently due to increased specialisation;
- they constitute alternative funding for the real economy; and
- they constitute a possible source of risk diversification away from the banking system.

At the same time, shadow banking entities and activities may also create a number of risks:

- deposit-like funding structures may lead to funding runs;
- high, hidden leverage can build up;
- rules can be circumvented, and regulatory arbitrage exploited; and
- disorderly failures could take place and affect the banking system. ■

ACT campaigns for derivatives victory

The European Market Infrastructure Regulation (EMIR) has finally been approved by the European Parliament.

As is usual with financial regulation in Europe, a significant amount of detail still has to be agreed. The so-called Level 2 technical standards will be determined by the European Securities and Markets Authority (ESMA), which now has until September 2012 to complete the task, compared with the previous deadline of June. For the moment the actual implementation date of 1 January 2013 has not been put back.

EMIR will introduce mandatory central clearing and margining of all over-the-counter (OTC) derivatives, the aim being to remove the interconnected web of credit exposures arising from derivative trading. There are also extensive reporting requirements to let regulatory authorities monitor activity and any build-up of positions.

Fortunately there is an exception for non-financial companies so that they will not be forced into central clearing unless their positions exceed a certain threshold. Nor do transactions "objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity of the counterparty or that of its group" count towards the threshold amount.

Corporate treasurers and their national treasury associations were instrumental in securing the carve-outs for non-financials, since for most companies the liquidity risk in having to put up margin or collateral would be unmanageable. That work is still continuing and most recently the ACT has submitted representations to ESMA on setting the threshold amount and defining what counts as hedging.

The essential principle for the ACT is that non-financial companies are not systemically important, so all but the very largest should be excluded. It is therefore crucial that the detailed rules and tests around the exclusion of non-financials minimise the exemption bureaucracy.

Some regulators start from the position that if most transactions by companies are for hedging purposes and do not count towards the threshold limits, then those limits can be set at or near zero. The ACT has suggested thresholds of the order of $6bn – most companies will be well within that amount and so will not even have to prove their transactions are for hedging. This amount is commensurate with the limits being proposed in the US. Limits based on notional amounts are more practical than market values, even though the latter would better represent the credit exposure.

If a company breaches the threshold for more than 30 days in a period of three months it will be caught. If it then turns out that the derivatives in question are not suitable for central clearing there will be a further obligation for the parties to mitigate risk by exchanging collateral on a bilateral basis.

The ACT has also been arguing that banks should be allowed to take some credit exposure without collateral, that initial margin is in this case inappropriate, and that any variation margin should be applied even-handedly between the parties, not solely in favour of the bank.

For all derivative transactions, there will be good practice requirements around prompt exchange of confirmations, ideally electronic, and properly performed reconciliations. ■

US regulators finalise swaps rules

While Europe is still considering the threshold amounts for exemption from its swap rules, the equivalent regulation in the US has made further progress. Last month the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) announced their final rules for defining a major swap participant.

The SEC and CFTC rules will look at each class of swaps separately – namely, rates (foreign exchange and interest), credit, securities and commodities. A company will become subject to the clearing rules if its current exposure exceeds $3bn in the rates class or $1bn in any other class. Hedging transactions will not count towards the totals.

In Australia by comparison the authorities are taking a far more relaxed attitude and are considering far less rigorous rules.

IN BRIEF

▸ **A new reference rate**, $ Euribor, was launched at the start of April by the European Banking Federation's Euribor-EBF. The set of US$ Euribor interest rates are defined as the rate at which US dollar interbank term deposits are being offered by one panel bank to another panel bank at 11.00am Brussels time. The fixings in early April came in massively higher than the US$ Libor rates as published by the UK's BBA. For example, the three-month $ Euribor has been running at close to 1.0% compared with $ Libor at around 0.45%. This is indicative of the difficulty European banks are generally having in funding themselves in dollars and perhaps reflects the make-up of the Euribor panel – 20 mostly lower-tier banks including two Chinese and one Turkish. On the other hand, the 18-strong Libor panel contains some of the big names in international banking such as Deutsche, HSBC, Citi and Bank of America. The Bank of England dollar swap facility with the Federal Reserve must help too.

▸ **Anti-corruption guidance** has been released by two international bodies. The Prague Declaration on Governance and Anti-Corruption was developed by the World Forum on Governance as a framework aimed at restoring trust in democracy and good governance. Its 10 principles include sections on bribery, companies and investors. The International Corporate Governance Network (ICGN) has issued a statement and guidance on political lobbying and donations, with a strong focus on transparency and disclosures.

▸ **The Prospectus Directive** amending regulation will come into effect from 1 July 2012, so many debt issuance programmes will need amendment. The base prospectus summary will require a standard form and be attached to the final terms of each issue. The final terms must not contain any significant free text, so the description of the securities contemplated by the programme will need to be more carefully described in the base prospectus. Prospectuses approved prior to 1 July 2012 will be grandfathered for a year.

▸ **The Commons Treasury Committee** has taken oral evidence from the ACT as part of its review of credit rating agencies. John Grout, ACT policy and technical director, explained the importance of rating agencies to end users, whether they are issuers, investors or engaged in commercial business with a rated party.