IN BRIEF

A fixed-fee factoring package for small businesses has been launched by new British bank Aldermore. SMEs with an annual turnover up to £500,000 will be able to access and utilise cash tied up in unpaid invoices for up to 80% of the invoice value. Servicing and discounting fees are fixed for two years and include CHAPS/BACS payments. A number of surveys have indicated that many small business owners are confused about the cost of invoice finance facilities. This fixed-fee facility should make factoring costs for SMEs simpler and more transparent.

The European Commission has launched a consultation on the role of statutory audit and the wider environment within which audits are conducted. The most extreme proposals could force accounting firms to choose between audit and non-audit services, and make audit rotation mandatory. Other proposals include obligatory joint audits, audit quality certification, expanded audit reports and EU-level regulatory oversight. The internal market and services commissioner Michel Barnier said: "The crisis highlighted failings in the audit sector. These need to be explored and we need to see what improvements can be made. I believe that it is important to approach this discussion in a frank and open manner. No subject should be taboo." Responses to the green paper are welcome until 8 December; the green paper can be found at: **http://bit.ly/qKnrBU**

The ACT has responded to a joint consultation between HM Treasury and HMRC on controlled foreign companies (CFC) reform, in particular the proposed finance company rules. It is proposed that a finance company partial exemption (FCPE) is applied to overseas financing that will usually tax a quarter of overseas intra-group finance income. In most situations this will result in an effective UK corporate tax rate of 5.75% on profits from overseas intra-group finance income by the year 2014.

The ACT acknowledges that FCPE improves the competitiveness of UK corporate tax and has commented on specific proposals, including the FCPE design options and the interaction of FCPE with treasury management activities. A copy of the ACT's response is available at: **www.treasurers.org/node/7276**

INTRODUCTION

By Michelle Price
Associate policy and technical director

With summer now well behind and the cold months ahead, we wait with baited breath to see if and how Greece is to be rescued. The thought of the euro area breaking up wasn't really contemplated, let alone discussed, before summer. That has all changed and the euro break-up article (opposite) provides some interesting practical considerations.

If a new drachma is added to the world's currencies it would be fascinating to understand what algorithmic models the banks build to profit from the exercise. The article on high-frequency trading (below) provides some insight into this world. I for one hadn't realised that high-frequency meant holding the position for literally seconds.

High-frequency trading in FX under investigation

The Bank for International Settlements' Markets Committee has published a report on high-frequency trading in the foreign exchange (FX) market. It presents the results of a fact-finding exercise with the aim of documenting the facts about the practice and identifying areas that may warrant further investigation.

The growth of high-frequency trading has been brought about by advances in IT and the spread of electronic trading. Electronic trading can be divided into two main types:

- manual, where instructions are executed by humans, as when a treasurer deals an FX trade using a system such as FX All; and
- automated, where instructions are executed by computer algorithms.

Algorithmic trading can itself be broken down into two subgroups:

- algorithmic execution, where a human trader decides to trade but uses an electronic trading programme to execute the trade; and
- algorithmic trade decision-making, where a firm builds a model to initiate a trade based on defined parameters, such as correlations within or across markets, that makes the trade decision and also executes the trade.

The report found that high-frequency trading firms operate as a subset of algorithmic decision-makers. Their earnings are generated by dealing a large number of small-size, small-profit trades in very short holding periods, usually well under five seconds and frequently less than one second.

Issues identified by the report that warrant further investigation include the following:

- **Behaviour in normal and stressed times**. While high-frequency trading can be seen as beneficial in normal times by increasing liquidity and providing narrow spreads for smaller trade sizes, this liquidity could dry up in times of market stress just when it is needed most.
- **The effect on other market participants**. High-frequency trading has prompted behavioural changes in traditional market makers in ways which aren't fully understood yet.
- **Systemic risks**. An analysis of trade data in the equity market suggests that systemic risk is more likely to be triggered by a "rogue" algorithmic trade than by pure high-frequency trading. However, high-frequency trading could accelerate and spread such shocks.
- **Market integrity and competition**. The FX market is essentially self-regulated, but in a number of jurisdictions guidance issued by FX committees on codes of conduct is being updated for electronic trading. To date high-frequency trading has been common among the major currency pairs but there are indications that algorithmic trading and possibly high-frequency trading are spreading to other less liquid currencies, including emerging market currencies.
- **Regulatory reform and the market infrastructure itself**. These are two of the drivers that will shape the future of high-frequency trading in the FX market.

For those wanting to read all the facts, the full report can be found at: **http://bit.ly/pIbfUn**

A euro break-up is 'all but impossible'

Company treasurers operating in the euro area may well already have been asked by their boards for a brief on the implications of a euro break-up and what planning their company should be doing in anticipation.

At its simplest let's assume that Greece withdraws from the euro so that Greek euros revert to a new drachma, and is effectively subject to a huge devaluation. For companies with Greek assets, the objective would be to minimise assets denominated in Greek euros while maximising liabilities in Greek euros. Any bank balances in Greek euros could be converted to suitcases full of euro notes on the assumption that devaluation would be thereby avoided.

Companies outside Greece planning acquisitions in the country would be advised to wait and buy assets more cheaply later. If a company is anticipating pulling out of a strong currency, the reverse will apply.

But in reality what are the prospects for a break-up of the euro? An insightful note from UBS Investment Research by economist Stephane Deo considers the practicalities. He concludes that in essence a break-up is almost impossible.

"For the time being there is no provision in the relevant European treaties for a country to exit the euro," he says. "There is certainly no provision for a country to be expelled from the euro."

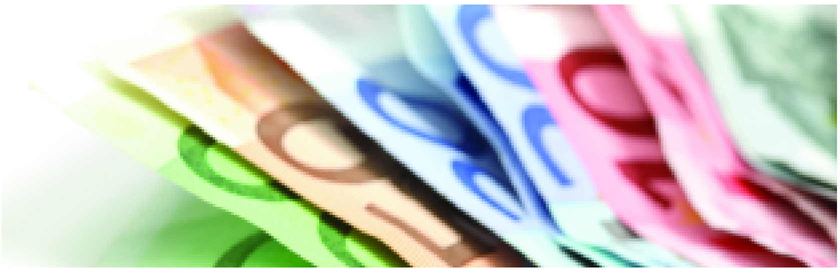
The relevant treaties were deliberately constructed with no opt-out mechanisms so as to make any exit more difficult and less likely. To exit legally would require treaty renegotiations by all member states, with some countries being required to hold a referendum; in other words, a legal exit is all but impossible. The alternative would be a unilateral repudiation of the European treaties – ie. an illegal secession.

So a unilateral exit, and then what? Greece's sovereign debt in euros could be left as euros but, assuming a massive 60% depreciation by the new drachma, such debt would become even more unaffordable. Converted to new drachma this would certainly represent a default with lasting consequences for cost of capital.

The same unaffordability or default dilemma would exist for corporate debt too. Presumably domestic deposits and bank accounts would have to be redenominated, so a run on the banks ahead of any secession would happen as expectations and rumours grew, and surely this would soon spread across the entire European banking system too.

Would the departing country at least enjoy an export boom on the back of the weak currency? Probably not, since the rest of the EU would retaliate with compensatory tariffs on its exports.

And the cost of a sovereign and corporate default, collapse of the banking system, trade and the economy, and possibly civil unrest? The UBS analysts suggest a 700bp risk premium once the initial paralysis abates. Taking the southern European countries as a benchmark, UBS estimates an initial cost of up to €11,500 per person in the seceding countries, plus a cost of up to €4,000 a year thereafter. ■



Ratings revealed
Standard & Poor's has launched a new free public website to provide more ratings transparency and education. The site contains videos, podcasts, articles and educational materials related to credit ratings.
www.understandingratings.com

IN BRIEF

The US Foreign Account Tax Compliance Act (FATCA) potentially imposes a 30% withholding tax on interest and principal paid by all US and non-US "financial institution" issuers, if they do not agree to provide the Internal Revenue Service with information on each financial account held by a US citizen or US-owned foreign entity. FATCA will impact not only European banks but also potentially non-financial foreign entities (NFFEs), which have to disclose whether they have any 10% US owners, or certify that they don't.

While the withholding tax is scheduled to be phased in over 2014 and 2015, FATCA contains a "grandfather" rule which excludes payments for debt securities treated as outstanding on 18 March 2012. This may make it difficult for any issuer whose debt securities are potentially subject to FATCA to tap (or re-open) after 18 March 2012 a series of debt securities issued and outstanding before this date.

Basel III and Solvency II could increase borrowing costs for European corporates by €30–€50bn a year while US borrowers will see their borrowing costs rise by only $9–$14bn by 2018, according to a recent report issued by Standard & Poor's. This equates to an increased margin of 50–70bp for an investment-grade borrower depending on banks' return on equity targets of 8–15%. S&P says: "European corporates will feel the effect more harshly because they typically rely more heavily on banks for funding."

The third quarter has been the quietest in the corporate bond market in more than three years. The high-yield market completely closed throughout August and only slightly reopened in September with €1.2bn issued. Investment-grade bond issuances also collapsed over the third quarter with year-to-date issuance €60bn behind volumes in the first three quarters of 2010.

John Kay has called for evidence for his review into how well equity markets achieve their core purposes. The review will assess how far equity market participants are excessively focused on short-term outcomes to the detriment of core purposes. Evidence will be taken until 18 November, with interim findings published in February 2012 and a final report in July 2012. The review is at: **http://bit.ly/oHp8yg**