CHANGES ARE AFOOT

As I celebrate my three-year anniversary in the ACT's policy and technical team, I look back with amazement at what has changed for the corporate treasurer. On the bright side, hedge accounting should get simpler once the IASB publishes (and the EU ratifies) IFRS 9, *Financial Instruments*. But the downsides include European Market Infrastructure Regulation reporting of derivatives, increased derivative pricing and the forthcoming separation of UK banks, as explained in the article below.

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{ IN DEPTH }

UK BANKING REFORM JUGGERNAUT ROLLS ON

The UK's Financial Services (Banking Reform) Bill, once completed, will represent the biggest ever overhaul of Britain's banking system. The Bill has passed through the House of Commons and, at the time of writing, had been through the first and second reading in the House of Lords with the Committee stage about to begin. Two big issues in the Bill that will affect corporates are ring-fencing and bail-in.

Ring-fencing

Ring-fencing will require 'core' banking services, in particular the taking of deposits from individuals and SMEs, to be undertaken by a separate legal entity, ie the ring-fenced bank. Larger corporates will have the choice of ring-fenced or non-ring-fenced banks since many products – such as lending and transaction banking – can be transacted by either the ring-fenced or the non-ring-fenced bank. But some products, such as medium-term notes, repos and private placements, can only be transacted through the non-ring-fenced bank.

Key issues for corporates:

- Ring-fenced banks will not be able to offer clients any non-linear derivatives. Hence corporates that want to use option products will need to trade with the non-ring-fenced bank and smaller companies may find this difficult to arrange. The ACT has argued strongly for this definition to be widened.
- Following on from the above point, corporates that have to deal with two legal entities (ie both the ring-fenced bank and the non-ring-fenced bank) will have increased operational complexity and risk. Legal documentation, counterparty limits and adequate credit lines are examples of this, not only at the time of bank separation, but also on an ongoing basis.
- The ring-fenced bank and the non-ring-fenced bank will potentially have different credit ratings due to the composition of their balance sheets and the level of deposits covered by compensation schemes. Corporates may have to transact with a lower-rated entity for certain products and services.

Bail-in

The objective of the proposed bail-in tool is to ensure that creditors of a failed bank, rather than the taxpayer, meet the costs of failure. As noted in *The Treasurer* (July/August 2013, page 10), a bail-in follows the creditor hierarchy that would apply in liquidation and the various layers – equity, subordinated debt, senior unsecured debt, etc – are written down until the losses are covered. And then the last surviving layer(s) of debt are partially converted into equity to recapitalise the continuing parts of the business. The bail-in option is to be available to the Bank of England as lead resolution authority.

> Two big issues that will affect corporates are ring-fencing and bail-in

So what does the bail-in tool mean for corporates? When the concept of a bail-in tool was initially suggested in the 2011 Vickers Report, the reference was to the conversion of a bank's bonds being converted into equity if the bank becomes distressed. But this was based on the assumption that a bank will have large amounts of bail-in-able debt, which is not always the case for deposit-funded banks. The scope of what is bail-in-able has now widened. While certain liabilities, including deposits covered by the Financial Services Compensation Scheme, are excluded, corporate deposits are not protected and could be bailed in by the Bank of England. The ACT is seeking changes to protect corporate users of the banking system where their exposures arise purely as a result of having to use the banking system. We believe operational bank accounts, as distinct from residual cash invested overnight, should also be protected and not bail-in-able.

YOUR SHOUT

The Treasurer's Wiki is now up and running. Members have access to add and update articles on the wiki website, so why not try expanding an existing article or even adding something not already there at wiki.treasurers.org?

{ INTERNATIONAL }

EMIR DERIVATIVES UPDATE

Under the European Market Infrastructure Regulation (EMIR) on derivatives, it is crucial for banks or dealers entering into derivatives with companies to know whether their counterparty is a non-financial counterparty (NFC) and whether it exceeds the thresholds of derivatives outstanding so as to become an NFC+. If it is an NFC+, then any derivatives dealt will need to be put through central clearing and collateralised with margin, and certain slightly more onerous risk mitigation measures (confirmations, reconciliations, etc) will apply.

Companies can, therefore, expect to be asked by their banks to make various representations as to their EMIR status. Effectively, companies self-certify as to their status and banks are entitled to rely on this unless they are aware of circumstances that bring those representations into doubt. For companies dealing with relatively few banks, the paperwork and admin around confirming your status as NFC+ or NFC- should not be onerous, but for companies with multiple dealing relationships, the process will become more burdensome, especially if the company is close to a threshold and likely to change its status from time to time.

A group of market participants, led by the British Bankers' Association and the International Swaps and Derivatives Association, have launched a new service, free to clients, with market data provider Markit. Called the Client Classification and Identification Database, it will ease the checking and communication that needs to be repeatedly carried out.

View the following technical updates, blogs and policy submissions at www.treasurers.org

A Practical Guide to Letters of Comfort – revised ACT briefing note

ACT response to S&P corporate ratings criteria changes

EMIR – frequently asked questions for non-financial counterparties

ACT response to IASB *Exposure Draft Lease*

{ WATCH THIS SPACE }

EC PUBLISHES BENCHMARK REGULATION PROPOSAL

The European Commission (EC) has published a legislative proposal for a regulation on financial benchmarks. The proposed regulation follows international calls for benchmark regulation off the back of recent investigations into Libor, Euro Interbank Offered Rate (Euribor) and Tokyo Interbank Offered Rate (Tibor) manipulation, as well as gas and oil price benchmarks. It also follows the July 2013 report from the International Organization of Securities Commissions, entitled *Principles for Financial Benchmarks*, which is intended to act as guidelines for benchmarks used in financial markets.

Key issues proposed by the regulation include the prohibition of unauthorised benchmarks in the EU. It has also been proposed that EU-supervised entities (such as credit institutions, investment firms and insurers) may only use a benchmark produced by a benchmark administrator established in a non-EU jurisdiction where the EC has adopted an equivalence decision for that jurisdiction. This would include non-EU indexes such as the S&P 500 and the Dow Jones. For benchmarks deemed 'critical', there may also be a mandatory requirement for EU-supervised entities to contribute input data. The proposed regulation needs to be agreed by the Council of Ministers and the European Parliament before coming into force.

Key for treasurers will be whether Libor can continue in its current form, which allows rate contributors to exercise expert judgement where transactional data is lacking. Regulators prefer benchmarks based mechanically on transaction data and are investigating alternatives to Libor.

{ TECHNICAL ROUND-UP }

FINANCIAL REPORTING, FATCA AND FRAUD

Proposed amendments to the *IFRS for SMEs* have been published in an exposure draft (ED) by the IASB. Following a 150-day comment period, the SME Implementation Group, an advisory body to the IASB, will review responses to the ED and make recommendations to the IASB. A final version is expected to be published in the second half of 2014 or the first half of 2015, with an effective date of 2016.

Foreign Account Tax Compliance Act (FATCA) online registration is now open for foreign financial institutions (FFIs) to set up their online accounts – these must be in final format from 1 January 2014. From 1 July 2014 for newly opened accounts and 1 January 2015 for pre-existing accounts, US financial institutions must withhold 30% on payments to FFIs that have not registered. An article outlining the impact of FATCA on non-corporates will be published in the December 2013/January 2014 issue of *The Treasurer* and online at www.treasurers.org/thetreasurer

The Financial Reporting Council's Financial Reporting Lab has published a document entitled *Are you doing what you can to answer investors' basic questions about debt and cash flows?* With financial statement preparation just around the corner, it provides a summary of suggested disclosures that are important to investors, when and why they are important, and how they are used. This document is available at www.frc.org.uk/Our-Work/Publications/Financial-Reporting-Lab/Are-you-doing-what-you-can-to-answer-investors-bas.pdf

Fraudsters have netted £7m from UK residents by 'vishing', according to a report by Financial Fraud Action UK. Vishing is where a potential victim is phoned by someone pretending to be their bank or building society fraud investigation team, the police or another legitimate organisation. They try to obtain financial information, such as credit and debit card details and bank account numbers, which they then use to gain access to their prey's finances. A variation on this scam is where the victim is deceived into transferring funds to an account that is accessible to the fraudster. Both consumers and corporate treasury teams should be wary of unsolicited approaches by telephone.