IN BRIEF

▸ The macro-economic impact of the **Basel III** proposals for stronger capital and liquidity requirements has been assessed in two reports by the Financial Stability Board and Basel Committee on Banking Supervision. They conclude that Basel III offers clear long-term benefits by raising the safety and soundness of the global banking system, thereby reducing the probability of a future financial crisis. Taken over four years each 1% increase in the bank capital requirement will lead to a decline in GDP of about 0.20%. The associated rise in banks' lending rates would amount to about 15 basis points for each percentage increase in the capital requirement.

▸ **Cheque usage** plummeted in Q2 2010, according to data from the Payments Council, with cheque numbers down 11.7% on the same period in 2009, equivalent to a drop of £21.5bn. The use of debit cards and Faster Payments took up all the slack left by cheques. Debit card usage rose £7.9bn year on year, up 12.4%, while the value of Faster Payments hit £16.9bn, a dramatic 67% rise as more banks made the service available to their customers.

▸ **The new EU framework for financial supervision** proposed by the European Parliament has been endorsed by the Council, which will enable the new supervisory authorities to be operational from 1 January 2011. A European Systemic Risk Board (ESRB) will provide macro-prudential oversight of the financial system, and three supervisory authorities will also be created: the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

▸ **Confidential ratings from Standard & Poor's** will be for issuers' own use from 7 September 2010, and issuers must agree not to distribute the confidential ratings to any third party. Ratings that issuers wish to disclose on a confidential basis to a limited number of third parties will be called private ratings, and those third parties will be able to access a private rating and related reports on a dedicated password-protected website. This new approach is prompted by an evolution in the law and regulations in a number of jurisdictions.

INTRODUCTION

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

One role of the ACT policy and technical section is to contribute to the debate on any reform or modification of laws, regulations, market practice, etc, in so far as they affect non-financial companies. We are pleased to find that our efforts are increasingly recognised and appreciated by many different authorities. However, selective input directly from companies likely to be affected by changes can make our efforts even more effective. We urge company treasurers – and members generally – to take part in the formation of ACT policy. Tell us what you think. Respond to requests for input in these pages or the ACT's monthly email. Take part in our subject working groups or our general "expert group" (details from technical@treasurers.org). Follow the ACT's blogs. Contribute your own responses to consultations when that might have most effect. Or all of the above!

OTC regulation comes another step closer

The European Commission has published draft legislation for central clearing of over-the-counter (OTC) derivatives. Like the Dodd-Frank law in the US, it will exempt non-financial companies unless they cross some threshold as a large user.

The exact threshold is not yet determined. That decision will be taken by new supervisory authority the European Securities and Markets Authority (ESMA), which comes properly into being on 1 January 2011. The thresholds will be defined "taking into account the systemic relevance of the sum of net positions and exposures by counterparty per class of OTC derivatives".

Many other details still have to be sorted out, along with several articles in the regulation that are unclear or unfriendly to users. For example, the method for calculating net positions and exposures is not defined, and could turn out to be a mixture of nominal amounts and mark to market, with or without a value at risk adjustment.

Non-financial end-users in Europe will not have to apply for any exemptions but merely have to start reporting their contracts, both existing and new, to a trade respository once they cross an information threshold. In the US, users must notify the Securities and Exchange Commission (SEC) or the Commodity Futures Trading Commission (CFTC) to gain exemptions.

The information threshold is defined by reference to all contracts whereas the clearing threshold will exclude hedging contracts, defined as those that are "objectively measurable as directly linked to the commercial activity of that counterparty". The extent to which this definition may end up relying on IAS 39 rules is open for debate.

Once clearing becomes mandatory, all contracts must be cleared rather than just those in excess of the threshold. This creates an unwelcome cliff edge. The ACT will continue to press for changes here, especially since in the US transactions prior to the legislation are exempted.

In the US, FX forwards and swaps can fall outside the definition of a derivative but in Europe there is no similar mechanism. FX spot is not a derivative.

Since the aim of the legislation is to help regulators prevent the dangerous build-up of exposures there are extensive requirements for reporting contracts to trade repositories but for non-financial companies (which have not exceeded the threshold) it is only the financial counterparty that has to report.

A further sting in the regulation is that financial counterparts are defined to include alternative investment funds managers under the AIFM Directive, so certain property companies and funds run by them could be forced into clearing and margining. That said, mandatory clearing applies only to derivatives that are sufficiently standardised; but even if a property derivative escapes clearing for that reason, bilateral exchange of collateral will be needed instead.

Given the importance of the central counterparties (CCPs) to the central clearing model, there are extensive obligations on them to ensure their robustness under all scenarios. ■

Moody's revisits MMFs

Ratings agency Moody's is proposing a new ratings methodology and scale for money market funds (MMFs). Historically, Moody's has emphasised portfolio credit quality and maturity structure when rating MMFs, with consideration also given to factors such as portfolio strategy, manager/adviser characteristics, and the likelihood of sponsor support.

The global financial crisis has heightened investor focus on new risks related to:

- the vulnerability of MMFs to market and liquidity risks, in addition to credit risk;
- the impact of the nature of the investor base on the susceptibility of a fund to redemption risk;
- the vulnerability of a fund to illiquidity, despite owning highly rated assets and the related investor expectation of high ultimate recoveries; and
- the ability and willingness of sponsors to provide financial support to troubled funds.

It has also become clear that potential runs on money market funds pose a systemic risk. Moody's new methodology will introduce objective measures to assess these factors better.

Moody's wants to distinguish MMF ratings from long-term bond ratings. It proposes to introduce a five-point scale ranging from MF1+ (strongest) to MF4 (weakest). The rating definition would capture MMFs' dual objectives of providing liquidity and preserving capital.

Due to the unique character of MMFs, a direct mapping of the proposed MF ratings to either Moody's long-term or short-term ratings is not appropriate, but comparisons can nevertheless be made. For example, MMFs rated MF1 or MF1+ would exhibit a risk profile broadly consistent with Prime-1 rated investments. However, there is a higher expected frequency of payment interruption offset by higher expected recoveries in the event of payment interruption.

The short-term Prime scale places much more weight on default probability than on loss-given default, so even conservatively invested funds may not be Prime-1 rated.

All these proposals are subject to a public consultation running to 5 November 2010. ■

WEBSITE WATCH

Company information

Access to accounts and filings by UK listed companies has become a lot easier with the start of the National Storage Mechanism. Searching by company or announcement type (prospectus, results presentation, etc) is possible, leading to the relevant announcement and the full underlying documents.

www.hemscott.com/nsm.do

UK proposes restructuring moratorium

The government has launched a consultation on proposals for a statutory restructuring moratorium. The Insolvency Service is concerned about the estimated £90bn of loans made to leveraged buy-outs expected to mature before 2015. A moratorium would help viable businesses avoid formal insolvency, offering them a breathing space to achieve a consensual restructuring.

The proposals are primarily aimed at larger companies where the complexities of dealing with diverse groups of competing creditors can make reaching a swift agreement particularly difficult.

The proposal is for a three-month moratorium, subject to various criteria such as having a viable business with sufficient funding to carry on its operations during that period. Directors would remain in place during the moratorium (akin to the "debtor in possession" concept) and any funding during the moratorium would enjoy super-priority status.

Since the directors remain in control, safeguards for creditors include the need for court approval of the moratorium and for it to be subject to constraints and sanctions in addition to ongoing checks by a court-appointed monitor.

In principle the idea is to be welcomed but insolvency law and procedures are notoriously complex, with many conflicting interests. As currently drafted, the moratorium would prevent secured creditors from appointing an administrator, accelerating their debts and enforcing their security, but does not appear to prevent suppliers exercising their contractual termination rights.

Submissions on the consultation are due in by 18 October 2010.

IN BRIEF

▸ Public service auditing body **the Audit Commission** is to be abolished to save money. Over the years since 1983 its role was extended to provide external audit for the NHS, offer comprehensive performance assessments of councils, and monitor the compliance of fire and rescue services.

▸ **The OECD transfer pricing guidelines** have been revised, the first major revision since 1995. The changes affect the arm's length principle, transfer pricing methods, and comparability analysis, as well as new guidelines for the transfer pricing aspects of business restructurings. The update contains more guidance on comparability analyses and how to apply transactional profit methods. In selecting the most appropriate transfer pricing method there is now no distinction between traditional transaction methods (comparable uncontrolled price, resale price, cost plus) and traditional profit methods (transactional net margin and transactional profit split methods). The choice of method should take account of the strengths and weaknesses of each method type. Subject to approval by Treasury order, the amendments will become relevant for UK tax purposes.

▸ The ACT has recently responded to several public consultations. Overall, the ACT supported the IASB proposals on **pension accounting**, even though the changes could materially change the numbers reported for many preparers. The IASB proposes to remove the corridor method for spreading gains and losses and will set very specific rules about the categorisation of costs between service costs, finance costs and remeasurement. Use of the expected return on plan assets will be replaced by an assumed interest rate.

On CESR's consultation on **standardisation of derivatives**, the ACT has argued that there is no need for regulatory action. Where there are benefits from standardisation, these should evolve through normal market forces.

In response to the European Commission review of the **Market Abuse Directive**, the ACT has broadly welcomed the moves to improve the integrity of markets and recommended the extension of the UK's RINGA (relevant information not generally available) concept to Europe. Trading while in possession of RINGA, a wider category than inside information, is prohibited in the UK.