IN BRIEF

▸ **The House of Commons Treasury Select Committee** has welcomed the Payments Council's announcement that cheques will be retained as long as there is customer demand for them – a significant departure from the council's original plan to kill them off for good in 2018. However, the committee has warned the council to ensure that banks do not attempt to abandon cheques by stealth, nor deter customers from using cheques.

▸ **Default rates** are falling, according to ratings agency Moody's July data. The global speculative default rate finished at 1.9% in July, down from June's revised level of 2.3%, and well below the July 2010 global rate of 5.5%. Three Moody's-rated corporate issuers defaulted in July, lifting the total default count to 16 so far this year. Last year, there were seven defaults in July.

▸ **Super-low loan pricing** has been achieved by Johnson & Johnson the US pharmaceutical and healthcare consumer group which has come to the market with a massive liquidity line – a 364-day $10bn backstop facility. The transaction has two one-year extension options, plus a $2bn accordion feature that allows the deal to be increased up to a maximum of $12bn. Rated Aaa/AAA (Moody's/S&P), loan pricing is based on the group's one-year CDS price with a floor of 10bp and a cap of 70bp, and a mere 1bp undrawn fee. Citi and JP Morgan are leading the funding.

▸ **A change in a sovereign issuer's credit rating** does not necessarily lead to a change in ratings or outlooks on similarly rated non-financial corporate borrowers in that country, according to Standard & Poor's in a statement made after it downgraded the US. "A corporate borrower's ratings may exceed those on the sovereign if we expect the company would continue to fulfil its financial obligations, even after a sovereign default. Depending on an industry's or individual company's financial strength, a borrower may be well positioned to withstand economic shocks or other country-related risks. In this light, our downgrade of the US hasn't affected our ratings or stable outlooks on the four remaining US-based AAA rated corporate issuers: Automatic Data Processing (ADP), ExxonMobil, Johnson & Johnson, and Microsoft."

INTRODUCTION

By Martin O'Donovan
Deputy policy and technical director

The final report of the Independent Commission on Banking has just been released as I write so it is difficult to judge how all the participants in the financial markets will react, but initially the clarity of the report and its well-presented arguments have taken the heat out of some of the more vociferous comments being made in the run-up. The recommendations seem fair and reasonable given the objectives, and the key remaining point for debate is whether the private costs of reform to banks are suitably balanced by the benefits to the economy as a whole from greater stability and the reduction in the implicit government guarantee.

Payments Council pushes account switching project

With the Treasury Select Committee and the Independent Commission on Banking putting their weight behind easy account switching, the Payments Council is moving fast on a project to make bank account switching easier for consumers and small businesses. The council announced its project in July and is committed to delivering real customer benefits by September 2013, with some improvements phased in earlier.

At present only outgoing payments such as direct debits and standing orders are moved automatically when a customer switches bank account: the customer still has to notify anyone paying money into the account – such as an employer – of their new account details. The Payments Council wants to ensure any incoming payments are also switched automatically to a customer's new account.

The Payments Council will also reduce the time taken to switch an account from around 18 working days to a guaranteed maximum of seven. It will clarify timescales and ensure consistency of experience across the industry.

Companies that collect direct debits or make payments directly into an account will need to update their own records promptly if a customer changes their account details. The Payments Council reminds BACS users that they must normally update their own records within three days of receiving the new account details through the BACS messages – Automated Direct Debit Amendment and Cancellation Service (ADDACS) or Advice of Wrong Account for Automated Credits Service (AWACS). Although this is primarily a bank project, companies, as payment originators, will have to play their part too.

The improvements will build on existing processes so that customers will end up with a new account number from the new bank. The Payments Council believes full account portability would be both more complex and more expensive than the account switching solution already under development, and would not provide benefits for consumers over and above that solution.

Most importantly, full account number portability could take a decade to implement. It would require a complete redesign of UK payment systems, and risks rendering the UK system incompatible with some international payment systems. The UPIC system for credit payments in the US provides useful features, but even so systems complexity means that no country has implemented a full account portability system. ■

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FRC urges better risk reporting

Companies should improve the way they report to investors on the key strategic risks facing their businesses, according to two new reports published by the Financial Reporting Council (FRC). The reports follow on from a January 2011 discussion paper.

For companies reviewing their board's approach to risk, the FRC's Boards and Risk report offers some clues to what other companies are doing. It gives a summary of its discussions with companies, investors and advisers, but should not be seen as guidance. The FRC drew three main conclusions from these discussions:

1. That there has been a step change in boards' focus on risk in the last few years. This conforms to the emphasis in the revised code on the board's responsibility for strategic risk decision-making.
2. While the document Internal Control: Revised Guidance for Directors (also known as the Turnbull Guidance) is still broadly fit for purpose, some change is needed to reflect the role of the board as articulated in the new version of the code. The FRC intends to carry out a limited review during 2012.
3. That the approaches and techniques used by boards have been developing rapidly. One size most definitely does not fit all, but some common themes and techniques are useful, and these are shared in the report.

Other findings that may warrant further thought and attention include mention of reputational risk. The FRC says: "The increased velocity of risk, with near-instantaneous global transmission of failure, required robust crisis management plans, including clear prior agreement on the respective roles of the chairman and chief executive in a crisis."

The FRC says focusing only on "net risk" after mitigations could obscure the true extent of a company's exposures and the interconnectedness of risks being taken. Boards needed a view of the combination of risks before the application of mitigation policies ("gross risk") in order to understand and challenge assumptions about the effectiveness of those policies.

The FRC also proposes that the audit committee should report to the whole board, with the audit report published in full (after it has been accepted by the whole board) in the company's annual report. The FRC intends to consult on proposals to amend the UK Corporate Governance Code to require companies to put their audits out to tender at least once every 10 years, or explain why they have not. ■

Vickers a victory for sense

In mid-September the much talked about and surprisingly not leaked Vickers Report was released, with recommendations to improve competition, increase bank capital and ring-fence retail banking. The ACT was pleased at its practicality and balance, permitting large corporate loans and deposits on both sides of the ring-fence – a point that had been made by the ACT and which was acknowledged in the report.

The ACT strongly supports the recommendation that decisions be taken quickly and clearly, while taking into account the progress of reforms already under way, even though implementation will inevitably take much longer.

We recognise that the report represents considerable internal change for the affected banks, with significant cost implications. However, expressed in terms of an additional cost of credit for customers, the annual cost of implementing Vickers is put at about 0.1%. The recommendations propose relatively small change in the context of other regulatory changes for banks and markets following the financial crisis.

It is also encouraging to see that one-stop relationships for customers who want both retail and investment banking services would be possible, as would expertise, information and some operational infrastructure sharing across subsidiaries. The ring-fenced banks will still be allowed to sell products from non-ring-fenced banks, such as hedging transactions. This was one of the ACT's concerns when it engaged with the Independent Commission on Banking (ICB) in the consultation and plays an important part in the efficient day-to-day functioning of businesses. ■

See Distance but no Divorce, p28

IN BRIEF

Return on equity in the investment banking sector could fall significantly because of regulatory initiatives, consultancy McKinsey has warned. It says that the average return on equity for the world's largest 13 capital markets-based banking divisions stood at 20% in 2010 but will be trimmed to just 7% as the banks are forced to hold more capital under measures such as the Basel III accord. Nevertheless, some investment banks will be able to pull back to a return on equity of 12–14% if they are able to overhaul their business models successfully.

A universal legal entity identifier is needed to make future systems for reporting OTC derivative transactions workable. The US Department of Treasury's Office of Financial Research (OFR) has been making progress in this field, with discussions of principles by global regulators, recommendations by a global coalition of financial services firms and trade associations, a technical specification for the identifier by an international standards body, and proposals by parties to manage the legal entity identifier. However, it acknowledges that additional work needs to be done to build international consensus on key issues before the OFR can issue a rule. The OFR believes that sufficient progress can be made to allow for an initial phase of implementation in 2012.

"Adequate procedures" to prevent bribery is a matter that is relevant to all businesses under the Bribery Act 2010, as is clear from the £6.9m fine imposed by the FSA on insurance broker Willis for systems and controls that were inadequate for countering the risk of corruption and preventing financial crime. Although the Willis fine arose from financial regulation, the point is that effective procedures are not enough unless there is effective implementation and compliance.
See The Long Arm of the Bribery Act, p32

A reference book on international payment systems is available from the Committee on Payment and Settlement Systems (CPSS). It describes the current payment, clearing and settlement systems in CPSS countries. The new edition covers Australia, Brazil, Canada, India, Korea, Mexico, Russia, Singapore, Sweden and Switzerland. Other countries remain covered by the 2003 edition until a new volume is published in 2012.