THIS MONTH

THINKING AHEAD

The ACT's policy and technical team aims to engage with the regulatory authorities at the earliest possible stage before proposals become too set in stone. This means that some of the subjects we discuss on these pages may seem remote and unreal threats. But as it is always worth thinking ahead, do still provide feedback to us. This month, however, our update covers changes that are already upon us and will require action to implement them right now.

Martin O'Donovan is ACT deputy policy and technical director @MartinODonovan1

{ IN DEPTH }

DERIVATIVES ARE STILL GETTING HARDER

Companies in Europe will have to report all derivative trades to a central database or trade repository by the end of the next day after the trade has taken place from an expected start date of 12 February 2014 (the deadline has been pushed back from 1 January). While the reporting rules in the European Market Infrastructure Regulation (EMIR) may seem straightforward, the practical steps for implementation are complicated, which is causing confusion and uncertainty. Some of the steps and decisions include:

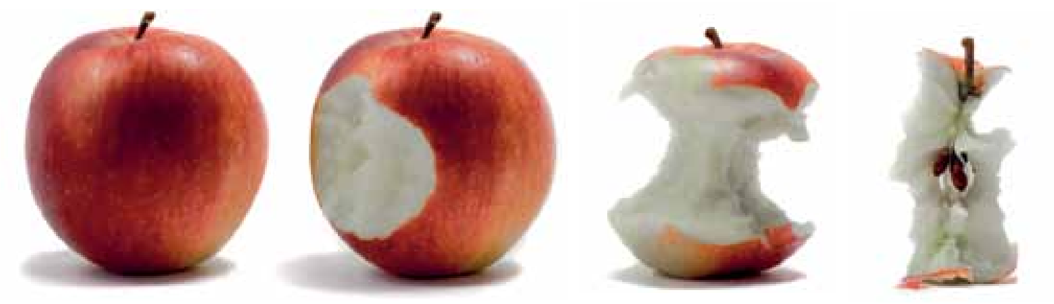
- Obtaining a legal entity identifier (LEI) for every company in your group that is transacting derivatives, either externally or internally.
- Deciding if you will report directly to a trade repository, via your bank if it offers that service, via a third party or using a combination of channels. Where intragroup derivatives must be reported, a third-party service might not be of particular help.
- Finding out whether all your banks can offer a derivative reporting service and reviewing the service level agreements they provide. Alternatively, select your preferred trade repository or third party and agree terms. Either way, you should consider whether your provider will be able to cope with on-boarding hundreds of thousands of new corporates.
- Figuring out which data has to be reported when the specified data fields in the regulation are far from clear.
- Creating or capturing a unique trade identifier (UTI) for every trade.
- Ensuring your IT or treasury management systems can support this reporting.

As the reporting infrastructure is being created from scratch, most of the parties involved are feeling their way forward. The UTI is a good case in point. The regulators have not stipulated how it is to be created, although some guidance is expected from the European Securities and Markets Authority. Ahead of this, the International Swaps and Derivatives Association and market participants have put forward ideas for a method of UTI generation. If one party to a trade creates the UTI, and if it incorporates its LEI (or part of it) as a prefix, that party can then add a transaction-specific reference controlled so that it is unique within that company. The combination of LEI plus internal reference should be unique externally, too. Then there has to be a hierarchy to determine which party generates the UTI or whether some third party – such as a dealing platform or broker – is better able to fulfil the role. For the moment, there is no conclusive 'process' so, ultimately, it will be up to the parties to a deal to agree what UTI they use. Obviously, both must use the same UTI.

If the UTI is communicated via a process that takes time for one side to capture and record, it could be that a party will not have the UTI in time for its reporting to the trade repository. In this case, it should use its own transaction reference number in the first instance and subsequently send in a correction and update.

International regulators thought that by legislating for derivative reform they would make these markets safer, but perhaps the unwritten agenda was to achieve that aim by making derivatives so complicated and onerous that their use would diminish?

For more on derivative reporting requirements under EMIR, **see page 39**



{ INTERNATIONAL }

THE DEMISE OF MONEY MARKET FUNDS?

It may sound dramatic to predict the demise of money market funds (MMFs), but September's draft regulation from the European Commission clearly wants to restrict the MMF sector such that it shrinks in importance. Its theory is that this part of the shadow banking system could be vulnerable to a run and therefore poses a risk to financial stability.

The Commission believes that constant net asset value (CNAV) funds are more prone to a run than variable net asset value (VNAV) funds. Hence, CNAV funds must convert to VNAV unless they build up a capital buffer of 3%. The ACT, on the contrary, takes the view that a run is triggered not by a CNAV fund breaking the buck, but by fears over the risk intrinsic in the fund. This risk depends on the fund's investments and liquidity, not its accounting valuation.

Corporate investors do not favour VNAV funds, but perhaps they will have to learn to accept them. Another major hurdle remains, however. The Commission proposes to ban MMFs from obtaining a credit rating in order to remove the risk that a ratings downgrade triggers a run. This is mad. Is it really better for investors to be denied information on risk? Surely this would just create the conditions for a run based on rumour?

NEW ON THE WEB

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

Derivatives – reconciliation arrangements needed by 15 September 2013

Project and Investment Appraisal for Sustainable Value Creation in the 21st Century

{ WATCH THIS SPACE }

CREDIT RATINGS AS INSIDE INFORMATION

Arguably, knowledge by an issuer of an impending ratings affirmation, change or change in outlook has always been inside information. But since the European regulation of credit agencies (CRA III) came into force in June 2013, there is no debate. The market abuse directive rules around inside information mean that a rating agency has to communicate such changes only to identified company staff who also become insiders for the 24 hours (minimum) before publication of the change.

This means that the company must:

- Keep a list of who in the company knows and when they knew;
- Remind people who know that they are accordingly insiders and may not:
  - trade related securities until publication; or
  - tell anyone inside the company or outside about it otherwise than as part of their job responsibilities, in which case they must:
    - keep a record of who was told and when; and
    - make sure that anyone told is also told they are an insider, etc; or
  - counsel anyone about trade in affected securities or procure or restrain their trading.

If, for example, the treasurer is told, they will probably tell the board and key people, including certain outside advisers. Support staff handling material may also be 'told'. All these are included in the consequent requirements. The record keeping, etc is not a small job.

If companies have not already alerted their staff to these matters, treasurers should take immediate steps to do so in collaboration with their compliance colleagues.

{ TECHNICAL ROUND-UP }

WIKI, BILATERAL MARGIN AND STRATEGIC REPORTING

The Treasurer's Wiki is up and running at wiki.treasurers.org. Members now have access to add and update articles on the wiki website, so why not try expanding an existing article or even adding something that is not already there? You will be contributing to the treasury community and, with time, helping to build a major and up-to-date reference source for the profession.

Bilateral margin is not required on non-centrally cleared derivatives that are executed by non-financial entities, according to recommendations from the Basel Committee on Banking Supervision and the International Organization of Securities Commissions. The exception is for systemically important non-financials, but, even then, thresholds of up to €50m need not be margined. For these entities, initial margin and variation margin should be exchanged, although physically settled FX is excluded from initial margin requirements.

Strategic reporting guidelines have been proposed by the UK's Financial Reporting Council (FRC). From 1 October 2013, the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 come into effect. In addition to previous requirements, the strategic report will require a company to include descriptions of its strategy and business model; information on gender diversity; as well as narrative reporting on human rights issues and other factors that may affect its development and performance.

The report should be fair, balanced, understandable and concise, and have forward-looking orientation. It should also include entity-specific information, be consistent with the size and complexity of the business, and link related information in different parts of the annual report. Immaterial information should be excluded since it can obscure the key messages and make the report harder to understand.

The regulations are applicable for reporting periods ending on or after 30 September 2013 and apply to all UK-incorporated companies, other than those entitled to take the small companies' directors' report exemption. The strategic report has evolved from the old Operating and Financial Review, which was repealed, and will replace the Business Review. The FRC consultation closes on 15 November.