IN BRIEF

An inquiry into rights issue fees has been launched. A grouping of UK investors known as the Institutional Investor Council is to investigate the fees charged for capital raising. It is seeking the views of interested parties and hopes to issue a report and recommendations by the end of the year. This process is intended to complement the work of the Office of Fair Trading on equity underwriting and will have a particular focus on the governance environment within which decisions are taken to use investment banks. For more information or to respond, please contact: **wclaxtonsmith@iicouncil.org.uk**

The ACT has warned the European Commission that **mandatory central clearing** is fundamentally the wrong technique for controlling any systemic risk from OTC derivatives held by non-financial companies. Nonetheless, the ACT accepts that beyond a certain size threshold some reporting to the authorities will be appropriate to allow monitoring and consideration of any further requirements.

The European Commission has proposed **extensions to the Market Abuse Directive** in a consultation paper. Other non-regulated markets, including certain derivatives, would be brought within the directive's scope. In its response the ACT welcomes this attempt to improve the integrity of financial markets and to extend some of the rules on market manipulation and inside information. Indeed, the ACT has recommended that the UK prohibition on trading while in possession of relevant information not generally available (RINGA) should be extended across the whole of Europe.

The implementation of the Bribery Act will be delayed until April 2011. It had been expected to come into force this October. The delay is largely to allow time for publication of guidance and suitable publicity. The Act will introduce a corporate offence of failure to prevent bribery by persons working on behalf of a business, and make it a criminal offence to give, promise or offer a bribe and to request, agree to receive or accept a bribe either at home or abroad. The measures cover bribery of a foreign public official, and increase the maximum penalty for bribery from seven to 10 years' imprisonment, with an unlimited fine.

INTRODUCTION

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

The ACT has previously voiced concern over the unintended consequences of some of the new financial regulation that is being created in the aftermath of the financial crisis. We find we always have to flag the question, "What about the corporate customers of the financial firms?" Regulators should, as a matter of course, be doing impact assessments, but this is not easy and the quality can be variable. We are glad to see that the Basel III rules being debated now are being eased and the implementation period being much extended, so much so that the need for new regulation may have evaporated before any rules appear. Perhaps that is the intent?

Where next for funding?

The expected downsizing of bank loans in the corporate funding mix has been confirmed by a report from credit ratings agency Fitch. According to the report, European Corporate Funding Disintermediation, the trend is set to accelerate.

European companies may want to move closer to the US norm of around two-thirds capital markets funding, but some regulatory and market pressures could frustrate this. Demand will be great, with governments themselves being major borrowers and with corporate loan maturities peaking in 2012, albeit many of the latter are undrawn and so could easily be scaled back.

On top of this the Basel III net stable funding ratio (NSFR) will set a minimum acceptable amount of stable funding based on the liquidity characteristics of an institution's assets and activities over a one-year horizon.

In other words, banks will be seeking longer-term funding themselves rather than being over-reliant on short-term wholesale funding.

At the same time insurance companies are saying that the Solvency II regulatory requirements, which will apply to them, will force them to invest shorter term so as to match their liabilities, or to switch to government bonds. A further factor is that many UK investing funds are in the course of switching out of their heavy bias toward UK credits.

Amid all this gloom there are some more positive moves around the Basel III capital and liquidity rules, which came out in December 2009 but left many of the specific ratios and numeric limits subject to review or "calibration".

One good piece of news for bond issuers has now come on liquid assets. Basel III requires banks to hold a liquidity coverage ratio (LCR) of at least 100%; in other words, they must hold a stock of highly liquid assets sufficient to cover expected net cash outflows for the next 30 days. High-quality (equivalent to AA- ratings or above) non-financial corporate bonds will count as liquid assets, subject to a haircut of only 15%. For well-rated companies a review of capital structure and target ratings may be worthwhile so as to tap into this increased demand.

In calculating the LCR various assumptions are made as to the likely drawdown of lending facilities and the run-off of bank funding from retail and other deposits. The July calibration relaxed many of these percentages and further adjustments to the NSFR are under consideration, so corporate lending may not end up penalised to the extent originally feared. ■

Country guides

The internet is a boon for finding country guides that explain business and financing conditions abroad, but it can still be hard to track down data for some of the more obscure countries. Meritas, a global alliance of independent, full-service law firms, offers good coverage of the Americas, the Carribean and Asia, but with an inevitable slant towards the legal aspects.
http://bit.ly/9oneDS

US bubble-buster law hits OTC deals

The massive Dodd-Frank Financial Reform Act was signed into US law in July and will reach into many corners of the financial markets.

Of particular relevance to treasurers will be the regulation of over-the-counter (OTC) derivatives, not least because of the precedent it sets for European regulation.

As in Europe, the US is making central clearing of OTC derivatives mandatory where the contract is suitable for clearing. For non-financial companies, that could create an unwelcome requirement to put up the cash collateral on any out-of-the-money deals. However, as long as the company is not a major swap participant, it can gain exemption from clearing.

A "major swap participant" is one that maintains a substantial position in swaps, excluding positions held for hedging or mitigating commercial risk. The big unknown will be how the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) in the US define "substantial position".

Credit ratings will also be affected by the new legislation. At present Rule 436(g) means that if a rating is referred to in a registration statement the rating agency does not incur liability as an expert. The repeal of that rule means an agency's consent will be required to allow use of its ratings and presumably this will not be forthcoming. Rule 144A issues could become more popular to avoid registration and these complications.

Another apparent problem will be the removal of the exemption for credit rating agencies from the SEC's fair disclosure rule (Regulation FD). This automatically allows issuers to provide the credit rating agencies with material non-public information without requiring public disclosure of such information. The ACT expects the rating agencies to become more willing to sign specific confidentiality undertakings to avoid this point. ■

Hints on hedge accounting's future

The IASB's exposure draft on hedge accounting is still pending, but the board is gradually revealing its thinking. A year ago it agreed to replace the mechanics used for fair value hedge accounting with an approach similar to cashflow hedge accounting so that fair value changes in the hedging instrument and the hedged item attributable to the hedged risk are taken to other comprehensive income, and any ineffectiveness (that is, any difference) is transferred immediately to profit or loss.

In July the board made a further tentative decision that the cumulative gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item in the balance sheet, and that the hedged item should not be remeasured. The meeting also considered ideas for simplifying the effectiveness testing process and in particular for removing the 80% to 125% band for prospective testing. It agreed to a combination of qualitative thresholds with minimum requirements tied to risk management or supplementary tests.

The discussions over hedging groups and net positions continued with a review of hedging net positions of forecast transactions. The board looked at the case of forecast sales and cost of sales hedged on a net basis for foreign currency exchange risk using forward exchange contracts. The board tentatively agreed to permit hedge accounting for such net positions, subject to consideration of any other consequences that may arise as IASB staff continue to explore the issues.

■ **Meanwhile a staff draft of an exposure draft has been issued on financial statement presentation, with the joint boards of the FASB and IASB not formally inviting comments but welcoming input from interested parties. The aim is for a more consistent disaggregation of information in the accounts, the prime split being between business and financing activities.**

One consequence is that cash is classed within the business section and cash equivalents are excluded. So, for example, money market fund investments would cease to be part of cash and cash equivalents, possibly with knock-on effects on net debt covenants.

See Cash Accounting, page 30.

IN BRIEF

A green paper on pensions has been issued by the European Commission, largely exploring the societal issues. However, one section debates the applicability to pensions of provisions similar to those in Solvency II for insurance companies, which come into force in 2012. The CBI has warned of the consequences if £500bn of extra capital were to be required for pension funds.

Changes to the Prospectus Directive have been approved by the EU parliament with the aim of simplifying the existing information requirements on issuers. Issuers must issue a summary document with the key information, and the directive requires that "no civil liability attaches to any person solely on the basis of the summary, including any translation thereof, unless it is misleading, inaccurate or inconsistent with the relevant parts of the prospectus".

Other major changes to the directive include an increase in the wholesale debt minimum denominations to €100,000, under which debt securities may be offered without a prospectus; an increase of the 100-person exemption to 150 individuals; the abolition of the annual information update; and a reduced disclosure regime for rights offerings.

The directive is expected to be effective by October. There will then be 18 months for EU member states to implement its provisions nationally.

The IASB has proposed that for **financial liabilities designated under the fair value option**, any changes in valuations arising from changes in the credit risk of the liability should not affect profit or loss. The ACT has submitted a response supporting this approach.

A seminar on issuing high-yield debt securities is being held by the Association for Financial Markets in Europe (AFME) on 23 September in London. With the high-yield market becoming an ever more important segment, this full morning's event will provide a timely overview of the market and explain the issuing process, and the typical terms and conditions, along with case studies. The seminar is complimentary for treasurers, finance directors, chief financial officers and investors. See: **www.afme.eu/IESLondon2010**