The future of leasing

Following my article in the May edition of *The Treasurer* on proposed tax and accounting treatment of leases, a member of the Association has contacted me, concerned that entering an operating lease now could have undesirable balance sheet consequences in the future. The extended uncertainty could make life very difficult for lessors and potential lessees.

To remind you of the timetable, a discussion paper was issued this year by the 'G4+1' group of standard-setters, which is likely to be followed by either another discussion paper or a draft standard, and only then by a standard. It is difficult to predict the exact timing, but a full standard would not be expected until 2002 at the earliest – and a more likely guess is 2003-2005. Also, it is quite possible that some countries (UK, Australia) might move forward faster than others. Clearly only the shortest leases taken on this year will be unaffected.

This raises the question of 'grandfathering', ie allowing an existing lease to be accounted for in the old way for the rest of its life. The discussion paper issued earlier this year made no mention of grandfathering, perhaps implying that there would be none. Apart from anything else, it would invite a flood of very long leases being finalised just before the standard became effective. It is possible that leases with a very short period to run could be grandfathered but these are unlikely to cause much of a balance sheet hit anyway.

Under the proposals in the discussion paper issued this year, it was possible to capitalise only minimal amounts by constructing a lease with a number of break points. The amount to be capitalised would only be the payments for the period up to the next break point (see the example in the article in the May edition). This might mean having, eg, rental reviews every two years or cancellation options which were unlikely to be exercised.

However, the ASB is reviewing the potential for abuse that this created and it seems likely that this will be addressed, with it being harder under the eventual standard to minimise reported assets and liabilities in this way. ■

LMA agreement

Just a reminder that the Association's 'Guide to the LMA syndicated loan agreement', written with the help of Slaughter and May, is freely available to members and non-members and can be found on the Association website, www.treasurers.org. We have already received feedback that it is very helpful in negotiating loan documentation, whether LMA-compliant or not. The guide identifies key areas of negotiation and suggests negotiating tactics.

For members who are not currently in the loan market but would like to keep abreast of developments, a hard copy of the LMA Agreement (or Primary Documents as it is more correctly described) can be obtained from the LMA (telephone Clare Dawson on 020 7282 7331) for £50 or may be available through banks and legal firms who are LMA members.

The User's Guide which comes as part of the package is also well worth reading. ■

Raising equity

Deep discounted issue

At the beginning of August, Pearson announced the UK's biggest ever rights issue and surprised the market by structuring it as a deep discounted issue. Under normal circumstances, underwriting would not be needed for a deep discount issue but the size of it was such that Pearson decided that most of it would be underwritten. However the cost of this has been reported as £7.5m instead of the £35m cost of a fully underwritten issue priced closer to market.

Readers may recall that, following the MMC report in early 1999 on share issuance, the Association worked with the Bank of England and other bodies on the production of a Bank guidance note recommending among other things that issuers consider deep discounted issues. This is reproduced in full in *The Treasurer's Handbook 2000*.

The guidance notes that the size of the discount does not of itself impose any loss on shareholders or any cost on the issuer. In effect, a deep discounted issue is a combination of a rights issue at market price and a bonus issue. It is a particularly useful option when market conditions make pricing an issue difficult. One possible drawback for the issuer is that shareholders might expect the same level of dividends on the enlarged equity, but Pearson has said it will scale back dividends on a pro-rata basis. Another concern is that retail investors can be liable to capital gains tax if they do not take up their rights.

Stabilisation and the 'greenshoe'

In another development, the FSA has asked us to help produce a fact sheet for issuers explaining stabilisation, ie the support of a share price in the market during the 30 days after launch. This is the only time that regulators allow lead managers to manipulate the market. There seems to be some concern that issuers are agreeing to a 'greenshoe' option, which allows the lead manager to buy additional shares from them at the end of the 30 days (thus increasing the issue size), without having a full understanding of the instrument or what they are agreeing to.

Treasury stock

Since March, Swedish public companies have been able to buy and sell their own shares in the market. Up until then they were not able to perform share buy-backs at all and since the law was passed, 50 listed companies have gained approval from their shareholders to do so. Commentators believe that nine out of 10 companies have bought back shares to adjust their capital structures, having been over-capitalised compared with their peers outside Sweden. Some have done so in order to accumulate shares for company incentive programmes and others to keep on hand shares that can be used to make acquisitions. Shares cannot be resold within three months or purchase but some investors are unhappy that the company should be trading in their own shares in the market.

The proposals for the introduction of treasury stock in the UK, put forward by the Association in conjunction with the ABI and NAPF, sought to deal with this problem by restricting the dealing price to within a 5% premium or discount to the current market price. The DTI is still working on the draft legislation needed to enable treasury stock to be held by UK companies. ■

Regulation

Codes of conduct

Through the summer, the technical committee has continued its work with the FSA and Bank of England in developing the new codes of conduct. The replacement for the London Code for non-investment products (NIPs) is developing along lines that anyone familiar with the London Code would recognise. The Inter-Professionals Code (IPC) will be much shorter. The Association's response to the FSA's consultation paper on the IPC is posted on the website. Overall, we have little concern over its content but we do have a concern over the complexity of the proposed structure of the FSA Handbook.

Treasurers operating as market counterparties (as opposed to intermediate customers for whom it will be a bit simpler) will need to locate the IPC, certain annexes, some factsheets and other sections of the market conduct sourcebook. We hope that a comprehensive overview of the structure of the FSA Handbook and its contents will be provided. ■

Fraud alert

A major corporate has brought to our attention two recent examples of attempted cheque fraud, one relating a dividend cheque and the other to a capital repayment to shareholders. In the first example, a fictitious document was created which at first sight could have been mistaken for genuine. In the second case, a genuine cheque appears to have been both fraudulently endorsed and the value of the cheque altered. The common feature of both is that they were presented for payment in the US. Investigations into the circumstances surrounding both instances are ongoing but the company wonders whether other treasurers have seen recent examples of anything similar, and if so, is there anything to indicate an organised attempted fraud on dividend cheques: Please send your responses to me if you have similar experiences and would like to exchange notes with the company concerned. Confidentiality of all respondents will be maintained. ■

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