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‣ A new **secured commercial paper (CP) facility** has been launched by the Bank of England under its asset purchase facility. The secured CP facility will offer to buy A1/P1/F1 rated securities backed by assets such as trade receivables. The CP can have maturities out to nine months. The weighted average life of the programme's assets must not exceed nine months, and no individual asset may have a term longer than 18 months. The secured CP facility is another mechanism to support the provision of finance to a broad population of companies, alongside the Bank's existing CP facility and bond purchase facility, which at the end of the second quarter had £1,950m and £776m outstanding respectively. Further details are available on the Bank's website at: **http://tinyurl.com/kpzh3a**

‣ The Financial Reporting Review Panel has published its annual activity report, concluding that the current **standard of corporate reporting** is good. The panel noted that all companies need to continue to improve their disclosure of financial risks, judgements related to the application of accounting policies, and sources of estimation uncertainty. Many markets remain highly volatile and this should be reflected in informative company-specific disclosures about the effects of these uncertainties on the amounts reported in their accounts.

‣ The Board for Actuarial Standards (part of the Financial Reporting Council) is consulting on **actuarial standards in pensions**. The aim is to ensure that trustees, sponsors and others receive clear and reliable actuarial information. Issues covered include: the principles underlying the selection of discount rates used to value pension scheme liabilities; whether prudent estimates of liabilities of pension schemes should be accompanied by best estimates of the same liabilities; and the content of the report produced after regular scheme funding reviews of pension schemes.

‣ **Financial sanctions** are currently in force in the UK against countries (such as Iran, Myanmar and Zimbabwe), individuals and entities connected with terrorism. Typical sanctions include the freezing of assets, a prohibition on the provision of funds and economic resources, and a ban on investment. The Treasury keeps a fully up-to-date list of all UN, EU and UK sanctions in force at: **http://tinyurl.com/lazzo2**

INTRODUCTION

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

The regulators and standard-setters have done the usual trick of clearing their desks prior to the holiday season and putting several important public consultations out to run over the holidays.

This month's Technical Update flags two very significant proposals for changes. One is from the IASB on replacing our old friend, accounting standard IAS 39, while the other from the European Commission may not have been so noticeable, but could represent the beginning of a series of radical and unwelcome restrictions on treasurers' ability to do normal derivative transactions.

Both proposals warrant a reaction from companies to make sure that treasurers' views are heard. You can respond directly or provide your feedback via the ACT.

Reform plans threaten to kill off OTC derivatives

The regulatory authorities in the US and the EU are moving forward with ideas to reduce the risk of over-the-counter (OTC) derivative positions threatening financial stability in the event of the collapse of a market participant.

The drive for action arises out of concerns about the size and lack of transparency in the credit default swap (CDS) market, but there is a very real danger that the ability of companies to use other OTC derivatives could inadvertently be severely curtailed.

The European Commission has put forward a range of ideas. The least radical is to encourage greater standardisation of derivatives to make electronic processing and automation easier. Standardisation of legal frameworks, as is the case for ISDA transactions, would be welcome, and specifying the parameters needed to define a deal, such as rates and dates, would work for some derivatives. But there will always be a need for specialised or tailored derivatives, such as property derivatives.

The Commission then goes on to encourage parties to any bilateral deals to post collateral between themselves.

A more extreme proposal is one requiring OTC trades to be novated to a central counterparty, transferring the credit risk for all parties to the central counterparty. This could certainly reduce system-wide exposures through extensive netting of positions, but it would mean posting collateral and handling margin calls to adjust the collateral based on daily changes in the mark-to-market valuations. For a corporate using derivatives for hedging, this would generate immediate and ongoing cashflows on the hedge, and create a most unwelcome timing mismatch with the cashflow on the exposure being hedged.

Pricing on exchange-traded futures tends to be slightly finer than can be achieved in OTC deals but companies rarely use futures. Presumably because they value the fact the banks are prepared to provide dealing lines of credit and do not demand margining, as is required for futures.

Forcing companies into providing collateral to a central counterparty could be very damaging, and particularly unwelcome at a time when many are close to their cash and funding limits.

The EU is also considering the possibility of pushing more transactions onto an exchange-traded basis, again with clearing through a central counterparty.

The ACT has produced a background briefing on the issues and is seeking reactions from treasurers. The briefing is available at: ■
http://tinyurl.com/qsmoru

Banking league tables
If you're not already inundated with league tables you can have free access to data on equity, debt and loan issues and a limited ability to re-analyse the data, via one section of the Financial Times website. Seemingly, the data is only updated every six months, though. Go to:
http://tiny.cc/FTleaguetables

Major IAS 39 change project gets under way

The IASB has published the first exposure draft in its IAS 39 replacement project covering the classification and measurement of financial instruments.

The changes are not expected to be mandatory until January 2012 but early adopters will be able to apply it in time for 2009 year-ends. The IASB's accelerated timetable for change includes a second exposure draft on impairment methodology, due in October 2009, and a third on how to improve and simplify hedge accounting, expected in December 2009.

The IASB proposes to reduce the many financial instrument classification and measurement categories in IAS 39 (held-to-maturity, available-for-sale, and so on) to just two. The greatest impact will be on companies holding financial assets but borrowers will be affected too, although probably to a lesser extent.

Debt instruments

For debt instruments, only those financial assets and liabilities with basic loan features and managed on a contractual-yield basis will be eligible for amortised cost measurement. A fair value option for reducing an accounting mismatch is retained. All other debt instruments are to be measured at fair value through profit or loss. Reclassifications between amortised cost and fair value are prohibited. The proposals remove the held-to-maturity category and its tainting rules.

Equity instruments

Investments in equity instruments will always be measured at fair value (under the current IAS 39 there is an exception for those that do not have a quoted price in an active market). This will introduce interesting valuation issues for holdings in subsidiaries, and possible consequences on holding company reserves.

Equity instruments held for trading have to be classified as fair value through profit or loss. For all other equities, management has the ability to make an irrevocable election to present changes in fair value in OCI (other comprehensive income) rather than profit or loss.

Embedded derivatives

Embedded derivatives will no longer have to be separated from a financial instrument that contains non-closely related embedded derivatives. Instead the entire instrument will be assessed to see if it contains only basic loan features. If the embedded derivative caused it to fail this test, then the entire instrument would be fair-valued, and not just the embedded derivative element.

The accounting for embedded derivatives in non-financial host contracts (such as purchase and sale contracts) remains unchanged.

Basic loan features

Basic loan features are defined as contractual terms that on specified dates give rise to cashflows that are payments of principal and interest on the principal outstanding.

The exposure draft provides some examples of basic loan features:

- fixed return over the life of the instrument;
- variable return equal to a single quoted or observable interest rate (such as Libor);
- combination of fixed and variable return (such as Libor+50bp); and
- embedded caps, floors, collars.

Contractual yield

Financial instruments are managed on a contractual-yield basis only if they are managed and their performance evaluated by the entity's key managers on the basis of the contractual cashflows generated when they are held or issued. This is most likely to be determined at a business unit level rather than the individual instrument level. Different sections in a bank could therefore treat the same instruments in different ways.

The proposals certainly simplify this side of IAS 39 and will be broadly welcomed by companies. However, those with financial instruments with embedded derivatives will need to review the effects, bearing in mind that the changes will affect old issues still outstanding. Comments are due at the IASB by 14 September.

The FASB is still developing its own proposals, which seem to be heading towards a greater use of fair values, and it expects to issue an exposure draft within the next few months.

PwC and the ACT have produced a webcast on the proposals and the implications for treasurers. Go to: **www.tinyurl.com/ACT-PWCwebcast**

The ACT is running a half-day financial reporting conference in London on 25 November offering a general update on what is happening in the world of treasury-related financial accounting and reporting, including IAS 39. ■

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▸ The **cheque guarantee card scheme** is in terminal decline and its rundown needs to be managed to provide clarity and certainty for users and acceptors, according to the Payments Council. The council wants to close the scheme in an orderly manner, and is asking the payments industry to confirm a viable date, allowing a period of two years for communicating and managing the process with all users and acceptors.

▸ A loan syndication during a takeover runs the risk that information provided to potential lenders could be in breach of the Takeover Code. To clarify matters, the Takeover Panel has issued Practice Statement 25 on **debt syndication during offer periods**. Normally any information provided to a shareholder must be made equally available to all offeree company shareholders at the same time (rule 20.1). If a potential lending bank is also a shareholder, then information may still be provided to the lending side only, provided adequate information barriers exist.

▸ **SWIFT is relaxing its corporate access rules** so that any company can join the network provided it is recommended by a bank located in a FATF (Financial Action Task Force) country. Previously, only corporates listed on an exchange in a FATF country could join the network, effectively barring entry to major privately owned multinationals.

▸ The **IFRS for SMEs** has been published by the International Accounting Standards Board as the culmination of a five-year project. The IASB describes the 230-page document as a self-contained standard "tailored for the needs and capabilities of smaller businesses".

▸ An update to the ACT guide to the **LMA documentation for investment-grade borrowers** has been added to the ACT website. The banking crisis has demonstrated that loan agreements often do not properly cater for defaulting banks. In July 2009 the LMA (Loan Market Association) published a memorandum containing instructions on how to incorporate changes into investment-grade agreements to cater for the consequences of a finance party default, along with amendments to the market disruption and cost of funds provisions. An update to the ACT guide is now available in the form of a Slaughter and May finance briefing at: **http://tinyurl.com/LMAupdate**
See Redrawing the Rules, p28