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▸ **A new exposure draft for leasing** is to be issued by the International Accounting Standards Board (IASB) and the US-based Financial Accounting Standards Board (FASB). While deliberations have not been completed, the decisions taken to date are viewed as sufficiently different from those originally published in the exposure draft to warrant re-exposure. Substantial changes include not capitalising short-term leases on the balance sheet, the lease term to include renewal options only if there is a significant economic incentive for the lessee to renew, and lessors applying a "receivable and residual" accounting approach. Deliberations will continue during Q3 2011, with a new exposure draft expected shortly afterwards. A final standard is expected to be issued in Q2 2012 with an effective date not before 1 January 2015.

▸ Final takeover changes have been announced by the **Takeover Panel** with an effective date of 19 September. The new rules have not changed materially from those reported on page 09 of the Dec/Jan 2011 issue of The Treasurer. For those companies involved in takeovers or mergers, the panel has produced transitional guidance, downloadable at **http://bit.ly/qQml31**. The full Takeover Panel announcement of all the changes to the takeover code can be downloaded at **http://bit.ly/pqY0lu**

▸ Average daily turnover in the **UK foreign exchange market** rose to a record \$2.2 trillion (£1.3 trillion) in April 2011, maintaining London's status as the world's largest FX market. This compares with the average daily global turnover of \$4.71 trillion, as reported by a Dow Jones Newswires analysis. The increase in UK turnover came from a 32% rise in spot transactions and a 19% hike in FX swaps.

▸ **Compulsory liquidations and creditors' voluntary liquidations** in England and Wales rose by 2.7% in Q2 2011 compared with the previous quarter and by 4.4% compared with Q2 2010. Other corporate insolvencies (consisting of receiverships, administrations and company voluntary arrangements) were down 6% on the corresponding quarter of the previous year. In the 12 months to the end of Q2 2011, around one in 349 individuals became insolvent, which is slightly down from the previous quarter.

INTRODUCTION

By Michelle Price
Associate policy and technical director

A year ago Technical Update focused on Basel III and the implications for corporates. A whole year later and we are still talking about Basel III regulation. While some steps in the right direction have been taken to minimise the impact on corporates, many unknowns remain. What will be the real impact of Basel III on corporates? We are still waiting for the banks to finish their calculations and analysis to answer that question. Not only do they need to make decisions on which product prices to increase and by how much, but more importantly, are there product offerings which will become too expensive from a capital perspective and may no longer be offered? After all, a bank's capital is finite and can only be spread so far. Also, will there be regulatory arbitrage between banks headquartered in different regions? While Europe is well down the road to Basel III adoption others may not be. The article below on the Capital Requirements Directive IV sheds some more light on the regulatory maze.

CRD IV implements Basel III

The Basel III framework for regulating bank capital adequacy and liquidity has started along the route to becoming law in Europe.

Produced by the Basel Committee on Banking Supervision, Basel III was encapsulated in July in draft legislation by the European Commission (EC) in its amendments to the Capital Requirements Directive (CRD IV).

Basel III proposes to safeguard the banking system by imposing much higher capital requirements for banks and new provisions to ensure adequate liquidity. Most of CRD IV is simply copied out of Basel III but with some small differences to ease the difficulties for corporates.

The EC is proposing that the 3% leverage ratio in Basel III will not be implemented as a binding measure to start with. Instead, it will be subject to an observation period so data can be collected on its effects, with a review and reconsideration in 2016 and possible later implementation.

The 3% ratio is based on non-risk-weighted assets and was intended as an ultimate backstop should the risk-weighted capital requirements fail to stop excessive leverage. The Commission has acknowledged that this ratio would have damaged the availability and cost of trade finance, a problem the ACT and others have been flagging to the authorities.

Contingent off balance sheet exposures from the likes of guarantees and performance bonds were to be included in the asset side using a 100% conversion factor, which seems excessively cautious and inconsistent with a conversion factor of 20% for loan commitments of less than a year.

Trade finance instruments of less than one year are still treated as if the maturity is a minimum of one year, thus making them more capital-intensive. The existing CRD allows national discretion to waive this one-year floor, but that is now to be harmonised so that actual maturity will be used for these exposures.

The prudential requirements on capital will be set by regulation rather than in a directive to speed up implementation and remove national divergences. In a further harmonisation move the minimum capital levels may not be set higher by individual member states (except for bank-specific risk profiles or through the counter-cyclical buffer on financial stability grounds).

CRD IV will go beyond Basel III with enhanced governance, sanctions if rules are breached, enhanced supervision, and reduced reliance on credit ratings.

However, CRD IV is a massive and highly complex piece of regulation and inconsistencies or unintended consequences are coming to light for customers of the banking system. The Basel III authors have said all along that derivatives not subject to central clearing or bilateral margining will be subject to additional capital requirements. This is through the application of a CVA (credit valuation adjustment) capital charge to "cover credit migration risk". As banks start to assess the impact on their models, they are finding that this is not a small adjustment but something that could multiply the normal capital required against derivatives by two to three times. Unwelcome indeed and surely a backdoor method of forcing more over-the-counter (OTC) derivative deals onto exchanges or into central clearing. ■

Hedge accounting starting date delayed

The International Accounting Standards Board (IASB) has proposed postponing the mandatory effective date of the IFRS 9 standard governing financial instruments from year ends beginning on or after 1 January 2013 to 1 January 2015.

The revised date will allow the IASB to complete all phases, avoid dual reporting for SEC filers and align with effective dates for other significant standards, such as leases. The IASB's exposure draft only changes the date when IFRS 9 would be mandatory and early adoption is permitted.

A delay to the effective date of an accounting standard is often met with a sigh of relief by preparers as it gives them more time to understand and implement the changes. However, the amendments to hedge accounting proposed and "tentatively decided" to date are generally beneficial to users. A delay is not necessarily a good thing and treasurers should give careful consideration to the question of early adoption (assuming EU endorsement).

Back to basics

The hedge accounting model has been overhauled in some areas, but the basics remain the same:

- hedge accounting is optional;
- the three methods of hedge accounting (cashflow, fair value and net investment hedging) remain; and
- any hedge ineffectiveness is booked to the income statement.

The following recap is a snapshot of some of the changes likely to have the greatest positive impact for treasurers. The ACT's response to the original exposure draft agreed with these changes.

Hedge effectiveness assessment

The two biggest hedge effectiveness changes are:

- the removal of the 80-125% threshold for hedge effectiveness testing; and
- retrospective effectiveness testing will no longer be required.

Prospective effectiveness assessment is still required and treasurers must calculate hedge ineffectiveness in order to account for this through the income statement.

Hedging with financial options

Hedge accounting for options has been made more attractive by the ability to defer the change in time value to Other Comprehensive Income (OCI) to be later reclassified to profit or loss. This may reduce income statement volatility.

Hedging risk components of non-financial items

Under the current IAS 39 only foreign exchange risk can be separated from non-financial items. This excludes some risks, such as commodity risks, from being hedge-accounted. The exposure draft proposed allowing components of non-financial items as hedged items as long as the hedged risk component is "separately identifiable and reliably measureable" and the board has agreed with this. In particular, inflation can now be a hedgeable risk component.

Derivatives as hedged items

The exposure draft proposed removing the current restriction in IAS 39 that prevents a derivative from being a hedged item. The IASB has tentatively agreed with this and will allow a derivative to be a hedged item if it is combined with an eligible non-derivative hedged item. For example, in the context of raising funds in one currency and swapping them into a second currency, a treasurer may subsequently want to convert that second currency from fixed to floating (or vice versa). This combined structure can now be hedge-accounted.

Redeliberations on the general hedge accounting model are expected to continue for a couple of months with the final standard expected to be issued before the end of the year. ■

http://www. WEBSITE WATCH

International bank account numbers (IBANs) were introduced to standardise the identification of bank accounts of parties involved in European cross-border payments. The Payments Council has a useful tool which allows you to check whether an IBAN is valid by either typing it in or copying and pasting it. Go to **http://bit.ly/qqGnwx**

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▸The **2011 Review of the UK National Payments Plan** (NPP) covered a wide variety of payments methodologies and related topics. The ACT collated feedback from a number of treasurers and submitted a response on those areas of particular interest to corporate treasurers. Specific comments included:

- the cost of clearing payments is a concern to many corporates;
- the full adoption of the Faster Payments Service (FPS) as a form of payment would be beneficial;
- a reduction in the three-day BACS/direct debit cycle would benefit corporate cashflows; and
- global best practice payment methodologies should be reviewed, and new account providers such as PayPal included in future NPP updates.

A copy of the ACT's response is available at **www.treasurers.org/node/7129**

▸**Dividend payments** are back to levels not seen since before the financial crisis. In the three months to July 2011, the total dividend payout of all UK listed companies combined was £19.1bn, an increase of 27% on the corresponding quarter of 2010.

▸The recent consultation by the **European Securities and Markets Authority (ESMA)** on the Prospectus Directive covered the format of the base prospectus final terms, the format of the summary, and a proportionate disclosure regime. In its response the ACT did not agree with appending the base prospectus summary to the final terms and we expressed some concerns on the proposed specific form of the prospectus summary. We concurred with ESMA that disclosure for rights issues should be less than for new issues and have asked ESMA to reconsider if the requirements can be further trimmed back. A copy of the ACT's response is available at **www.treasurers.org/node/7128**

▸**The effect of UK equity markets** on the competitiveness of UK business is to be examined by an independent review headed by professor John Kay. The study will examine the mechanisms of corporate control and accountability provided by UK equity markets and their impact on the long-term competitive performance of UK businesses. A copy of the Kay Review's terms of reference is downloadable at **http://bit.ly/j2xOgA**