IN BRIEF

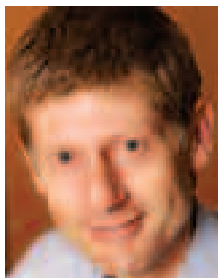
The Office of Fair Trading is looking at the use of cheques. The OFT is investigating whether there is any significant demand from consumers and businesses for speeding up cheque clearance times and how it would benefit them. A report due out in the summer will look at the relative economic efficiency of making and receiving payment by cheque compared with other payment methods; what customers understand by clearing times; the different practices of financial institutions as regards cheque clearing; certainty of fate; streamlining the unpaids process (which could potentially have an impact on withdrawal times); and agreeing maximum times for clearing for value and withdrawal purposes.

An exposure draft of amendments to IAS 23 *Borrowing Costs* has been published by the International Accounting Standards Board. The IASB is proposing that borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset must be capitalised and that the current option to recognise these costs immediately would be eliminated. The purpose of the change is to bring the IAS into line with the US standard SFAS 34 *Capitalization of Interest Cost*. The ACT will be submitting its response to the IASB and is minded to object to this move as being convergence for the sake of convergence.

The argument for capitalising interest costs is that the costings for creating your own asset are thereby consistent with the treatment were the asset to be purchased from a third party. However, nothing in the current standard or the exposure draft deals with the inconsistency that the capitalised costs do not allow for the cost of equity, or that if an entity does not have borrowings there is no attempt to capitalise the opportunity cost of the cash used.

The accounting therefore depends on the manner in which the asset construction is financed. Given that capitalisation does not of itself create true consistency, the option to expense the costs immediately should be retained.

The Japanese authorities have taken a tough line on Sumitomo Mitsui Bank to discourage the cross-selling of products. The bank is subject to a six-month suspension in being able to offer interest rate derivative products as a penalty for abusing its dominant position by forcing corporate clients to buy interest rate swap products as a condition for extending loans.



INTRODUCTION

By Martin O'Donovan
ACT Technical Officer

The Treasurer's two pages of technical update each month aim to alert you to new rules and regulations which may affect treasury activity and to areas where the ACT is having an input. However, in keeping up with the new, let's not forget periodically to go back to established ideas and practices and see if we can refresh our thinking. This may be a review of treasury policy or checking back on routine operational procedures or even the ACT's code of ethics. I am indebted to the _Pittsburgh Post Gazette_ for the reminder about the latter through its recap on the string of convictions and appeals in the Enron case, reported opposite. ■

Transparency Directive laid bare

The Financial Services Authority (FSA) has been consulting on the implementation of the Transparency Directive in the UK and, in particular, on areas where the existing listing rules already go futher than strictly required by Europe. The Transparency Directive introduces requirements for listed companies in three areas – namely, publication of financial information, disclosure of shareholdings and the dissemination of Transparency Directive information. The directive must be incorporated into UK law by January 2007.

The directive requires issuers to produce annual and half-yearly reports, and to produce interim management statements in the intervening quarters as well. The FSA's proposals include:

- Copying out the Transparency Directive requirements for the content of such reports and statements into the disclosure rules, and dissemination of this information on a timely, pan-European basis;
- Removing the listing requirement for issuers either to publish half-yearly reports in a newspaper or to send such reports to every holder of their securities;
- Removing the obligation to issue preliminary statements because the timescale for publishing the full accounts is being reduced to the same 120 days; and
- Retaining a number of listing rules that set slightly more stringent requirements than the Transparency Directive – for example, the listing rule requiring all listed issuers to produce at least an annual report, even though the Transparency Directive exempts issuers that issue exclusively wholesale debt.

The Transparency Directive sets out requirements for the disclosure of acquisitions or disposals of major shareholdings. The FSA is inviting views on two possible options:

- Option 1: To retain the broad parameters of the current UK regime, with notifications by the shareholders necessary when shareholdings reach a 3% threshold, and every 1% thereafter, and covering shares traded on a regulated market or an exchange regulated market such as AIM.
- Option 2: To introduce the Transparency Directive minimum requirements, under which notifications become necessary when shareholdings reach thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%. This would apply to holdings in issuers with shares admitted to trading on a regulated market only.

The FSA does not currently propose to extend the scope of disclosure requirements to cover economic interests in shares more broadly, such as contracts for differences. The ACT has recommended that HM Treasury should reconsider this, since knowledge of all holders with a significant economic interest is relevant in the case of predatory action or even just to ensure well-targeted investor relations efforts and would be consistent with the approach taken by the Takeover Panel.

The Transparency Directive requires issuers to disseminate information in a timely manner on a pan-European basis. The FSA proposes:

- to retain the UK's current model, where issuers report information through a small number of primary information providers for onward dissemination; but
- to invite views on whether, as the Transparency Directive allows, issuers should have a choice of disseminating directly or through a service provider.

Of Enron and ethics

With 24 out of 34 defendants already found guilty, the Enron case is amazing.

In particular, back in 2004 Enron Assistant Treasurer Timothy DeSpain pleaded guilty to making "false representations" to credit rating agencies "to manipulate fraudulently Enron's credit rating".

In his plea bargain DeSpain said: "I and others intentionally withheld relevant information from the rating agencies about the true financial performance of Enron and the way in which Enron achieved its cashflow numbers.

"In communicating with representatives of the credit rating agencies, I and others at Enron did not truthfully present the financial position and cashflow of the company and omitted to disclose facts necessary to make the disclosures and statements that were made to the rating agencies truthful and not misleading.

"Among other things, I and others at Enron falsely represented to the credit rating agencies that Enron's cashflows from its non-regulated businesses were stable and predictable."

For ACT members the ethical code rule 8 (c) is relevant here in pointing out that "professional duty is to honour the trust which such outside parties (represented by bankers and others with whom a member deals on his employer's behalf in the course of his duties) may reasonably place in him as a member and by virtue of his appointment".

And 7 (a) insists on: "acting honestly and in good faith towards all those outside his own organisation who deal with him; and upholding, in whatever way is appropriate to the member's occupation or appointment, the standards of integrity and fair dealing required for the honest conduct of business and for the effective functioning of the financial markets in which the member or his employer play a part". ■

Mandatory costs in loans

The Bank of England's new framework for its operations in the sterling money markets is now in force, so the question arises as to its effect on the mandatory cost clause in loan agreements.

Traditionally, the loan interest rate can be supplemented by an amount designed to reimburse the cost to the lending bank of having to maintain non-interest bearing deposits at the Bank of England under the so-called cash ratio deposits scheme, plus the cost of having to carry interest-bearing special deposits at the Bank, which are currently not imposed, along with a sum to cover FSA supervisory fees.

The new operational framework allows each bank to set its own target level of balances (reserves) at the Bank, averaged over a maintenance period running from one Monetary Policy Committee (MPC) decision date to the next. If a member's average balance is very close to the targeted level the balance is remunerated at the Bank's official rate. If a bank fails to hit its target level of balances with the Bank over the monthly maintenance period, it will be subject to penalty costs.

Participating banks are also eligible to have standing facilities to borrow from the Bank at rates based on the official rate.

The reserves system, the standing facilities and general open market operations by the Bank are designed so that the overnight and very short-term market rates will be in line with the official rate and their volatility will be minimised.

However, since the requirement to maintain cash ratio deposits of 0.15% of eligible liabilities (which theoretically finances the Bank's monetary and financial stability functions) remains in place, the normal mandatory cost formula will still be relevant.

A further worry for borrowers might be that any penalty costs of missing the targets will somehow get added to the mandatory cost formula or be recouped via an increased cost clause.

Since the targeted balances scheme is effectively voluntary, it is hard to see that this could be included in a formula designed to cover costs imposed by regulation or law.

Equally, as regards increased costs, this clause will usually cover increased costs of "having entered into the lending commitment, or funding or performing its obligations" under the loan, which can hardly be applied in the voluntary circumstance of the new scheme. ■

IN BRIEF

The ACT has responded to the call for evidence from the Davidson Review of the implementation of EU legislation in the UK. The ACT's core position is that while the review shows a laudable desire not to 'gold-plate' EU directives (that is, not to use implementation of the directive to load on new provisions), great care is still needed where a new EU directive is less adequate than current UK provisions. The ACT gave examples of times when it is in the interests of the UK markets and its participants to uphold higher standards.

The IASB has started its redeliberations on IAS 37 and contingent liabilities. The ACT and the majority of respondents to the earlier exposure draft disagreed with the proposal to omit the current probability recognition criterion from a revised IAS 37. The IASB's framework definition of a liability includes the phrase "the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits". The IASB has decided to clarify that "expected to" is not intended to imply that there must be a particular degree of certainty that an outflow of benefits will occur before an item meets the framework's definition of a liability.

The Company Law Reform Bill has been working its way through parliament and attracted numerous significant amendments even as it enters its final stages before enactment. Among the contentious issues still to be settled is the codification into law of directors' duties, in particular the extent to which they should take into account the environmental and social impacts of a company's activities. It remains to be seen whether some of the more controversial clauses will be retained – for example, compelling institutional investors to disclose how they vote at company annual meetings, requiring companies to recognise indirect investors who give them notice of their interest and giving them the same rights as registered shareholders. The bill's third reading in the House of Commons is scheduled for 17 July.

The European Commission is looking into transparency in the bond markets and related derivatives markets. It will focus on investor protection and a possible extension to bonds of the pre- and post-trade transparency regime of the Markets in Financial Instruments Directive (MiFID) applicable to shares. The subject has already been examined by the FSA.