Basel II hits borrowing

With Basel II implementation on the horizon, there is growing speculation among borrowers and banks about the impact that the new accord will have on pricing and other elements of future borrowing.

By January 2007, UK banks will have implemented the standardised approach of calculating capital adequacy, with the more complex internal-ratings based approach coming into play in larger banks the following year.

Len Sinclair, Head of Basel II at RBS, said: "Basel II is already having an impact on pricing. The new rules on capital risk and capital management are already being considered.

"However, it may take some time before any real impact can be seen. There will certainly be a period of settling in during 2007."

While banks have to deal with the various global jurisdictions, each with their own way of applying the new rules, treasurers should be looking at current and future loan arrangements and considering the cost implications after implementation.

Sean West, Treasurer at Land Securities, said: "If there are going to be some effects I expect it will be a gradual progress, especially as there are smoothing rules to limit the amount of capital released by the banking market in 2007-2009. The other point to note is that the Basel II regulations outline the minimal capital required only. Other factors such as rating agency requirements may also impact on the actual level of capital maintained."

Despite the likelihood of gradual price alterations to borrowing, banks still recommend paying some attention in this area.

Sinclair said: "I think corporate treasurers should be aware of the changes that will be occurring in 2007. It is always important to know what changes are coming up."

See page 22, Into the Unknown: Basel II, and Building Success, page 18. ■

Bank rolls out money market framework

The Bank of England has launched its new framework for implementing monetary policy. This modernisation brings a fundamental change to the way interest rate decisions made by the Monetary Policy Committee are implemented and the way the liquidity of the banking system is managed.

From mid-May, for the first time in its history, the Bank is paying interest on reserve balances held by banks and building societies, which now target average balances with the Bank over the periods between the MPC's monthly interest rate decisions rather than having to 'square up' every day. The Bank has moved from daily to weekly short-term open market operations.

The announcement coincided with a keynote speech to The Treasurers' Conference by MPC member Paul Tucker. Another 17 banks and building societies (making 58 in total) now have access to the standing deposit and lending facilities. The new system is designed to ensure that very short-term market interest rates are stable and in line with the decisions of the MPC. By reducing volatility and bringing many more banks into the system, it creates an efficient, flexible and simple framework for banks to manage their day-to-day liquidity.

See page 08 for TTC coverage. ■

Anxiety on IAS 39

A poll of UK corporates has revealed disquiet over IAS 39 *Financial Instruments: Recognition and Measurement* following its implementation last year, despite a 53% majority reporting no change in the hedging instruments they use.

Accounting volatility was limited to within 10% of reported profits for 56% of companies participating in the poll, but 71% agreed that "IAS 39 and 21 *The Effects of Changes in Foreign Exchange Rates* make company accounts more confusing for everybody." And 62% blamed the confusion on a "lack of practical advice and consistency" among accountancy firms.

The poll was taken at a conference hosted by the ACT in London on Wednesday 17 May, which gave members the opportunity to discuss the standard's impact on hedging practices in their organisations and hear from speakers, including, among others, Ken Wild, global IFRS leader at Deloitte, and Peter Elwin, head of accounting and valuation research at Cazenove.

A debate threw up some fresh angles, such as whether volatility was inherently bad or just a natural driver of markets, and whether hedging transparency might reveal business-critical information in some sectors, such as commodities.

Debate sponsor Lloyds TSB Financial Markets contributed a series of filmed interviews with large corporate clients, in which the message was that business and commercial sense had to come before accounting.

"There was a definite feeling among the treasurers present that IAS 39 risked creating a disconnect between what the business was doing and why, and what was represented in the accounts," said Clare Francis, Managing Director of Sales at Lloyds TSB Financial Markets.

She added: "What they expect is for analysts to come at the accounts with a business head, rather than looking at them as a set of abstract performance measures."

Francis also said that evidence of companies shying away from hedging because of IAS 39 was "mainly anecdotal", while Ken Wild of Deloitte suggested that reduction in hedging was "at the margins only".

Over half of the delegates at the conference said that they had made dedicated presentations to relevant groups – including banks and rating agencies as well as investors – on the impact of IAS 39 on accounts.

Corporates were encouraged to take advantage of resource 'wherever available', especially if free.

This mirrors the consultancy role some banks are offering to support sales of the relevant instruments, including Lloyds TSB, whose sponsorship of the debate was part of its bid for thought-leadership in this area.

Praise for IAS 39 was limited to its engendering a closer interest in the economic detail of hedging, including what drives the price fluctuation of hedging instruments.

Yet it was suggested that analysts would remain relatively distant from the full detail of IAS 39-compliant accounts unless an event occurred that drove them in to the detail, such as a pensions-related swing in valuation.

See Deeply Flawed, page 32. ■

British companies told to stump up £130bn to plug pension hole

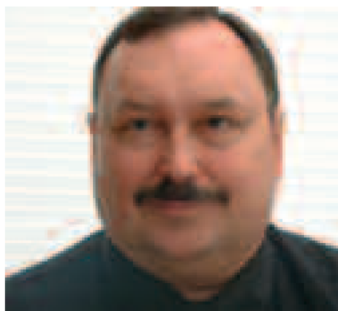
The Pensions Regulator is pushing UK companies to pay an estimated £130bn overall to decrease their pension deficits in a bid to take the strain off the recently established Pension Protection Fund (PPF).

If companies fail to produce a suitable and realistic plan to reduce the deficit within 10 years, the regulator may intervene and set the levels of contribution.

Andrew Conquest, Head of Pensions Advisory at Grant Thornton, said: "Trustees will need to take into account employers' business plans and the likely effect any recovery plan would have on employers."

The Pensions Regulator said there would be a certain degree of flexibility for companies that were struggling to meet the 10-year target to ensure that plugging their deficit would not threaten the company with bankruptcy.

John Hawkins, Former Head of Finance and Risk at Invensys, said: "There is a significant minority who would find this difficult, as the regulator has acknowledged. Companies in this position will be able to have a longer period if they can genuinely demonstrate that their business would otherwise be damaged."


John Hawkins: It's a balancing act.

Hawkins said an important element for the regulator to consider were those companies that could plug their deficit in less than 10 years but were not doing so.

He said: "If they don't do so, the PPF will have a greater exposure as a result of those cases than it would had the regulator sought a shorter period.

"However, there is a balancing act here. Many companies that could afford a shorter correction plan might be able to make a case to trustees that this shouldn't be imposed on them; the *quid pro quo* is that they may face higher PPF levies in the long term." ■

ECB set to hike rates

The European Central Bank (ECB) is virtually guaranteed to raise interest rates over the summer and possibly twice again in 2006, according to a foreign exchange expert.

The news comes after two recent interest rate increases, the first of which came 29 months after the last increase.

In December 2005 and March 2006 the increase was 25 basis points, but there is growing concern that the next increase could be as much as double this figure.

John Wraith, Head of Rates and Strategy at Royal Bank of Scotland, said: "The ECB has been preparing the market for this increase for about six months now. We can almost guarantee that interest rates will increase.

"What is a concern at the moment is the possibility that they will be raised by 50 basis points."

The ECB has raised interest rates due to its concern that persistently high oil prices, teamed with strong money supply and credit growth, will feed through to push up the inflation over the next year.

Wraith said: "Although the euro zone is reported to be doing better it is not so clear cut. The underlying data tells a different story.

"In isolation the first-quarter growth is good but it follows an extremely bad quarter in the previous year."

Wraith argued that the recovery that the President of the ECB, Jean-Claude Trichet, had discussed was not quite so obvious. In May, the euro was just a few cents away from its historic high against the dollar.

Analysts say the euro zone is better able to cope with a higher euro than in 2004 because economic growth is accelerating. The stronger currency also helps the ECB's bid to check inflation by effectively tightening monetary policy.

Wraith said: "What growth there has been in Europe, in particular in Germany, has been pretty much dependent on export. This is not necessarily a big problem.

"However, if net trade is the big contributor, what happens if this changes? Will domestic demand be able to replace it?" ■

Tax trend accelerates

The worldwide trend among multinational corporations towards moving their operations from high-tax to low-tax regimes has accelerated in the past year, according to a survey by accounting firm KPMG.

In a poll of senior tax executives from 120 multinational corporations, 62% reported that they were planning to move assets or operations to low-tax regimes. This is a significant increase on the 55% who gave the same answer in a poll in 2005. This year, 14% said that they had already moved part of their operations to a lower-tax regime in response to more aggressive tax-planning challenges from tax authorities.

On the move...

- **Baris Akcali**, AMCT, formerly Treasury Manager at Brambles Industries, has joined SunGard AvantGard as Senior Consultant.
- **Stephen Baseby**, MCT, has returned to Thames Water at Reading from a two-year secondment to its parent, RWE, as Manager Corporate Finance and has joined the team arranging the sale of Thames Water.
- **Andrew Beaumont**, MCT, previously Treasurer at RWE Thames Water (Europe) and RWE Npower, has been appointed Head of Treasury at RWE Water.
- **Michael Cassidy**, MCT, previously Treasury Director at Ebookers has joined Wyndham Worldwide as Head of Treasury, EME.
- **James Gibbons**, AMCT, has joined Nationwide Building Society as Senior Dealer, Capital Markets. Previously he was Treasurer for K2 Corp, which was fund-managed by Dresdner Kleinwort Wasserstein.
- **Dominic Osborne**, AMCT, formerly Finance and Analysis Manager at Svenska Shell, has been appointed Investment Finance Manager at Shell International Exploration & Production.
- **Robert Williams**, MCT, formerly Head of Finance at BBC Radio and Music, has been appointed Group Financial Controller at the University of Oxford.

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Members' contact details are updated regularly at **www.treasurers.org**. *Email changes to Anna Corr:* **acorr@treasurers.org**

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