



**UK QE AND REGTECH**

In the UK, the latest round of quantitative easing has affected yields and we write below on the double-edged sword of cheap debt and low pension discount rates. Elsewhere, we are monitoring the development of the Brexit plan and continue our conversations with regulators and key decision-makers to ensure that the voice of the corporate is heard. Further afield, EU money market fund (MMF) legislation evolves, while the new US MMF rules come into being this month – make sure your policies remain effective.

If you have views you'd like to share with the ACT policy and technical team on any of these subjects or have your own submission you are willing to share, please email us at [technical@treasurers.org](mailto:technical@treasurers.org)



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{ IN DEPTH }

# UK QE: investment stimulus, cheaper corporate financing or pension deficit booster?

The Bank of England (BoE) has started its next phase of quantitative easing (QE): the attempt to stimulate investment by lowering long-term lending costs by competing in the markets to buy UK government and corporate debt.

This follows the lowering of the base rate to 0.25%, to lower further short-term investment yields and encourage cash holders, individuals and businesses to risk their deflating cash asset on other assets.

The problem the UK shares with other Western economies is that the acceptable stimuli have become few. The BoE has base rates and QE, a target consumer price inflation of 2% (currently 0.6%), coupled with a commitment to a stable financial system. The government of the moment can tinker with tax rates and/or overspend (that is, borrow). Simple and crude weapons in the battle for growth.

However, investment decisions are not simple or uniform in their nature. Business needs to consider the reliability and cost of supplies, and the likelihood of customers at the right price, while satisfying a host



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of planning, environmental, labour and tax laws.

Then there is the cost of financial capital to consider – of which the cost of debt is a part. The base erosion and profit shifting initiative may affect the cost of capital as the benefit of lower interest rates is eroded by caps on interest deductibility.

**Economic uncertainty**

And then there are the levels of uncertainty in the economy: the Brexit process is hardly started. Financial institutions may need to digest the loss of EU passporting and the risk

that they do not have financial regulation equivalence in its place (see passporting and equivalence primer, opposite). Non-financial businesses, which comprise the bulk of our members' employers, also have uncertainty over equivalence; the future form of environment and labour laws and practices, and, more critically, continued access to overseas supplies and customers on terms that enable their UK-based businesses to thrive.

One flaw in the QE argument is that too much simultaneous change becomes difficult to digest. The variables in the business plan become too many. The best-case and worst-case scenarios move further apart. Where you may end up in the gap between becomes less certain. A lower cost of debt only assists to ameliorate the broader uncertainty, and the borrower may wish to do no more than use borrowed funds to distribute to shareholders, many of which are not UK domiciled, thereby passing on the investment decision beyond the UK.

Another flaw of QE is that the buyers of UK debt remain

substantially the long-term funds, including the defined benefit (DB) pension funds of many borrowers. Beyond a requirement to invest part of their funds in low-yielding gilts, these DB funds' mismatch of assets and liabilities is worsened by the use of long-dated gilt yields (whose rates are lowered by QE) as the discount factor to value the fund.

The UK has so long a history of DB pension funds that even those that closed their years ago still have DB funds, because we have become very good at staying alive, and so the assets accumulated in the past cannot meet the forecast liabilities of today.

Tata Steel and BHS may, in time, become known as the beginning of the end of DB funds – the point at which we began to consider whether we want to be comfy pensioners or be an economy with tax-paying businesses and employees to fund all that social infrastructure that helps us to live so long.

In the meantime, we will continue to argue that QE may aid financial market stability, but it cannot be relied on to stimulate the commercial sector, which must reconcile uncertain times for its business with an increasing social welfare liability. Broader-based stimuli, which are focused on areas of need, are required, and for this we must look to the chancellor and not the BoE governor, whose remit is too limited.



View the technical updates and policy submissions at [www.treasurers.org/technical](http://www.treasurers.org/technical) and [www.treasurers.org/events/webinar](http://www.treasurers.org/events/webinar)

- **Brexit 2016 – a post-referendum checklist for treasurers**
- **Brexit Q&As – painting by numbers**
- **ACT responds to UK BEPS consultation**

The policy and technical team has written various blogs this month at <https://blogs.treasurers.org>

- **Responding to the UK’s payments strategy consultation**
- **Brexit myopia leads to non-Brexit solutions?**
- **ACT: the corporate voice in developing UK Markets Standards**
- **QE: investment stimulus, cheaper corporate financing or pension deficit booster?**

{ INTERNATIONAL/BREXIT }

## PASSPORTING AND EQUIVALENCE – A PRIMER

> The UK has the largest financial services industry in the EU and, post-referendum, the small matter of how this industry will continue to operate looms large.

Passporting, which is how the industry operates at present, is a European Economic Area (EEA) right and, subject to meeting any conditions under a relevant single market directive (for example, Solvency II), a firm authorised in an EEA state is entitled to carry on permitted activities in any other EEA state by either exercising the right of establishment (of a branch and/or agents) or providing cross-border services.

For the UK, one post-Brexit model mooted is the ‘Norway’ model; a member of the European Free Trade Association and so in the EEA, Norway has

passporting rights in exchange for free movement of people. This may not be acceptable to the UK for political reasons (free movement of people being the major issue for the UK electorate), and so an alternate solution would be required – perhaps equivalence.

Equivalence rests on ensuring that similar regulatory outcomes, such as reducing systemic risk in the financial markets, are achieved irrespective of regulatory framework. This is the way that countries such as the US currently ‘trade’ within the EU.

As current UK regulation is based on EU rules, establishing equivalence should be relatively straightforward, and the UK would ‘just’ need to demonstrate that future changes in regulation do not impact the outcome from a systemic risk perspective.

{ WATCH THIS SPACE }

## Regtech – the new fintech?

Even while some of us are still getting our heads around fintech and what it means in practical terms for our organisation, there is a new kid on the block: regtech (regulatory technology – the use of technology to deliver solutions to regulatory requirements). And, this time, the practical application may be more apparent to treasurers.

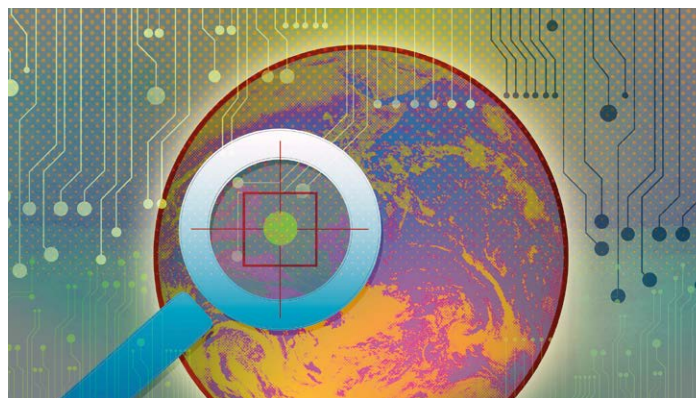
Firms want to comply with ever-expanding, but frequently inconsistent, regulatory requirements; regulators want to make use of the information provided – at present, neither of these things are happening efficiently.

Furthermore, as all the theories tell us, data needs to be accurate, secure, timely and standardised, and reporting needs to be cost-effective, flexible and timely to comply with whatever the regulators require. This is where regtech comes in.

Regtech solutions are being designed to provide consistent interpretation of the rules, compliance and the automation of reporting by taking standardised data from legacy systems and having the flexibility to manipulate it into the reporting formats that the various regulators require. The magic of regtech (in theory) is that one set

of data can be cut in many different ways to provide the information required by different regulators and, as a result, it helps firms automate compliance tasks and reduce operational risks associated with compliance and reporting obligations.

Ultimately, it might even provide a solution for the agony for most corporates that is KYC...



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{ TECHNICAL ROUND-UP }

### The US money market fund (MMF) reforms come into effect on 15 October.

The Securities and Exchange Commission Rule 2a-7 defines the quality, maturity and diversity of investments allowed in MMFs. A significant Rule 2a-7 change is the introduction of variable (or floating) net asset value funds for prime, ie non-government, MMFs. The US Association of Financial Professionals’ 2016 liquidity survey found that 62% of corporates plan to make changes in how they invest in prime funds as a result of these reforms. European MMF regulatory changes are still a work in progress, with triologue negotiations taking place and a possibility of seeing the final text before the end of 2016.

### The Global Financial Markets Association has issued a report.

commissioned from Oliver Wyman, called *Interaction, Coherence, and Overall Calibration of Post Crisis Basel Reforms*. The report provides a comprehensive analysis of the potential costs of the new Basel standards on lending and capital markets. Overall, it estimates that the median increase in funding cost for loans is 60-84% bps. A copy of the report can be found at [www.oliverwyman.com/content/dam/oliverwyman/global/en/2016/aug/post-crisis-basel-reforms.pdf](http://www.oliverwyman.com/content/dam/oliverwyman/global/en/2016/aug/post-crisis-basel-reforms.pdf)

### Poland has become the first European country to issue a panda bond.

In late August, the Polish government issued a three-year ¥3bn bond with a yield of 3.4%. Panda bonds, yuan-denominated onshore bonds issued by foreign entities, were first permitted in 2005 and, historically, issuers have been international financial institutions. Key developments in the panda bond market were outlined in *The Treasurer* (July/August 2016, page 32).