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IAFEI News

Letter of the Editor **February 28, 2012**

Dear Financial Executive,

You receive the **IAFEI Quarterly XVI th Issue**.

This is another issue of the electronic professional journal of IAFEI, the International Association of Financial Executives Institutes. This journal, other than the IAFEI Website, is the internal ongoing information tool of our association, destined to reach the desk of each financial executive, or reach him, her otherwise, at the discretion of the national IAFEI member institutes.

This issue, like its predecessors, offers a broad range of articles on financial subjects. While all of them do matter to the financial executive, the following ones deserve special pointing at:

The Position Paper by the European Association of Corporate Treasurers to the European Commission`s Proposal for Further Regulation of Credit Rating Agencies.

Financial Repression, a historically already proven method for the gradual reduction of state over-indebtedness.

UBS Basel III-compliant Loss-Absorbing Notes, an innovative and attractive financing and investment instrument in response to the worldwide financial crisis.

Enjoy reading this IAFEI Quarterly.

Once again, I repeat our ongoing invitation to IAFEI member institutes, and to their members, to send us articles for inclusion in future IAFEI Quarterlies, and to also send to us your suggestions for improvements.

With best personal regards

Helmut Schnabel

Helmut Schnabel

AerLingus

The man ...

Andrew Macfarlane joined Aer Lingus as CFO in December 2009. Prior to his appointment he most recently served as chief financial officer of Rentokil Initial. His early career was with Ernst & Young, and he has held the position of chief financial officer at Land Securities Group plc and Holiday Inn.

Established in 1936, Aer Lingus Group Plc is the flag carrier of Ireland. The company employs 4,000 people and in 2010 had revenues of EUR 1.2 billion. Aer Lingus flew 9.3 million passengers in 2010.

By Steven Arons

The sky over Dublin is a brilliant blue. But the clouds hanging over the Irish economy are dark and threatening. Just a day earlier, the rating agency Moody's slashed the country's sovereign rating, reducing it to junk status. The headlines at the news stands are screaming; Ireland is stunned. The decision is a severe setback for the country.

In spite of the bad news, Andrew Macfarlane remains calm. "[An Irish default] is not my core expectation," says the CFO of Aer Lingus, one of Ireland's best-known companies. Indeed, Mr Macfarlane is eager to set the record straight on his home country. "Ireland has a few things going for it. Export performance has been good, especially in the IT and pharmaceutical sectors," he says. "The Irish government has been very serious about its austerity measures. The performance of the economy so far in 2011 has been pretty much where they expected it to be." The IMF's latest World Economic Outlook report, issued in April, forecasts Ireland to grow at 0.5 per cent this year, barely above stagnation, after contracting by 7.6 per cent in 2009 and by 1 per cent last year.

An extreme assumption

If the worst-case scenario were to unfold, the impact on the Irish flag carrier would be extremely painful. "I imagine consumer behaviour would be very defensive and demand would go down significantly," Mr Macfarlane says. This plunge in demand would come hard on the heels of last year's decline in passenger numbers – to 22.6 million, down from a peak of almost 30 million in 2008.

These numbers notwithstanding, the CFO insists the aftermath of a default would be manageable. "[O]nce debt would have been restructured, which I would presume to happen rather quickly, things would start to go back to normal," he says.

The Cloudy Skies of Ireland

Aer Lingus is under the triple pressures of the eurozone debt crisis, rising fuel prices and relentless competition from Ryanair.

CFO Andrew Macfarlane tells FINANCE how the Irish flag carrier is coping with the enormous challenge.

He also points out that Aer Lingus is fairly insulated against the threat of rising borrowing costs: "We're in the happy position of having significant net cash, and most of our debt [...] is at fixed and fairly cheap rates."

Rather than dwelling on the worst case, Mr Macfarlane draws attention to the fact that Aer Lingus is set to benefit disproportionately from an Irish recovery. "The change in our passenger numbers tends to be twice the change in GDP," he explains. "We have a large fixed cost base so a good part of top-line growth goes straight through to the bottom line." The strong reaction of demand to a better outlook, he says, is rooted in Ireland's culture. In spite of its small population of only about 4 million, the country plays host to many of the world's largest aircraft leasing firms and is home to two major airlines, Aer Lingus and Ryanair. "The Irish love to travel," he says, with the average adult boarding an airplane up to five times as often as other Europeans per year.

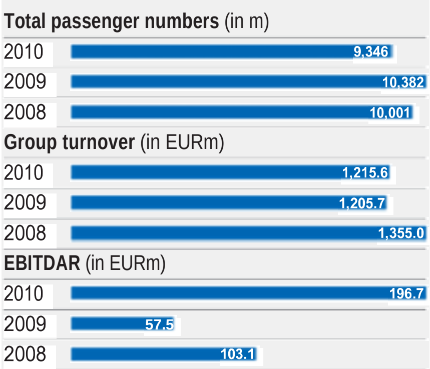
Their passion for air travel aside, the Irish have not been easy customers for Aer Lingus. The ascent of low-cost carrier Ryanair, now Europe's highest-volume passenger airline headquartered a stone's throw from Aer Lingus at Dublin airport, has made Irish tourists extremely sensitive to ticket prices. A formidable rival has been created who competes with Aer Lingus on a whopping 85 per cent of the latter's routes.

>> We're very sensitive about the price we pay for an aircraft. But 15 per cent of fuel savings is absolutely worth it. <<

Ryanair's success also propelled the Aer Lingus, which celebrates its 75th anniversary this year, into an ill-fated attempt to emulate the low-cost competitor. Due to Ryanair's "structurally lower cost base", says Mr Macfarlane, the strategy was doomed to failure, resulting in deep losses in 2008 and 2009 and the replacement of the entire top management in 2009. The current CEO, Christoph Mueller, joined Aer Lingus in September 2009, followed by the appointment of Mr Macfarlane to the CFO post three months later.

Having abandoned its copycat strategy under the new CEO, Aer Lingus is now seeking to reposition itself between the low-cost carrier on the one side and what it calls the "full-service flag carriers" on the other. The fundamental aim of this strategic overhaul is to cater simultaneously to both the Ryanair-conditioned Irish tourists and the less price-sensitive business travelers >>

Moving figures: Aer Lingus in numbers



Source: Aer Lingus

An uncertain outlook: an Aer Lingus A320 lands in front of the new Terminal 2 at Dublin Airport.

Getty

on their way to London. “The same physical equipment served by the same crew has to work equally well for the visiting friends and relatives versus the businessperson,” Mr Macfarlane explains. “At the core is a reasonably–priced, comfortable seat. If you’re prepared to pay for more, we’d like to give you the opportunity to buy extra services.”

A margin climb

Early signs suggest the new strategy is paying off. Yield per passenger, a key performance indicator for Aer Lingus, soared in 2010, with average fare per short-haul passenger climbing by 11.4 per cent and per long-haul passenger by 19 per cent. However, with fuel prices rising again – crude prices have surged from a low around USD 70 per barrel last year to a high over USD 120 earlier this year – the carrier’s profitability is expected to remain flat or even sink in 2011 and beyond, the CFO cautions. Higher airport charges at Dublin and Heathrow, its two most important hubs, are also buffeting the carrier and compounding the need to whittle away at its cost base.

The Irish propensity to spend their money on flights was also the cause for the construction of a gleaming new terminal at Dublin airport, inaugurated last November, which has raised the passenger capacity of the airport from 18 to around 30 million passengers a year. At the time the project was commissioned, during the heydays of the Irish boom, that much capacity seemed like a reasonable investment. Over 23 million passengers passed through the hopelessly overcrowded airport in 2007, making it one of Europe’s most dreaded. But then the bubble burst – and the number of passengers plunged to a mere 18.4 million last year, in some ways giving the new terminal the atmosphere of a large grocery store during night hours. Albeit bad news for the airport operator DAA, the emptiness actually makes for a pleasant and easy travel experience. Few airports in Europe can boast shorter queues.

It’s his job

The twin challenge of fostering Aer Lingus’s transformation into a “value carrier” while adapting the new strategy to a steep reduction in demand has been taking up almost all of Mr Macfarlane’s time. But bringing down costs is no easy feat for the Irish flag carrier. Fuel prices can be hedged, which the CFO has been doing with reasonable success, but are impossible to influence. Airport charges, the third largest cost factor after fuel and staff expenses, are regulated and thus equally difficult to cut.

As a result, most of the carrier’s cuts have been in capacity. The rejuvenation of its aircraft fleet has been postponed, routes have been cancelled and labour costs slashed. This included a 10 per cent pay cut for all but the lowest earning employees and 300 layoffs from a total staff of around 3,500, thereby reducing staff costs by 17 per cent in 2010.

The combined measures, collectively labelled the Greenfield cost reduction programme, have produced good results. In spite of the Irish debt meltdown, Aer Lingus returned to the black in 2010, achiev-

Dangerous curves: Brent crude price (in USD)

Source: BP

ing an operating profit of EUR 26.6 million. Although the carrier did dive back into the red in the first quarter of 2011, it was an incredible overall reversal considering its operating losses of EUR 170 million and EUR 161 million in 2009 and 2008, respectively. Even if the turnaround owed much to falling fuel prices, it is undeniable that the increase in efficiency has been pronounced.

Strike looms

Confident in a recovering Irish economy, Mr Macfarlane hopes to avoid further cuts to capacity, for good reasons. Such moves would not only jeopardise Aer Lingus's ability to benefit from an upswing; further staff reductions would also threaten to rekindle restive labour relations with its cabin crews. A bruising conflict with IMPACT, Ireland's largest services trade union, cost the airline an estimated EUR 15 million in the first quarter of 2011 after the union reneged on an agreement signed in 2010. Asked if he worries about future unrest if further staff cuts had to be implemented, Mr Macfarlance only comments that the "substantial dispute with our cabin crew [is] behind us now".

The reluctance with regard to further staff cuts does not mean Mr Macfarlane has abandoned his relentless pursuit of tapping potential savings. His next big project: finding a remedy to the carrier's notorious seasonality. "We fly about a million passengers in our busiest month, July, but only 600,000 in February," he says. "At present we have too many short-haul aircraft in winter. We want to know whether we can rent them out to someone who has the opposite seasonal demand." Though implementation of the plan is unlikely to be quick enough to begin this coming winter, the CFO sees a good chance of that happening the following year.

In view of Aer Lingus's vulnerability to rising fuel costs – a change in price by one dollar raises or reduces costs by around USD 450,000, the carrier estimates – raising efficiency is high on the CFO's agenda too. For example, instead of purchasing Airbus A330 aircraft, Aer Lingus will buy the A350s, he says. The latter model costs between EUR 236.6 million and EUR 300 million, or 15 to 50 per cent more than the A330 according to Airbus list prices, but consumes 15 per cent less fuel. "We're very sensitive about the price we pay for an aircraft," he explains. "But 15 per cent of fuel savings is absolutely worth it. Every tonne of fuel that we don't burn saves us a thousand dollars." He adds that Aer Lingus has a list of 23 initiatives to help them reduce their fuel consumption, including cleaning the jet engines and using lighter trolleys.

Incidentally, raising fuel efficiency has the pleasant side effect of enhancing Aer Lingus's green image and preparing the carrier for the introduction of the so-called EU Emissions Trading Scheme (ETS) to the aviation industry. This new scheme will force airlines to pay for carbon emissions that are in excess of a free allowance, which Mr Macfarlane projects to cover around 90 per cent of their total emissions, though the EU will not publish the precise proportion of the allowance until September. The CFO expects this to shave between EUR 5 and 10 million directly off of his bottom line – and adversely affect Aer Lingus's competitiveness if non-EU airlines succeed in their fight for exemption from the scheme. "What we don't want to do is find ourselves competing with a carrier on the same route who doesn't have to pay carbon taxes," he says.

A side question

However, the introduction of the ETS does not amount to much more than a little afterthought. What really counts for Mr Macfarlane and Aer Lingus is whether the Irish will soon have the economic certainty again to start spending their money. The fact that many passengers on return flight EI 656 from Dublin to Frankfurt buy a sandwich and a drink – the complimentary snack having fallen victim to the Ryanisation of the Irish aviation industry a long time ago – demonstrates that people are willing to pay for extra services. But will they reach for their wallets often enough for Aer Lingus to withstand the triple onslaught of Ryanair, the eurozone crisis, and rising commodity prices? The question hangs in the air as the A320 ascends into the blue sky. ||

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European Union, Study: EACT Funding Survey / Autumn 2011,
Issued February 26, 2012

By EACT,
European Association of Corporate Treasurers

The attached EACT Funding Survey is the third such Survey. This type of survey was started after the collapse of Lehman Brothers and the ensuing worldwide financial crisis.

The study tries to point at the changes in the aftermath of the worldwide financial crisis, which treasurers face in Europe, when they are funding their corporations through banks.

A record number of 562 financial executives has contributed to this study.

The EACT is a grouping of 20 national associations representing treasury and finance professionals in 19 European countries. It brings together in excess of 8.500 members representing approximately 5.000 companies located in Europe. It comments to the European authorities, national governments, regulators and standard-setters on issues faced by treasury and finance professionals across Europe. It seeks to encourage the profession of treasury, corporate finance and risk management, promoting the value of treasury skills through best practice and education.

please turn over

1. Name of your association:

	Response Percent	Response Count
ACT – United Kingdom	7,8%	44
ACTSR - Switzerland	6,0%	34
AFTE - France	13,7%	77
AITI - Italy	8,9%	50
ASSET - Spain	10,7%	60
ATEB - Belgium	2,1%	12
ATEL – Luxembourg	0,2%	1
CACT - Croatia	2,7%	15
CAT – Czech Republic	6,2%	35
DACT - Netherlands	6,6%	37
FACT - Finland	3,4%	19
GEFIU - Germany	2,5%	14
HTC - Hungary	2,8%	16
IACT - Ireland	5,3%	30
ÖPWZ - Austria	0,0%	0
PCTA - Poland	0,0%	0
SACT - Sweden	0,0%	0
SAF - Slovakia	2,7%	15
SCTA - Slovenia	3,4%	19
VDT - Germany	**14,9%**	**84**
	answered question	**562**
	skipped question	**0**

2. Your company turnover:

	Response Percent	Response Count
Less than 100 million Euros	17,0%	91
Between 100 and 500 million Euros	21,5%	115
Between 500 million and 1 billion Euros	14,6%	78
Between 1 and 2 billion Euros	12,7%	68
More than 2 billion Euros	**34,2%**	**183**
	answered question	**535**
	skipped question	**27**

3. Has your company had any credit lines reduced by the lenders?

	Response Percent	Response Count
Yes	22,1%	111
No	**77,9%**	**391**
	answered question	**502**
	skipped question	**60**

4. If yes, were the lines committed, uncommitted or a mixture?

	Response Percent	Response Count
Committed	22,0%	24
Uncommitted	28,4%	31
Mixture	**49,5%**	**54**
	answered question	**109**
	skipped question	**453**

5. Has your company had any credit lines cancelled?

	Response Percent	Response Count
Yes	13,4%	66
No	**86,6%**	**427**
answered question		**493**
skipped question		**69**

6. If yes, were the lines committed, uncommitted or a mixture?

	Response Percent	Response Count
Committed	22,7%	15
Uncommitted	**40,9%**	**27**
Mixture	36,4%	24
answered question		**66**
skipped question		**496**

7. Has any of your banks increased the margin applied to your uncommitted short term credits?

	Response Percent	Response Count
Yes	49,4%	240
No	**50,6%**	**246**
answered question		**486**
skipped question		**76**

8. If yes, the increase of the margin is:

	Response Percent	Response Count
Less than 50 basis points	**39,7%**	**94**
From 50 to 100 basis points	**39,7%**	**94**
From 100 to 300 basis points	16,9%	40
More than 300 basis points	3,8%	9
	answered question	**237**
	skipped question	**325**

9. Has any of your banks changed the margin and / or other charges applied to your committed lines of credit?

	Response Percent	Response Count
Yes	35,6%	170
No	**64,4%**	**308**
	answered question	**478**
	skipped question	**84**

10. If yes, the increase of the margin (or equivalent in other charges) is:

	Response Percent	Response Count
Less than 50 basis points	**42,7%**	**73**
From 50 to 100 basis points	**42,7%**	**73**
From 100 to 300 basis points	12,9%	22
More than 300 basis points	1,8%	3
	answered question	**171**
	skipped question	**391**

11. If margins have increased, do you consider that any element of the increase is attributable to the credit standing of the lending bank?

		Response Percent	Response Count
Yes		**59,2%**	**213**
No		40,8%	147
		answered question	**360**
		skipped question	**202**

12. Have you asked your banks to increase uncommitted short term lines of credit?

		Response Percent	Response Count
Yes		26,5%	123
No		**73,5%**	**342**
		answered question	**465**
		skipped question	**97**

13. If yes, your banks:

		Response Percent	Response Count
Accepted		**61,4%**	**78**
Refused		38,6%	49
		answered question	**127**
		skipped question	**435**

14. Have you asked your banks to increase committed lines of credit?

	Response Percent	Response Count
Yes	32,0%	148
No	**68,0%**	**315**
	answered question	**463**
	skipped question	**99**

15. If yes, your banks:

	Response Percent	Response Count
Accepted	**74,3%**	**110**
Refused	25,7%	38
	answered question	**148**
	skipped question	**414**

16. Has any of your banks seeking additional securities (pledges, guarantees, raising the level of covenants, ...) in return for lending or other credit commitments?

	Response Percent	Response Count
Yes	28,2%	129
No	**71,8%**	**329**
	answered question	**458**
	skipped question	**104**

17. Are banks actively seeking to tie ancillary operational business to lending commitments?

	Response Percent	Response Count
Yes, more than pre crisis	**56,9%**	**259**
No more than pre crisis	43,1%	196
answered question		**455**
skipped question		**107**

18. Has any of your banks stopped financing in some currencies?

	Response Percent	Response Count
Yes	19,3%	88
No	**80,7%**	**367**
answered question		**455**
skipped question		**107**

19. Comments:

	Response Count
	54
answered question	**54**
skipped question	**508**

20. Do you consider the behaviour of your banks?

	Response Percent	Response Count
Flexible	**55,8%**	**251**
Not flexible	44,2%	199
answered question		**450**
skipped question		**112**

21. In your view have treasurers learnt from the financial crisis in terms of management of their bank borrowings?

	Response Count
	238
answered question	**238**
skipped question	**324**

22. Have your banks informed your company on the likely impact on pricing of implementing Basel III and CRD IV?

	Response Percent	Response Count
Yes	42,9%	192
No	**57,1%**	**256**
answered question		**448**
skipped question		**114**

23. Are your banks concentrating on trying to attract your surplus cash directly in their balance sheets, as opposed to encouraging other types of investments such as UCITS?

	Response Percent	Response Count
Yes	**41,0%**	**182**
No	22,5%	100
N/A	36,5%	162
	answered question	**444**
	skipped question	**118**

24. Are you financing your company more on the financial/capital markets (commercial paper, bonds …) and less with your banks?

	Response Percent	Response Count
Yes	26,2%	116
No	**52,8%**	**234**
N/A	21,0%	93
	answered question	**443**
	skipped question	**119**

25. What is the percentage of your financial loans covered by your banks?

	Response Percent	Response Count
N/A	15,3%	68
Less than 33%	30,7%	136
Between 34 and 66%	16,7%	74
More than 67%	**37,2%**	**165**
	answered question	**443**
	skipped question	**119**

26. Since the beginning of the financial crisis, have you asked a credit rating agency to rate your company?

	Response Percent	Response Count
Yes	17,8%	79
No	**82,2%**	**364**
	answered question	**443**
	skipped question	**119**

27. What is the classification of your company under the Markets in Financial Instruments Directive (MiFID)?

	Response Percent	Response Count
Retail client	15,9%	70
Professional client	**72,6%**	**320**
Eligible counterparty	11,6%	51
	answered question	**441**
	skipped question	**121**

28. Under MiFID, do any of your banks ask you to complete a survey on suitability and appropriateness tests?

	Response Percent	Response Count
Yes	21,9%	96
No	**78,1%**	**342**
	answered question	**438**
	skipped question	**124**

29. Comments:

	Response Count
	12
answered question	12
skipped question	550

European Association of Corporate Treasurers

Press Release – 28 February 2012

The European Commission's Proposals for Further Regulation of Credit Rating Agencies

The *European Association of Corporate Treasurers* (EACT) is a grouping of 20 national associations representing treasury and finance professionals from 17 countries of the European Union.

The members of the EACT's treasury associations work in the 'real economy' and are directly impacted by the European Union's financial regulatory initiatives in response to the financial crisis. Much of this regulatory programme includes potentially adverse and often unintended consequences for the real economy and this is particularly true of the latest proposals[1] for a Directive and Regulation of credit rating agencies (CRAs). The European Commission's proposals are being considered by the Parliament and Council and are already the subject of a draft report from the ECON committee of Parliament[2].

The EACT welcomes certain aspects of the proposals, especially where these address acknowledged past failures (such as in the rating of structured products) and encourage the view of ratings as opinions that should not be relied upon to the exclusion of independent analysis. However the EACT believes that other measures proposed by the Commission would have material negative consequences on the use of ratings by corporate issuers, the real economy participants in the rating process.

The attached position paper describes the EACT's concerns in detail. The two most important issues are:

- *The proposals for mandatory rotation of CRAs are both impractical and remove the continuity of experience in the CRAs. Such rotation cuts right across the investment both issuers and CRAs make in their working relationships, building understanding of the issuer and of the methodology used to produce the rating. Far from encouraging competition the proposal may have the perverse outcome of discouraging issuers from seeking ratings. This can only lead to less money being raised and at a higher cost, at a time when bank lending is already becoming tighter. The EU-US gap in corporate bond funding, already a serious impediment to business in Europe, would widen..*
- *The differences between CRA methodologies are highly valued by real economy issuers. The introduction of ESMA oversight of these methodologies raises the concern that this range of different approaches to credit analysis may be lost. The EACT and issuers see such a possible outcome as an eventual threat to financial stability.*

Whilst recognising the further work still to be done by Council and Parliament the EACT also has concerns about some of the proposals contained in the ECON report. These reflect ideas previously debated in Parliament but rejected by the Commission in its preparation of the proposals now being debated. The most controversial of these ideas are:

- *A move from the 'issuer pays' to an 'investor pays' model: this is likely to impact adversely the ratings coverage of mid-sized companies, as well as reducing rather than increasing market competition.*

[1] COM(2011)0747 – C7-0420/2011 – 2011/0361(COD)
[2] 2011/0361(COD)

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- *Limitation on a CRA's market share for any given asset class: this raises issues both of practicality and of consistency in the application of CRA's methodologies*
- *A ban on CRAs producing 'Outlooks' for sovereign issuers: this would result in more rather than less market volatility.*
- *A move to avoid the use of the word "opinion" about credit ratings: this fundamentally fails to recognise that ratings are not determinative but rather statements of opinion about the future.*

Commenting on the regulatory proposals, EACT Chairman Richard Raeburn said:

"It is of great importance that in developing proposals for further regulation of credit rating agencies, Brussels tailors its approach so that it both addresses the very real failings of ratings in certain specific areas and recognises how real economy issuers use ratings to support access to capital to fund growth.

Aspects of the Commission's proposals – such as the requirement for mandatory rotation – will neither encourage the agreed objective of greater competition nor improve the quality of ratings themselves.

I regret that ideas that had in our view correctly been rejected by the European Commission are being raised again but confident that ECON, Parliament and Council will be alert to proposals that could seriously jeopardise the positive role CRAs play in the real economy.

The EACT strongly encourages Parliament and Council to take careful account of how ratings help encourage capital formation and growth in the economy; and thereby to ensure that further regulation concentrates on the past ratings failures, without making an assumption of systemic failure of ratings quality, oversight and competition".

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The European Association of Corporate Treasurers

Interest Representative Register ID: 9160958318-89

Credit Rating Agencies

Proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No 1060/2009 on credit rating agencies

This briefing note has been prepared by the European Association of Corporate Treasurers[1] (EACT) in response to the European Commission's proposal for a Directive (COM(2011) 746/2) and a Regulation (COM(2011) 747/2), as well as the Draft Report by the European Parliament (2011/0361(COD)) on the regulatory proposals.

Executive Summary

The EACT and treasurers working in companies across Europe have a keen interest in the availability of high quality credit ratings. Our members and their companies use credit ratings to assist in raising new borrowings and also as an information source in their dealings with financial institutions and other businesses generally. With solicited ratings the issuer provides confidential information on business plans and strategy to the credit rating agencies (CRAs). This is assessed by the CRAs and reflected in their rating decisions and in their reports, without disclosure of confidential information. The publication of credit ratings is an important mechanism in the provision of good quality information to the markets.

As with all new financial regulatory proposals it is vital to consider any harmful effects on the real economy. In the case of the new CRA proposals the EACT believes that there could be significant unintended consequences that lower the quality and richness of the information conveyed to the market through ratings. Such a reduction in quality (and reputation) of ratings may lead issuers to cease to value being rated and the EACT considers this will further reduce the flow of good credit information to the markets.

The EACT believes that the ***proposals for mandatory rotation*** of CRAs are both impractical and remove the continuity of experience in the CRAs, as well as the ability of users of ratings to assess the reliability and consistency of ratings over an extended period. A "forced" rotation may bring in a ratings firm without the necessary experience and reputation to prepare sound analysis; in addition, issuers will not want to disclose confidential information to a CRA they have not learnt to trust.

The ***proposal for ESMA oversight of methodologies*** creates the danger that the range of different approaches to credit analysis will be lost, leading to the feared reduction in the quality of market information. The CRAs' different approaches (such as the Moody's combination of probability of default and loss given default into one rating, whereas S&P publishes separate ratings for each aspect) play a part in building financial stability through the data they offer to the users of ratings.

The EACT calls on the European Parliament and Council to take into account the risk of damaging the value and usefulness of credit ratings for end users through the proposals now being considered. The EACT is concerned about the implications of some of the additional issues raised by the draft report of Rapporteur Dominici for the ECON Committee of the Parliament.

[1] Background information on the EACT and contact details are provided on the last page of this note

EACT briefing

The EACT is concerned by the addition of a number of new regulations — both finalised and nearing finalisation — in areas that directly impact treasurers' activities: Basel III for banks, Solvency II for insurers, new regulation on derivatives and CRAs. Insufficient attention has been given to the harmful effects of these regulations on the real economy, particularly in the field of corporate funding.

The EACT underlines to regulators that corporates (the real economy), while they are directly and negatively impacted by the new regulations, were not at the origin of the financial crisis; and in the case of the CRAs, no significant incident has been identified the past years giving legitimate concern about the ratings of corporate issuers.

Treasurers have had a long-standing interest in improving CRAs' operating behaviour. The French, English and American treasurers' associations issued their own Code of Standard Practices for Participants in the Credit Rating Process in March 2005. This work was substantively included in the code principles subsequently published by the International Organisation of Securities Commissions (IOSCO).

Companies make use of credit ratings in a variety of ways:

- to assist in any funding from the bond and loan markets;
- to assess the risks from taking on exposure to financial counterparties through investments, risk management and other transactions;
- to help assess and manage the business risks arising from trading with their customers, suppliers and business partners; and
- in the case of sovereign ratings, to reflect these in the decisions referred to above and as a significant part of strategic planning activities etc.

The process of gaining a solicited credit rating involves the issuer in providing the CRAs with confidential information on business plans and strategy and allows them extensive contact with management. This information is digested by the CRAs and reflected in their ratings levels awarded and in their reports but without disclosing confidential information. It is thus an important mechanism for providing good quality information to the markets. The EACT is concerned that some of the measures in the proposed regulation will threaten the quality of that information flow.

It is against this background that the EACT expresses here its views on the draft amendment to CRA regulation currently before the European Parliament and the Council, focusing only on the more important elements.

The EACT believes that certain measures under consideration are going in the right direction. For example:

- the importance and treatment given to actions on rating "outlooks'';
- the incentive given to market participants to conduct their own analyses, using ratings as one consideration rather than relying solely on the opinions of CRAs;
- the requirement that references to credit ratings be removed from regulations where practical;
- the requirement for two ratings from two CRAs for structured products, thus recognising the real and necessary distinction between the rating of a company and the rating of structured products created and distributed by banks/financial intermediaries;
- the requirement for greater transparency on CRAs' invoicing; and
- the need to clearly identify unsolicited ratings.

However the EACT believes that other measures would have material negative consequences on the rating of corporate issuers:

1) The most questionable element for the EACT is the compulsory rotation of CRAs every three or six years, according to whether the rating is established by one or two CRAs. Such a rule is inappropriate in the context. Furthermore, it fully neglects the necessary commitment that both the issuer and the CRA must make in solicited ratings to ensure proper understanding not only of the issuer (which goes without saying) but also and especially that of the industry, the position of the company in its sector, its internal policies (particularly financial and risk management) and so on. This proposed rotation disregards the value of the necessary continuity in the monitoring of the company and of its business sector.

For investors that continuity is important too so that they, and others, can monitor the track record of the CRA's views over an extended period of time and over the whole life of a long term bond.

The EACT does not believe that this extension of the principle of rotation (which European regulations have already implemented for credit analysts within CRAs) will enhance competition within a sector, because issuers are only willing to pay for ratings that are recognised internationally. If the rotation principle forces the use of a CRA lacking suitable expertise or a recognised reputation, issuers will simply have to decide if the rating has real value or whether they may elect to cease having a solicited rating.

Rotation also ignores the different methodologies used by different CRAs and differences in the ratings. For example, some CRAs publish default ratings and separate recovery-given-default ratings, while others "notch" their default ratings to take account of different recovery probabilities.

Lastly, the proposed principle that a CRA must hand over its files to its successor at the end of its contract encourages a view of rating as a perfectly routine process. This is unfair and can only negatively impact the quality of this same process. CRAs are given highly confidential information. If there is any risk that this information has to be passed on to an unknown replacement CRA issuers will cease to disclose that information in the first place. If this happens then ratings become mere public information ratings and lose much of the forward-looking insight possible now.

2) The EACT is also concerned about the proposed ESMA approval of methodologies used by CRAs. Transparency of rating methodologies is already good. CRA methodologies are widely publicised and are accessible to all market participants; any modification of these methodologies is subject to an open consultation process prior to being implemented.

If rating methodologies have to be approved by ESMA there is a danger that a degree of uniformity of approach will be introduced; this will result in a loss of crucial information to the markets. At the moment the fact that methodologies differ means that each rating brings out different subtleties on the business and credit risks of the issuer. Understanding why different CRAs give different weights to certain characteristics provides a deeper understanding of the issuer's credit.

It is valuable for investors and other market participants that CRAs are able to use the same general methodologies worldwide. Today this is the case. This will cease to be possible if official approval is required for methodologies in Europe. The EACT fears that involving a public regulatory body could diminish the perception of ratings concerning European issuers, on the grounds that they were established using different/regulated methodologies.

3) Imposing civil liability on CRAs is another cause for concern. The EACT understands the need to address cases of glaring and manifest errors in CRAs' compliance with regulations. This is best dealt with administratively. The EACT would oppose expanding the notion of liability, keeping in mind that CRAs are not auditors and neither are they investment advisors nor credit insurers. Imposing an excessive and wide liability would dramatically increase the cost of ratings because of the increased capital requirement (insurance, itself expensive, will probably not be available in sufficient quantity). This increase in cost would discourage issuers from seeking ratings, thus depriving the market of valuable information and opinions.

It is proposed in the draft Regulation that the burden of proof is changed, so that the CRA will have to prove it did not commit any infringements alleged against it. This opens the CRA to potentially vast expense of rebutting frivolous claims, the cost of which will inevitably be borne by issuers in the fees they pay. Reversing the burden of proof is a violation of principle that should only be made in the most difficult cases and with the strongest justifications; we do not see such justification here.

Furthermore, while regulators properly wish to open the sector to competition, the proposed measures on liability would have dramatically the opposite effect, potentially limiting the appetite of possible new entrants.

The EACT calls on regulatory authorities to take into account that fact that solicited corporate ratings, for which the issuer invests time and financial resources, should enjoy uniform quality and perception on all markets. There is considerable risk that excessive or ill-adapted regulation could lead markets to consider the ratings of European issuers with suspicion. Furthermore, as Europe moves towards decreased financial intermediation and greater reliance on capital markets, the imposition of greater requirements on CRAs can only make the rating process more expensive and time consuming, thus preventing smaller companies (including SMEs) from seeking ratings.

Additional comments on Rapporteur Domenici's draft report for ECON

We have seen the draft report of Rapporteur Domenici and we make some additional comments below on four points within the proposed amendments in that draft.

1. Amendments 2 (to Recital 6) and 27 (to Article 6) seek to move to a wholly "investor pays" business model for CRAs. The EACT believes that the investor pays model is likely to result in reduced coverage of companies – especially of sub-investment grade companies and of mid-sized and smaller companies. Such a move may tend to reinforce the dominance of the largest CRAs, limiting the growth of real challengers. Investors would need to subscribe to the incumbents because of their wider coverage. Investors are likely to supplement that only with small, specialist CRAs. Historically the shift to "issuer pays" was in part because of the need for wider coverage, as companies were obliged to turn to debt capital markets with the banks' capacities becoming less adequate.

2. Amendments 3 (for a new Recital 7) and 30 (to Article 6) seek to limit a CRA's market share to 25% of an asset class. Unless a CRA has comprehensive coverage it is more difficult to assess the quality of its ratings. Combined with the proposed rotation, this makes for a very fragmented ability to track the performance of a CRA applying its full methodology. The EACT sees great difficulty with the mechanics of such a limitation – for instance, how rationing of a highly-demanded CRA's services will be determined. But it may have the advantage that in a fragmented rating market the arguments for other regulation of the business to prevent abuses largely drop away, enabling an important simplification of regulation.

3. Amendment 9 (for a new Recital 29) proposes to prevent CRAs from issuing 'Outlooks' for sovereign issuers. The purpose of credit ratings is to reduce, in part, the informational inequalities between issuers and investors and between different investors. While CRAs are relatively slow response indicators, this is mitigated by the publication of "outlooks" ("stable", etc.) and the ability to put issuers on "credit watch" (perhaps with "positive" or "negative" expectations). It is important to remember that ratings are about the necessarily uncertain future – not the possibly better understood past. Any commentary issued by the CRA at the time of changing or affirming outlooks adds further information. The alternative is to force CRAs to change ratings more frequently and possibly unnecessarily. The EACT believes that the combination of effects would be to make markets more volatile. This would also damage corporate issuers, given the relationship between sovereign and corporate ratings.

4**. There is a move to avoid the use of the word "opinion" about credit ratings** (for instance, amendment 18, amending Article 1). Credit ratings are not determinative – they are merely statements of opinion about the future. The EACT believes that anything that encourages users to give too much weight to CRA views by using more positive language should be avoided.

The European Association of Corporate Treasurers

The EACT is a grouping of 20 national associations representing treasury and finance professionals in 19 European countries. We bring together in excess of 8,500 members representing approximately 5,000 companies located in Europe. We comment to the European authorities, national governments, regulators and standard-setters on issues faced by treasury and finance professionals across Europe. We seek to encourage the profession of treasury, corporate finance and risk management, promoting the value of treasury skills through best practice and education.

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France, Article: Who Watches the Watchers ? The Role of the Rating Agencies in the Crisis

By Anwar HASSOUNE, December 22, 2011, original Contribution for the Centre d´étude et de prospective stratégique, CEPS, article provided by French IAFEI Member Institute, DFCG, February 2, 2012

Anwar Hassoune, entrepreneur, head of enterprise**,** member of the board of management of an African rating agency, and professor of applied economics

Rating agencies and the advent of the crisis

The current financial crisis is the result of many complex interactions that have crystallized around the U.S. housing market, then spread to other assets. At the root of this crisis, there are generations of financial innovations capable of handling endless monetized assets, less and less representative of a creation of real wealth. The most revolutionary of these innovations was the securitization. Securitization is to make liquid, in the form of securities, financial assets that are not *a priori* liquid, like a mortgage loan. The securitization process involves the use of an entity *ad hoc* (a *Special Purpose Vehicle* or SPV, called securitization fund under French law), without capital, but with a balance sheet: on the assets side, credits (not liquid and characterized by a certain level of risk) and on the liabilities side, bonds, traded in a market (highly liquid and characterized by a variable degree of risk).

But this processing activity is impossible without the contribution of major rating agencies. It is them who rate the obligations which “ come out ” of the SPV: they judge their relative risk. But when risky credits and of poor quality are securitized, and if the latter ones suffer a shock, then it is also what “comes out” of the SPV what suffers: the risk premiums on these bonds explode and their value collapses. One realizes that the pyramid of securitization is based on no solid foundation.

However, it is not accurate to say that the rating agencies have not responded to the crisis. They started to lower their ratings on the securitizations made starting in 2005, only 24 months before the outbreak of the subprime crisis. But no doubt, they had not taken the measure because of induced systemic effects. Above all, these cuts of notes resulted from technical correction, the market rate being a variable of the models used. So it was simply a mechanical reduction and not an own decision. Before and during the crisis, rating agencies failed in their mission: to produce a deep analysis and prospective of the economic situation.

The paradoxes of rating agencies

Moreover, the rating agencies themselves are plagued by many paradoxes. Their shareholders first: the three major rating agencies[1], that share the market, are all three owned by private capital. They must therefore obey to a logic of profit, including the 15 % return on equity after taxes.

To achieve these goals, agencies are encouraged to make the volume, while maintaining the highest prices possible. However, it is the issuers who pay for their rating score, and not the investors. Agencies are tempted to try to retain customers and for that, not to lower their rating score too abruptly. If we look more specifically at one of them, Moody´s, we find that its shares are listed on the U.S. market. The senior analysts of the agency are paid a fixed salary, a variable and stock options. This is a new incentive to encourage pure profit, in order for being able to exercise ones options in the best financial conditions, which leads to rate indulgently transactions with toxic securitization.

To prove their good faith and show their independence vis-à-vis external pressure of any of their clients, agencies communicate on the structure of their portfolios. They show that the dependence on "big customers" is weak, to say that no customer contributed enough to their turnover to threaten the financial agencies in the event of defection, not even of the government of the United States.

This presumed independence will not withdraw their concern to maintain margins at the top. To do this, agencies must produce a large number of opinions. And in recent years, before the bursting of the "subprime", the assessment of securitization has become the primary source of revenue for the rating agencies. Difficult to think that agencies have not been lenient for these ratings. On the other hand, agencies have had to cut costs and increase the average productivity of analysts. In this perspective, some agencies have rapidly increased the pace of work, by loading on analysts more and more credit cases. Others have engaged in a price decline, focusing on volume, and preferring to hire more junior analysts, and thus necessarily less experienced ones.

In all the cases, the quality of the analysis can only suffer. However, the ratings are not like other financial services, they participate in the "*fides*", that is to say, the confidence of the actors in relation to their financial system, the commercial banks and the central bank included. So that the quality remains the prerogative of the credit rating, analysts should not be permanently " nose to the grindstone ", but to have the means to gain height, distance, and holidays. They must have time to read, listen to Nobel Prize and return to the university.

A plea for a public rating agency

In fact, the activity of production of ratings is quasi an offspring of public service. Monitoring of credit markets is one of the missions of the regulation of bond financing. However, self-

[1] Fitch, Moody´s and Standard & Poor´s

regulation of markets has shown its limits. We must now rethink the role of rating agencies. We cannot impose on private shareholders to sacrifice margins for the public good, it is not their role or mandate that was given to them by the markets. In addition, there is not the question of nationalizing the existing rating agencies: the market needs them. But it is not about to let them dominate this activity without counterweight or safeguards. Therefore, it is time to see the emergence of a public rating agency, in that it would be owned by public capital.

Only the public actor has no excessive requirement in relation to the remuneration of capital invested. But so far, states are entities marked too ideologically and politically, insufficiently detached from economic issues. Therefore, the new public rating agency will necessarily be supranational, or owned by public supranational capital. The World Bank emerges as the perfect shareholder, and in particular its financing arm directed to the private sector, the International Finance Corporation (IFC). Already well rooted in fundraising, in development and in grants, the World Bank and IFC have long been highly seasoned in global eco-financial questions, and have long since rubbed themselves in multifaceted crises that shook the world for the past two decades of deregulation.

One could imagine a rating agency totally controlled by the IFC as a shareholder, but running on a system similar to that of the private sector. Its headquarters would be based in the City of London, and would rely on the tight territorial network of the World Bank in the world. Of course, the financial activities of the IFC would be completely separated from its rating business, and this, under the supervision of a team of inspectors from the World Bank. Without seeking excessive profits, analysts of this new agency could seek to take 2 or 3 times fewer cases than in the private sector agencies. Training budgets and recruitment would be relatively more important to ensure both the maintenance of a high degree of competence and also of the diversity of talents.

The project of a public rating agency responds to common expectations yet latent. In economics, as in any other form of human interaction, actors need direction, that is to say a direction clearly identified and with a minimum of symbolic meaning. The private rating agencies, constantly torn between the benefit of shareholders and the pursuit of analytical grade, are poorly able to reconcile these conflicting objectives. In the middle stand the analysts, often frustrated, always tired. If the community of world public can help them to provide to us this service, then why should we deprive ourselves of this ?

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New year, old problems – Europe's sovereign debt crisis

Speech to the International Bankers' Club
in Luxembourg

Monday, 06 February 2012

– Check against delivery –

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1 Introduction

Ladies and Gentlemen

Thank you very much for your invitation. I am delighted to have the opportunity to speak to you today at the International Bankers' Club. As you will know the central banks of Luxembourg and Germany work closely together and exchange views regularly – this is why I am here today. Even at the start of a new year, we are still facing the same old problems: we are battling a crisis which is now in its fifth year and has reached its fourth stage.

The first stage was the subprime crisis which struck the US real estate market. At its heart were those financial products which spread the risks stemming from US housing loans all over the world. The loss of confidence within the international financial system following the Lehman Brothers bankruptcy

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and the subsequent global economic crisis mark the second stage. The third stage has been the ongoing European sovereign debt crisis, which became visible to the whole world in Greece in May 2010. It was initially perceived as a problem of what is known as the “euro-area periphery”. Now, in the fourth stage of the financial crisis, however, it is no longer limited to these countries.

The sovereign debt crisis, unfortunately, has now spread to the core of the euro area. This was made painfully clear to us once again in the middle of last month. On the 13th of January, Standard & Poor’s downgraded nine euro-area countries. However, I do not want to join the chorus of criticism against the rating agencies. Those who would pin the blame on the agencies are confusing cause and effect. The agencies are merely the bearers of bad news, and “shooting the messenger” is not only unfair – it does not solve the problem, either.

I would therefore like to take a closer look at the causes of the bad news which has been hitting us in waves since the outbreak of the sovereign debt crisis. There are three questions I would like to examine more closely. *Firstly*, what actually caused the crisis? *Secondly*, how do we contain the crisis? *Thirdly*, where do we want to go with our monetary union in the long run?

2 The causes of the sovereign debt crisis

Severely unhealthy economic developments had apparently been brewing in several euro-area countries for many years. These included, most notably,

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excessive lending, asset price bubbles and a loss of competitiveness. These structural problems were the breeding ground for the sovereign debt crisis.

The actual weak link at the launch of our monetary union, however, was the combination of a single monetary policy and a decentralised fiscal policy. Monetary policy, as you know, is set at the European level – by the European Central Bank. On the other hand, responsibility for fiscal policy rests with the individual member states, i.e. at national level. However, in a currency area where fiscal policy is decentralised, the member states have a relatively large incentive to borrow. If a country accumulates more and more debt, it does not face the consequences by itself as these are spread across the entire currency area – for example, through rising interest rates.

The founding fathers of our monetary union therefore created a framework of rules to prevent, or at least correct, such unsound developments: the Stability and Growth Pact. This was intended to keep national fiscal policies in check. One of its tenets was that annual government budget deficits may not exceed 3% of gross domestic product. The penalties for breaching this deficit limit could be escalated all the way to financial sanctions.

There is one more key building block in the edifice of the euro area alongside the Stability and Growth Pact: the no-bail-out principle, which forbids member states from assuming liability for the debts of other member states. The guiding principle of monetary union was therefore individual responsibility: member states' individual responsibility for the consequences of their policies and financial market agents' individual responsibility for the consequences of their investment decisions.

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Despite these rules, however, member states' borrowing has not been effectively contained. Why not? Mainly, because the rules of the Stability and Growth Pact were not only circumvented but even stretched to its limit. This was possible thanks to a crucial flaw in the system: countries that violated the deficit limit were not automatically punished. Instead, the other member states voted on a sanction. This, of course, encouraged an attitude of "I won't punish you today if you don't punish me tomorrow."

Looking back, it must also be noted that the financial markets did not exert the desired disciplining effect on fiscal policy. Investors turned a blind eye to the misbehaviour of some member states for far too long. By the time the interest rates on government bonds started to rise, the damage had already been done.

And, faced with that situation, it is extremely difficult to uphold the no-bail-out principle. As I'm sure you will remember, no member state is allowed to assume liability for another's debts. This principle was, at the very least, stretched quite a long way when assistance was granted to Greece. That, however, was not entirely unjustified: the euro-area countries are now so closely integrated that problems in one country can spread quickly to the entire euro area in a phenomenon known as contagion. When push came to shove, it appeared necessary to help other member states. And that is quite understandable in the short term. However, in the long run it is dangerous if countries with a debt problem can expect to receive help no matter what. This risks triggering a dangerous spiral of more and more assistance and less and less confidence in the will of the affected countries to mend their ways.

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3 Routes to a stable monetary union

And such a loss of confidence is just what we are facing right now. The public, and also the markets, have lost faith – in politics, but also in the architecture of our monetary union. The question is: how do we go about restoring confidence?

Let me begin by stating clearly what won't work. Setting up larger and larger rescue packages is not the way to instil lasting confidence. This strategy ultimately has its limits – be they political or financial. And the proposal of circumventing financial limits by printing money is dangerous. Of course the resources of a central bank are, in theory, nearly without limit. Using them to finance sovereign debt, however, does not solve problems but, instead, creates new ones. Such an approach would endanger the key foundation of a stable currency: the independence of a central bank dedicated to price stability. This would throw overboard the very things that need saving.

And, as I said earlier: money can't buy confidence. Even the largest rescue packages can provide no more than a temporary reprieve. Time, in fact, is the only thing you can buy. But this bought time must actually be used to eliminate the root causes of the crisis. And this leads us to three key steps that the Bundesbank believes need to be taken.

Firstly, government budgets need to be put back in order. This goes for all euro-area countries but is particularly the case for those countries which have put off the necessary adjustments time and again. This is where the critics jump in to say that excessive saving damages economic growth. However, I

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think this is too short-sighted. Of course fiscal consolidation normally dampens economic activity. But there is no way the present situation can be described as “normal”! In fact, doubts about the sustainability of government finances are probably themselves a considerable drag on growth. The critics are right about one thing, though: consolidation alone is not enough to solve the problems we are facing.

Secondly, the countries affected by the crisis therefore need to conduct structural reforms in order to become more competitive and to promote economic growth. Such reforms are, naturally, difficult and painful. Ireland has shown, however, that they are possible, and the German experience has proven that they pay off in the long run.

And, *thirdly*, we need a stable architecture for our monetary union. Instead of constantly patching up the results of fiscal policy mistakes and insufficient implementation of the Stability and Growth Pact, the framework of monetary union has to be changed in a way such that sound fiscal policy is also truly guaranteed in future. In my view, there are two options open to the euro area: either we can return to the founding principles of monetary union agreed at Maastricht, or we should venture the step towards a deeper European integration which also includes fiscal policy.

3.1 Returning to the founding principles of monetary union

Regarding the first option – returning to the founding principles of monetary union – I do not share the frequently voiced fear that the current framework is

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unsuited to monetary union. Nevertheless, it does require considerable adjustment. There are three key points here.

Firstly, the Stability and Growth Pact needs to be given “teeth”. In particular, stronger automatism is needed to penalize breaches of the deficit and debt limits.

Secondly, the no-bail-out principle needs to be reinforced: no member state should be permitted to assume liability for the debt of another member state. Financial market investors will only punish bad fiscal policy behaviour promptly if they expect to lose their money.

Thirdly, the euro area needs a permanent crisis mechanism. Recourse could be taken to this mechanism if a crisis erupts and financial stability throughout the euro area is at risk. However, there are three important aspects to note: assistance to individual countries must be tied to strict economic and fiscal policy conditionality, it must only be granted with appropriate interest rate premiums, and private-sector investors have to bear their losses themselves in the event of a default.

In view of these pressing needs, a “fiscal compact” was agreed upon at the EU summit last week. This compact includes the introduction of debt brakes which should be firmly enshrined in national law. At the same time, the Stability and Growth Pact will be enhanced to be better protected from political influence in the future. Whether these decisions represent a major step forward remains to be seen. As happened before, the initial agreements seem to have been watered down during the negotiation process. The rules regarding the

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debt brakes leave significant room for interpretation, and their application and enforcement will not be monitored at the European level. It seems that the new version of the Stability and Growth Pact might not be followed too strictly at the European level, either. Altogether, the latest decisions are not entirely convincing.

3.2 Deepening European integration

Besides strengthening the existing framework of monetary union, there is an alternative route to stabilising the euro area. This would involve deepening European integration. However, it would not necessarily also mean the wholesale transfer of fiscal policy from national to European level. National parliaments could retain their independence in deciding on revenue and spending; European involvement would only affect borrowing and indebtedness if limits are breached. So what form could this involvement take?

It would be important to set strict deficit and debt limits at the European level for national budgets. These limits would then apply at all national levels. In Germany, for example, this includes federal, state and local government and the social security systems. The European rules would have to be combined with strict powers of intervention as this is the only way to make them enforceable.

But it has to be crystal-clear: any member state in breach of the predefined deficit and debt limits would lose its fiscal policy sovereignty. Ultimate budget-setting authority would therefore no longer rest with national parliaments but at the European level.

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In this area, however, the latest EU summits have made little headway. The adopted “fiscal compact” does not provide for intervention in national fiscal policy even if a country repeatedly breaches the rules. This means the “fiscal compact” is not the same as a true “fiscal union”. If, for instance, Eurobonds were to be issued now, there would be a mismatch between liability and control: all euro-area countries would be jointly liable for the debts of other euro-area countries but would not be able to keep them in check. However, in this framework, mutual assistance must be granted only as a last resort, must be strictly conditional and must involve considerable interest rate premiums, in order to give countries an incentive to balance their government budgets.

3.3 Financial market reform as a necessary addition

National fiscal policymakers are ultimately responsible for convincing market participants to invest in their sovereign bonds. The recent past has served as a painful reminder that the status of sovereign bonds as a de facto risk-free asset has to be defended time and again. And rightly so: the only way to get governments to live within their means is if the financial markets reward good fiscal policy and punish bad fiscal policy.

However, in order to have a disciplining effect, the financial markets need a firm set of rules – as was made abundantly clear by the crisis. And significant progress has already been made in adapting the rules. The reform of the capital framework, which will improve the quantity and quality of banks’ capital and thus their capacity to absorb losses, is certainly a particularly welcome development. Increasing the amount of losses the banks’ investors are able, and required, to take, reduces the danger of taxpayers once again having to foot

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the bill. The phenomenon of systemically important banks, however, also shows that Basel III is by no means the final step. The internationally agreed rules for dealing with the “too-big-to-fail” issue now have to be implemented quickly – and in an internationally consistent manner. The oversight and, if necessary, regulation of the shadow banking system remain atop the reform agenda.

The laundry list of regulatory reforms continues to be very long, and its details are often so complex that it is difficult to explain to the general public. This opens the door to populist calls for seemingly simple solutions – such as a financial transactions tax. We at the Bundesbank are of the view that, if at all, such a tax would have to be introduced at least in all major financial centres.

Looking at the financial markets and their regulation, however, I would like to mention one more thing. The sovereign debt crisis is shining a new light on a commonly held assumption, namely, that crises are caused by unfettered markets and can be avoided only by giving the state more space. However, the sovereign debt crisis has shown quite clearly that even sovereign debtors can fail.

Of course, the crisis has opened our eyes to a blind faith in the market that has sometimes prevailed; however, statism and dirigism are, by no means, the right path to take. Instead, I suggest we return to a founding tenet of the social market economy: individual responsibility. Those who take risks must also face the consequences. Attaching more importance to reviving this principle would represent major progress – including with respect to the sovereign debt crisis.

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4 Conclusion

Ladies and gentlemen, dear members of the International Bankers' Club, I have touched upon various aspects which I believe to be essential for overcoming the sovereign debt crisis. At the EU summit last week, policymakers decided to adopt a "fiscal compact" designed to strengthen, and in some cases go beyond, the Maastricht Stability and Growth Pact. This is, in principle, a good first step, but it has yet to prove its usefulness and effectiveness in "everyday use". In any case, the Bundesbank will not cease to call for the compact to be implemented in a manner which is conducive to safeguarding stability. In this endeavour, we hope for your support.

* * *

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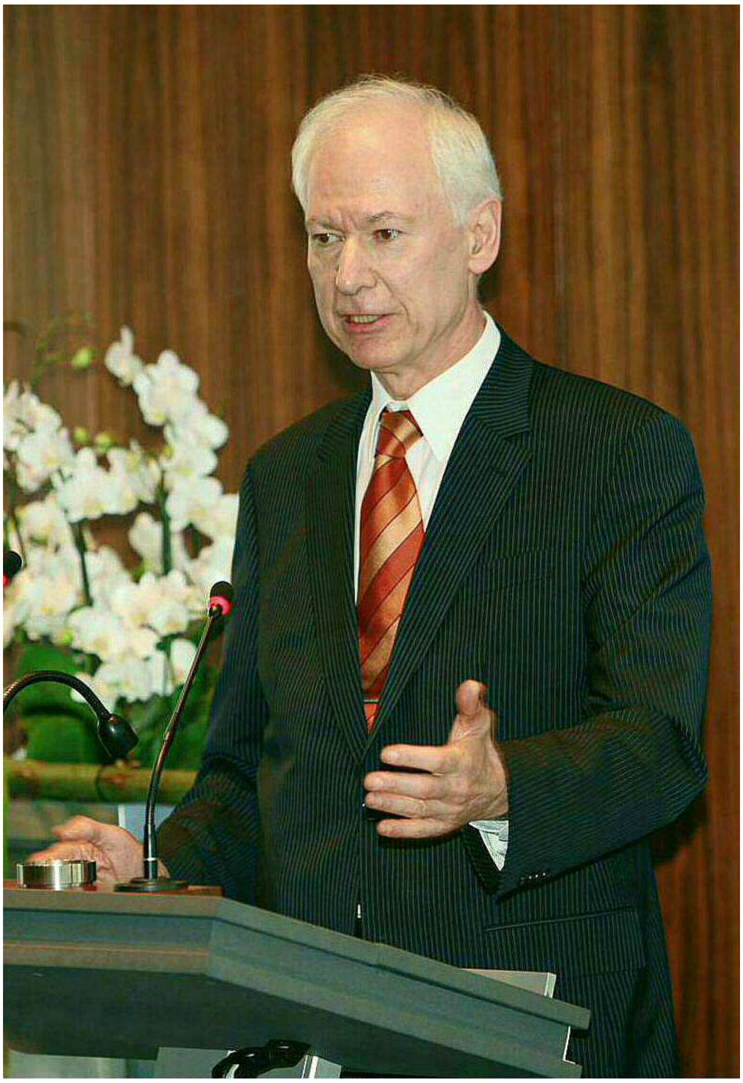
Germany, Article: **Eurobonds Extend the Crisis, Instead to Resolve It**

The Point of View of:

Franz-Christoph Zeitler,

from 2006 to 2011 Vice President of the Bundesbank, the German Federal Reserve Bank



Would one, after fixing the exchange rate, also unify the interest rate for government bonds - as this is attempted with so-called Eurobonds, with all their variations - then this would lead, over time, only to the point, where distrust would express its effects in other market data.

So, and as a consequence, one would have to be afraid from pressure growing on the exchange rate of the Euro, with the resulting consequence of an increasing interest rate level and of higher inflation rates in the Euro area. With the introduction of Eurobonds, therefore, the present state indebtedness and balance of payments crisis of some states would turn into a crisis of the Euro itself.

The proponents often awaken the impression, Germany would thus have the “ key of the crisis solution“ in the hand, but would not want to hand it out because of avarice. Now, it must first of all not be a taboo, to speak about the financial and political consequences of this. If one estimates the interest rate of Eurobonds on the basis of average interest rates weighted with the GDP-shares of European government bonds, or with the return difference to bonds of the bailout umbrella EFSF, then there results an additional interest rate burden for Germany of 1.2 to 2.0 percent, which over time with a state indebtedness of 2.1 billion Euro results in an additional expense burden of 25 to 42 billion Euros. In this case - and different from the so far done transfers within the European Union - it would be a not transparent financial transfer, because a clear calculation of the additional costs through the Eurobonds would not any longer be possible, when German government bonds would not be issued any more, or when their interest rate would be displaced upwards through a higher liquidity premium.

In the long term even more detrimental than the financial and political consequences, would act the negative incentive effects of Eurobonds. Once the liability for indebtedness is socialised into a liability of the entire union as such, then the incentives for a sustained budget and household consolidation will evaporate quickly. The incentive, contained in market discipline, can also not be substituted by legal prescriptions for budget consolidation and structural reforms. The experiences with the Stability Pact have shown in an impressive way, that all attempts, to achieve budget discipline and structural reforms with legal prescriptions, are without success, when there are no strong economic incentives working in the same direction.

Now, the most efficient economic incentive, to regain market confidence by own achievements, is the ultimate consequence of an (orderly) state insolvency procedure. The rules for such an insolvency procedure, or better said solvency reestablishment procedure, are by now only existing in fragment form, for instance the introduction of debt restructuring clauses for all government bonds, which have been decided by the European State Government Heads for the Stability Mechanism starting 2013. Such rules would be overthrown, when the individual liability by States would be replaced by the liability of the entire Community. The participation of the private creditors, which is essential and central for the market discipline, would become pointless, when the debtor of the debt is not identical with the one who economically causes the debt.

Much too little light is cast on the long term effects of Eurobonds on the European unification process. Similarly, as like in the nineties, the original tandem measure between political union and the currency union has been cancelled and has not promoted the readiness to give away part of sovereignty in exchange for a genuine political union, in the same way the readiness, for an even more far reaching form of European unification and therewith further transfer of parts of sovereignty, would sink drastically, when the economic advantage of a political union, that is the participation in the creditworthiness and the credibility of Germany in the capital market, would have been achieved in advance, without giving away part of sovereignty. Eurobonds, therefore, are counterproductive in terms of politics for a unified Europe.

Next to the economic questions, counts the legal argument. The radiating power of Europe as an order and community for peace and freedom, is based on a large part on a commitment to abide to the law. This has always been the constituting essence of the great European Speeches. The introduction of Eurobonds would represent giving up the principle of the financial political individual responsibility, which is essential for the European Currency Constitution (Article 125 AEUV: " One Member State is not held liable for the liabilities of….. other Member States "). This, by the way, holds true for all variations of Eurobonds introduced into the public discussion, also so-called AAA – Bonds, to the degree that is comes to a liability, externally, over and above the own national share.

Also, and in interpreting the German Constitution, the Federal German Supreme Court has stated in its " Greece – Decision" of September 11, 2011, that "contractual legal Mechanisms, which result in a taking over of liabilities for political decisions of other states", are not compatible with the budget privilege of parliament, if not explicitly in each case approved by the Federal German Parliament, the Bundestag.

Responsible for translation: Gefiu; translator: Helmut Schnabel

Bankhaus Lampe

Government Debt Reduction Through Financial Repression?

December 2nd, 2011

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In many industrial nations, government debts in relation to nominal GDP have increased to such a degree by now that there is strong doubt about their sustainability. Thus, first priority for economic policy makers should be to put a halt to this development or to reverse it. As long as debt restructuring and haircuts are being left aside, the scenario of financial repression has the strongest leverage for the reduction of government debt. In this scenario, interests are kept at a low level through artificially induced demand for government bonds by central banks and financial regulatory authorities. This approach reduces refinancing costs for governments and ideally provides debt relief through negative real interest rates. The experiences of some countries after the World War II show that the long-term application of this strategy can be very successful. Even today, elements of financial repression are already in use - and their importance should increase in the future.

Debt sustainability often no longer exists

- **In the process of the escalating financial crisis and the Lehman insolvency in autumn of 2008, the budget deficits of many industrial nations have increased at a much higher rate than during previous years. As a result, government debts in relation to GDP also increased significantly. The problem is that by now, in some countries debts have reached critical levels or even exceeded those levels. In consequence, investors increasingly lose confidence in those countries with regard to the sustainability of their debt and their solvency.**
- **In published academic literature, critical levels of government debt are defined between 85% and 90%.[1] For example, government debt in 2011 is estimated**

[1] For *Cecchetti*, *Mohanty*, *Zampolli* [2011, p. 21] the critical level of government debt is at 85%, for *Reinhart* and *Rogoff* [2009, p. 23] as well as *Kumar* and *Woo* [2010, p. 21], who base their definition on the effect of high government debt levels on growth, the level is 90%.

to reach 88% in Great Britain, 84% in the European Monetary Union[2] and 102% in the United States. Compared to 2007, these figures reflect increases of 40, 22 and 40 percentage points, respectively. Thus, the government debt rose at a much higher rate than in the years prior to 2007. This development is the main reason for the ever expanding crisis over the last few years.

- **The critical level of government debt is an important indicator for policy makers. In order to minimise the risk of government default, ideally governments will implement precautionary economic counter-measures. However, many industrial nations missed that critical point in time. Since it cannot be the political goal to fuel the crisis of confidence through further government defaults, and thus potentially risk a negative impact on economic growth and the job market again, policy makers have to put a halt to rising debts. For the affected countries, the main question is what an efficient strategy for the reduction of debt would be.**

Pure inflation not the best cure

- **With respect to the reduction of the ratio of government debt and nominal GDP, we have analysed the three most obvious scenarios.[3] The goal of this analysis was to identify the best possible approach for policy makers to reduce debt during the evaluation period in consideration of the individual circumstances.**
- **In our basic scenario, we assume that the 10-year interest rate equals real GDP growth plus inflation; to simplify matter, we did not apply a risk premium. Our deflation scenario contains a declining price level compared to the same period**

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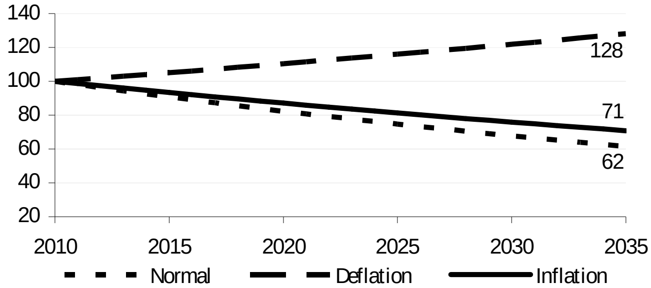
[2] Projection of government debt as percentage of nominal GDP for 2011: Greece 163%, Italy 120%, Portugal 102%, Ireland 108%, Belgium 98%, France 86% and Germany 82%.

[3] Assumptions for basic scenario: real GDP growth 2.0%, inflation rate 1.9%, primary balance 2.0%, 10-year interest rate 3.9%; assumptions for deflation scenario: real BIP growth 1.0%, inflation rate -0.5%, primary balance 0.5%, 10-year interest rate 2.0%; assumptions for inflation scenario: real GDP growth 1.5%, inflation rate 8.0%, primary balance 2.0%, 10-year interest rate 10%.

last year. For our inflation scenario, we assume a higher inflation rate as well as a higher interest rate. For all scenarios, we assume moderate economic growth and a surplus in the primary budget.[4] Both are absolutely essential factors for a reduction in debt; however, through structural reforms and budget consolidation, it will take time.

- The results are illustrated in the chart below. Based on a debt level of 100% for the analysed period, it looks as deflationary tendencies should not escalate. In this case, the value of money would increase and thus also the value of the government debt. Therefore, in our example, the debt level rises above the basic level to 128%. In contrast, the inflation scenario would ease the government debt; the level declines to 71% over the period. As further shown by chart 1, in the basic scenario, a decline to 62% would even be possible. Therefore, the basic scenario appears to be the superior solution.

Chart 1: Basic scenario enables efficient debt reduction



Source: Bankhaus Lampe

- However, we are in great doubt that this reduction of government debt can be achieved with the instruments (growth, inflation, primary budget) that are available in the basic scenario. This is mainly attributable to politics. In order to secure their re-election, politicians will avoid measures that are uncomfortable to the voting public. These measures include structural reforms, which typically also lead to certain negative impacts

[4] Primary budget = government revenues minus government expenses, excluding interest payments. Primary budget stated as percentage of nominal GDP.

(e.g. higher unemployment) and need time to reach their full effects.[5] Moreover, in the past several years, governments have often lost the election if they overdid measures of budget consolidation from a voter's point of view. Thus, policy makers will only take measures of structural reforms and budget consolidation for which punishment during the next election will be less likely. In the end, this will hinder the process of debt reduction.

- **Moreover, we believe that an intentional inflation is not feasible in the long term. In the short term, there should be success as a result of considerable growth of the nominal GDP. However, this requires that the financial markets would be caught by surprise by this strategy. In the medium term, risk premiums—and thus the refinancing costs—should rise markedly, as investors will demand compensation in refinancing auctions for the higher inflation rate. This is likely to have a negative effect on economic growth. Similarly unsuitable for debt reduction are also debt restructurings and haircuts, as these measures destroy trust and deter investors probably for the long term. If used, such measures should only be taken in small doses.**

Financial repression as driver for the reduction of government debt

- **Due to the reasons as outlined above, it does not seem very promising that the reduction of government debt will be achieved in the future through higher growth, pure inflation, a sustained budget consolidation and debt restructuring or haircuts. For *Reinhart* and *Sbrancia* [2011] the nominal interest rate will thus become the critical instrument for the process of debt reduction. In their approach to financial repression[6] it is the first priority that nominal interest rates are low and thus also decrease the refinancing costs for the countries.[7] As this can not be guaranteed in an**

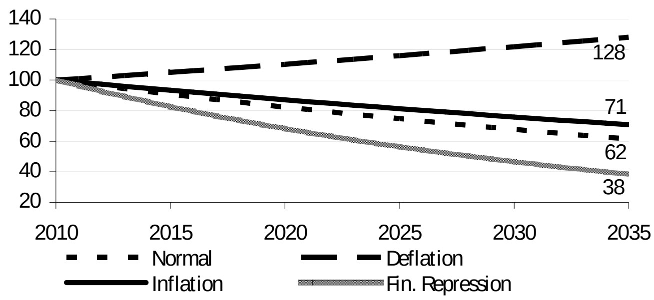
5 Example: Agenda 2010 in Germany.

6 For Pillars of Financial Repression see Reinhart and Sbrancia [2011, p. 6].

7 See Reinhart und Sbrancia [2011, p. 19].

environment of free movement of capital, the central banks will come into play. They can keep the base interest rates—and thus the money market interest rates—low and artificially suppress the long-term interest level through the purchase of government bonds. Alternatively or better complementary, the national financial regulatory authorities can pass laws that will coerce domestic investors and financial institutions into buying more national government bonds.[8] Thereby, the limitation of capital mobility prevents a capital drain. On balance, the measures available in a financial repression only treat the symptoms of the sovereign debt crises.

Chart 2: Financial repression is the superior strategy for debt reduction



Source: Bankhaus Lampe

- **As illustrated by chart 2, compared to the other scenarios, financial repression[9] provides the greatest leverage for the reduction of government debt. Due to the separation of interest rate and risk, the reason for this lies in the real interest rate, which, contrary to the other scenarios, is much lower. In an ideal situation, central banks accept an even higher inflation rate, which pushes the real interest rate in the negative range.[10] Thereby, the approach of financial repression is targeting the level of government debt and therefore focuses on the cause of the debt crises. As long as the higher rate of inflation is accepted by the general public, it will accelerate the**

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8 Several measures are taken into account (e.g. more favourable balance sheet accounting, tax exemptions). Generally, pressure on investors can be increased beyond Basel III.

9 Assumptions financial repression: real GDP growth 2.0%, inflation rate 1.9%, primary balance 2.0%, 10-year interest rate 2.0%.

10 Refer to Reinhart and Sbrancia [2011, p. 40]. The risk here is possible much higher inflation and economic turmoil.

process of debt reduction. This explains that ultimately, the government bond investor will foot the bill through hidden taxes. In this regard, *Reinhart* and *Sbrancia* [2011, p. 19] speak of a repression tax, which depends on the degree of regulation of the financial markets and the development of inflation. The advantage of this tax is that, contrary to revenue increases and expenditure cuts, the transparency is missing.[11] As the public is generally not aware of the tax, it is less "painful" than the direct impact of share price losses.

- The scenario of financial repression is not new. *Reinhart* and *Sbrancia* [2011, p. 37 ff.] demonstrate that, immediately after World War II, Great Britain and the United States applied this strategy successfully. From a scenario perspective, in addition to fortunate circumstances of higher growth at that time, these countries also allowed for a higher rate of inflation, regulated the financial markets and did not require debt restructuring or haircuts. At that time, Great Britain was able to reduce its level of debt over a period of ten years from 216% to 138%. In the same period, the United States achieved a reduction of its debt from 116% to 66%.

Financial repression is already underway

- The behaviour of important central banks today also includes elements of financial repression. The Bank of England and the US Fed have been tolerating for some time a markedly higher inflation rate of 5.0% and above 3.0%, respectively, and have kept their base interest rates at nearly zero for almost three years. In addition, the central banks have also continuously increased their purchased quantities of government bonds. Also the European Central Bank is keeping the base interest rate lower as it should be, considering the inflation target of close to but below 2.0% and an inflation rate of currently 3.0%. At the same time, the ECB is buying

11 Refer to Reinhart and Sbrancia [2011, p. 12].

European government bonds. In comparison to Great Britain and the United States, however, these measures have been applied to a much lesser extent. Therefore, the euro zone is currently going through a "light version" (which does not have a debt-reducing effect yet) of financial repression. Financial regulatory measures also play a role already in the aforementioned countries. In addition, real interest rates have been low for more than two years. The financial repression will increase further in our view as the availability of other instruments is insufficient for the above stated reasons.

- **The scenario of financial repression has an influence on our market projections for 2012.[12] As a low nominal interest rate level is the prerequisite for the controllability of sovereign debt (crises), we assume that both the Bank of England and the Fed will keep their base interest rates unchanged. The ECB should have lowered its base interest rate by January to 1.0%; our risk scenario (probability of occurrence 30%) contains reductions of the base interest rate to 0.5%. As there is no effective alternative to the purchase of government bonds, we expect the yield of the 10-year gilt and treasury to be markedly below 3.0%. Due to their safe-haven status, federal bonds should indirectly benefit from this approach and only suffer to a limited extent if the ECB starts purchasing unlimited quantities of government bonds in order to prevent a system collapse.[13] The negative real interest rate level, which investors continue to have to acquiesce to, also favours tangible assets (including stocks). In the absence of further haircuts, this does not rule out the purchase of nominal values entirely, as the real rate of return on government bonds in some (EMU) countries should remain positive also in 2012.**

References

[12] Refer to our *Capital Market Outlook 2012*, 22 November 2011.

[13] If the measures of the central banks are not sufficient to keep the general interest rate level low, the financial regulatory authority can pass regulations, which make the purchase of certain bonds mandatory. For example, if Eurobonds are introduced, they could be affected as well as the market could not be interested depending on the structure of the bonds.

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December 2, 2011
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Hongkong, Interview: **The Euro-States Must Convince the Markets**

Interview with Donald Tsang, Head of Government of Hongkong

Donald Tsang has gone through two economic crises in Asia. He warns, that from the Euro-Area could emanate a Finance-Tsunami.

Mister Tsang, at the World Economic Forum in Davos you said, for 2012 you are worried as never before. Why?

The crises in Asia 1983 and 1997 were restricted to the region. Now the disease of the Euro is affecting the entire world drastically quickly. This is frightening. And the consequences of today`s crisis can barely be estimated. In Hongkong we are barely affected by the state indebtedness. But our banks are working together with banks in the United States, and the customers are residing in Europe and America. If our banks would be hit, then all of Hongkong would suffer from it. In addition to that, we are seeing not only a collapse of the market, but of the state finances and the monetary policy in the European Union, as well as a balance of payments deficit in the United States, which will barely be resolved before the Presidential Elections - and therefore my anxiety of a Finance Tsunami.

What can Europe learn from the Asian-Crisis ?

A whole lot. First of all, one must, with one`s solutions, not in the first place convince oneself, or the voters, but the markets, that is the investors, the speculators, the hedge funds, and to the extent possible to exceed their expectations. What counts: The longer one waits, the higher will be the price to be paid. Secondly, one can eliminate the institutional deficits, which become visible in a crisis. However, one must not forget the people. To put it differently: All measures of austerity must be aligned with growth impulses, which create jobs. It is not only about "firewall" and money for the banks, but about hope for the people and their jobs, in order that they consume. Europe may be in budget difficulties, but safe jobs are important, and to this the markets pay attention.

How can jobs be created, when Europe is facing a recession ?

I do not know precisely the situation. In Hongkong, at the time, a credit crunch was threatening the small and medium sized companies .At the same time they had good products. So, we guaranteed the loans from the banks. At the end, the corporations survived, and with them the jobs. Bit it had to happen quickly, in order that the hope did not disappear. In addition, we helped the poorest in the population, for instance via rent subsidies in state owned apartments, or via subsidies for payments to schools. Through this, the level of consumption could be maintained. Today, Hongkong is stronger than ever. We have full employment, and the economy is growing. We have a AAA – Rating from the rating agencies.

Shall one best tell the full truth to the people ?

The people do not expect solutions overnight. But they should be fully informed about how the state indebtedness can be got rid of. Parallel to this, the small and medium sized corporations must be supported, because they create the urgently needed jobs.

Do you already feel the effects of the crisis in Europe and America ?

The consequences are already visible. Our exports to Europe and America are decreasing, even though not to the level of 2008. Fortunately, the exports to China are a certain equalisation. As a platform of trade in all of East Asia, we even have a good indication for the dangers of recession, which are threatening globally.

Is, in 2012, threatening a decrease of exports out of Hongkong ?

This could indeed happen. In the first quarter of 2011 they grew by 17 percent, compared to the previous year, in the second quarter they stagnated, and in the third quarter they decreased by 4 percent. This trend, I estimate might continue.

Is Hongkong moving into a growth dent ?

I can estimate the development only by way of several indicators, but it is well possible, that the increase of Gross Domestic Product is shrinking to 2 percent, versus 5 percent in 2011.

What do you think about Angela Merkels opposition against higher "firewalls" in the Euro-Zone ?

It depends on what the money shall be used for. It makes sense in the case of liquidity problems which are temporary. But "firewalls" cannot protect states, which basically are insolvent. The markets will tear down such walls. Also the Chinese Wall could not fend off all enemies. The solvent market economies must not be put in danger. For this reason, the case of Greece must be resolved quickly. The longer one is waiting with a solution, the sharper and deeper must be a debt cut. This, however, makes the agreement of the creditors more difficult. Speed is decisive, and the testing ground is Greece.

The Germans are also against Eurobonds. What do you say, is it right ?

They can be effective, if all agree. But they must go along with the discipline, to cure the economic, fiscal and monetary deficits. From the point of view of the markets, Eurobonds can be a reasonable means, to stop the further collapse of the system. The Euro-Zone is like a marriage. It must endure good and bad times.

The interview was made by **Jürgen Dunsch**

Responsible for translation: GEFIU ; translator: Helmut Schnabel

UBS

UBS *news*

UBS launches USD 2 billion Basel III-compliant loss-absorbing notes

Zurich/Basel | 22.02.2012 07:00 | Price Sensitive Information

Zurich/Basel, 22 February 2012 – UBS announced today that it is issuing USD 2 billion of subordinated loss-absorbing non-dilutive notes. The notes, which will qualify as tier 2 capital under Basel III standards and have a maturity of 10 years with an optional call at year 5, will pay a non-deferrable coupon of 7.25%. The loss absorption trigger is set at a 5% common equity ratio, with the ratio calculated under the prevailing regulatory regime, being Basel 2.5 until year end 2012, and "phased-in" Basel III thereafter until those new rules become fully applicable on 1 January, 2019.

The notes were offered in minimum denominations of USD 200,000 and were widely placed with private and institutional investors in Asia and Europe.

Group Chief Financial Officer Tom Naratil said: "Today's capital issuance represents an important step in our compliance with Basel III/ FINMA capital requirements and is a further proof point that we are delivering on our capital plans. The very competitive coupon of 7.25% for this 10-year benchmark-size offering reflects UBS's strong capital, liquidity and funding position. Today's deal marks the beginning of an issuance program as we build our loss-absorbing capital base to meet FINMA and the Basel Committee requirements for systemically important banks well in advance of the regulatory deadlines."

UBS AG

Please turn over

Comment: To the UBS Basel III-compliant Loss-Absorbing Notes,
an innovative and attractive financing and investment instrument

By Helmut Schnabel

The UBS Loss-Absorbing Notes have to be seen in the context of the Basel III regulation, the even tighter Swiss Financial Market Supervisory Authority FINMA regulations, and the even more ambitious targeted equity structure of UBS.

<u>**The BASEL III regulations** essentially require this, to be built up starting 2013, step by step, and until 2019 at the latest:</u>

a hard core capital, tier 1, common equity, of 7.0 percent,
also referred to as " Common Equity Tier 1 capital, CET1)
a total core capital, i.e. tier 1 plus additional tier 1, of 8.5 percent
a total equity capital, i.e. total core capital plus additional capital tier 2, of 10.5 percent

over and above this, an anticyclical equity buffer for systemically important banks, of between 0 percent to 2.5 percent, can be requested by the national regulators of individual countries

<u>**The Swiss Financial Market Supervisory Authority FINMA regulations, in combination with the Swiss Banking Law Amendment Too big to fail,** are more ambitious, to be built up starting 2013, step by step, and until 2019 at the latest:</u>

a hard core capital, tier 1, common equity, as per Basel III, of 10.0 percent
a total equity capital, , i.e. total core capital plus additional capital tier 2, as per Basel III, of 19 percent, **for systemically important banks**, also called Too big to fail (like, as an example, UBS)

<u>**The targeted equity structure, targeted by UBS**, is even more ambitious:</u>

A hard core, tier 1, common equity, as per Basel III, of 13 percent, to be achieved by 2013 under "phased-in" Basel III regulations

As per the UBS press release, the issued Loss-Absorbing Notes qualify as tier 2 capital under Basel III regulations. This issue therefore fills the pocket of tier 2 equity, which has to be filled beyond the total core capital, tier 1, common equity, of 10 percent under the Swiss FINMA regulations.

The loss-absorption trigger is set at a 5 percent common equity trigger, which means, if the common equity ratio of the bank due to ongoing losses decreases to 5 percent, then the bond is booked as a total loss to the investor and an offset to preceding losses at the bank. Obviously, the new bond holders of the bank do not expect such a situation to happen, and they rather look at the high and attractive coupon. Their demand for the bond issuance was so strong, that UBS went from the planned issuing volume of USD 1 billion up to the higher issuing volume of USD 2 billion. The bond was issued in tranches of USD 200.000,-. There were many investors from Asia and Europe. This issue is considered to be just the start of a series of such issues, to be made, in order to meet all aforementioned equity targets by 2019..

The Swiss Law Amendment of the Banking Law, for the purpose of the Regulation of " The Too big to fail " problem – area, was passed by the Swiss parliament on September 30, 2011, and enacted by the Swiss Bundesrat/ Federal Council on February 15, 2012, and becoming effective as of March 1, 2012.

The Loss-Absorbing Notes instrument is to be considered as an extremely innovative and attractive financing and investment instrument.

The Loss-Absorbing Notes financing and investment instrument is an impressive and convincing reaction of Switzerland, and of UBS, to the worldwide financial and banking crisis.

Sources: Basel III, Bundesbank/ German Central Bank, Swiss Financial Market Supervisory Authority FINMA , Schweizerische Eidgenossenschaft/ Confédération Suisse, UBS press releases

The Financial Executives Institute of Poland, FINEXA, joined IAFEI as new member, in January, 2012

In January 2012, the newly established Financial Executives Institute of Poland, FINEXA, joined IAFEI.

IAFEI has given a warm welcome to the Polish FINEXA Institute.

42nd IAFEI World Congress, Cancun, Mexico, November 14 to 17, 2012

IMEF, Instituto Mexicano de Ejecutivos de Finanzas, will organise and host this 42nd IAFEI World Congress.

On the occasion of this IAFEI World Congress, the next IAFEI physical IAFEI Board of Directors meeting will take place.

2013 IAFEI World Congress

Hosting member institute, and exact date, not yet determined.

2014 IAFEI World Congress, The Philippines

Hosting member institute will be the Financial Executives Institute of the Philippines, FINEX. The exact date has not yet been determined.