

## Quarterly Quiz 2009 Quarter 3

### Question 1

There have been calls for more regulation of all Over The Counter (OTC) derivative products since the financial markets seized up in late 2008. The regulation proposed has focussed on eliminating which of the following problems?

- (a) access to 'bespoke' risk management products was too easy for non-financial companies
- (b) non-financial companies were not competent to use OTC risk management products
- (c) unregulated trading of OTC derivatives by non-financial companies posed a systemic risk to the world's financial markets
- (d) unregulated trading of OTC by financial companies posed a systemic risk to the world's financial markets
- (e) don't know

### Answer

The right answer is (d) *unregulated trading of OTC by financial companies posed a systemic risk to the world's financial markets.*

*Data included in the ACT Paper "Corporate Concerns about OTC Derivative Regulation" shows that the non-financial companies' proportion of outstanding derivative trading is very small relative to the overall market. In fact, for CDSs, one of the derivatives most frequently cited as a culprit for the melt down, the non-financial companies' share is 1.7% of the market.*

*For reference the other shares for non-financial companies' derivatives are: FX 15.8%, interest rate 5.4%, equity-linked derivatives 11.3%.*

*These proportions do not appear to represent a systemic risk.*

*Corporate Concerns about OTC derivative regulation:*

*<http://www.treasurers.org/otcderivatives/euproposals/eactresponse>*

*Statistical data from which this is drawn can be found at <http://www.bis.org/statistics/derstats.htm>*

### Question 2

The EU has suggested that derivative counterparties should deposit margins to cover any losses on derivatives in the way that futures exchanges require margins against open positions.

The intention is that unrealised losses would always be covered by the margin held. Margins would be paid by one counterparty directly to the other.

Exporter PLC expects a Euro payment to arrive in 2 months. In order to remove any impact of exchange rate movements Exporter enters an OTC currency forward contract to sell the Euros on the expected date of receipt for the forward EUR/GBP rate of 1GBP=1.2 EUR. As the spot exchange rate changes between entering the forward contract and maturity, margins are payable between the two counterparties. After three weeks the rate has moved to 1GBP=1.1EUR.

Assuming margining is required which of the following best reflects this situation?

- (a) Exporter PLC is unaffected by the changing exchange rates.

- (b) Exporter PLC has a gain on the derivative and has received margin payments from the counterparty. These payments cannot be used within the business as they may need to be repaid if rates revert to previous levels.
- (c) Exporter PLC has a loss on the derivative and has made margin payments in cash to the counterparty. The company has suffered a cash shortfall now in order to preserve an exchange rate in the future.
- (d) Exporter PLC fears missing a margin payment with the result that its risk-managing derivative is closed out and it is left without any forward cover at all.
- (e) Don't know

**Answer**

*The right answer is (c) Exporter PLC has a loss on the derivative and has made margin payments in cash to the counterparty. The company has suffered a cash shortfall now in order to preserve an exchange rate in the future.*

*The move in exchange rate is to the benefit of Exporter PLC. Having taken forward cover the situation is now that the spot rate would give a gain over the forward rate and the derivative would show an equal and opposite loss. So Exporter has to pay cash out now – in equal and opposite amounts to any change the spot rate causes to its exposure. This seems sub-optimal.*

*The opposite situation where spot rates move against them, would see Exporter receiving margin payments. However, the receipts would not be useable because they may be “reclaimed” at any time as rates move. So – rates move for you and you have to pay cash now; rates move against you and you receive cash that you can't use.*

*Corporate Concerns about OTC derivative regulation:*

<http://www.treasurers.org/otcderivatives/euproposals/eactresponse>

**Question 3**

The IASB and the FASB have published a joint discussion appear on the presentation of financial statements. Which of the following describes the main proposal of the paper?

- (a) All financial statements will converge towards FASB standards
- (b) All financial statements will converge towards IASB standards
- (c) Presentation of all three main financial statements should emphasise 5 categories of financial activity: operating, investing, financing, taxation and discontinued operations.
- (d) Presentation of all three main financial statements should emphasise 3 categories of financial activity: operating, investing and derivative activity
- (e) Don't know

**Answer**

*The right answer is (c) Presentation of all three main financial statements should emphasise 5 categories of financial activity: operating, investing, financing, taxation and discontinued operations.*

*The discussion paper is the subject of an article in the September issue of the Treasurer by Standard and Poor's. The current plan for the convergence project calls for an Exposure Draft by April 2010 and a final standard later in that year.*

*The Treasurer September 2009 The Quest for Clarity by Sue Harding, European Chief Accountant, Standard and Poor's. <http://www.treasurers.org/node/5175>*

#### Question 4

The IASB has published the first exposure draft of its project to revise its IAS 39. The first draft addresses classification and measurement of financial instruments. The second exposure draft will address impairment methodology and the third will address the issue of hedging.

What are the revised classifications called?

- (a) Available for sale, amortised cost and held to maturity
- (b) Amortised cost and fair value through profit and loss
- (c) Held to maturity, fair value through profit and loss
- (d) Amortised cost and available for sale
- (e) Don't know

#### Answer

*The right answer is (b) Amortised cost and fair value through profit and loss*

*It is thought that the greatest impact will be felt by companies with financial assets, although borrowers will also be affected.*

*The Treasurer September 09 Technical Update by Martin O'Donovan p09*

#### Question 5

The Payment Services Directive (or the Payment Services Regulations 2009 in the UK) came into force on November 1<sup>st</sup>. In advance of this date most companies have received revised terms and conditions from their banks. The regulations give bank customers significant protection against liability for unauthorised transactions. The bank's revised terms may give notice of the bank opting out of providing this protection – which they are entitled to do.

There is a precedent in the US for determining how liability for unauthorised transactions may be shared between the bank and its customer. Which of the following fairly describes the precedent, to be found in the US Uniform Commercial Code?

- (a) If the customer can show that it has followed its own rules, then the bank bears the loss
- (b) If the customer can show that its own organisation did not cause the loss, then the bank bears the loss
- (c) If the bank can show that it accepted the instructions for the transaction in good faith then the customer bears the loss
- (d) If the bank can show that it complied with its own rules then the customer bears the loss
- (e) Don't know

#### Answer

*The right answer is (b) If the customer can show that its own organisation did not cause the loss, then the bank bears the loss.*

*Clearly, the internal rules of either the bank or the customer may or may not be adequate for the burdens imposed on them. Therefore the fact that inadequate rules were followed will never shift liability. However, it has been established under the US Uniform Commercial Code (UCC 4a) that if the customer can show that its organisation did not cause the loss then the bank must bear any losses.*

*This may well be a useful point for negotiating any revision to terms and conditions.*

*The Treasurer October 2009, Technical Update "Banking payments shake-up to go live" by Martin O'Donovan. For more information on the UCC4a go to <http://tinyurl.com/nyyggc>*

### **Question 6**

Earlier this year the Takeover Panel issued a Consultation Paper produced by their Code Committee. This followed a review undertaken in February this year and put forward proposals developed from the outcome of the review.

The ACT delivered its response to the consultation in July of this year.

What were the main proposals of the Consultation Paper?

- (a) There should be disclosure of the opening position in offeree and offeror securities plus disclosure of all dealing during the bid for all relevant parties.
- (b) There should be disclosure of the opening position in offeree and offeror securities and disclosure of all dealing during the bid for all relevant parties plus any securities borrowing and lending activity.
- (c) There should be disclosure of the opening position in offeree and offeror securities plus disclosure of all dealing and any long or short positions during the bid for all parties with 1% or more of any class of securities plus any securities borrowing and lending activity.
- (d) There should be disclosure of the opening position in offeree and offeror securities plus disclosure of all dealing and any long or short positions during the bid for all parties with 1% or more of any class of securities plus any securities borrowing and lending activity plus disclosure by any party with a significant short-only position.
- (e) Don't know

### **Answer**

*The right answer is (c) There should be disclosure of the opening position in offeree and offeror securities plus disclosure of all dealing and any long or short positions during the bid for all parties with 1% or more of any class of securities plus any securities borrowing and lending activity.*

*The final addition of the requirement to disclose a significant short-only position was the only suggestion from the review that the Code Committee chose not to include in their proposals. It was felt that the application of this would be rare enough to warrant omission at present.*

*The Takeover Panel Consultation Paper*

<http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/pcp2009012.pdf>

*ACT Website link to the Consultation Paper and the ACT response:*

<http://www.treasurers.org/takeovercode/response>