CPD Quarterly Quiz

Summer 2007
Answers

Question 1 Answer

The right answer is (b) 20% - 25% greater value

In fact the 20 year annuity is worth 23.4% more than the 14 year annuity.

The relevant formula is $\left(\frac{1}{r} - (1-(1+r)^{-n})\right)$ where r is the relevant rate and n is the number of years of the annuity. Using this formula (or, in fact using an Excel spreadsheet to list out each year separately) it can be seen that a 14 year annuity is valued at 9.295 times the annual payment while a 20 year annuity is valued at 11.470 times the annual payment. This is an increase of 23.4%.

Question 2 Answer

The right answer is (d) a statement of awareness, shareholding relationship and a disclaimer

Each of the other possible answers is mentioned as a feature to avoid. Advance negotiation regarding the content of the letter can be construed to constitute an awareness that the letter would create binding obligations. Similarly a statement of governing law is tantamount to a realisation that law was relevant to the letter. An Australian court has recently ruled that "It is our practice to ensure .." is the same as "We promise to ensure .."

The Treasurer May 2007 p11
www.treasurers.org/technical/resources/comfort.pdf

Question 3 Answer

The right answer is (a) Foreign exchange risks

This category of risks was rated 4 or 5 out of 5 by 53% of respondents. Next in perceived importance were strategic risks, at 47%, and financing risk, at 40%. Competitive risks were lower at 39%, reputational risks were lower still at 33%, while regulatory or government risks were the lowest of the sample here at 26%.

The Treasurer May 2007, The Risk/Return Trade Off by Roger Heine, Deutsche Bank, pp34-35.

Question 4 Answer

The right answer is (c) terms and conditions are comparable with those for a high yield bond

The term "covenant-lite" implies rather loose terms and conditions. In fact as John Grout (Policy and Technical Director at the ACT) has pointed out in letters both to the Select Committee and to the FT, the situation is rather more nuanced. John points out that the appropriate comparison is with high yield bonds rather than with conventional bank loans due to the difficulty of negotiating with many non-bank lenders. Specifically referred to are the restrictions on acquisitions and disposals and secured or priority borrowing as well as the restrictions on overall debt.

The topic of cove-lite loans is also covered in The Treasurer for July/August by Stephen Kensell of Allen and Overy.

ACT Letter to the Treasury Select Committee into Private Equity on Covenant-lite loans. http://www.treasurers.org/purchase/customcf/download.cfm?resid=2302

'Covenant-lite' loans are very far from being covenant-free, By John Grout FT July 18 2007, http://www.ft.com/cms/s/ea9c7524-34c7-11dc-8c78-0000779fd2ac.html

The Treasurer, July/August 2007, Heavy Issues over Covenant Lite, pp38 40, Stephen Kensell, Allen and Overy.

Question 5 Answer

The right answer is (a) To complete the issuance of Codes of Practice for trustees giving examples of best practice in a variety of different situations.

All ten Codes of Practice for trustees have already been completed and issued. The most recent came into force in January 2007.

The Pensions Regulator's website www.thepensionsregulator.gov.uk
The Treasurer, June 2007, Technical Update, p7

Question 6 Answer

The right answer is (b) unless otherwise specified, the relevant definitions are those in the updated version of the Definitions at the date the document is agreed.

Of course, any definitions can be amended or excluded if specifically agreed and documented. The implication for treasurers entering into transactions using the revised 2006 ISDA Definitions is that definitions should be checked at the time of entering the transaction, rather than only on publication of the new version.

The Treasurer, June 2007, Keeping Up With The Market by John Berry and David Vincent of Allen and Overy and Katherine Darras of ISDA, pp32,33