IN BRIEF

- The International Accounting Standards Board (IASB) is debating the **hedge accounting rules** and intends to publish its entire proposals in the first quarter of 2010. On eligibility criteria the board tentatively decided that derivatives could be designated as hedged items in several new situations, in particular when the hedged exposure is a combination of a derivative and a non-derivative. The IASB also tentatively decided that proportions of nominal amounts and one-sided risks would be eligible for designation as hedged items. All these announcements are welcome developments.

- The Committee of European Securities Regulators (CESR) has proposed a pan-European **short-selling disclosure regime**. Net short positions in all shares that are admitted to trading on a market regulated by the European Economic Area (EEA) over a threshold of 0.2% should be disclosed to the relevant competent authority, with further steps of 0.1%. Once above 0.5%, the disclosures would also need to be made to the market as a whole.

- The new **retail bond platform** operated by the London Stock Exchange has expanded its coverage of corporate bonds, taking on issues from Marks & Spencer, Unilever, Safeway, Kingfisher, National Grid Gas, Compass Group and Imperial Tobacco Finance. The total value of retail bonds traded for the first five weeks since launch at the start of February stands at over £80m, which consists of £66.5m executed on book in the gilts and £13.6m in the corporates.

- The Takeover Panel is planning a consultation to consider whether some **Takeover Code** provisions and the timetable for determining the outcome of offers could usefully be improved. This follows suggestions from the minister for business, innovation and skills, prompted in part by the Kraft/Cadbury takeover. The Code Committee has also issued a consultation paper on profit forecasts, asset valuations and merger benefits statements.

- New uniform **rules for demand guarantees** will come into force on 1 July 2010. URDG 758, issued by the International Chamber of Commerce, will replace URDG 458. The changes are designed to make demand guarantees more user-friendly and attractive to banks.

INTRODUCTION

By Martin O'Donovan
ACT assistant director, policy and technical

The good news is that the efforts of the ACT and the European Association of Corporate Treasurers to present the reasons why over-the-counter (OTC) derivatives are an essential tool for non-financial companies seem to be bearing fruit. EU officials and even Gary Gensler, the chairman of the US Commodity Futures Trading Commission (CFTC), have recognised the need for accessible and cost-effective hedging, although the final outcome will depend on the politicians. With a storm raging on the use of credit derivatives on Greece, the real issues are in danger of being overwhelmed by emotive and ill-informed comment. The misuse of terminology, like accusing speculators of short-selling naked credit default swaps (CDS), doesn't help.

MEPs weigh into EU OTC derivatives reform

After various consultations and much input from the users of over-the-counter (OTC) derivatives, the European Commission is now working on draft legislation to reform the OTC derivative markets. In particular, it wants trades to be standardised, dealt on an exchange or cleared centrally, meaning that margin would have to be posted as collateral against changes in mark-to-market values.

Even before it has been presented with the Commission's formal proposals, the European Parliament has started to consider the same subject. An own initiative report has been published in draft from the Committee on Economic and Monetary Affairs, written by German MEP Werner Langen.

Langen's very short draft report contains several indicators that companies will regard as encouraging.

As rapporteur, he says: "Firms need to be able to manage the risks inherent to their business in a targeted fashion." And he recommends: "As regards regulation, a distinction must be made between derivatives to hedge firms' transactions and pure financial market derivatives."

Langen also makes the telling observations that most derivatives used by businesses involve no systemic risk, and that, as a rule, non-financial institutions' interest rate, foreign exchange and commodity contracts require no additional regulation.

Another recommendation may be good news or bad, with the MEP backing the intention to provide for exemptions and lower capital requirements for SMEs' bilateral derivatives. The risk here is that larger companies may not get this helpful treatment.

Meanwhile in a letter to the Federal Reserve Bank of New York and other global supervisors, the International Swaps and Derivatives Association (ISDA: the body that sets terms and conditions for derivative trades) and a group of major market participants have given voluntary undertakings about increasing transparency and standardisation in OTC derivatives. They say they will increase the proportion of their trades that are centrally cleared to around 92-95%, depending on transaction type. This is a strong message saying that much of the systemic risk is already being minimised without legislation. ■

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Negotiating loan agreements

Understanding loan agreements and what provisions are worth fighting for comes with experience, or by getting expert advice from the ACT Borrower's Guide to LMA Loan Documentation for Investment Grade Borrowers. This 125-page guide was produced by law firm Slaughter and May and is packed with explanations and advice on the pros and cons of specific clauses and topics, and the rationale to support changes tailored to your needs. Download it from:
www.treasurers.org/loandocumentation

Risk disclosure in working capital statements

The FSA has devoted a special edition of its List newsletter to working capital and risk factors, two of the most important disclosures in prospectuses and circulars, in particular the interaction between the two.

As usual, the discussion and comments from the FSA cannot be taken as official guidance, but the paper provides helpful advice.

In certain prospectuses and circulars, an issuer has to make a working capital statement about the adequacy of its working capital for the coming 12 months.

Where a risk factor accurately describes a situation that is fundamentally inconsistent with a clean working capital statement, either the facts underlying the risk factor should be addressed (for example, by securing additional facilities), or the working capital statement should be provided on a qualified basis.

It will not be appropriate simply to remove or modify the risk factor if it would lead to deficient disclosure in the document. For example, a risk factor that the business might not be sufficiently cash-generative over the next 12 months, rendering it unable to meet its next debt repayment, would be inconsistent with a clean working capital report.

On the other hand, the existence of significant risks will not always require a qualified working capital report.

The example that the FSA gives is that a risk of an issuer's facilities including covenants that might limit its scope for expansion would not necessarily be inconsistent with a clean working capital statement, although in this particular case the business strategy section should tell the same story.

Equally, some high-impact low-probability risks may be consistent with a clean working capital statement. Such a risk may be expressed as being terminal for the issuer, but so remote as not to impact the working capital statement. ■

EU seven-point plan to bolster banks

The EU's new internal markets and services commissioner Michel Barnier has announced proposals to make changes to the Capital Requirements Directive so as to strengthen the resilience of the banking sector.

The seven areas of potential action proposed by Barnier for the latest series of amendments to the directive are as follows:

- **Liquidity standards.** A liquidity coverage ratio requirement may be introduced, underpinned by a longer term structural liquidity ratio.
- **Definition of capital.** The quality, consistency and transparency of the capital base may be raised.
- **Leverage ratio.** A leverage ratio may be introduced as a supplementary measure to the Basel II risk-based framework based on appropriate review and calibration.
- **Counterparty credit risk.** The directive may strengthen capital requirements for counterparty credit risk exposures arising from derivatives, repos and securities financing activities.
- **Countercyclical measures.** A framework may be introduced to create a more stable banking system that will dampen, instead of amplify, economic and financial shocks.
- **Systemically important financial institutions.** The European Commission is consulting on appropriate measures to deal with the risk posed by such institutions.
- **Single rulebook in banking.** The Commission is consulting on areas where more stringent requirements might be necessary, as well as the appropriate prudential treatment of property lending, as part of its commitment to create a single rulebook in Europe.

The proposed changes set out in the consultation document are closely aligned with the forthcoming amendments to the Basel II framework and the introduction of a global liquidity standard currently being drawn up by the Basel Committee on Banking Supervision.

IN BRIEF

Credit rating agencies Fitch and Standard & Poor's have announced that **structured finance ratings** will carry an additional designatory symbol from summer 2010. Fitch will be using an "sf" symbol and S&P "SF". The symbol will indicate only that the security is a structured finance instrument and will not reflect any other change to the meaning or definitions of either agency's ratings.

The agencies' actions were prompted by the EU's regulation on credit rating agencies last year. Moody's announced in October 2009 that it would add "SF" to all its structured finance ratings.

In a speech looking at the regulatory challenges, Sally Dewar, FSA managing director for risk, has flagged new developments in the **bond markets**.

The FSA will be looking at new measures and issues, including:

- mandatory post-trade transparency on corporate bonds and consideration of the case for improving pre-trade information;
- access to the retail bond market and the potential risks to retail clients;
- the ongoing review of the EU Prospectus Directive;
- non-traditional funding for banks – whether hybrid capital or covered bonds – the FSA being supportive of asset-backed bonds where used prudently;
- improving the quality of credit ratings; and
- the global nature of regulation.

The British Bankers' Association (BBA) has responded to HM Treasury on **non-bank lending** by supporting choice for issuers and investors but stressing they must have information to enable them to make informed decisions.

The BBA says there is no evidence of unsatisfied demand for non-bank finance at the moment. It notes the differences in the UK and US markets and is wary of any moves to require universal disclosure of the terms of private loan agreements or smaller transactions. It also outlines the inherent systemic risks of moving high-yield business away from banks and into the capital markets.

Non-bank lending continues to be debated widely, and in a roundtable discussion at 11 Downing Street, hosted by Lord Myners, the ACT made the point that reliance on bank lending was a relatively recent phenomenon and that a return to greater use of the corporate bond market should be seen as normal and achievable.