IN BRIEF

Credit rating agencies are to come under further scrutiny with the announcement by the Committee of European Securities Regulators (CESR) that it will be reviewing the rating process relating to structured finance instruments looking in particular at human resources allocated to rating and monitoring; the transparency of the agencies' rating methodologies; potential conflicts of interest (such as the agencies' remuneration structures); and periodic monitoring of the ratings and timeliness of rating actions. The CESR report is due in May 2008.

Recent events in the **global credit markets** are to be subject to a systematic review by the International Organization of Securities Commissions (IOSCO). It will focus on risk management/prudential supervision, transparency/due diligence, and the valuation of assets/accounting issues. The review will take into consideration that investors may have relied on the ratings provided by credit rating agencies as not only an assessment of the probability of default by an entity, but also as an assessment of the product's liquidity. It will also consider credit rating agencies and their role as it relates to the sub-prime market. The report is due in May 2008.

The timetable for implementation of the **Companies Act 2006** is to be put back to October 2009 for those provisions that were previously scheduled to kick in in October 2008. This is caused by the changes required in Companies House systems and may cover the general duties of directors in respect of conflicts of interest and the repeal of the restrictions under the Companies Act 1985 on financial assistance for the acquisition of shares in private companies.

The Payments Services Directive was officially adopted by the EU on 15 October under the Parliament-Council co-decision procedure. EU member states will have until 1 November 2009 to bring into force the necessary provisions to comply with the new framework. Separately, the UK government has announced that the Financial Services Authority will be the UK regulator for the provision of payment services. Meanwhile it was earlier agreed that the migration to the Single Euro Payment Area that had been planned to start on 1 January 2008 will be moved back 28 January 2008 to reduce the risk of additional technical problems arising due to the change of year.

INTRODUCTION

By Martin O'Donovan
ACT Assistant Director, Policy and Technical

After the excitements in the financial markets over the late summer no doubt we have all been reassessing our attitude to risk in our professional roles and perhaps also in our personal financial affairs.

Portfolio theory tells us about the advantages of diversification but this is hardly a new science, as the merchant Antonio made clear 400 years ago in Shakespeare's *Merchant of Venice*: "My ventures are not in one bottom trusted/Nor to one place; nor is my whole estate/Upon the fortune of this present year;/Therefore, my merchandise makes me not sad."

I wonder if Antonio ever considered the extent to which correlations or the lack of them break down under severe pressure. Another risk to stress-test?

FSA raises CfD concerns

The Financial Services Authority (FSA) has published its concerns that contracts for differences (CfDs) are being used to seek to influence votes and other corporate governance matters on an undisclosed basis, and to build up stakes in companies, again without disclosure.

The FSA's comments come in a consultation paper looking at the disclosure of CfDs referenced to prices of UK shares admitted to trading on a regulated market.

The use of CfDs in the UK has grown significantly in the last five years. Current estimates suggest that about 30% of equity trades are in some way driven by CfD transactions referenced to the underlying shares. CfD holders cite leverage, the ability to go short, the avoidance of stamp duty and anonymity among the prime reasons for using them.

Lack of disclosure causes concern among investors and issuers because:

- CfD holders can build substantial economic interests and exert influence over the voting rights attaching to the underlying shares;
- issuers don't know who has significant economic exposure to their shares, giving scope for abuse or misleading representation; and
- traditional investors are disadvantaged compared with hedge funds, which have better information on holdings.

Conversely, CfD writers and holders would argue that increased disclosure could hamper the market by introducing excessive or contradictory information, and could damage liquidity in CfDs and so ultimately in the underlying equities.

The FSA's research suggests that the policies and practices of the investment banks writing CfDs do not allow the holder to close out positions into the underlying stock, nor for the CfD writers to vote the stock. Even if CfDs are not in effect a substitute for the shares on a systematic basis there remains the view that there exists a market failure relating to inefficient price formation, a distorted market for takeovers; and diminished market confidence.

The FSA has put forward three options:

- to leave the current regime as it stands
- to strengthen it by requiring the disclosure of substantial (more than 3%) economic interests (unless the holder has taken specific steps to preclude exercise of influence over the underlying shares); or
- to introduce a comprehensive regime, similar to the major shareholder notification regime, requiring disclosure by all holders of substantial (more than 5%) "economic interests in shares".

The ACT considers there is some merit in increased disclosure and intends to respond to the FSA's consultation. We would welcome input from readers and in particular from those responsible for investor relations. Contact **modonovan@treasurers.org** ■

Several sites can provide historical data for currency exchange rates and plot graphs, but Rates FX stands out by also giving volatility data for 30 major and not so major currencies including a 95% prediction level, which may be relevant to your currency risk assessments. Elsewhere on the site, you can set an exchange rate alarm and there are pages for a range of currencies, with links to central banks or other local information sources. ■

www.ratesfx.com

Enlightened shareholder value focus could impact loan documentation

The ACT has published a briefing note on how the Companies Act 2006 affects loan agreements.

The codification of directors' duties and stress laid on enlightened shareholder value mean there is likely to be greater focus on the content of board minutes, which are normally required as a condition precedent. Generally speaking, in the context of a plain-vanilla corporate loan, it will be inadvisable and unnecessary to extend board minutes to itemise consideration of the enlightened shareholder value factors.

Directors may be at greater risk of liability for breach of duty as a result of the new derivative claims regime, which came into force on 1 October 2007. A derivative claim is a claim brought by a shareholder on behalf of the company against a director – for example, for breach of fiduciary duty or negligence.

Against this background, it is thought that some lenders may be considering extending existing provisions in loan documentation dealing with litigation to cover derivative claims. For example, the Loan Market Association (LMA) agreement for investment-grade borrowers includes a representation as to "no litigation".

Borrowers will want to oppose the extension of this representation on the grounds that a derivative claim is one made on behalf of the company against a defaulting director: the lenders' concern in this representation is properly with proceedings against the company.

New provisions in the Companies Act 2006 and the disclosure and transparency rules are designed to facilitate e-communication. While they do not directly affect credit documentation, they may give lenders and borrowers scope to discuss increased use of e-communication.

In line with market practice, the LMA documentation does not currently permit electronic communication between borrower and agent, but lenders may now be prepared to discuss provision for notices – for example, on drawdown – by email.

The full ACT briefing, prepared for us by law firm Slaughter and May, is available at: **www.treasurers.org/technical/lmaguide.cfm** ■

For more on directors' duties, see p36

Screw tightens on insider dealing

The FSA is trying to step up its enforcement efforts around insider dealing by seeking additional detail on insider lists and timetables to to help it in any investigations.

The FSA *Market Watch* publication for October gave some general pointers as to the sort of information the FSA might require and which go beyond the official obligations under the disclosure rules and transparency rules already in place.

In the context of proposed company takeovers, a record of important meetings should be maintained, along with dates, times and participants. The record should list the participants and explain what specific information was passed or discussed between those present, with more detail included as the deal or other event becomes more certain and approaches its conclusion.

Insider lists should be comprehensive and include both "super insiders" (such as senior management with no direct input into the event but with managerial oversight of transactions) and all support staff (such as control room staff, those with IT access and secretarial staff).

Lists will need to include names, addresses and telephone numbers of all parties connected to the event, together with when they knew about both the event and/or the announcement of the event. This will involve not only individuals from the principal and its adviser, but also all others involved in the deal.

In any investigation the FSA will generally ask for a timetable of the events that led up to the particular announcement. The information given should include all key actions such as:

- internal discussions;
- board meetings;
- briefings of external advisers (legal; accountancy; PR firms);
- briefings of other relevant parties (pension trustees; union representatives; financial printers, rating agencies);
- contacts with shareholders; and
- contacts with a target company and/or possible finance providers.

The end message is to think about how widely price-sensitive information is accessible within your company and among its advisers and take steps to minimise that access. ■

IN BRIEF

▸ The latest **Bank of England Financial Stability Report (October 2007)** focuses on recent problems, lessons to be learnt and prospects. Charts show the nature and extent of the problems and it includes recommendations for better liquidity management, stress testing and contingency planning, and greater transparency for structured products. See: **www.bankofengland.co.uk**

▸ New guidance on **rights of indirect investors** to receive regular corporate information and exercise governance rights has been published by the Institute of Chartered Secretaries and Administrators on its website. The Companies Act 2006 allows an indirect investor (that is, someone on whose behalf a registered shareholder holds shares) to receive regular company information and exercise governance rights in the case of companies traded on a regulated market.

▸ Proposals made by the **review of performance reporting** by standards bodies IASB and FASB have come in for severe criticism from the Corporate Reporting Users' Forum (CRUF). CRUF disagrees with the proposal that there should not be an earnings subtotal within a performance statement and says that users need to be able to distinguish remeasurement gains and losses from other income and costs in order to focus on the underlying performance of companies. In a telling opinion on the use of fair values, CRUF says: "Remeasurement gains and losses are of themselves generally not useful for forecasting future cashflows from those assets or liabilities."

▸ **The Pensions Regulator** has been consulting on revised guidance on clearance processes. The ACT has responded, pointing out some specific difficulties with the proposals and expressing concern that the new guidance could introduce less clarity and certainty into the clearance process and so cause delays.

▸ The ACT has supported **retention of pre-emption rights** in its response to the European Commission on proposals to repeal the Second Company Law Directive. The Commission is seeking to remove rules that are redundant or relate solely to national issues. However, the ACT regards the obligation first to offer new shares to existing shareholders as a crucial protection against the possibility of transfer of value by a company's management to new shareholders, away from existing shareholders without the latter's consent.