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▸ **Standard & Poor's is explicitly recognise credit stability as a rating factor**. This will mean that a corporate credit rating could be constrained to a lower level if a security has a high likelihood of experiencing unusually large adverse changes in credit quality under conditions of moderate stress. The new approach will be implemented over a period of roughly six months and will apply to ratings on all types of issuers and securities and to both new and existing ratings. S&P expects the change to have very little, if any, effect on corporate and government ratings. It is anticipated to have a more pronounced impact in certain areas of structured finance, particularly ratings on derivative securities.

▸ **The Financial Reporting Review Panel** has announced its priorities for 2009 and 2010. It will continue to review accounts from companies in sectors impacted by the deteriorating economy. It reminds companies that the business review of quoted companies, as required by the Companies Act 2006, must refer to the main trends and factors likely to affect the future development and performance of the business. It also points out that all business reviews must contain a description of the principal risks and uncertainties facing the company.

▸ **Disclosure of contracts for difference (CFD) holdings** will be required from 1 September 2009, according to an announcement by the FSA, following an earlier consultation. CFD holdings disclosure will apply only to long CFD positions in shares in excess of 3% of the company's share capital. The 3% threshold is an aggregate of shareholdings and CFD holdings.

▸ **Invoking a material adverse change (MAC) is notoriously difficult**, as a note from Denton Wilde Sapte, entitled "Material adverse change: 15 questions to ask before you call a MAC event of default", explains. The only English cases in which a lender has successfully called a MAC event of default have involved a debtor's insolvency, or something making insolvency highly likely. However, the context is key. The lender must also consider if the adverse change comes out of nowhere. If the borrower's plight was reasonably foreseeable given what you knew, or should have known, when you made your credit decision, then the chances of a successful claim are reduced. The full note is at: **http://tiny.cc/mac728**

INTRODUCTION

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

Lead times in the production of a magazine mean that the technical news included here can never be completely up to date, but we hope that it is nonetheless relevant for those wanting to keep an eye on what rules and practices are changing, or to understand the markets better.

The ACT does attempt to keep the media and consequent public debate informed of the corporate viewpoint and its reaction to the more rapid changes in the market that we are experiencing these days. More up-to-date policy and technical news of this sort can be found on the ACT website.

IASB proposes more changes to financial instruments disclosure

The greater focus on the need for transparency on financial instruments, driven by current market conditions, have prompted the International Accounting Standards Board (IASB) to issue an exposure draft of proposed amendments to its IFRS 7 disclosure standard. The proposed amendments focus on:

- enhancing disclosures about fair value measurements, particularly for those that use the most subjective inputs; and
- improving disclosures about liquidity risk, including proposing quantitative disclosures for derivative liabilities based on how liquidity risk is actually managed.

FAIR VALUES

The IASB follows the hierarchy of bases for establishing fair values already in force in the US under the Financial Accounting Standards Board's (FASB) fair value measurement standard Statement 157, namely:

- **Level 1:** fair values measured using quoted prices in active markets for the same instruments;
- **Level 2:** fair values measured using quoted prices in active markets for similar instruments or using other valuation techniques for which all significant inputs are based on observable market data; and
- **Level 3:** fair values measured using valuation techniques for which any significant input is not based on observable market data.

Based on the split of financial instruments between these three levels, the exposure draft proposes new disclosures about:

- the level of the fair value hierarchy into which fair value measurements are categorised;
- the fair value measurements resulting from the use of significant unobservable inputs to valuation techniques. For these measurements, the disclosures include a reconciliation from beginning balances to ending balances; and
- the movements (and reasons for them) between different levels of the fair value hierarchy.

Clearly this is of particular relevance to financial institutions but even companies with minimal volumes of financial instruments recorded at fair value are also required to disclose the fair values (again split by the three-level hierarchy) even of instruments measured at cost or amortised cost.

Where fair value measurements are categorised as level 3, the IASB is proposing additional disclosures and reconciliations, including disclosure by class of asset of the effect, if significant, of changing the input assumptions to a reasonably possible alternative.

LIQUIDITY

The exposure draft confirms that liquidity risk disclosures are only required for financial liabilities that will result in an outflow of cash or other assets. Thus disclosure requirements would not apply to financial liabilities settled in the entity's own equity instruments and to liabilities in the scope of IFRS 7 settled with non-financial assets.

The proposed amendments:

- require entities to provide quantitative disclosures based on how they manage liquidity risk for derivative financial liabilities;
- require entities to disclose the remaining expected maturities of non-derivative financial liabilities if they manage liquidity risk on the basis of expected maturities; and
- strengthen the relationship between qualitative and quantitative disclosures of liquidity risk. ■

IFRS impact on cost of equity

A research paper from accountants' body ACCA considers the effects of accounting standards on the cost of equity and whether improvements in accounting and disclosure quality are driven by mandatory standards or market incentives.

Proponents of mandatory standards argue that the adoption of a common accounting language should improve the international comparability of financial statements. This in turn would facilitate cross-border capital flows and so reduce the cost of capital. The supposition is that mandatory IFRS applied in countries starting from lower standards will reduce information asymmetry, so that investors will be able to monitor managerial performance better and so demand a lower risk premium. If this analysis is correct, the greatest impact of IFRS would be among smaller European countries with lower-quality accounting and disclosure standards, such as Greece and Portugal.

The alternative argument is that preparers' incentives and institutional context affect the quality of financial reporting more than mandatory accounting standards. Businesses with a strong demand for more capital may be especially willing to seize the opportunity from the switch to improved accounting standards as a way of attracting more funds from the equity markets.

The ACCA research took a sample period of 1995 to 2006 across European countries and compared changes in the corporate cost of capital from before the enactment of IFRS until after its introduction. Although the proponents of mandatory standards predicted a more significant cost of capital reduction in countries originally with low financial reporting incentives and enforcement, this was not supported by the research findings.

On the other hand, the proponents of market incentives predicted a greater cost of capital reduction in countries that already had high financial reporting incentives and enforcement. And this is, in fact, what the research found, in particular in the UK, where high reporting incentives are driven by the importance of the equity market.

So in countries where equity-based financing dominates, and corporate disclosure quality is already high, IFRS appears to be more effective.

This has important implications for regulators as well as the users of financial statements. Imposing on debt-based capital markets the accounting standards developed for equity-based markets may not be effective, at least in the short run. IFRS may well be suitable for stock-market-based economies such as the US and the UK. It is by no means certain, however, that what is best for such economies is also best for other forms of capitalism.

The present situation, where IASB and FASB decide what is best for the EU and other major trading blocs, may yet prove unsustainable. ■

Equal charges on way for euro direct debits

The European Commission is proposing to extend the principle of equal charges for similar domestic and cross-border euro payment transactions to direct debits.

Regulation 2560/2001 introduced the principle of equal charges to cross-border euro payments within the European Economic Area countries. The regulation applies to credit transfers, cash withdrawals at cash dispensers and payments by means of debit and credit cards up to €50,000.

The Commission's proposal means that charges for local and cross-border direct debits would have to be the same. Subject to agreement by the EU Parliament and Council, it would be effective from 1 November 2009, coinciding with the introduction of the SEPA direct debit.

The Commission has also been reviewing the reporting of cross-border payments over €12,500 to various central banks for balance of payments statistical purposes. The preferred option is to raise the exemption threshold to €50,000 and to abolish balance of payment reporting based on settlements by January 2012.

The would reduce costs of payments to the maximum possible extent, and remove any administrative distinctions between national and cross-border payments.

All international financial reporting standards (IFRS) endorsed by the European Commission from 2003 to 15 October 2008 have been published in a single consolidated document, and all cross-references updated. The EU webpage is an alternative location for the full texts of all the current IAS, IFRS, and IFRIC and SIC interpretations, and is completely free of charge.
http://tiny.cc/ifrs

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The information on the payer which must accompany fund transfers is already subject to EU regulation for anti-money laundering purposes. The Committee of European Banking Supervisors (CEBS) and other authorities are now planning to tighten up procedures within payee banks to ensure that complete details are received, and if not, that the payment is rejected or the banks seek the required details on the payer's identity.

Changes to the UK Companies Act have been drafted to implement the **EU Shareholder Rights Directive**, due to come into force on 3 August next year. The minimum notice period for meetings other than annual general meetings is to be extended from 14 to 21 days, unless the company offers the facility for electronic voting for all members and this is approved by shareholders. Further provisions deal with voting procedures and processes.

Ideas for establishing **central counterparties for credit default swaps** are moving swiftly forward. In October EU Commissioner Charlie McCreevy called for a central counterparty to absorb losses and improve oversight of the risks, with concrete proposals by the end of 2008. The European Central Bank has since met the potential providers of such central counterparties, their regulators and the main users, including dealers and buy-side. The participants agreed on the importance of reducing counterparty risk and of enhancing transparency in over-the-counter derivatives markets.

The Pink Sheets is not a stock exchange but a venue for over-the-counter (OTC) electronic trading of smaller or closely held companies. It has introduced a new OTCQX premium quotation, providing a place for reputable issuers to distinguish themselves from the rest of the OTC market and to provide credible disclosures to investors.

HMRC is looking for a principles-based approach to disguised interest. Rather than proposing to introduce tightly articulated legislation and specific rules that can be applied with certainty, HMRC is taking a new and unwelcome approach to tax legislation. The generic principles being put forward to deal with disguised interest fail to provide taxpayers with the clarity and certainty they expect from taxation. Companies are urged to register their views with HMRC.