Accounting changes worry loan banks

A massive change in the way banks lend could result within the next few years if international accounting regulators have their way. A working group of accounting standard setters is close to publishing a discussion paper on the issue of fair value accounting. The result could see all banks active in syndicated lending having to mark their loan portfolios to market.

Although enforcing regulations would take at least two years to implement, all banks involved in global syndicated lending would be forced to comply with the rules. Banks' own accountants would effectively act as regulators as they would need to certify final financial records.

Banks are now faced with the same issue that confronted institutional investors several years ago – when regulators devised rules for them to mark to market their loans.

Although many resisted the change, they have gradually adopted it, especially over the last 12 months. All funds now mark to market both their bank loan and bond paper. This latest move on the part of the regulators is in response to two main factors.

Firstly, the large amounts of leveraged paper that many banks are now holding and secondly, the growing concerns over the credit quality of the loan portfolios of some banks. Such concerns have been exacerbated by a rash of defaults.

At present, most investment banks mark to market nearly all of the loan paper on their books – although this is usually relatively little given their policy to trade out of most of their positions. However, few if any commercial banks mark to market, opting instead to hold positions to maturity on most loans they book.

Historically, commercial banks are only forced to mark to market if a loan nears default. Otherwise, they provision against their portfolio either through allocations to specific or general loan loss provisions

The issue of marking to market is far more problematic for commercial banks. If the current proposal were to be adopted, banks across the globe face a near-impossible task – especially in Asia and Europe, where the secondary loan markets are scarcely developed.

Nevertheless, some bankers actively welcome the proposals. "Going to mark to market could be good for the industry – and will eventually get there. It would mean a massive boost to the market and people would trade far more – for example, if a company appears to be on a downward spiral, banks would sell their positions far quicker than previously," said one banker at a US commercial bank.

"Most people are leaning towards marking to market. This would slow down primary syndication, but would make secondary trading much more active because people would want to sell," said another banker. IFR

Sony to take the tracking route

Sony, the globally known consumer electronics manufacturer, plans to issue a tracking stock for its internet business. Sony Communication Network (SCN), a wholly-owned subsidiary and Japan's fourth largest ISP with 1.5m subscribers, was established in 1995 and has developed its presence through its 'Postpet' cartoon e-mail service.

The idea is to reflect the value of the high-growth business unit without ceding ownership rights or spinning off the business. Holders of the tracking stock will have voting rights as Sony shareholders, but not in SCN. Dividends on the tracking shares will be based on the earnings of the unit. Sony has said it will seek approval for the measure at an extraordinary shareholders' meeting in January.

Immediately after Sony's announcement, the Tokyo Stock Exchange (TSE) unveiled a set of new listing standards for tracking stocks. The TSE said tracking stock issuers must be listed companies with a prospect of posting a profit, and the stocks must be issued in units of more than 4,000 shares. The Tokyo exchange will also require companies hoping to issue tracking stocks to disclose detailed information on the 'tracked' subsidiaries.

However, the market response to these developments was generally sceptical. One equity syndicate manager doubted whether tracking stock brought any good for investors. "It is questionable if tracking stocks are attractive investment opportunities. If the underlying business unit is valuable for investors, they want an IPO or spin-off, not tracking stocks," he said. "AT&T Wireless in the US and Alcatel Optronics in Europe do not seem to be performing well. Moreover, we doubt if the [tracking] stocks have enough liquidity with few investors in play."

A senior banker agreed that it remained in doubt whether a tracking stock would offer the same liquidity as a normal IPO – a key factor for investors. The real advantages, however, are for the selling company.

In the case of Alcatel, which launched tracking stock earlier this year, the company had strategic reasons for maintaining full control of its optronics division, and the tracking concept provided the opportunity to gain greater market recognition for the value of that business without diluting ownership. The tracked subsidiary also arguably benefits as well. By remaining part of a larger organisation it continues to be able to leverage infrastructure benefits.

Sony has been investing in an array of internet-related services that are yet to show any remarkable results. However, SCN is now one of leading internet-service operators in Japan, and with its own share price falling by more than 45% this year, Sony is naturally keen to reveal the hidden value in the group. Tracking stock could be just the ticket. IFR

Telecoms stocks suffer

The difficult time telecoms companies had in raising new equity in early December would have been a breeze a few months ago. But given the change in market mood, bankers have had to work hard to get those deals through the market. The implications for forthcoming telecom issues are disturbing.

Telefonica Moviles, the mobile telephone subsidiary of Telefonica, priced its IPO at €11. The deal suffered from the mood in a market spooked by the very concept that enchanted it a matter of months before – third generation mobile telephony.

The problem is not only one of sentiment. The facts of the situation have also changed. Deutsche Telekom has pulled out from the French 3G licence auction, and there is a growing feeling that the 3G hysteria that gripped governments and telcos alike is over.

There is an awful realisation that many companies have massively overpaid for a service with little obvious customer demand. Licence contests in Austria, Switzerland, Italy and Belgium have also been hit by withdrawals.

Telefonica and its bankers tried to reflect that change in terms and conditions. The Moviles IPO ended up at only 8.9% of the company, and the price was substantially lower than early valuations suggested. The final €11 price was definitely a reflection of the market realities.

In the final event, there was also more dependence on retail, increasingly the anchor of big European equity offerings. In the end Telefonica Moviles was 61% allocated to retail Spanish investors – compared with a planned 55% – as all the greenshoe went to retail.

Telekom Austria priced its IPO at the very bottom of a €9 to €12 range. The deal was just 1.5 times subscribed, and 25% of the total was retail. This was an offering of only secondary stock in which OIAG, the Austrian state holding company, was the only seller. The free float is 24%.

By the close on November 24, Telekom Austria was trading at €8.49, not as far below the €9 issue price as some bankers had feared, but a worrying comment on the irrelevance of Vienna to many investors.

Early December was was tough. But as bankers surveyed the damage last Friday the real concern was the medium-term outlook. There is a lot of telecoms paper in the pipeline, not least the planned offering in KPN Mobile, once mooted as 2000 business. A lot hinges on the reception given to France Telecom's Orange subsidiary, but with US mobile companies like Verizon also on the way, some bankers were talking about a doomsday scenario. IFR

OTC derivatives growth

Global over-the-counter derivatives use grew by 3% in the first half of 2000, according to a semi-annual market survey sponsored by the International Swaps & Derivatives Association (ISDA). However, among the top 10 reporting institutions volume was up 10% to $33.48trn in notional principal outstanding.

The survey tracks market growth in interest rate swaps, interest rate options and currency swaps, as reported by member organisations. For the six months ending 30 June 2000, total derivative exposures in these asset classes amounted to $60.366trn, compared with $58.265trn at the end of last year. For the period ending 30 June 1999, the total stood at $52.711trn.

Thomas Montag, vice-chairman of ISDA, and chairman of the market survey committee, said: "These figures reflect the continuing appeal of OTC derivatives as a risk management mechanism, and demonstrate that consolidation among institutions has not slowed the growth of product use."

Compiled twice a year by consultancy Arthur Andersen, the ISDA survey is performed on a confidential basis and produces a single headline statistic. Outstandings represent notional volumes of 100 member institutions, 78 of which were also participants in the previous semi-annual survey. IFR

First Cat bond on storms and quakes

AGF IART placed the first catastrophe securitisation of storm risk in France, and the first transaction to securitise earthquake risk in Europe. Goldman Sachs was sole manager and bookrunner for the $129m multi-year reinsurance transaction, which was also the first securitisation for a primary insurance company in France. The deal follows storms Lothar and Martin, which caused several billion dollars' damage in France in December 1999.

Prospects for the catastrophe bond market are looking up. Reinsurance rates are increasing, as insurers look to recoup last year's serious losses. One industry official believes that the reinsurance market has been near the bottom of the cycle for some time, but rates are finally firming.

In AGF's deal, Mediterranean Re, a special purpose reinsurance company, issued two tranches of bonds, due to mature on 18 November 2005, to finance the reinsurance coverage. Losses are calculated by EQECAT (specialists in evaluating and modelling natural risks based on the physical parameters of the event). Their loss model is tailored to two fixed income portfolios, designed to replicate AGF IART's actual insurance exposure in France and Monaco.

The securitisation covers AGF IART for losses from earthquake damages in the Monaco region of up to €381m, and from major storm damages or a first event with losses above €381m, and a subsequent event with losses above €305m. Neither risk is covered by the French governmental natural catastrophe programme, CATNAT. Storm losses will be based on peak wind-speed measurements at a network of 70 Meteo-France wind-speed recording stations. Earthquake losses will be based on the size and distance of the epicentre from Monaco, as reported by the European Mediterranean Seismological Centre. IFR

These extracts are from IFR (International Financing Review). For further details, please contact Lara Bull on 020 7369 7984 (tel) or 020 7369 7397 (fax). Email: lara.bull@tfeurope.com