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▸ At its May board meeting, the IASB decided to press ahead with **hedge accounting** proposals presented in September 2007 covering what exposures could qualify for hedge accounting. It will not be permitted to include time value in a hedged item when using the hypothetical derivative method, so for most hedging with a bought option the time value element will have to be taken to earnings rather than deferred in reserves. This change will affect periods starting on or after 1 January 2009 but will need to be applied retrospectively to 2008 comparatives.

▸ The concept of **"true and fair"** has been reaffirmed as still applicable in a legal opinion from Martin Moore QC and published on the FRC website. Following the implementation of the UK's Companies Act 2006 and the preparation of accounts under international accounting standards, doubts had been expressed. The new opinion is clear that the "true and fair" concept is still relevant to the preparation and audit of financial statements.

▸ **The UK's first National Payments Plan** has been published by the Payments Council. The plan seeks to identify areas where collaborative efforts are needed to drive forward improvements and innovation in the payments world. One initiative will be to look at alternatives to payment by cheque given the steady decline in cheque usage.

▸ **Reporting on greenhouse gas emissions** in the business review section of accounts will become compulsory for all companies if an amendment to Clause 80 of the Climate Change Bill survives the next stages in Parliament. This would create the anomaly that, under the Companies Act 2006, only quoted companies have to report on environmental matters generally in the business review but all companies would have to cover greenhouse gas emissions.

▸ **US auction rate securities** have been causing problems for issuers who found that the auctions failed. Existing holders had to continue holding the securities, but in return were entitled to penal rates of interest. With first quarter results out from many US companies, it has emerged that names such as Google and Starbucks have been investing heavily in the securities and will be subject to write-downs in their valuations.

INTRODUCTION

By Martin O'Donovan
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It is difficult to avoid all the doom and gloom about the losses and write-downs from the credit crunch, the impact on the financial systems across the globe and the consequent feed through into economic activity and personal hardships.

That said, though, the optimist in me searches out the silver lining in today's clouds.

Perhaps we should reflect on some of the positives. The shocks to the financial world have shaken us all – treasurers, bankers, regulators, whoever – out of whatever ruts we were in and given us a spur to re-examine what we are doing, reconsider our strategies and the risks.

This is no bad thing to be doing from time to time, but it is a shame if it takes a disaster to force this on us.

The credit crunch fall-out

While financial regulators around the world are relatively powerless to solve the current financial crisis, they are steadily churning out reviews of past problems and recommendations for the future. The International Organization of Securities Commissions (IOSCO) has reported on the sub-prime crisis with proposals under four headings.

- **Issuer transparency and investor due diligence.** Here, IOSCO wants to look into disclosure practices for private placements of asset-backed securities as compared to publicly traded asset-backed securities, and to review the level of due diligence on structured products performed by investment managers of collective investment schemes.
- **Firm risk management and prudential supervision.** Recommendations include developing best practices for originators and sponsors of securitisation programmes to reinforce due diligence and risk management practices.
- **Valuation and accounting issues.** Recommendations include consideration of further guidance and disclosure related to measurement at fair value to meet the needs of investors, and whether, as a matter of internal control, registered intermediaries and investment advisers have access to sufficient skills in modelling fair valuations in illiquid market conditions.
- **Credit rating agencies.** After a public consultation, IOSCO has made changes to its code of conduct on credit rating agency fundamentals in relation to the role of the agencies in the market for structured finance products. Agency analysts are now prohibited from making proposals or recommendations about the design of structured finance products that the agencies rate, and there are further requirements around independence and decision-making, and the transparency of methodologies.

The rating agencies have not escaped from further advice from the Committee of European Securities Regulators (CESR). It wants the European Commission to create an international agency standard-setting and monitoring body formed of senior representatives of the investor, issuer and investment firm communities. If this fails to get support from market participants or fails to meet the objectives of ensuring integrity and transparency of ratings, then supervisory authorities should become involved through regulation.

More recently, EU Commissioner Charlie McCreevy has determined that he will regulate the rating agencies with mandatory, targeted internal governance reforms and stronger external oversight, although not the rating opinions themselves.

The European registration of agencies and enforcement of the IOSCO code is among the few financial services priorities of the French presidency of the EU, which runs from July to December 2008.

Meanwhile, back in the UK, HM Treasury has set out proposals for the financial markets through a Banking Reform Bill, which will:

- enable the Bank of England to lend in a more effective manner;
- let the FSA collect information from banks with difficulties and share it with the Financial Services Compensation Scheme (FSCS) to help it to carry out its functions, and the Bank of England or HM Treasury where relevant, to maintain financial stability;
- introduce a special resolution regime to allow the tripartite authorities to intervene when a bank gets into severe difficulties; the regime includes a new insolvency regime for banks;
- improve FSCS to make payouts faster; and
- give the Bank of England a financial stability objective and amend the size and composition of the Bank's court. ■

LMA launches buy-back debate

The loan obligations of some borrowers in the syndicated market have been trading at significantly below par, largely for reasons of lack of liquidity, prompting discussion on the possibility of the borrower buying back into its own loans through the market.

In the bond market this is accepted practice, but for loans the legalities are more complicated. For this reason, the Loan Market Association (LMA) is to consider whether changes can be made to its template loan documentation. The LMA will work on giving borrower and lenders the option to negotiate whether loan buy-backs should be permitted or not, and if they are, to lay down rules to govern the process.

The legal circumstances present a conundrum. If a borrower buys its own loan from a lender, it would end up contracting with itself, which cannot be done under English law since no party can sue itself, although there are exceptions in securities law and in the case of bills of exchange.

For this reason, the debt has to be extinguished, but in that case is the loan purchase really a prepayment? If it is a prepayment, it might well infringe the rules around prepayments that most loan agreements contain, or raise questions on whether sharing provisions apply to treat all lenders pro rata.

Over and above this, it may be that the cash to make the loan repurchase has come from a disposal of assets. In that case there may be restrictions derived from permitted use of proceeds clauses in the agreement.

Making the repurchase via a subsidiary may be a solution to the problem of contracting with yourself. But there may remain the complications that assignments/transfers can often only be made to "another bank or financial institution". Inter-company loans to fund the deal may be forbidden by inter-creditor agreements, and voting rights on restructuring and insolvency arrangements could be problematic.

Alternative structures using a third party and affecting a funded sub-participation or total return swap are probably allowed but clearly not straightforward. ■

Tips on handling inside information

Regulated financial firms are not the only ones that need to take care over the handling of inside information, according to the latest edition of the FSA's *Market Watch* newsletter. Although the FSA's thematic work concentrates on regulated firms, the responsibilities go further to all market participants.

An industry working group has published *Principles of Good Practice for the Handling of Inside Information*, a set of voluntary guidelines aimed more at non-regulated companies. If some information could be deemed material to the price of a share or a derivative of it, that 'inside information' should in general be made public as quickly as practical, and until then, a party in possession of that information should not be dealing in the market. This information could be about some merger and acquisition, a company results statement or trading updates, board appointments, contract wins and losses, changes in accounting treatment, or a major business crisis.

The six principles contain practical examples of how to protect sensitive information and cover:

1. policies and procedures to control access and set clear responsibilities for overseeing controls;
2. awareness and training to ensure relevant staff understand the importance of keeping information secret and the implications of improper disclosure, including the potential legal liabilities;
3. 'need to know' criterion for giving staff access to inside information, and ensuring confidential matters are not discussed publicly (or outside of meeting rooms if in the office);
4. caution on the passing of price-sensitive information to third parties, which should be made aware of their obligations;
5. information technology security; and
6. personal dealing policies.

The full text of the principles, including all the day-to-day examples and advice, can be found at: **http://tinyurl.com/4pkf66**

For data junkies Crestmont Research provides masses of information and amusement. You will find the US yield curve plotted for the past 100 years and a great deal of other US-oriented material. Content includes a stock market matrix charting compound annual returns for any period since 1900, and research into the relationships between markets, the economy and the current volatility. See **www.crestmontresearch.com**

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Foreign exchange settlement risk could be reduced, according to the Bank of International Settlements. In a report, the bank highlighted the need for commercial and central bankers to take further action to lower risk. It recommended individual institutions to encourage counterparties to use CLS Bank or other payment-versus-payment service arrangements.

The dollar Libor fixings in London are under review by the British Bankers' Association. The BBA is to tighten procedures for taking rates from contributing banks and will increase their number. It is considering whether to introduce a second fixing time later in the day in addition to the current 11am London fixing.

The UK market abuse regime is to continue with its existing rules, which are more stringent than elsewhere in the EU. Following a public consultation, the FSA has decided to retain the UK's stricter rules until 31 December 2009 rather than let them expire at the end of June 2008. This covers trading while in possession of relevant information not generally available, which is more widely defined than inside information, and takes in a broader range of "behaviours likely to give rise to false or misleading impressions or to distort the market". The ACT welcomes this extension.

The Combined Code is to be amended by the FRC for accounting periods beginning on or after 29 June 2009. It will remove the restriction on an individual chairing more than one FTSE 100 company, and allow the chairman of a listed company outside the FTSE 350 to be a member, but not chair, of an audit committee provided the chairman is considered independent on appointment.

Structured finance ratings from Moody's are to be supplemented by two measures. An assumption volatility score will assess potential rating volatility based on the uncertainty of rating model assumptions, with the V score ranking transactions on a one-to-five scale. A loss sensitivity score will capture a rating's sensitivity to a change in the expected loss rate on the collateral pool backing the security. It will measure the number of rating notches Moody's would expect a security to be downgraded should the expected loss rate on its underlying collateral pool rise to a highly stressed level.