Bond issuers' deadline has passed

The deadline for exemption from the provisions of the EU Savings Directive was 1 March 2000. From now on, issuers must ensure that they are protected from any negative impact should the Directive come into force during the currency of their bond issue. Essentially issuers need to ensure that their obligations are fully satisfied by paying interest gross, and that they are insulated from any difficulties experienced by the paying agent or any downstream paying agents. The definition of paying agent in the Directive is wide and encompasses any corporate body paying interest over to a retail investor. So a Luxembourg bank acting as agent for a Belgian dentist would be obliged to withhold tax from interest payments to the dentist, even where the bond listing and paying agent was based in London.

It appears that institutional investors will be little affected by the Directive so demand for bonds should remain strong. There is still a question mark however over the ability of issuers to adequately protect themselves. Although we understand that market participants are developing language to put into bond documentation, we had not seen this at time of writing. We hope to include an overview of the relevant provisions of the Directive in the next edition of *The Treasurer*. ■

Syndicated loan documentation

Changes to the LMA Agreement

The LMA Primary Documents have been extended to include optional extras like bills, letters of credit and swingline facilities. At the same time, both the LMA and the Association are conducting their own annual review of the documents. We are waiting to see what proposals the LMA has for change, but we have already written to them on a number of points.

One of the key ones is that the document still provides for auditors' certificates which are becoming increasingly difficult to obtain. The issue was aired in the Hotline in the July/August 2000 edition of *The Treasurer* but it seems that borrowers are still agreeing to include this in their loan documentation and are then discovering that they can't fulfill the obligation. Clearly the LMA document should reflect current reality. Two other issues we have some concerns about are ECB reserve costs and giving notices by email.

Any changes to the documents will be reflected in The ACT Guide to the LMA Agreement on the website. (www.treasurers.org/know/services/tech/LMAguide.pdf).

Market acceptance of the LMA Agreement

Feedback from the market suggests that although take-up of the agreement was slow, it is now becoming much more common. Ironically usage was held back because borrowers felt it was too biased towards lenders and lenders felt it was too favourable to borrowers.

Up to now it has been more common to see 'LMA compliant' documents and some borrowers wanting to use the LMA format have had some difficulty in persuading the lawyers to do so. On the plus side, the use of the LMA format is making negotiations quicker and easier. On the other hand, some borrowers have found that when using the LMA format, it seems to always be assumed that the bank-friendly options are appropriate and there is little opportunity for negotiation. The technical committee is concerned that the format should not develop into a standard and members are urged to refer to The ACT Guide for advice on what and how to negotiate. ■

Basel II

Following last year's consultation exercise, the Basel Committee's new proposals have been published and on the face of it look much better from a borrower's point of view. The large increase in capital originally proposed for loans to A relative to AA rated companies has gone. The risk weightings (risk buckets) for corporate loans are now as follows:

AAA to AA-	20%
A+ to A-	50%
BBB+ to BB-	100%
Below BB-	150%
Unrated	100%

The relationship between low-rated and non-rated loans is also now more logical although the incentive for low rated companies to get rated has disappeared.

However, these weightings are for banks using the standardised approach based on external ratings. Lending banks in the UK market are more likely to instead use the more sophisticated internal rating approach which has been developed by the Basel Committee over the last year or so. Depending on the particular bank's internal systems, this allocates capital in relation to a curve of risk weights against expected default experience rather than the broad brush risk buckets outlined above.

One issue that may have ramifications for borrowers is the proposal for allocating capital against the documentation risks associated with credit derivatives. Some have speculated that the market for this instrument will stop growing and could even dry up. In this case, banks may be even more keen to have transfer clauses in loans.

The overall impact of Basel II is that there will be much more focus on credit quality overall and borrowers should be prepared for lenders to push harder for covenants that protect credit quality and for loan transfer clauses in loan documentation. ■

Accounting for financial instruments

The discussion document recently published by the joint working group of international standard setters makes the following proposals:

- measurement of virtually all financial instruments at fair value;
- recognition of virtually all gains and losses resulting from changes in fair value in the income statement in the periods in which they arise;
- preclusion of special accounting for financial instruments used in hedging relationships;
- adoption of a components approach for accounting for transfers of financial assets; and
- some expansion of disclosures about financial instruments, financial risk positions and income statement effects

The technical committee will be discussing these proposals over the next few months and is keen to hear from members on this topic of vital interest to treasurers. There seems to be a general acceptance that the information asked for is reasonable and will improve transparency. What is a matter of dispute is whether it should or should not be included in the accounts proper, as opposed to for example the notes to the accounts.

The Australian treasury association, the FTA, is particularly concerned at the preclusion of hedge accounting. It has already come out with a statement expressing concern that increased volatility in the profit and loss account might discourage sensible management of financial risk. They also believe that by, in effect, encouraging companies to take more undisclosed risk, transparency may be reduced rather than increased. ■

Dematerialisation of money market instruments (MMIs)

The Bank of England has been working since 1998 on a project to dematerialise MMIs and to migrate their settlement arrangements to the CREST system. CREST is currently promoting the settlement of commercial paper (CP) through the central Moneymarkets Office CMO service and has published a factsheet 'Commercial Paper in CMO' which can be found on the CREST website at www.crestco.co.uk. Discussions between CREST, CP dealers and issuing and paying agents have been positive and the first issue of CP, from Tesco Plc, was lodged into CMO in November 2000.

The Bank of England has published an interim report on the progress towards dematerialisation and is looking for market views on whether trade bills and letters of credit could be candidates. Further information is on www.bankofengland.co.uk/markets/money/mmfuture.htm. ■

Amendments to ISDA master agreement

ISDA has responded to pressure from regulators to tighten up on aspects of the Master Agreement by proposing some amendments which the technical committee is not entirely happy with. As the amendments would be incorporated into the Master Agreement through a set of Annexes, it would be for the parties to decide whether or not to apply any of them depending on the circumstances. However some give rise to concerns over systemic risk which could affect all market participants. In addition, the proposals for calculating 'replacement value' for terminated transactions favour, in our view, the dealing community over end users.

The ISDA Master Agreement is perhaps unique in its even-handedness between the parties which has largely accounted for its success. We would be unhappy to see this change so we have written to ISDA expressing our concern. ■

The future of corporate pensions provision

The Association has responded to a consultation document published by the government asking for comments on the future of the Minimum Funding Requirement (MFR). The MFR was introduced in 1995 as a response to the Maxwell affair. The Association's response notes that it has not achieved its objective of providing adequate security to scheme members and has had a distorting and damaging effect on the financial markets. The MFR should certainly be replaced but the question remains- with what? The full text of the response and the accompanying press release is on the website under 'What's New - on site' and on the home page of the technical section. ■

Hotline is prepared by Caroline Bradley, the Association's Technical Officer. For any comments or new items, please contact her at cbradley@treasurers.co.uk. Additional technical updates are available on the website: www.treasurers.org.