Corporate default rates set to rocket

With the global credit crisis deepening and credit spreads widening, corporate default rates are set to spike sharply over the next 12 months, predicts Moody's Investor Services.

The agency's default rate forecasting model predicts that its global speculative-grade issuer-weighted default rate will have jumped to 4.2% by the end of this year and to 7.9% in 12 months' time.

The figure for the US is likely to end 2008 even higher, at 5.1%, says Moody's. The index stood at 1.3% a year ago just after the credit crunch had begun, and had already risen to 2.1% at the end of the second quarter of 2008 and to 2.8% by the end of the third quarter.

Moody's said Europe's durable consumer goods sector would have the toughest time in the year ahead with the highest default rate, while in the US problems would be worst in the consumer transport industry.

The group's speculative-grade corporate distress index, measuring the percentage of rated issuers that have debt trading at distressed levels, has also jumped sharply. A year ago the index stood at 4.5%, but had reached 17.7% at the end of the second quarter this year, and 29.6% by the end of the third quarter.

Volatility torpedoes M&A transactions

The mergers and acquisitions market has contracted sharply since early September, with deals worth more than $120bn being withdrawn in recent weeks. Figures issued by Dealogic also showed that deals worth around $90bn collapsed because no new bidders were ready to step in and salvage them.

The volatility in the financial markets and the resulting equities bear market that has emerged over recent months have provided opportunities for stronger companies to pick up bargains. However, the huge swings on the world's equity markets, with huge price falls and gains in a single day common, have made it virtually impossible for acquirers to place sensible valuations on their intended targets.

The problems have been intensified by the closure of much of the debt markets. This has undermined potential M&A deals planned by companies other than those with extremely strong balance sheets. Most of the casualties occurred after Lehman Brothers' collapse on 15 September.

Comply or explain regime still offers best value

Europe's 'comply or explain' corporate governance codes are the best means of combining best practice with the flexibility needed by companies and should be retained, according to the EU's commissioner for competition and the internal market, Charlie McCreevy.

McCreevy: very real challenges

McCreevy outlined his views at the Institute of Chartered Secretaries and Administrators' recent EU summit in Brussels.

Keynote speaker at the event, Peter Montagnon, of the Association of British Insurers, said: "Comply or explain faces some very real challenges but we should be careful not to abandon it in favour of an alternative that doesn't deliver value.

"The alternative is regulation, regulation and more regulation of companies, investors and markets."

McCreevy also said that the EU would review companies' risk management and remuneration policies over the coming months in the light of the recent financial crisis. However, he added: "Adjustments may be needed but knee-jerk reactions are not what are required." ■

Silver linings for pension schemes

Recently issued reports offer pension trustees mixed news on the state of company schemes.

Although the surpluses reported just before the credit crunch took hold last year have now been wiped out by bearish stock markets, schemes should still manage to continue paying their accrued benefits, suggests pensions consultancy Mercer, provided, of course, that their sponsoring employers remain solvent.

And while the slide back into deficit will damage companies' balance sheets, Mercer said that recent government bailouts of many major banks will increase the supply of gilts and potentially increase yields.

Deborah Cooper, head of Mercer's retirement resource group, said: "Corporate bond yields are also higher than they have been for a number of years, even after allowing for increased insolvency risk. As a result, balance sheet liabilities have not fallen as steeply as markets suggest. The cost of taking steps to mitigate future risk exposure could also become more reasonable since these are often tied to bond yields."

But the recent spike in the retail price index to 5% will have a £25bn knock-on effect on the UK pensions industry, according to Aon Consulting.

The group's head of corporate solutions, Marcus Hurd, warned that most companies would have factored in a 3% inflation rise and budgeted £15bn rather than £25bn for the commensurate pension increases.

"This additional significant financial burden comes at a time when most UK companies can least afford it," Hurd said. ■

Fed extends rescue to debt markets

The Federal Reserve again rode to the rescue of the US financial system last month. The lifeline this time around was an offer to buy debt directly from US companies unable to borrow short-term funds as the banking crisis intensified.

The US central bank is to buy three-month, unsecured commercial paper (CP) direct from the companies that issue the debt in an effort to unfreeze what is normally a $700bn market. But banks, money market funds and other institutions were increasingly reluctant to buy the debt, preferring instead to hoard cash. In the week ended 1 October, the market contracted by a record $95bn to $1.61 trillion in outstanding debt after a $61bn fall the previous week.

The Fed said it was taking action as the commercial paper market was "under considerable strain" and its action would ensure that eligible issuers would be able to pay investors by rolling over their maturing CP obligations.

On the move...

- **Alex Cockerell**, AMCT, previously a manager for Deloitte & Touche, has joined Dunfermline Building Society as financial risk manager.
- **Neil Cotter**, MCT, has joined PartyGaming as director of treasury and insurance. He moves to the post from his position as group treasurer at LogicaCMG.
- **Peter Graham**, AMCT, has been appointed interim group treasurer at SThree. He was previously interim group treasurer at Torex.
- **Ai Jun Jiang**, AMCT, previously the head of finance at Tiens Biotech Group (USA), has joined Qiao Xing Universal Telephone as chief financial officer.
- **Edward Krawitt**, FCT, has joined Rustins as managing director. Previously he was chief finance officer for Global Strategies Group.
- **Andrew Paton**, MCT, previously assistant treasurer at Rio Tinto, has moved to Kazakhmys as group treasurer.
- **Krzysztof Piechna**, MCT, has been appointed treasury operations manager for Anglo American. Previously he was treasury operations manager for Fujitsu Services.
- **Tom Milligan**, AMCT, previously group treasurer at John Menzies, has been appointed group Treasurer at British Midland Airways.
- **Daniel Shepherd**, AMCT, has joined Liberty International as assistant group treasurer. He previously held the position of treasury manager at easyJet.
- **Daniel Allison**, AMCT, previously treasury manager for Hilton Hotels, has been appointed group treasurer for Monarch Airlines.

MEMBERS' DIRECTORY

Members' contact details are updated regularly at **www.treasurers.org**. *Email changes to Matthew Trickey:* **mtrickey@treasurers.org**, *or phone +44 (0)20 7847 2557.*

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Accounting standard setters react to crunch criticisms

Reacting to criticism of the role of accounting standards in the credit crisis, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have created a global advisory group.

The body will focus on accounting for financial instruments, and will include regulators, preparers, auditors, investors and other users of financial statements.

Sir David: action co-ordinated globally

The advisory group will help to ensure that reporting issues arising from the global economic crisis are considered in an internationally co-ordinated manner.

Sir David Tweedie, chairman of the IASB, said: "Recent statements from the G7 and other world leaders highlight the need for an internationally co-ordinated policy response to the credit crisis.

"The IASB has acted quickly to issue amendments on reclassifications, fair value measurement guidance for illiquid markets, and disclosures. We are pleased that the EU has acted quickly to accept our amendments on reclassifications.

"The new advisory group will help the boards to develop rapidly a co-ordinated response to the economic crisis, and will provide additional global perspective to both standard-setting organisations as we address the increasingly complex issues that investors are facing."

The advisory group will meet in public session and will be webcasting.

Robert Herz, chairman of the FASB, said: "Ongoing developments in the global financial crisis and actions by governments and regulators are reshaping the financial markets here and around the world.

"All of this is likely to raise important issues in financial reporting, both here in the US and across the international capital markets.

"The advisory group that we and the IASB are establishing is aimed at helping both boards to identify reporting issues arising from ongoing developments in the global financial markets so that we can develop common solutions that promote sound reporting and enhance transparency." ■

Beat slump with risk management

Companies can use their risk management and insurance strategies to improve liquidity, free up cash, strengthen financial resilience and maintain profits even during an economic downturn, suggests Marsh.

The insurance broking and risk management group's recently published executive briefing, "Improving Working Capital and Business Resilience", outlines ways for companies to reduce their insurance and risk management costs.

At the same time, it suggests, they can improve their management of changing risk factors such as supplier liquidity, customer default and increasing production and transportation overheads.

"Businesses should welcome the news that there are some simple actions that can be taken around insurance and risk management," said Marsh CEO Martin South.

"These actions can free up cash for use in the business. Insurance can also be used as an additional security to facilitate either greater borrowing or cheaper cost of borrowing, or as a solution to offset liability on the balance sheet."

Among the actions outlined in the briefing, Marsh suggests managing insurance costs to create additional working capital, maximising the value of trade credit insurance, paying insurance premiums by instalment, considering other forms of insurance and building business resilience.

Full details of the report can be accessed at www.marsh.co.uk