

Index

- ABN Amro 10, 59, 149–50, 165
Accountancy Age 32
accountants
 consultant ambitions 262
 credit rating agency links 57–8, 263
 fees 261–2
 future prospects 263
 journal entries 214–15
 litigation threats 7
 monopolies 57–8, 262
 qualified accounts 263
 responsibilities 1, 43–8, 140–1, 157, 165–8,
 199–216, 230–41, 260–3
 service limitation proposals 59–60
 shortfalls 48, 55–7, 117–18, 140–1, 165–8, 174–5,
 177–98, 260–3
 true and fair view 217, 220, 262–3
 Value at Risk 235–41
accounting foundations 21–41
accounting manipulation
 Freddie Mac 17–19
 off-balance sheet vehicles 178–98
Accounting Research Board 51 (ARB 51) 51,
 185–6, 187
accounting standards
 see also Financial . . . ; International . . .
 artificial volatility 22, 26–8, 67–76, 81–3, 221–41,
 245–7
 bifurcation rules 44, 51–2, 120–1, 139–40, 164–5,
 173–4
 company law 166, 230
 credit derivatives 156–7
 credit risk 119–20, 129, 139–57, 159–75, 237–41
 critique 1–2, 3, 4–6, 15, 21–41, 44–5, 54–7, 59–62,
 65–76, 117–18, 153–7, 164–8, 172–5, 202–16,
 217–41, 244–58, 259–63
 derision 31
 embedded derivatives 5, 122–37, 164–5, 245–50,
 253–5
 financial crises contributor 21–2, 31–2, 139, 218
 future prospects 263
 importance perceptions 60
 improvement attempts 1, 259–63
 insurance 6, 24, 156, 171–2, 193–4, 243–58
 loans 15, 21, 24–6, 31, 34–5, 77–115, 146–57
 obeying pressures 1–2, 3, 41, 46, 59–62, 261–2
 matching concept 66, 68, 69–70, 185, 245–50
 mixed-model approach 4–5, 21–2, 23–41, 65–76,
 217–41
 off-balance sheet vehicles 5, 21–3, 177–98,
 221–41, 259–63
 post-Enron rules 32–41, 120–1, 139, 187, 219, 248,
 259–62
 proactive/reactive approaches 29, 41, 261–2
 proprietary trading 202–4
 prudence concept 31
 reform needs 174–5, 261–3
 rogue traders 202–4
 securitisation market 159–60, 162, 164–8, 177–98
 shareholder protection measures 15, 36–9, 121–2,
 218–19
 structured products 119–37, 139–57, 164–75, 263
 activism considerations, shareholders 49–50
Adhikari, Ajay 195–6
AIG 255–8
Allied Irish Bank 133, 199, 201–2
American standards
 see also US
 EU standards 5, 177–98
Americredit 184–5
Amery, Paul 260
annual reports 19, 45–6
approvals, loans 142–4, 157
ARB . . . *see* Accounting Research Board . . .

- arbitrage opportunities 64, 162, 200–4
 rogue traders 200–4
 securitisation market 162
- arrangement fees 22, 36–9, 121
see also effective interest rates
- Arthur Andersen 19, 262
- artificial volatility, concepts 22, 26–8, 67–76, 81–3, 221–41, 245–7
- asset treatments
- artificial volatility 22, 26–8, 67–76, 81–3, 221–41, 245–7
 - cherry-picking 6, 18–19, 28, 41, 72–3, 172–3, 221, 243–4
 - classification of assets 18–19, 24–6, 31, 40–1, 72–6, 93–7, 105–15, 122, 152–3, 164, 172–3, 191–2, 202, 219–23, 226–9, 236–41
 - foreign exchange 104–15
 - IAS 39 18–19, 24–6, 31, 67–76, 87–9, 122, 136–7, 202, 244–57
 - impairment requirements 30–1, 33, 53–4
- asset-backed commercial papers (ABCPs) 192–4
- asset-backed securities 24, 192–4
- Association of British Insurers 32
- audit committees 32
- auditors 2, 6–7, 19, 32, 41, 45–6, 56, 57–60, 139–40, 165–8, 171–2, 182–4, 192, 199–216, 217–41, 261–3
- appointments 57–8
 - conflicts of interest 2, 6, 46, 140, 160, 202, 262
 - consultant ambitions 262
 - fees 2, 59–60, 121, 261–2
 - risk management systems 32
 - service limitation proposals 59–60
 - true and fair view 217, 220, 262–3
- ‘Available for Sale’ assets classification 18–19, 24–6, 31, 40–1, 166, 172–3, 220, 236–41
- average debt levels 35
- the back office 201–4
- bad debts 36–8, 53–4, 146–7, 151–6, 159
see also loan impairments
- balance sheets 2–3, 5, 7–8, 9–10, 14–15, 17–18, 21–2, 23–6, 29, 31, 33, 34, 35, 54–7, 68, 79–115, 126–7, 153–7, 177–98, 235–41
see also off . . .
- consolidations 22, 29, 33, 34, 54–7, 177–80, 185–98
 - embedded derivatives 126–7, 245–50, 253–5
 - pension accounting 32, 33
 - share options 33
- Bank of England 167, 261
- Bank of Ireland 22
- Bankers Trust 52
- banking books, concepts 40–1, 219–23, 229
- bankruptcy risks, banks 159–60
- banks
see also loans
- approved loans 142–3
 - bankruptcy risks 159–60
 - Basel 2 requirements 5, 7–8, 15, 35, 44–5, 86, 119–22, 146–7, 159–60, 162, 166, 203, 217, 228–41, 259–60
 - bonus incentives 1–2, 3–4, 6, 9–10, 11–15, 16–19, 24, 29, 34–5, 41, 43, 44–5, 63–4, 118–20, 200, 202–4, 226–9, 259–63
 - British Government bailout 63–4, 139–40, 149–50, 166, 261
 - careless behaviour 141–2, 259–63
 - credit spirals 217–19, 259–60
 - critique 1–2, 6–10, 29, 34, 54–7, 117–18, 120–1, 139–57, 165–8, 174–5, 199–216, 217–41, 259–63
 - embedded derivatives 128–9, 164–5
 - fees 10–11, 119–20, 121, 165, 174–5
 - footnotes 177–8
 - handouts 1
 - hedge fund contrasts 8, 29, 218
 - Japanese banking crisis 218–19
 - the middle office 201–8
 - moral hazard 44–5, 46, 140–1, 146, 159, 161–2, 167–8
 - offshore vehicles 120–1
 - risk management failings 1–2, 5, 6–10, 29, 34, 39, 54–7, 117–18, 120–1, 133, 139–57, 168–9, 199–216, 223–41, 259–63
 - salary levels 46
 - shareholders 1–2, 7–8, 34, 36–9, 43–64, 121–2, 230–41
 - sources of finance 232–4
 - traders’ dilemma 14–15, 16–19, 46–7
 - UK Treasury Select Committee attacks 140
 - vulture funds 53–4, 56–7
- Barclays 63–4, 168–9, 230
- Barings Bank 199, 201–2, 207, 210, 216, 260
- Barrington, Mike 184–5
- Basel 1 requirements 35, 120–1, 162
- Basel 2 requirements
see also risk measurements
- background 5, 7–8, 15, 35, 44–5, 86, 119–22, 146–7, 159–60, 162, 166, 203, 217, 228–41, 259–60
 - concepts 230–41, 259–60
 - credit rating agencies 233
 - credit spreads 86, 146–7, 233–5
 - critique 44, 119–22, 162, 166
 - implementation delays 146
 - income distributions 230–1
 - internal risk weightings assessments 233–5
 - introduction 230
 - purposes 231–2, 234–5, 241
 - RAROC 119–20, 229

- rationale 234–5
- regulatory arbitrage 162
- volatility 231–4
- Bawag 56
- BCCI 260
- Bear Stearns 7, 44, 46, 160, 263
- beneficial interest 23, 45, 49–50, 57
- Betancourt, Luis 195–6
- bifurcation rules 44, 51–2, 120–1, 139–40, 164–5, 173–4
- Black, Bernard 49
- ‘black box’ mentality, credit rating agencies 62–3
- Black–Scholes options pricing model 16–17, 30, 137
- BNR *see* Incurred But Not Reported Losses
- Bolton, Anthony 35, 143
- bonds 8–9, 10–11, 21–2, 31, 39–41, 47–8, 52–3, 57–61, 77–115, 117–37, 157, 161–2, 171–2, 184, 186–98, 200, 220–41, 256
 - see also* credit rating . . . ; inverse floaters
 - cash flow interest rate swaps 91–7
 - CDOs 47–8, 58–9, 157, 171–2, 184, 256
 - prices 131–2
 - securitisation market 148, 157, 161–2, 168–9, 171–2, 186–98, 232–41
- bonus incentives 1–2, 3–4, 6, 9–10, 11–15, 16–19, 24, 29, 34–5, 36, 41, 43, 44–7, 63–4, 118–20, 146–7, 174–5, 200, 202–4, 226–9, 259–63
- bad debts 36
- Barclays 63–4, 168–9, 230
- Black–Scholes options pricing model 16–17
- British Government restrictions 63–4, 149–50, 166
- examples 11–15, 17–19
- financial crises contributor 1–2, 3–4, 14–15, 16–19, 24, 29, 41, 43, 47, 259–63
- hidden losses 2, 7–8, 9–10, 14–15, 17–18, 23, 24, 44–6, 48, 54–7, 67–8, 76, 118, 128, 172–5, 226–9, 259–60
- measuring considerations 16–19
- moral hazard 44–5, 46, 47–8, 159
- proprietary trading 200
- RAROC adjustments 119–20, 229
- risk measurements 6, 11–12, 14–15, 16–19, 43, 44–5, 118–22, 128–9, 159–60, 174–5, 200, 202–4, 259–63
- share price alignments 48
- statistics 47–8
- traders’ dilemma 11–15, 16–19, 46–7
- Value at Risk 229
- volatility 3, 15, 16–17, 36, 48, 149–50, 200, 202–4, 226–9
- book values *see* cost model
- Boots 144
- ‘breakeven’ credit spread 145–6
- Brendsel, Leland 17
- British Government
 - see also* UK
 - banks 63–4, 139–40, 149–50, 166, 261
 - bonus incentives 63–4, 149–50, 166
 - credit crunch 63–4, 166
 - moral hazard problems 167
- bubbles 259–61
- Buffett, Warren 7, 10, 17, 48, 259
- business combinations *see* consolidations
- Business Week* 182–3
- Cable, Vince 64
- call options 16–17, 22, 48, 137, 200
 - Black–Scholes options pricing model 16–17, 137
 - proprietary trading 200
- Capco 257–8
- Carlyle Hedge Fund 218
- carry trade 54, 104, 171–2
- ‘carve out’ features from IAS 39 1–2, 5, 24–6, 28, 65–6, 217, 219–41
 - see also* ‘fair value option’
- cash flow (CF) hedge qualification
 - concepts 69–76, 77–8, 91–115, 208–15, 217–41
 - effectiveness 73–4, 112, 115
 - foreign currency transactions 100–15
 - illustrative examples 77–8, 91–115, 208–15
- cash flow interest rate swaps 91–7
- CDF *see* cumulative discount factor
- CDOs *see* Collateralised Debt Obligations
- CDS *see* Credit default Swaps
- central banks
 - handouts 1
 - interest rates 163
- CEV *see* Current Exit Value
- CF *see* cash flow . . .
- CFD *see* Contract for Difference
- cherry-picking opportunities 6, 18–19, 28, 41, 72–3, 172–3, 221, 243–4
- chief executive officers
 - see also* directors
 - ‘retiring’ executives 43, 46–8
- China 171
- Chirac, Jacques 219–20
- Citibank 7, 43, 45–7, 140, 164, 177–8, 184, 218
- Citigroup 32, 43, 53, 177–8, 184
- Citron, Robert 52, 117–19
- classification of assets 18–19, 24–6, 31, 40–1, 72–6, 93–7, 105–15, 122, 152–3, 164, 172–3, 191–2, 219–23, 226–9, 236–41
- classification as debt/equity considerations 15, 34–5, 122, 189, 191–2
- Collateralised Debt Obligations (CDOs) 47–8, 58–9, 157, 171–2, 184, 256
- commercial paper 192–4, 218
- commodity risk 117, 129, 141, 164
- company law, accounting standards 166, 230

- complexity problems 1–2, 3, 5, 7, 9–11, 21–2, 23, 27–8, 29, 43, 44, 45–6, 48–52, 61–4, 65–76, 117–37, 139–40, 164–71, 173–4, 203–4, 207–8, 223–4, 261–3
- attributes 10–11
- bifurcation rules 44, 51–2, 120–1, 139–40, 164–5, 173–4
- financial crises contributor 3, 5, 7, 29, 31–2, 43, 48–9, 61–4, 139, 261
- future prospects 263
- liquidity links 166
- ‘conduit’ 192
- conflicts of interest 2, 6, 9, 10, 45–50, 60–2, 140, 160, 170–1, 202, 262–3
- auditors 2, 6, 46, 140, 160, 202, 262
- credit rating agencies 2, 6, 10, 45–7, 48–9, 140, 160, 262
- ‘independent’ valuers 6, 263
- institutional investors 6, 45–6, 60–2, 140, 170–1, 202, 262–3
- shareholders 49–50, 202
- consolidations 22, 29, 32, 33, 34, 54–7, 177–80, 185–98
- see also* goodwill; mergers ...
- FASB rules 185–9, 195–8
- IAS 27 *Consolidation* 22, 29, 32, 34, 177
- IFRS rules 185, 189–98
- non-consolidations 55–7, 178–80
- off-balance sheet vehicles 34, 54–7, 177–80
- Constant Proportion Debt Obligation (CPDO) 10, 48–9, 59, 62–4, 165
- contagion effect 218
- Contract for Difference (CFD) 45, 49–50
- convertible bonds 64, 200
- ‘cookie jar’ reserves 4, 18–19, 23, 146–7, 152–3
- corporate governance 5, 41, 43–64, 144–50, 168–9, 185–6, 188–9, 260–3
- beneficial ownership 49–50, 57
- complex structured products 48–51
- derivatives 49–51, 168–9
- EU efforts 49, 50
- hedge funds 49–50
- investment entities 60–2
- non-consolidations 54–7, 177–80
- shareholder votes 49–50, 57, 60–1, 144, 185–6, 188–9, 260, 262–3
- structured products 51–3, 168–9
- correlation coefficient 228–34
- cost model 6, 18–19, 23–31, 41, 65–76, 172–3, 217–41, 243–58
- benefits 28, 217
- cherry-picking 6, 18–19, 28, 41, 72–3, 172–3, 221, 243–4
- concepts 23–31, 65–76, 172–3, 217–41
- general guidelines 26, 31
- impairment treatments 31, 33
- insurance 244–58
- mixed-model approach 4–5, 21–2, 23–41, 65–76, 217–41
- ‘covenant lite’ loans 140, 143–4
- CPDO *see* Constant Proportion Debt Obligation
- creative accounting 9–10, 17–19, 21–3, 28, 30, 36, 54–7, 67–76, 102–5, 118, 146–7, 172–3, 180–9, 243–58
- see also* cherry-picking; ‘cookie jar’ reserves; off-balance sheet vehicles
- foreign loans 102–5
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* 18, 23, 36, 146–7, 151–3
- insurance products 243–5
- credit crunch 1–3, 6–7, 16–19, 24, 31–2, 43, 51, 55, 58–9, 63–4, 120–1, 139–40, 141, 147–8, 157, 159–60, 174–5, 217–18, 235, 259–60, 262–3
- see also* financial crises
- contagion effect 218
- contributing factors 2–3, 16–19, 24, 31–2, 43, 139, 217–18, 235, 259–63
- credit rating agencies 147–8
- credit spirals 218–19, 259–60
- credit default risk 129, 148–50
- Credit default swaps (CDS)
- see also* financial guarantees
- concepts 148–50, 156–7, 163, 173–4, 218, 244
- prepayment risk synthetic securitisations 162–3
- credit derivatives 2, 7–11, 63, 141–2, 148–57, 160, 163, 167–8, 171–2, 173–4, 193–4, 218, 221–41, 243–58, 262–3
- see also* financial guarantees
- accounting rules 156–7
- bank fees 10–11
- concepts 7–10, 63, 141–2, 148–57, 163, 167–8, 218, 237–41, 243–4
- critique 7–10, 141–2, 148–50, 156–7, 167–8, 221–41, 243–4, 262–3
- financial crises contributor 156–7, 218
- IAS 39 150, 156–7, 237–8
- insurance 156, 160, 167–8, 171–2, 193–4, 243–58
- loan documentation 9
- prepayment risk synthetic securitisations 162–3
- statistics 8–9
- credit migration risk 129
- credit rating agencies 2, 6, 10, 45–7, 48–9, 57–9, 139–57, 160–3, 165–8, 232–41, 262–3
- accountant links 57–8, 263
- appointments 57–8
- Basel 2 requirements 233
- ‘black box’ mentality 62–3
- conflicts of interest 2, 6, 10, 45–7, 48–9, 140, 160, 262
- CPDOs 10, 48–9, 59, 62–4, 165
- credit crunch 147–8

- critique 2, 6, 10, 45–7, 48–9, 57–9, 139–57, 160, 163, 165–8, 232–3, 262–3
- downgrades 237–8, 256
- fees 2, 45–6, 52, 160
- inverse floaters 52–3, 127–8
- litigation threats 61–2, 148
- monoline insurance companies 147–8, 171–2, 193–4
- monopolies 57–8, 148, 262
- regulatory powers 233
- reputations 57–8, 148
- responsibilities 165–8
- structured products 51–3, 139–57, 160–2, 163, 165–8
- ‘super-senior’ investment products 148, 168–9
- UK Treasury Select Committee attacks 140
- credit risk 2, 5, 6, 7–10, 51–3, 63, 83–91, 114–15, 117, 119–20, 129–30, 139–57, 159–75, 190, 207–8, 221, 237–41, 261
- accounting standards 119–20, 129, 139–57, 159–75, 237–41
- CDS 148–50, 156–7, 173–4
- concepts 129, 139–57, 159–75, 207–8, 237–41, 261
- credit derivatives 2, 7–11, 63, 141–2, 148–57, 160, 163, 167–8, 171–2, 173–4, 193–4, 218, 221–41, 243–58, 262–3
- financial guarantees 141, 156, 167–8
- IFRS 7 disclosures 238–41, 260–1
- loans 142–56
- RAROC adjustments 119–20, 229
- structured products 51–3, 117, 129–30, 139–57, 159–75, 190, 237–41
- types 129
- credit spirals 217–19, 259–60
- credit spreads 37–8, 77, 81–97, 144–5, 212–15, 224–6, 233–5, 237–41
- Basel 2 requirements 86, 146–7
- ‘breakeven’ credit spread 145–6
- concepts 81–97, 144–5, 224–6, 233–5, 237–41
- definition 81, 86
- examples 86–91, 144–6, 234–5, 237–8
- FASB treatment 87–91
- IAS 39 treatment 87–9, 237–8
- incorrect calculations 86
- swaps 81–91
- Credit Suisse 169–71
- CTW 32
- cumulative discount factor (CDF), valuations of swaps 82–3
- Current Exit Value (CEV) 255
- Darling, Alistair 261
- data-capture failings, rogue traders 201–4
- Davies, Paul J. 54
- Davis, Paul 178, 194
- DB Zwirn hedge fund 6
- debt
- see also* liability . . . ; loans
- average debt levels 35
- bad debts 36–8, 53–4, 146–7, 151–6, 159
- IAS 32 *Debt vs. Equity Classification* 15, 34–5, 122, 189, 191–2
- off-balance sheet vehicles 35
- ‘Debtors/Creditors’ control accounts 204
- Deferred Profit & Loss accounts 72–6
- deposit criterion, property clubs 143, 157
- derivatives 1–2, 5, 7–10, 13–15, 18–19, 23, 27–8, 29, 39–40, 49–53, 65–76, 79–115, 121–37, 149–57, 167–8, 203–16, 221–41, 262–3
- see also* credit . . . ; forward contracts; futures; hedge accounting; options; structured products; swaps
- artificial volatility 22, 26–8, 67–76, 81–3, 221–41, 245–7
- concepts 13–15, 39–40, 49–53, 65–76, 121–37, 149–57, 262–3
- corporate governance 49–51, 168–9
- critique 7–10, 18–19, 29, 39–40, 49–53, 65–76, 117–18, 121–2, 149–50, 165–8, 203–4, 221–41, 262–3
- definition 129–30
- embedded derivatives 5, 122–37, 245–50, 253–5
- FAS 153 18–19, 59–60, 78–115, 122–6, 128–9, 262 forms 13–15
- fundamentals 129–30
- IAS 39 1–2, 5, 23, 27–8, 39–40, 65–76, 122, 150, 156–7, 237–8, 244–57
- loss-making derivatives 30
- market value (mark-to-market) accounting 39–40, 172–3
- Profit & Loss accounts 39–40, 67–115, 126–7, 164–9, 245–50, 253–5
- settlement 129–30
- types 130–7
- volatility 39–40, 48, 65–6, 69–76, 81–3, 200, 227–9
- ‘weapons of mass destruction’ 7, 10, 168
- Deutsche Bank 50, 61, 127
- directors
- see also* chief executive officers
- auditors 57–8
- responsibilities 32, 43–64, 202–4, 262–3
- ‘retiring’ chief executives 43, 46–8
- disclosures 5, 9, 11, 15, 23, 43, 44, 50, 119, 122, 126–7, 140–1, 169–71, 178, 190–2, 202–4, 227–41, 260–3
- see also* transparency shortfalls
- accounting 235–41
- credit disclosures 238–41
- critique 178, 235–41, 260–3
- IFRS 7 *Financial Instruments: Disclosures* 5, 9, 11, 15, 23, 43, 44, 122, 128–9, 141, 142, 190–2, 227–41, 260–1

- discount factors
 valuations of forwards 101–15, 133–4
 valuations of swaps 80–91, 124–6, 213–15
- diversification issues
 hedge funds 8
 structured products 147–8, 159–60, 163
 Value at Risk 227–9
- dividends, shareholders 63–4, 230–1
- documentation requirements
 headings 114–15
 hedge accounting 100, 114–15
 swaps 59–60
- dot.coms 23, 53–4
- double-counting 196–8
- downgrades, credit rating agencies 237–8, 256
- Dynegy 23, 181–2
- Earnings Per Share (EPS) 3–4
- EBF *see* European Banking Federation
- Eden, James 64
- EEV *see* European Embedded Value
- effective interest rates 22, 36–9, 57, 156, 171–2, 251–2
see also arrangement fees
- Elan 182–4
- embedded derivatives
see also structured products
 banks 128–9, 164–5
 concepts 5, 122–37, 164–5, 245–50, 253–5
 definition 129
 illustration of the problem 122–6
 new accounting treatment 126–8
 old accounting method 126–7
- embedded value process, insurance 245–50, 253–5
- endowment mortgages 260
- Enron 7, 22, 23, 31–2, 34, 41, 55, 56, 120–1, 139, 183, 187, 219, 248, 259–62
- EPS *see* Earnings Per Share
- Equitable Life 260
- equity
 concepts 34–5, 122
 IAS 32 *Debt vs. Equity Classification* 15, 34–5, 122, 189, 191–2
 risk 117, 129, 141, 164
- Equity Reserve account 26, 40, 72–6, 93–8, 105–15, 153, 166, 172–3, 210–15, 220–2
- Ernst & Young 59
- Eurex 199
- European Banking Federation (EBF) 223, 226
- European Embedded Value (EEV) 248–50
- European Union (EU) 1–2, 5, 27–8, 65–6, 177–98, 199, 217, 219–23
 American standards 5, 177–98
 IAS 39 pressures 1–2, 27–8, 65–6, 217, 219–23, 241
 Société Générale (SocGen) 5, 39, 199–203, 207, 210, 216, 260
 ‘external’ shareholders 188–9
- fair value hedge qualification
 concepts 69–76, 77–115, 208–15, 217–41
 illustrative examples 77–115, 208–15
 options 114
- ‘fair value option’ (FVO)
see also ‘carve out’ features from IAS 39; market valuations
 background 5, 6, 24–6, 40, 44, 49, 54, 67–76, 169, 197–8, 217, 226–41
 concepts 226–7, 237–41
 corporate governance 49, 50
- Fannie Mae 3–4, 17
- FAS 125 *Accounting for Transfer of Assets and Extinguishment of Liabilities* 19
- FAS 133 *Accounting for Financial Instruments and Hedging* 7, 18–19, 59–60, 78–115, 122–6, 128–9, 262
 critique 18, 59–60, 128–9, 262
 Freddie Mac 18–19
- FAS 140 34
- FASB *see* Financial Accounting Standards Board
- the Federal Reserve Board 1, 46, 166–7
- fees
 accountants 261–2
 auditors 2, 59–60, 121, 261–2
 banks 10–11, 119–20, 121, 165, 174–5
 credit rating agencies 2, 45–6, 52, 160
 insurance companies 244–7
 investment funds 11–15, 46–7, 119, 121
- fictitious provisions *see* ‘cookie jar’ reserves
- Fidelity 143
- Financial Accounting Standards Board (FASB)
see also FAS . . . ; SFAS . . .
 consolidation rules 185–9, 195–8
 credit spreads 87–91
 foreign currency transactions 100–15
 hedge accounting rules 66–7, 77–115
 interest rate swaps 87–91
 lobbying pressures 3, 53–4, 60, 261–2
 off-balance sheet vehicles 185–9, 195–8
 QSPEs 177, 179–80, 186–9, 195–6
 revenue recognition 53–4
 SAB 101 23, 54, 256–7
 Statement no 138 89–91
- financial crises 1–3, 16–19, 24, 31–2, 43, 51, 55–7, 58–9, 63–4, 120–1, 139–40, 141, 147–8, 156–7, 159–60, 174–5, 217–18, 235, 259–60
see also credit crunch
- contributing factors 2–3, 16–19, 24, 31–2, 43, 139, 217–18, 235, 259–63
- credit spirals 218–19, 259–60

- financial engineering, critique 7, 117–18, 159–60, 165–8, 259–63
- financial guarantees 141, 156, 167–8
see also credit derivatives
- financial instruments
see also derivatives
 complexity problems 1–2, 3, 5, 7, 9–11, 21–2, 23, 27–8, 43, 45–6, 48–51, 61–4, 65–76, 117–37, 139–40, 164–71, 203–4, 207–8, 223–4, 261
 misuse concerns 8–10
 nature and extent of risks 239–41
 valuations 1, 4–6, 9–10, 18, 19, 21–2, 23–31, 65–76, 128–9, 165–6, 221–41
 Value at Risk 239–41
- Financial Services Act 1986 260
- Financial Services Authority 175, 261
- Financial Times* (FT) 24, 35, 46, 47, 53, 54, 57, 63–4, 128, 142–4, 147, 149, 156–7, 160, 165, 167–9, 177–8, 183–4, 193–4, 199–200, 203, 207, 218–19, 248, 256
- finite insurance 250–2
- 'First to Default' bonds 173–4
- fixed rates, interest rate swaps 65–6, 77–115, 133–7, 207–15, 222–3
- floating bonds 40–1
- floating rates, interest rate swaps 65–6, 77–115, 133–7, 207–15, 222–3
- Flottl, Walter 56
- footnotes, banks 177–8
- Ford Motor Company 195–6
- foreign currency forwards 30, 65–6, 69–76, 100–15
 accounting treatments 108–12
 concepts 69–76, 100–15
 interest rate changes 102
 time value 108–15
 transaction costs 100–15
 valuations 101–15
 value change reasons 108
- foreign exchange 5, 30, 65–6, 69–76, 100–15, 208–15
 accounting treatment 108–12
 concepts 100–15
 creative accounting 102–5
 examples 100–2
 IAS 21 *The Effects of Changes in Foreign Exchange Rates* 102–15
 risk 51, 117, 129–30, 141, 164
- foreign loans, borrowing expenses 102–5
- forward contracts 30, 65, 66–76, 100–15, 121–2, 130–7, 205–15
see also derivatives
 examples 74–6, 100–15, 132–7
 futures contrasts 132–3
 hedge accounting 66–76, 100–15
 interest rate changes 102, 133–7
 pre-IAS 39 accounting 67–8
 time value 108–15
 valuations 101–15
 value change reasons 108
- Forward Rate Agreements (FRAs) 74–6
- Freddie Mac 17–19
- FT *see* *Financial Times*
- FTSE 129
- fund managers *see* investment funds
- future prospects 263
- futures 49–50, 65, 121, 130–7, 204–16
 concepts 130–2, 204–16
 examples 130–2, 204–15
 forwards contrasts 132–3
 initial margin 130–2, 204–16
 interest rate changes 131–2
 margins 130–2, 204–16
 valuations 131–2
 variation margin 130–2, 204–16
- FVO *see* 'fair value option'
- Gapper, John 47, 256
- Garland, Michael 32
- gearing 12–15, 122, 231
see also debt; loans
- Gen Re 257
- German banks 192
- Gibson Greetings 52
- glossary 265–6
- goodwill 22, 23–4, 29–31, 32, 33, 55–7, 64, 249–50
see also consolidations; reputations
 accounting abuses 29–30, 33, 55–7
 impairment requirements 30–1, 33
 valuations 23–4, 29–30, 33, 55–7, 249–50
- Goodwin, Fred 149–50
- Greek pension funds scandal 52–3, 127–8
- Guardian* 56, 173, 180–1
- Gulf funds 171
- hedge accounting 1–2, 5–6, 8, 16–19, 23, 27–8, 29, 39–41, 65–76, 77–115, 130–7, 208–15, 217–41
 artificial volatility 26–8, 67–76, 81–3, 221–41
 cash flow hedge qualification 69–76, 77–8, 91–115, 208–15, 217–41
 cash flow interest rate swaps 91–4
 concepts 1–2, 5–6, 8, 16–19, 23, 27–8, 29, 39–41, 65–76, 77–115, 130–1, 133–7, 217–18
 credit spreads 81–97, 224–6
 critique 1–2, 5–6, 8, 16–19, 23, 27–8, 29, 65–76, 217–18
 documentation requirements 100, 114–15
 effectiveness 73–4, 112, 115
 fair value hedge qualification 69–76, 77–115, 208–15, 217–41
 FASB rules example 66–7, 77–115
 foreign exchange hedge 100–15
 forward contracts 66–76, 100–15
 FRA example 74–6

hedge accounting (*Continued*)

- IAS 39 1–2, 5, 23, 27–8, 32, 39–41, 65–76, 87–9, 136–7
- illustrative examples 77–115, 208–15
- interest rate swaps 65–6, 77–115, 208–15
- matching concept 66, 68, 69–70, 185
- net investments in foreign operations hedging qualification 69–76
- options 112–14
- permissions 40–1, 65–6, 69–76, 81–97, 108, 112, 114–15, 130–1, 208–15, 226–9
- pre-IAS 39 accounting 67–8
- rules 40–1, 65–6, 69–76
- swaps 65–6, 77–115, 133–7, 208–15
- swaptions 112–14
- Value at Risk 224–6
- hedge funds 6, 8, 9–10, 16–19, 29, 49–50, 53–4, 56–7, 72–3, 132–7, 139–57, 167–8, 172–3, 191–2, 200–15, 218–23, 224–6, 244, 260
- bank contrasts 8, 20, 218
- cherry-picking 6, 18–19, 29, 72–3, 172–3, 221
- corporate governance 49–50
- diversification needs 8
- regulation shortfalls 8, 49–50
- relative value trading 200–4
- vulture funds 53–4, 56–7
- 'Held to Maturity' assets classification 18–19, 24–6, 31, 40–1, 153, 164, 220, 236–41
- Hewlett-Packard 61
- hidden losses
 - off-balance sheet vehicles 2, 7–8, 9–10, 14–15, 17–18, 21–2, 23–4, 29, 31–2, 44–6, 48, 54–7, 65–6, 67–8, 76, 118, 128, 153, 172–5, 180–5, 218–19, 226–9, 244, 255–8, 259–60
 - roque traders 200–4, 216
- HSBC 127, 177–8, 230
- Hu, Henry T.C. 49
- Hughes, Jennifer 156–7
- IAS *see* International Accounting Standard . . .
- IASB *see* International Accounting Standards Board
- IFRS . . . *see* International Financial Reporting Standard . . .
- IIF *see* Institute of International Finance
- illiquid nature, structured products 51–2, 117–18, 120–1, 164–6, 207–9, 217–18, 224, 263
- ILP *see* Irish Life & Permanent
- IMF *see* International Monetary Fund
- impairment requirements
 - asset treatments 30–1, 33, 53–4
 - loan impairments 32, 36, 38, 53–4, 147, 151–6
- implied volatility 169
- incentives *see* bonus incentives
- Incurred But Not Reported Losses (IBNR) 147
- independent financial advisors 142–3, 157, 263
- 'independent' valuers, conflicts of interest 6, 263

inefficient nature

- loans 157
- structured products 51, 157
- initial margin, futures 130–2, 204–16
- Institute of Chartered Accountants in England and Wales 173
- Institute of International Finance (IIF) 62
- institutional investors 2, 6, 41, 45–6, 49–50, 60–2, 140, 144, 170–1, 202, 262–3
 - conflicts of interest 6, 45–6, 60–2, 140, 170–1, 202, 262–3
 - voting powers 2, 41, 45–6, 49–50, 60–1, 144, 260, 262–3
- insurance
 - see also* life assurance companies
 - accounting 6, 24, 156, 171–2, 193–4, 243–58
 - AIG collapse 255–8
 - artificial volatility 245–7
 - cherry-picking opportunities 243–4
 - credit derivatives 156, 160, 167–8, 171–2, 193–4, 243–58
 - critique 1–2, 6, 9–10, 117, 147–8, 160, 171–2, 193–4, 243–58
 - EEV 248–50
 - embedded value process 245–50, 253–5
 - fees 244–7
 - finite insurance 250–2
 - IAS 3 252–3
 - IAS 39 243–57
 - IASB 243–5, 251–5
 - IFRS 4 156, 243–58, 260
 - Lloyds TSB case study 248, 250
 - loans 243–4, 250–1, 255–8
 - mismatching case study 245–50
 - negative carry trade 54, 171–2, 193–4
 - off-balance sheet vehicles 6, 160, 171–2, 193–4, 243–58
 - Phase Two embedded value 243, 253–5
 - regulations 156, 243–58
 - reinsurance contracts 244, 250–2, 256–8
 - significance of risk 244–7
 - unbundled loans 250–2
 - up-front costs 244–7
- Interest Margin Hedging (IMH) 223
- interest rate futures 204–15
- interest rate risk 51, 117, 129–30, 141, 164
- interest rate swaps 19, 27, 56, 59–60, 65–6, 77–115, 123–6, 133–7, 189–90, 208–15, 221–41
 - see also* swaps
 - cash flow interest rate swaps 91–7
 - credit spreads 81–97
 - FASB treatment 87–91
 - hedge accounting 65–6, 77–115, 133–7, 208–15
 - IAS 39 treatment 87–9, 136–7
 - interest rate changes 94–7
 - long accounting treatment method 87–91, 94–100

- short-cut accounting treatment method 87–91, 93–100
- shortcut valuation procedures 82–3
- two accounting treatments 87–9
- unwind of the discount 94–7
- valuations 80–3, 124–6, 133–7
- value change reasons 94–7
- interest rates 10, 19, 22, 26–8, 37–8, 48–9, 52–3, 56, 59–60, 62–3, 65–6, 76, 77–115, 122–6, 129, 131–7, 145–6, 161–2, 164, 171–2, 189–90, 204–15, 222–5, 234–8
- central banks 163
- credit spreads 37–8, 77, 81–97, 144–6, 233–5, 237–41
- effective interest rates 22, 36–9, 57, 156, 171–2, 251–2
- foreign currency forwards 102
- forward contracts 102, 133–7
- futures 131–2
- inverse floaters 52–3, 127–8
- Libor 10, 37–8, 48–9, 62–3, 76, 78–91, 102–3, 122–6, 129, 133–7, 145–6, 161–2, 164, 171–2, 189–90, 204–5, 209–10, 214–15, 222–5, 234–8
- unexpected changes 94–7
- internal risk weightings assessments, Basel 2 requirements 233–5
- International Accounting Standard, IAS 8 *Accounting Policies, Change in Accounting Estimates and Errors* 253
- International Accounting Standard, IAS 18 *Revenue Recognition* 23, 43, 53–4, 171–2, 189, 193–4, 235, 256–7
- International Accounting Standard, IAS 19 *Provision Accounting* 32, 33, 118
- International Accounting Standard, IAS 21 *The Effects of Changes in Foreign Exchange Rates* 102–15
- International Accounting Standard, IAS 27 *Consolidation* 22, 29, 32, 34, 177
- International Accounting Standard, IAS 32 *Debt vs. Equity Classification* 15, 34–5, 122, 189, 191–2
- International Accounting Standard, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* 18, 23, 36, 146–7, 151–6
- International Accounting Standard, IAS 39 *Financial Instruments: Recognition and Measurement*
- asset treatments 18–19, 24–6, 31, 67–76, 87–9, 122, 202
- background 1–2, 5, 7, 11, 15, 22–3, 27–41, 44, 51–2, 65–76, 87–9, 102–4, 122, 128–9, 136–7, 140–1, 151–3, 189, 191, 195–8, 202, 209–15, 243–4, 260
- bank fees 11
- Beneficial Interest* 23, 57
- bifurcation rules 44, 51–2, 120–1, 139–40, 164–5
- ‘carve out’ features 1–2, 5, 24–6, 28, 65–6, 217, 219–41
- Classification of Assets* 24–6, 32, 40–1, 73–4, 152–3, 164, 172–3, 226–9, 237–41
- credit derivatives 150, 156–7, 237–8
- critique 68, 122, 128–9, 153–7, 195–8
- double-counting 196–8
- Effective Interest Rates* 22, 36–9
- embedded derivatives 122, 128–37
- EU pressures 1–2, 5, 27–8, 65–6, 217, 219–23, 241
- foreign exchange 102–15
- hedge accounting 1–2, 5, 23, 27–8, 32, 39–41, 65–76, 87–9, 136–7
- Hedge and Derivative Accounting* 1–2, 5, 23, 27–8, 32, 39–41
- insurance 243–57
- interest rate swaps 87–9, 136–7
- Loan Impairment* 32, 36, 147, 153–6
- loans 32, 36, 147, 151–6
- two versions 5, 28, 217, 219–41
- International Accounting Standards Board (IASB)
- background 1–2, 5, 22–3, 27–8, 65–6, 178, 195–8, 217–41, 243–5, 251–5
- EU pressures 1–2, 5, 27–8, 65–6, 217, 219–23, 241
- improvements 22–3, 178
- insurance 243–5, 251–5
- off-balance sheet vehicles 189–98, 243–5
- International Financial Reporting Standard, IFRS 2 *Share-Based Payments (employee benefits)* 16–17, 22, 32–3, 45, 60, 192
- International Financial Reporting Standard, IFRS 3 *Goodwill (Business Combinations)* 22, 29, 32, 33, 55–7, 64, 76, 189–98
- International Financial Reporting Standard, IFRS 4 *Accounting for Insurance* 156, 243–58, 260
- International Financial Reporting Standard, IFRS 7 *Financial Instruments: Disclosures* 5, 9, 11, 15, 23, 43, 44, 122, 128–9, 141, 142, 190–2, 227–41, 260–1
- concepts 235–41, 260–1
- qualitative/quantitative disclosures 240–1
- International Financial Reporting Standards
- financial crisis contributor 31–2
- post-Enron rules 32–41, 187, 219, 248, 259–62
- International Monetary Fund (IMF) 140, 156
- International Swaps Dealers Association (ISDA) 8, 59–60
- Internet bubble 260
- intrinsic value of options 112–14
- inventory valuations 66–70
- inverse floaters 5, 48, 52–3, 127–8
- see also* structured products
- investment banks 32, 53–4, 56–7, 157
- see also* banks
- investment entities, corporate governance 60–2

- investment funds 11–15, 46–7, 117–18, 119, 121, 245–7
 gearing 12–15, 122
 management fees 11–15, 119, 121, 245–7
 performance fees 11–15, 46–7, 119, 121
 traders' dilemma 11–15, 46–7
- investment trusts 2, 9–10, 41, 49–50, 260, 262–3
- investors
 see also shareholders
 voting powers 2, 41, 45–6, 49–50, 57, 60–1, 144, 185–6, 188–9, 260, 262–3
- IR swaps *see* interest rate swaps
- Irish Life & Permanent (ILP) 245–7
- ISDA *see* International Swaps Dealers Association
- Jackson, Tony 24
- Japanese banking crisis 218–19
- joint ventures 182–4
- journal entries, accountants 214–15
- JPMorgan 52–3, 127–8, 259
- Jubb, Guy 50
- Kerviel, Jerome 199–203, 207, 210, 216
- King, Mervyn 261
- King Pharmaceuticals 50
- KKR 144
- KPMG 56, 182–3, 186–7
- Latin American crises 219
- Leeson, Nick 199, 201–2, 207, 210, 216
- lessons learned 61–2, 127–8, 259–63
- leveraged buyouts (LBOs) 57, 231
- Levitt, Arthur 4, 18, 56, 59–61, 261–2
- LGD *see* loss given default
- liability treatments 15, 22, 26–8, 30, 34–5, 57–76, 81–3, 104–15, 122, 189, 191–2, 202, 221–41, 245–7
 artificial volatility 22, 26–8, 67–75, 81–3, 221–41, 245–7
 foreign exchange 104–15
 loss-making derivatives 30
- Libor 10, 37–8, 48–9, 62–3, 76, 78–91, 102–3, 122–6, 129, 133–7, 145–6, 161–2, 164, 171–2, 189–90, 204–5, 209–10, 214–15, 222–5, 234–8
- life assurance companies 6, 243–58
 see also insurance
- linear derivatives, concepts 13–15
- liquidity crisis *see* credit crunch
- liquidity risk 6, 119–20, 174, 190, 207–9, 217–18, 224, 229, 259–60
 control efforts 259–60
 RAROC adjustments 119–20, 229
- litigation threats
 accountants 7, 61–2
 credit rating agencies 61–2, 148
- Lloyds TSB 248, 250
- loan impairments 32, 36, 38, 53–4, 147, 151–6
 see also bad debts
- loans 5, 6, 9, 14–15, 21, 22, 24–6, 29, 31, 32, 34–5, 36–9, 40–1, 45–6, 53–4, 77–115, 140–57, 159–75, 186–98, 213–15, 217–41, 243–4, 250–2, 255–8
 see also banks; debt . . .
 accounting standards 15, 21, 24–6, 31, 34–5, 77–115, 146–57
 approvals 142–4, 157
 bad debts 36–8, 53–4, 146–7, 151–6, 159
 'cherry-picked' loans 6, 29, 72–3, 172–3, 221, 243–4
 'covenant lite' loans 140, 143–4
 credit derivative documentation 9
 credit risk 142–56
 credit spreads 37–8, 77, 81–97, 144–6, 233–5
 effective interest rates 22, 36–9, 57, 156, 171–2, 251–2
 foreign loans 102–5
 IAS 39 32, 36, 147, 151–6
 inefficient nature 157
 insurance 243–4, 250–1, 255–8
 LGD 144–6, 233–4
 moral hazard 44–5, 46, 140–1, 146, 159, 161–2, 167–8
 PD 144–7, 154–5, 234–5, 238–41
 poor credit controls 142–4
 pre-IAS 39 accounting 151–3
 rules 151–6, 228–41
 securitisation market 5, 142–4, 157, 159–75, 186–98
 self-certified earnings 157
 SPVs 29, 152–3, 161–2, 178–98
 sub-prime loans 14–15, 24, 43, 57, 141–4, 159–60, 162, 166–7, 174–5, 178, 184–5, 192, 218, 235, 259–60
 term sheets 36–9
 unbundled loans 250–2
 vulture funds 53–4, 56–7
- 'Loans & Receivables' assets classification 24–6, 31, 40–1, 219–20, 236–41
- lobbying pressures, accounting standards 1–2, 3, 41, 46, 59–62, 261–2
- long accounting treatment method, interest rate swaps 87–91, 94–100
- Long Term Capital Management (LTCM) 164–8, 191, 200, 260
- loss given default (LGD) 144–6, 233–4
- loss-making derivatives 30
- losses
 moral hazard 44–5, 46, 140–1, 146, 159, 161–2, 167–8
 profit smoothing 4, 17–18, 36, 67–8, 146–7
- LTCM *see* Long Term Capital Management

- McCreevy, Charlie 49–50, 199
- Mackintosh, James 53
- management fees, investment funds 11–15, 119, 121, 245–7
- margins, futures 130–2, 204–16
- mark-to-market accounting *see* market value . . .
- market risk 2, 5, 51–3, 114–15, 117–37, 139–40, 164, 190, 227, 229, 244–7
- RAROC adjustments 119–20, 229
- structured products 117–37, 139–40, 190
- market valuations 4–6, 10, 18, 19, 21–2, 23–31, 39–40, 44, 65–76, 128–9, 165–6, 169, 172–3, 197–8, 217–41, 262–3
- see also* ‘fair value option’
- concepts 23–31, 39–40, 44, 165–6, 169, 172–3, 217–41
- critique 5–6, 10, 18, 19, 21–2, 23–31, 65–76, 165–6, 169, 172–3, 217–41, 262–3
- general guidelines 26, 31
- mixed-model approach 4–5, 21–2, 23–31, 65–76, 217–41
- market value (mark-to-market) accounting 29, 30–1, 39–40, 128–9, 172–3, 217–41
- benefits 29, 39–40, 217
- concepts 29, 30–1, 39–40, 172–3, 217–41
- derivatives 39–40, 172–3
- marking-to-model accounting, concepts 30
- matching concept 66, 68, 69–70, 185, 245–50
- materiality concept 4
- mergers & acquisitions 30, 33–4, 45
- see also* consolidations; goodwill
- Merrill Lynch 7, 32, 46, 47, 148
- the middle office 201–8
- misuse concerns, financial instruments 8–10
- mixed-model approach 4–5, 21–2, 23–41, 65–76, 217–41
- see also* cost . . . ; market value . . .
- monetary assets/liabilities, concepts 104–5
- monoline insurance companies 54, 147–8, 160, 171–2, 193–4
- monopolies
- accountants 57–8, 262
- credit rating agencies 57–8, 148, 262
- Montagnon, Peter 32
- Moody’s 58, 160, 165
- moral hazard 44–5, 46, 47–8, 140–1, 146, 159, 161–2, 167–8
- Morgan Stanley 32, 127
- mutual funds 60–1
- Mylan Laboratories 50
- negative carry trade 54, 171–2, 193–4
- net investments in foreign operations hedging qualification 69–76
- Nigeria 118
- non-consolidations 54–7, 178–80
- Northern Rock 17, 44, 46, 159–60, 166–7, 191–2, 202, 260–1
- Norwegian structured products crisis 53, 128
- off-balance sheet vehicles 1, 2, 5–8, 9–10, 14–15, 17–18, 21–2, 23–4, 29, 31–2, 34–5, 44–5, 48, 51–2, 120–1, 142–4, 152–3, 157, 159–75, 177–98, 221–41, 259–63
- see also* Structured Investment Vehicles
- accounting standards 5, 21–3, 177–98, 221–41, 259–63
- American/European accounting differences 5, 177–98
- Americredit 184–5
- Bawag 56
- case studies 180–5
- concepts 177–98, 221–41
- consolidations 34, 54–7, 177–80, 185–98
- debt 35
- definition 173
- double-counting 196–8
- Dynergy 23, 181–2
- Elan 182–4
- Enron 56, 120–1, 139, 183, 187, 219, 248, 259–62
- examples 55–7
- FASB rules 185–9, 195–8
- financial crises contributor 2–3, 5, 17–18, 21–2, 24, 31–2, 173, 221–41, 259–63
- forward contracts 67–76
- hidden losses 2, 7–8, 9–10, 14–15, 17–18, 21–2, 23–4, 29, 31–2, 44–6, 48, 54–7, 65–6, 67–8, 76, 118, 128, 153, 172–5, 180–5, 218–19, 226–9, 244, 255–8, 259–60
- historical background 56, 180–1
- IASB 189–98, 243–5
- IFRS rules 185, 189–98
- insurance products 6, 160, 171–2, 193–4, 243–58
- loans 152–3
- manipulations 178–98
- SEC experiences 179–85
- securitisation market 5, 142–4, 157, 159–75, 186–98, 232–41, 256–8
- synthetic leases 186–9
- take or pay contracts 186–9
- transparency shortfalls 1, 5, 54–7, 168–9, 174–5
- US GAAP 181–2, 195–6
- Office of Federal Housing Enterprise Oversight (OFHEO) 17–19
- offshore vehicles 120–1, 257–8
- OFHEO *see* Office of Federal Housing Enterprise Oversight
- O’Neill, Stan 46, 47
- operational risk 6, 29, 51–2, 119–20, 174, 207–8, 224, 229
- complex derivatives 207–8, 224
- RAROC adjustments 119–20, 229

- opportunity cost of capital 249–50, 253–5
 options 3, 15, 16–19, 22, 30, 32–3, 47–9, 76, 112–14,
 124–6, 130–7, 169, 200, 244
 see also call . . . ; put . . .
 Black–Scholes options pricing model 16–17, 30,
 137
 hedge accounting 112–14
 intrinsic value 112–14
 valuations 16–17, 30, 137, 169
 volatility effects 16–19, 48, 200
 Orange County, California 51–3, 59, 117–19, 127
 Ormond Quay 192
 over the counter market (OTC) 209–15
 overview of book 4–6

 Pacific Gas & Electric 59
 ‘park the trade’ activities, rogue traders 201–2
 Partnoy, Frank 52, 57–9, 148, 207
 PD *see* probability of default
 Pearson 248
 pension accounting 32, 33
 pension funds 8, 32, 33, 46–7, 49–50, 52–3, 117–18,
 127–8, 142–3, 157, 260
 Greek pension funds scandal 52–3, 127–8
 regulations 8, 32, 33, 46–7, 49–50, 117–18, 127–8
 perfect hedges 27–8, 70–1
 performance fees, investment funds 11–15, 46–7, 119,
 121
 permissions, hedge accounting 40–1, 65–6, 69–76,
 81–97, 108, 112, 114–15, 130–1, 208–15, 226–9
 perpetual equity 35
 Perry Corp 50
 Pillar 3 requirement 15, 121–2
 see also Basel . . .
 precipice bonds 128–9
 preference shares 35, 63–4
 prepayment risks, securitisation market 162–3
 present values 80–115, 124–6, 134–7, 197–215,
 251–5
 presentation considerations 15, 34–5, 122, 189, 191–2
 Prince, Chuck 43, 47, 178
 private equity 231
 proactive/reactive approaches, accounting standards
 29, 41, 261–2
 probability of default (PD) 144–7, 154–5, 234–5,
 238–41
 Procter & Gamble 126
 Profit & Loss accounts 3, 16–19, 21–2, 24–8, 33, 37,
 39–41, 53–4, 67–115, 120–9, 151–7, 164–9,
 172–3, 177–98, 206–15, 219–23, 226–9, 236–41,
 245–52, 253–5
 classification of assets 40–1, 72–6, 93–7, 105–15,
 122, 152–3, 164, 172–3, 191–2, 219–23, 226–9,
 236–41
 derivatives 39–40, 67–115, 126–7, 164–9, 245–50,
 253–5
 effective interest rates 22, 36–9, 57, 156, 171–2
 embedded derivatives 126–7, 245–50, 253–5
 hedge accounting 67–76, 79–115
 loans 151–7
 margin payments 206–15
 options 112–14
 pension accounting 33
 revenue recognition 6, 11, 23, 38–9, 43, 46, 53–4,
 66, 171–2, 189, 193–4, 235, 256–7, 260–1
 share options 3, 16–17, 22, 33, 45, 64
 profit smoothing 4, 17–18, 36, 67–8, 146–7
 profits
 income distributions 230–1
 moral hazard 44–5, 46, 47–8, 140–1, 146, 159,
 161–2, 167–8
 retained profits 67–76, 178–98, 208–15
 revenue recognition 6, 11, 23, 38–9, 43, 53–4, 66,
 171–2, 189, 193–4, 235, 256–7, 260–1
 valuation manipulations 19, 28, 67–8
 property clubs, deposit criterion 143, 157
 proprietary trading 200–16
 see also ‘shorting the market’
 provisions 4, 18–19, 23, 146–7, 151–6
 see also bad debts
 prudence concept 31
 put options 137, 244

 Qatar Investment Authority 169–71
 QSPes *see* Qualifying Special Purpose Entities
 qualified accounts, future prospects 263
 Qualifying Special Purpose Entities (QSPes) 177,
 179–80, 186–9, 195–6
 qualitative/quantitative IFRS 7 disclosures 240–1

 Raines, Franklin 3–4
 Rajan, Raghuram 47
 RAROC *see* Risk Adjusted Return on Capital
 reconciliation procedures
 concepts 199–216
 illustrative example 208–15
 regulations 8, 15, 21–41, 44–6, 49–50, 51–2, 53–7,
 67–76, 81–3, 117–22, 139–40, 151–7, 159–60,
 162, 164–8, 173–5, 199–216, 218–41, 245–7,
 260–3
 see also Basel . . .
 arbitrage opportunities 162
 artificial volatility 22, 26–8, 67–76, 81–3, 221–41,
 245–7
 bifurcation rules 44, 51–2, 120–1, 139–40, 164–5,
 173–4
 breaches 53–7, 174–5
 credit derivatives 156–7
 embedded derivatives 5, 122–37, 164–5, 245–50,
 253–5
 future prospects 263
 hedge accounting 40–1, 65–6, 69–76

- insurance 156, 243–58
 loans 151–6, 228–41
 the middle office 201–4
 mixed-model approach 4–5, 21–2, 23–41, 65–76, 217–41
 pension funds 8, 32, 33, 46–7, 49–50, 117–18, 127–8
 reform needs 174–5, 261–3
 rogue traders 199–216
 securitisation market 159–60, 162, 164–8, 177–98, 232–41
 Value at Risk 5, 121, 140, 164, 201–2, 207, 217, 223–41
 regulators, responsibilities 166–8
 reinsurance contracts 244, 250–2, 256–8
 see also insurance
 relative value trading 200–4
 reputations 10, 30, 57–8, 148, 166–7
 see also goodwill
 responsibilities
 accountants 1, 43–8, 140–1, 157, 165–8, 199–216, 230–41, 260–3
 credit rating agencies 165–8
 directors 32, 43–64, 202–4, 262–3
 regulators 166–8
 retained profits 67–76, 178–98, 208–15
 ‘retiring’ executives 43, 46–8
 returns on capital, concepts 118–20, 229, 254–5
 revenue recognition 6, 11, 23, 38–9, 43, 46, 53–4, 66, 171–2, 189, 193–4, 235, 256–7, 260–1
 concepts 23, 43, 53–4, 66, 171–2, 189, 193–4, 235, 256–7
 negative carry trade 54, 171–2, 193–4
 rewards
 see also profit . . . ; return . . .
 risk 10–15, 45–8, 119–21
 risk, rewards 10–15, 45–8, 119–21
 Risk Adjusted Return on Capital (RAROC), concepts 118–20, 229
 risk management 1–2, 5, 6–10, 29, 32, 34, 39, 54–7, 114–15, 117–18, 120–1, 133, 139–57, 168–9, 199–216, 217–41, 259–63
 audits 32
 documentation requirements 114–15
 failings 1–2, 5, 6–10, 29, 34, 39, 54–7, 117–18, 120–1, 133, 139–57, 168–9, 199–216, 223–41, 259–63
 the middle office 201–8
 rogue traders 5, 39, 133, 199–216
 risk measurements 2, 3–4, 5–6, 7–8, 11–12, 14–15, 16–19, 32, 43, 44–5, 46–7, 118–22, 128–9, 139–57, 159–60, 174–5, 199–216, 217, 223–41, 244–58, 259–63
 see also Basel 2 . . . ; Value at Risk
 bonus incentives 6, 11–12, 14–15, 16–19, 43, 44–5, 118–22, 128–9, 159–60, 174–5, 200, 202–4, 259–63
 data-capture failings 201–4
 difficulties 6, 11, 16, 46–7, 140–1
 financial crises contributor 2, 3–4, 14–15, 16–19, 32, 139–41, 159, 235, 259–60
 IFRS 7 5, 9, 11, 15, 23, 43, 44, 122, 128–9, 141, 142, 190–2, 227–41, 260–1
 insurance 244–58
 the middle office 201–8
 RAROC 118–20, 229
 risk transfers, credit derivatives 7–8, 141–2, 159, 167–8
 risk-free rates 16–17
 Riskmetrics 229
 rogue traders 5, 39, 133, 199–216
 accounting standards 202–4
 arbitrage opportunities 200–4
 the back office 201–4
 background 199–216
 common denominators 200, 216
 data-capture failings 201–4
 hidden losses 200–4, 216
 ‘instincts’ 201
 the middle office 201–8
 ‘pick the trade’ activities 201–2
 proprietary trading 200–16
 reconciliation procedures 199–216
 relative value trading 200–4
 ‘shorting the market’ 131, 200–16
 ‘star’ traders 200, 202–4
 trading styles 200–1
 Ross Capital 56
 Royal Bank of Scotland (RBS) 149–50
 Rubicon 50
 rules *see* regulations
 Rusnik, John 133, 199, 201–2

 SAB 101 23, 54, 256–7
 Sachsen LB 192
 salary levels 46
 sales, revenue recognition 6, 11, 23, 38–9, 43, 46, 53–4, 66, 171–2, 189, 193–4, 235, 256–7, 260–1
 Salomon Brothers 48
 Sarbanes–Oxley Act 7, 260
 SEC *see* Securities and Exchange Commission
 Securities and Exchange Commission (SEC) 4, 6, 18, 51–3, 59–61, 179–85, 255–8
 securitisation market 2, 5, 8, 45–6, 140, 142–4, 157, 159–75, 177–98, 218, 232–41, 256–8
 accounting standards 159–60, 162, 164–8, 177–98
 arbitrage opportunities 162
 benefits 159–60
 bonds 148, 157, 161–2, 168–9, 171–2, 186–98, 232–41

- securitisation market (*Continued*)
- concepts 157, 159–75, 186–9, 195–8, 232–41, 256–8
 - critique 157, 159–60, 165–8, 186–9, 195–8, 256–8
 - diagrammatic examples 161, 163
 - examples 157, 160–2
 - negative publicity 157, 159–75
 - overview 160–2
 - prepayment risks 162–3
 - processes 157, 160–3, 167–8
 - regulations 159–60, 162, 164–8, 177–98, 232–41
 - subordinated interests 196–8
 - 'super-senior' investment products 148, 168–9
 - synthetic structures 162–3
 - US GAAP 181–2, 195–6, 257
- self-certified earnings, loan applications 157
- self-correcting mechanisms 45
- settlement, derivatives 129–30
- SFAS 107 19
- SFAS 125 *Accounting for Transfer and Servicing of Financial Assets and Extinguishment of Liabilities* 187
- SFAS 133 19
- SFAS 140 *Accounting for Transfer and Servicing of Financial Assets and Extinguishment of Liabilities* 177, 179–95
- SFAS 157 174–5
- share incentive schemes 16–17
- share lending 49–50
- share options 3, 15, 16–17, 22, 32–3, 45, 60, 64, 76, 260–1
- balance sheets 33
 - Profit & Loss accounts 3, 16–17, 22, 33, 45, 64
- share price alignments, bonus incentives 48
- shareholders 1–2, 5, 6, 7, 15, 34, 36–9, 41, 43–64, 121–2, 140, 144, 170–1, 185–6, 188–9, 202, 218–19, 230–41, 245–50, 259–63
- see also* corporate governance; investors
- activism considerations 49–50
- AGMs 57–8
- banks 1–2, 7–8, 34, 36–9, 43–64, 121–2, 230–41
- Barclays 63–4, 168–9, 230
- conflicts of interest 49–50, 202
- dividends 63–4, 230–1
- EU efforts 49, 50
- 'external' shareholders 188–9
- institutional investors 2, 6, 41, 45–6, 49–50, 60–2, 140, 144, 170–1, 202, 262–3
- opportunity cost of capital 249–50, 253–5
- protection measures 15, 36–9, 121–2, 218–19
- small/large contrasts 45–6
- voting powers 2, 41, 45–6, 49–50, 57, 60–1, 144, 185–6, 188–9, 260, 262–3
- short-cut accounting treatment method, interest rate swaps 87–91, 93–100
- short-cut swap valuation procedures 82–3
- 'shorting the market' 131, 200–16
- see also* proprietary trading
- SIVs *see* Structured Investment Vehicles
- Smith, Terry 44–5, 56, 102, 173
- Société Générale (SocGen) 5, 39, 199–203, 207, 210, 216, 260
- Sorensen, Arne 53
- Soroosh, Jalal 186–8
- Soros, George 45
- sources of finance, banks 232–4
- Special Purpose Entities (SPEs) 29, 152–3, 161–3, 177, 178–98
- Special Purpose Vehicles (SPVs) 29, 152–3, 161–3, 177, 178–98
- see also* off-balance sheet vehicles; securitisation . . .
- speculators 17–19, 23, 65–6, 69
- SPEs *see* Special Purpose Entities
- Spitzer, Eliot 60–1, 243
- split capital funds scandal, UK 61, 128–9, 260
- SPVs *see* Special Purpose Vehicles
- standard deviations 227–30
- see also* volatility
- Standard Life Investments 50
- 'star' traders 200, 202–4
- structured credit products 2, 7–10, 63, 139–98, 221–41, 263
- see also* credit derivatives; securitisation . . .
- accounting methods 172–4
 - complexity problems 139–40, 164–71, 173–4
 - SFAS 157 valuations 174–5
- Structured Investment Vehicles (SIVs) 22, 34, 35, 48, 51–2, 173–4, 177–8, 189–92
- see also* off-balance sheet vehicles
- structured products
- see also* credit derivatives; derivatives; embedded derivatives; inverse floaters; securitisation . . .
- accounting methods 172–3
 - accounting standards 119–37, 139–57, 164–75, 263
 - bifurcation rules 44, 51–2, 120–1, 139–40, 164–5, 173–4
 - concepts 5–6, 43, 50–3, 117–37, 139–57, 159–75, 263
 - corporate governance 51–3, 168–9
 - credit rating agencies 51–3, 139–57, 160–3, 165–8
 - credit risk 51–3, 117, 129–30, 139–57, 159–75, 190, 237–41
 - diversification issues 147–8, 159–60, 163
 - future prospects 263
 - illiquid nature 51–2, 117–18, 120–1, 164–6, 207–9, 217–18, 224, 263
 - illustration of the problem 122–6
 - inefficient nature 51, 157
 - market risk 117–37, 139–40, 190
 - Norwegian structured products crisis 53, 128
 - Orange County 51–3, 59, 117–19, 127

- sub-prime loans 14–15, 24, 43, 57, 141–4, 159–60, 162, 166–7, 174–5, 178, 184–5, 192, 218, 235, 259–60
see also financial crises
- subjective valuations 23–4, 29, 137, 146, 172–3, 217–41
- subordinated interests 196–8
- ‘super-senior’ investment products 148, 168–9
- swaps 19, 27, 56, 59–60, 65–6, 77–115, 123–7, 133–7, 189–90, 207–15, 221–41
see also interest rate swaps
 cash flow interest rate swaps 91–7
 CDS 148–50, 156–7, 163, 173–4
 credit spreads 81–97
 documentation requirements 59–60
 FASB treatment 87–91
 Freddie Mac 19
 hedge accounting 65–6, 77–115, 133–7, 208–15
 IAS 39 treatment 87–9, 136–7
 interest rate changes 94–7
 long accounting treatment method 87–91, 94–100
 short-cut valuation procedures 82–3
 unwind of the discount 94–7
 valuations 80–3, 124–6, 133–7, 213–15
 value change reasons 94–7
- swaptions
 Freddie Mac 19
 hedge accounting 112–14
- synthetic leases, off-balance sheet transactions 186–9
- synthetic structures, securitisation market 162–3
- TAF *see* Term Auction Facility
- take or pay contracts, off-balance sheet transactions 186–9
- takeovers *see* mergers & acquisitions
- Tavakoli, Janet 167–8
- taxpayers 46
- Term Auction Facility (TAF) 157
- term sheets, loans 36–9
- Terra Securities 53, 128
- Tet, Gillian 53
- tier-one capital 228–9
- time value changes in swaps *see* unwind of the discount
- traders’ dilemma
 banks 14–15, 16–19, 46–7
 concepts 11–15, 16–19, 46–7
 measuring considerations 16–19, 46–7
- ‘Trading’ assets classification 18–19, 24–6, 31, 40–1, 152–3
- trading books, concepts 40–1, 219–23
- trading styles, rogue traders 200–1
- transaction costs, foreign currency forwards 100–15
- transparency shortfalls 1, 4–5, 9–10, 45–6, 54–7, 168–9, 174–5, 201, 260–1, 263
see also complexity . . . ; disclosures
- treasurers of corporates, traders’ dilemma 14–15
- Trichet, Jean-Claude 8
- true and fair view 217, 220, 262–3
- Tucker, Paul 143
- Tweedie, David 178
- UBS 7, 45–6, 56, 148
- UK
see also British Government
 bailout efforts 63–4, 139–40, 149–50, 166, 261
 Bank of England 167, 261
 Barings Bank 199, 201–2, 207, 210, 216, 260
 BCCI 260
 Equitable Life 260
 Northern Rock 17, 44, 46, 159–60, 166–7, 191–2, 202, 260–1
 pensions misselling scandal 260
 scandals 260
 shareholder votes 50, 185–6
 split capital funds scandal 61, 128–9, 260
 Takeover Panel 50
 Treasury Select Committee 140
 unbundled loans, insurance 250–2
 underlying assets, artificial volatility 22, 26–8, 67–76, 81–3, 221–41, 245–7
 undiversified VaR 228–9
see also Value at Risk
- Union Excess 258
- unwind of the discount, swap value changes 94–7
- US
see also Financial Accounting Standards Board
 EU standards 5, 177–98
 the Federal Reserve Board 1, 46, 166–7
 GAAP 181–2, 195–6, 257
 SEC 4, 6, 18, 51–3, 59–61, 179–85, 255–8
- valuations 1, 4–6, 9–10, 16–17, 18, 19, 21–2, 23–31, 39–40, 44, 65–76, 128–9, 137, 165–6, 169, 172–5, 197–8, 213–15, 217–41, 262–3
see also cost model; market . . .
 artificial volatility 22, 26–8, 67–76, 81–3, 221–41, 245–7
 critique 5–6, 10, 18, 19, 21–2, 23–31, 65–76, 165–6, 169, 172–3, 217–41, 262–3
 financial crises contributor 24, 31–2, 218
 foreign currency forwards 101–15
 forward contracts 101–15
 futures 131–2
 general guidelines 26, 31
 goodwill 23–4, 29–30, 33, 55–7, 249–50
 implied volatility uses 169
 mixed-model approach 4–5, 21–2, 23–31, 65–76, 217–41
 options 16–17, 30, 137, 169
 profit level manipulations 19, 28, 67–8
 SFAS 157 valuations 174–5
 short-cut swap valuation procedures 82–3

- valuations (*Continued*)
 subjective valuations 23–4, 29, 137, 172–3, 217–41
 swaps 80–3, 124–6, 133–7, 213–15
 transparency shortfalls 1, 4–5, 168–9, 174–5
- Value at Risk (VaR)
see also risk measurements
 accounting 235–41
 background 5, 121, 140, 164, 201–2, 207, 217, 223–41
 definition 224–6, 227
 financial instruments 239–41
 hedging principles 224–6
 illustrative examples 227–9
 undiversified VaR 228–9
 users 229
 volatility 226–9
 zero coupon bonds 224–6
- value of in-force life assurance contracts (VIF) 249–50
- Variable Interest Entities (VIEs) 177, 186–98
- variation margin, futures 130–2, 204–16
- Varley, John 64, 169
- VIEs *see* Variable Interest Entities
- volatility 3, 15, 16–19, 22, 26–8, 36, 39–40, 48, 65–6, 67–76, 81–3, 149–50, 200, 202–4, 221–41, 245–7
- artificial volatility 22, 26–8, 67–76, 81–3, 221–41, 245–7
- Basel 2 requirements 231–4
- bonus incentives 3, 15, 16–17, 36, 48, 149–50, 200, 202–4, 226–9
- derivatives 39–40, 48, 65–6, 69–76, 81–3, 200, 227–9
- option values 16–19, 48, 200
- Value at Risk 226–9
- Volcker, Paul 1
- voting powers of investors 2, 41, 45–6, 49–50, 57, 60–1, 144, 185–6, 188–9, 260, 262–3
- vulture funds 53–4, 56–7
- Wachovia Bank 32
- warrants 64
- ‘weapons of mass destruction’, derivatives 7, 10, 168
- weighting matrix, Value at Risk 229
- Weninger, Gunter 56
- WorldCom 7, 23
- Xerox 23
- yield curves 132–7
- zero coupon bonds, Value at Risk 224–6

Index compiled by Terry Halliday