Book reviews

Restructuring and Workouts — Strategies for Maximizing Value

Consulting Editor: Ben Larkin

Globe Business Publishing, London; 2008; ISBN 978 1 905783 20 5; 240pp; hardback; €173.18

More than 20 professionals with expertise in operational areas and financial engineering in financial institutions, financial consulting and legal firms have contributed to this book, providing insight and practical reference to the critical processes and legal structures involved in restructuring the distressed organisation and paving the way for its successful workout. Given the current financial crisis, which has spread worldwide like a bushfire, affecting industries across many economic sectors, it is a privilege to have access to such a book.

It is important to note, however, that most of the contents are based on the European environment. The European focus is compensated by practical information and examples of transactions applicable in many jurisdictions, given the universality created by the globalisation of financing structures.

The chapter on 'The restructuring and workout environment in Europe' gives insight into the trends and relevant legal and financial issues of these processes.

The chapters on 'The World Bank's benchmarking of insolvency systems' and 'Debt for equity swaps' provide thought- provoking analysis seasoned with statistics and practical references on these subjects.

The chapters on 'Pre-packs', 'Valuation of distressed businesses', 'Schemes of arrangement for long-tail liability claims', 'Jurisdiction shopping', 'Workouts of structured vehicles' and 'Rescue financing' condense concepts, methodologies and examples that guide the reader through their relevant topics.

There are chapters describing insolvency and bankruptcy proceedings in France, Germany and the USA. A full chapter is allocated to each country, providing a quick reference guide to the important facts that those involved in the restructuring and workout of distressed businesses domiciled in these countries should keep in mind.

Finally, the chapters on 'The role of the trustee' and the 'Impact of a UK pension scheme deficit in a workout situation' describe the importance of giving due consideration to internal and external factors when setting out a workout strategy.

The expertise of the authors in each of the fields considered in the book ensures its information will be very useful to those readers who oversee, advise or work on restructuring and workout processes, as well as those readers with a financial background who would like to get acquainted with such processes, especially in the current times where the ongoing financial crisis makes it a must for responsible business managers to understand the options for business continuity when a worst-case scenario comes knocking at the door.

In 240 pages, this book provides up-to-date information in such a sensitive business area.

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Anticipating Correlations: A New Paradigm for Risk Management
by Engle Robert

Princeton University Press, Princeton, NJ; 2009; ISBN 978-0-691-11641-9; 176pp; hardcover; $39.50, £28.95

As we begin forensic examination of the wreckage that is conventional risk management, one item that deserves particular scrutiny is the treatment of correlation. Arguably, the escalation of systemic risk at the heart of this crisis has occurred because 'formerly uncorrelated risks [have] shift[ed] and become highly correlated. When that happens, then insurance and diversification models fail'.[1] More specifically, many blame the constant correlation models used to assess the riskiness of collateralised debt obligations (eg Gaussian Copulas) for the errors that led to the subprime crisis itself. Against this background, Professor Engle's new book 'Anticipating Correlations' is both timely and potentially important. Certainly, this is a well-constructed book that usefully brings together an important and current literature. However, on the basis of the evidence presented, it is hard to see Professor Engle's approach to anticipating correlations becoming a new paradigm in risk management as the subtitle of the book suggests. The methods discussed are currently too complex and the gains too small to be worthwhile. It is however a useful reminder that fixed correlations are assumed at one's peril.

This book summarises the burgeoning literature (led by Professor Engle himself) on the dynamic conditional correlation (DCC) class of models in a way that makes these models accessible to those involved in the financial industry — or at least those at the highly quantitative end of the industry. The basic idea behind DCC is to extend Engle's hugely influential models of time-varying volatility (ARCH, GARCH etc) into the arena of correlation and so allow estimates and forecasts of time-varying correlation between assets.

The book opens with a nice discussion of the concept of correlation giving concise descriptions of approaches to dependence such as Copulas. Engle also demonstrates how Campbell's simple variance decomposition approach can be used to describe the forces that act on correlation (although this is rather grandly described as an economic model of correlation, which seems a stretch). This section also highlights a few stylised facts about correlation that bear repeating. For example, the observation that correlation is higher in periods of higher volatility and that even multivariate normal distributions with constant correlation will exhibit this property may be simply a statistical artefact. However, even after allowing for this statistical effect, empirical evidence suggests that correlation in periods of falling returns does seem to be much higher than standard fixed correlation models would suggest.