The Government as Investor/Owner in Europe

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Presentation Outline

I. Why do European governments invest?

II. How do they do it?

III. Corporate governance impact

IV. Preliminary assessment
I. Why do European Governments Invest?

• Varies over time / across countries
  – Providing a public good or access to utilities
  – Industrial, trade and fiscal policies
  – Ideology

• Main goals during current crisis
  1. Fostering lending
  2. Minimizing restructuring costs
  3. Protecting jobs
     → Substituting (deficient) market participants
     → Focus on banks
     → For the short term (?)
II. How do European Governments Invest?

• **Equity**
  – ‘Nationalization’: Isolated cases (D, NL, UK – not F)
  – Recapitalization: Preferred and common shares

• **Debt**
  – Convertible bonds and collateralized loans
  – Guaranteeing and insuring liabilities/debt issues

• **Impaired assets**
  – Setting-up of bad banks
  – Purchasing illiquid and/or toxic assets

*ECB estimate: > EUR 3 trillion committed thus far*
III. Corporate Governance Impact for Assisted Firms

• Multiple and diverse within/across countries
• Ownership/supervision regimes not decisive
• Management
  – Replacing directors and executives
  – Governmental influence (e.g. lending policies)
• Shareholders
  – Voting and dividend restrictions
  – New major shareholder/convertible debtholder
  – Significant and related party transactions approval
  – M & A constraints
• Creditors
  – Governmental financing and guarantees
  – Exit/Restructuring/winding-up conditions
EU Framework for MS Investments

- **ECOFIN common principles**
  - Support in principle temporary
  - Legitimate interests of competitors, no negative spillovers
  - Protecting taxpayer interests, *burden on shareholders*
  - Change of management and no undue benefits for managers

- **EC state aid rules for banks**
  - Pricing of governmental contributions
  - Dividend and coupon restrictions
  - Restructuring requirements
  - Duration and *exit incentives*

- **Few complaints amongst governments**
- **Significant corporate governance impact**
a) Board and Compensation: Lloyds (UK)

• Ownership
  – Government body (UKFI) owns 43% stake
  – Biggest private shareholder base in UK

• Board composition
  – UKFI presses for chairman untainted by HBOS deal
  – Removing non-executive directors tainted by HBOS deal
  – Reducing the number of executive directors

• Management compensation
  – UKFI objects to £120m bonus proposals for 2008 due to inadequate future performance conditions
  – Agreement: £45m to 40,000 junior staff + £35m for guaranteed deals. Further bonuses in subordinated debt with claw back

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b) Shareholder Approval : Fortis (B/NL)

• Purchase of Fortis subsidiaries
  – B: 99.93% in Fortis Bank N.V./SA
    Price: €9.4 bn + €2.5 bn in SPV for impaired assets, 75% resold to BNP Paribas
  – NL: 100% in Fortis Bank Nederland Holding
    Price: €16.8 bn + €60 bn in loans/guarantees
  – Fortis’ parent share price drops from €5 to €1

• SH in Fortis parent challenge sales
  – B Court: SH must have a say based on expert report
  – NL Court: Board can decide alone, but fiduciary duty issue

• SH approval saga
  – Experts: Board was logical + reasonable, but better sale possible
  – B and BNP Paribas sweeten the deal for Fortis SH
  – SH reject new deal, with only pre-sale SH allowed to vote
  – Court allows all SH to vote, sale is approved – but no discharge

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c) M & A Constraints: OPEL (D)

• **Two final bids for GM Opel unit**
  – Canadian-Russian venture: Magna/GAZ + Sberbank
  – Belgian private equity group: RHJ International Inc.

• **Competing interests**
  – Protecting 25’000 jobs, fostering trade and energy supply
  – Minimizing taxpayer risk
  – Keeping GM product development and IP control
  – Signaling monitoring of management by new GM board

• **Magna deal framework**
  – New ownership: 55% Magna, 35% GM, 10% employees
  – Germany provides additional €4.5 bn in loans /guarantees
  – Cutting jobs in Belgium/Spain/Poland/UK rather than Germany?
  – Approval by the Opel Trust and the European Commission

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d) Early Exit : UBS (CH)

• ‘Market’ approach to recapitalization
  – ‘Swiss finish’: Tapping private investors in good times
  – Credit crisis: Early political pressure to get more capital
  – Recapitalization is choice-based: UBS opted in, not CS

• Recapitalizing UBS
  – SFR 6 bn mandatory convertible note, 12.5% coupon
  – SFR 60 bn in impaired assets sold to SNB vehicle, with SFR 6 billion contribution by UBS and profit sharing scheme
  – No dividend restrictions, no gov’t representative on UBS board
  – Government involvement in compensation issues

• Selling the public stake
  – Coupons + conversion lead to SFR 1.2 bn profit
  – Keeping the pressure on capital ratio and compensation
IV. Preliminary CG Assessment

• Shareholder value of government investments
  – Credit crisis provides no clear answer
  – In line with empirical studies on privatization

• Stakeholder clout in distressed situations
  – Retail investors in firms with dispersed shareholders
  – Employees in manufacturing firms

• Contribution to transparency debate
  – Avoiding excessive transparency on bad loans
  – Accounting conservatism cannot fully substitute market to market

• Risk management spillover
  – Rapid return to profitability justifies (some) risk taking
  – Winding-up must be pre-planned
  – Compensation incentives are hard to set properly
  – Combining capital requirements and taxation?

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