Transatlantic Corporate Governance Dialogue

The New Role of Government in Corporate Governance

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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

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

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

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 mark 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?