RECENT EXPERIENCE WITH TEMPORARY GOVERNMENT CONTROL OR OWNERSHIP OF COMMERCIAL ENTITIES

Position paper by the OECD Working Group on Privatisation and Corporate Governance of State Owned Assets

The paper summarises the main conclusions of a study of temporary government ownership or control in the course of the 2008-2009 financial crisis. It was completed and derestricted by the Working Group on 6 November 2009.

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The global financial crisis has required a number of governments to provide capital support to distressed enterprises, including in particular financial institutions. The result has in many cases been either majority government ownership or a significant government influence in the assisted enterprises. The justification for government intervention have generally been one of two: that the failure of a particular institution would have created systemic risks that mandated government support ("too big to fail"), or that broad based government support was necessary to promote confidence in the system. In almost all cases, the ownership or control has been or is planned to be temporary in nature.

Temporary government ownership/control of private sector enterprises has given rise to a range of corporate governance challenges for the governments concerned. The solutions adopted have depended upon the specific legal, regulatory and administrative landscape of each country. They have also depended upon the severity of the underlying problems government capital support has sought to address. In particular, there are clear differences in approach depending upon whether the support has been provided as an emergency rescue of an individual enterprise in danger of imminent collapse or as part of a broader based programme of capital support for a sector.

Individual rescue operations

In cases of individual rescue, interventions were mostly designed under the assumption that existing shareholders would have suffered either complete or significantly greater capital losses in the absence of the government support. For this reason concerns about the appropriate treatment of existing shareholders, creditors and other stakeholders have figured less prominently than might otherwise have been the case. In addition, the urgency of many rescue operations served as an additional justification for swift, across-the-board action so as to eliminate the risk of free-rider problems. In these circumstances, governments have shown a tendency to intervene in the operational affairs of the assisted companies, including changes to the board and senior management coupled with direct interventions into the strategic direction of the company.

Maintaining level playing fields in the case of individual rescues has been a significant challenge. In many cases, governments have sought to implement a range of behavioural restrictions to prevent institutions that receive government support from unfairly gaining from the actual or perceived benefits from capital support.

Broadly based programmes

For more broadly based support programmes, governments have generally implemented comprehensive legal and regulatory frameworks for assisting financial institutions. Where support is available to all market participants on equivalent terms, "level playing field" concerns become less important, since there is limited capacity for differential treatment. However, some subsequent public controversy over remuneration has arisen in consequence of the safeguards for competitive neutrality: the relatively stronger recipients of capital assistance have seen their profitability boosted, triggering large payouts to management and key staff.

In establishing legal and regulatory frameworks which govern the capital support measures, governments have also sought to enunciate clearly the objectives of government support programmes. In some cases, government support has been conditional on changes in the composition of the board, usually via mandating board representation consistent with their level of control. In many cases, support has also been conditional upon achieving certain systemic objectives, such as ensuring a continuation of lending to businesses and/or individuals.

There have been some examples where governments – in the absence of, or in supplement to, board representation – have reserved specific powers. Most commonly, this has involved limitations on the manner in which executive remuneration is negotiated and structured. Often these have been motivated by political unease at having to honour managerial remuneration contracts that would have been void but for the fact that government capital support prevented a collapse of the respective institutions. Beyond these specific measures, governments have generally not sought to utilise broad based support measures to effect structural corporate governance reforms.

In some cases, government capital injections have been allied with schemes to support banks' asset base, either by entering into guarantee arrangements for credits or establishing "bad banks" for compromised assets. Where this has occurred, avoiding agency problems during the transitory phases (including outright irregular practices by the remaining "insiders") has been an additional concern, and governments have been more willing to impose operational controls, such as the capacity to declare dividends or to enter into large scale transactions. By relying, in this, on specific, transparent rules governments have been able to uphold the capacity of boards to exercise their independence within the remaining scope of their authority.

The ownership function

The nature of ownership arrangements has varied. In many cases governments have sought to rely on existing bodies (for instance centralised ownership units or deposit insurance corporations) utilising their ownership expertise. Where suitable, for example when specialised bodies did not exist, central agencies of the executive have tended to take responsibility.

Whatever ownership model has been chosen, a high degree of coordinated action among the ownership bodies, regulatory agencies, and general government has been required to ensure consistent approaches to providing support, ongoing ownership and ultimate exit strategies. Formalising the relationship between these entities, regulators and general government, for instance via the governance of the ownership entity itself, has been instrumental in obtaining a necessary separation of the ownership functions from the rest of government – in particular regulatory agencies.

Exit strategies

Establishing consistent and transparent frameworks for the terms on which individual institutions may exit from government support measures is important for ensuring consistency of treatment. In this regard assistance frameworks so far have generally been sympathetic to non-government shareholders. Ensuring private capital remains invested in assisted institutions facilitates a more orderly exit for government support. Dependent on whether or not preemptive rights are put in place the actual exit may imply an added benefit to the non-government shareholders. Retaining independent directors that have not been nominated by government has ensured that the interests of all shareholders can continue to be met, and governments have generally respected the role and independence of the board of directors to provide strategic direction and monitor management.

A focus on establishing strategies for exit at the time of providing the support (for instance, via the use of hybrid instruments) may formalize the process of balancing the interests of non-government shareholders with the justifiable interests of government earning an appropriate return for the risks assumed. Hybrid instruments have allowed governments to structure their investments to provide incentives for early repayment (for instance, via step-up rates of interest and repayment rates). However, it also appears that where behavioural or operational restrictions (such as in relation to remuneration) have been mandated as part of the capital support, this has provided strong incentives for companies to seek an early resolution of government equity participation.

The OECD Guidelines on Corporate Governance of State-Owned Enterprises

The approaches adopted across OECD governments provide an opportunity for assessing the usefulness of the OECD Guidelines on Corporate Governance of State Owned Enterprises ("the Guidelines") as a tool in guiding policy choices in circumstances where government control of private sector enterprises is undertaken as an emergency and temporary measure. The evidence to date suggests that the Guidelines provide a meaningful framework to assess the policy options available in such situations.

Governments have generally seen benefits in conforming to the Guidelines' recommendations in relation to establishing transparent legal and regulatory frameworks; clearly identifying the ownership function and separating it from regulatory bodies; and respecting the independence of the board of directors. Adhering to good practices of corporate governance, even in situations of great urgency, is of vital importance in safeguarding a level playing field, ensuring efficiency in the use of public money and paving the way for an orderly exit.