

## More transparent banks “good news for bondholders”, says F&C’s Luis



The last few months have been tough for those with positions in financial companies. Following the collapse of Lehman's and the AIG bail-out, concerns over possible further bank failures persist and investors now need to consider how comfortable they are with their current exposure. Fatima Luis, Manager of F&C's Strategic Bond Fund, said: “Governments should now put the sanctity of the financial system ahead of avoiding moral hazard. Unfortunately, that does not necessarily mean that all investors in banks will be saved. Soon though, if not already, the concern will move to the more traditional economic downturn facing much of the developed world. Faced with deteriorating sales and margins, questionable availability of finance and less chance of a government saviour, many non-financial companies will struggle to survive. Banks will not escape the effects but the recapitalisation process, assuming that they complete it, should provide the necessary cushion”.

The US Government's proposal for a new rescue vehicle to take on much of the bad debt on bank balance sheets is essential to any financial recovery. “This will help provide support for asset prices at a time when a smaller number of banks are seeking to accelerate their write-downs and sell-off unwanted assets in a market with very little appetite from potential buyers,” said Luis. “It will be a challenging task for any new organisation to determine a price acceptable to both the banks and the taxpayer.” Luis argues that the performance of the housing market on both sides of the Atlantic is also essential to any long-term recovery. “It is only once there is some sort of ‘floor’ underpinning values that we will start to see the end of asset write downs. The rates being charged to mortgage holders remain high, which is not helping matters, though in the UK we have seen moves by some providers to cut rates to new buyers and a move in the right direction,” she added.

According to Luis, banking lending criteria will become stricter and much more transparent both in terms of activity and reporting. “In the short-term banks are likely to be less profitable as activity slows and they focus on reconstructing their balance sheets. But the financial system going forward should be more secure, which is good news for bondholders.” She concluded: “The need for a flexible approach to asset allocation has never been more evident than in the current climate of extreme risk aversion but also when markets start to turn and a rapid response is needed to make the most of emerging opportunities”.

### Growing concern on UK corruption

The notable drop in the UK's rating - to 7.7 from 8.4 - in the 2008 Corruption Perception Index (CPI) published recently by Transparency International raises the question of whether corruption is a growing problem in Britain. The CPI is a compilation of polls and studies relating to the perception of corruption, and is one of the most widely regarded indicators of corruption at the individual country level.

George Dallas, Director of Corporate Governance at F&C, said: “F&C supports Transparency International's advocacy for higher anti-corruption standards in the UK, and believes this is fundamental to the interests of investors. We have been actively involved in developing engagement outreach on anti-corruption issues in both developed and emerging markets in addition to being the convener of the working group that developed the forthcoming International Corporate Governance Network (ICGN) Guidance on anti-corruption - a document which is currently being finalized at the ICGN”. F&C's own engagement on anti-corruption at individual companies focuses on a range of factors including the development of anti-corruption policies and internal controls with board level oversight. F&C also encourages companies to develop employee hotlines, to factor anti-corruption into remuneration policy and to report publicly on the effectiveness of these policies and processes.

“Whilst the CPI does not address the precise causes of the decline in the UK's rating the visibility and the controversies surrounding the corruption investigation at BAE Systems are likely to have had some impact on the lower score,” Dallas said. More fundamentally, we believe that the lack of robust legislation and enforcement in the area of corruption can position

Britain at a relative disadvantage to other highly developed economies”. Dallas concludes “Given the particular importance of financial markets and the knowledge based economy in the UK, growing perceptions of corruption or mistrust can prove to be a competitive disadvantage”.

### Calls for more protection for Brazil's minority shareholders

For the second time in less than a month, F&C has been joined by a group of leading institutional investors, to call for greater protection for minority shareholders in Brazil. In August, the group of investors wrote to the Brazilian securities regulator, the Comissão de Valores Mobiliários (CVM), expressing their concerns about the bid launched by Votorantim Celulose e Papel (VCP) on paper producer Aracruz. Last week, another letter was sent to the São Paulo Stock Exchange (Bovespa) regarding the recent announcement that construction and property company Gafisa SA will acquire a controlling stake in Construtora Tenda SA. On this occasion, the concern lies with the mechanics of the merger, which involve a large issuance of Tenda shares to Gafisa in exchange for the incorporation of Gafisa's subsidiary Fit Residencial Empreendimentos by Tenda. According to the investors, although Tenda's management has sought to portray the transaction as an acquisition of Fit, it's clear that the deal actually provides Gafisa with control of a severely diluted Tenda on effectively an indirect takeover. “While many details of this acquisition have yet to emerge, we are concerned that the deal has been structured so as to circumvent Brazilian law, Bovespa listing standards and the rights of minority shareholders,” said Karina Litvack, Head of Governance & Sustainable Investment at F&C. Since its launch, Bovespa's Novo Mercado – a listing segment for shares issued by companies that voluntarily undertake to abide by higher corporate governance standards and transparency requirements in addition to those requested by Brazilian law and the CVM – has been driving a new age of equity investment in Brazil, attracting interest from more and more international investors. “The good reputation of Brazil's Novo Mercado as a ‘gold standard’ in governance could be under threat if the exchange sanctions this type of transactions,” Litvack added. “However, we are encouraged that Bovespa has just announced it will be reviewing the rules governing its premium governance segment with a special focus on ‘novel’ mergers and transactions, such as the ones that triggered both our letters.”

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