

Schaeffler's bid sets dangerous precedent in Germany, says F&C's Dallas



F&C, which manages over €120 billion of assets, has written to the German securities regulator, the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), calling for greater transparency and disclosure of direct and indirect ownership positions taken by minority investors in public companies. This action was triggered by the controlling interest taken by Schaeffler Group, a private engineering company, in Continental AG, the Dax 30 company and a leading worldwide automotive supplier and tyre-maker.

While the near term effect on Continental's share price has been positive, F&C's concerns relate to the hidden way in which Schaeffler built its position in Continental – through a combination of direct share ownership (3.06%), call options (4.95%) and cash settled equity swaps (28%).

"The accumulation of this aggregate 36% economic stake has been achieved without prior public disclosure, with the result that neither Continental nor its minority shareholders were aware that Schaeffler had positioned itself to take a controlling interest in the company," said George Dallas, Director of Governance at F&C. While Schaeffler's approach to building an accumulated economic stake in Continental may accord with German securities law, it would seem to exploit the lack of a disclosure requirement for investors to aggregate direct holdings, call options and swap positions in a common statement of disclosure. "This differs notably from the approach taken by the UK's Financial Services Authority in its policy on disclosure of contracts for difference which calls for disclosure on long derivative positions which exceed a 3 per cent threshold", he continued. F&C believes this relative lack of disclosure allowed in Germany can be detrimental to minority shareholders, particularly those investors that may have sold Continental shares without an awareness of Schaeffler's hidden economic position. Dallas stressed that while the recently concluded Investment Agreement

between Schaeffler and Continental provides some understanding of Schaeffler's approach to this transaction – including that it is content with a stake in Continental at less than 50% - open questions remain. "An active market for corporate control, which we are supportive of, needs to be accompanied by high standards of transparency and disclosure. In the case of the Schaeffler bid, the levels of disclosure were not sufficient," Dallas said.

F&C, a shareholder in Continental AG, sees this as a dangerous precedent for other so-called "creeping takeovers" in Germany, and notes that a similar precedent has already occurred with the accumulation of shares in Volkswagen AG by Porsche AG. To the extent that minority investors may be disadvantaged by limited disclosure on economic stakes in German firms, this could impact the credibility of German corporate governance in the institutional investment community, both within Germany and internationally.

F&C's letter encourages BaFin to launch a review of disclosure thresholds in Germany to encompass both direct economic stakes as well as indirect stakes through equity swaps or other forms of derivative contract. "Such a step would be welcomed by both the domestic investment community in Germany and by international investors and would be a positive move forward for German corporate governance", he added. "Our concerns have been echoed by some Dax 30 companies who sent a letter to the German finance minister to denounce this loophole in the German law".

Falling oil eases inflationary pressures

The recent fall in the price of oil and other commodities is good news for the markets as it eases inflationary pressures, according to Jeremy Tigue, Head of Global Equities at F&C. He commented: "Not everyone feels the same as there is an argument that the fall in oil prices is a result of collapsing demand as the world slumps into recession. Although I can see the logic behind this view, I am more optimistic." Tigue believes that the biggest problem facing the global economy is still the continuing effect of the credit crunch. The most effective way for central banks to deal with the aftermath of the credit crunch is to cut interest rates. However, with the oil and other commodity prices rising so fast, central banks have been nervous about the effects that rate cuts could have on inflation. "An easing of inflationary pressures means that interest rates across the developed world now have the potential to come down further and faster than had been expected even just a few weeks ago. This is encouraging news for both equity and bond markets. However, while the global outlook is improving the UK economy continues to struggle. The recent fall in the

pound has made the problems worse".

Insurers in the eye of the storm

With Gustav down and Hanna, Ivan and Josephine still to go, the 2008 hurricane season threatens another year of big catastrophe payouts. Post-Gustav claims could reach \$10 billion - but with US officials predicting a further 14-18 tropical storms this season, versus the historical average of 10, the insurance bill may yet top the \$30 billion paid out last year.

Alexis Krajieski, Associate Director of Governance & Sustainable Investment at F&C, said: "The latest research indicates the past decade has been the hottest in the northern hemisphere in at least 1,300 years, and these extreme global weather events bear this out. This week's devastation in the US and Caribbean is a reminder of how vital it is for insurance companies to protect themselves against the rising cost of claims". Krajieski says insurers have been slow off the mark and urgently need to develop climate change strategies. "A stable and efficient insurance sector provides vital underpinning to society and the economy by allowing consumers and businesses to pool risks, thereby making investments they could not otherwise afford. But the system is under threat: - the real cost of insurance cover is not necessarily reflected in the premiums insurers charge, because climate change means the past is no longer a reliable guide to the future".

"Some insurers have responded in the US, for example by reducing premiums for customers who install flood defences on their homes, but several major US insurers have simply withdrawn from high-risk areas, leaving the state to step in. The UK industry, by contrast, has successfully engaged the government to shore up flood defences and allow flexibility in pricing to reflect underlying risk."

Last autumn, F&C issued a report - 'In the Front Line: The insurance industry's response to climate change' - which coincided with 38 companies pledging to take action on climate change through the ClimateWise principles. "The past year has seen some improvements, particularly with some larger European and US players developing climate risk strategies" says Krajieski. "But, globally the industry has yet to respond sufficiently."

Krajieski concludes: "Insurers are in real danger of becoming the victims of climate change. They need to act now and play a key role in shaping regulatory policy, so that the industry as a whole can adapt to the challenge posed by climate change and continue to fulfill its core function of enabling customers to protect their assets at the right price."

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