

Securum and the Way out of the Swedish Banking Crisis

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1. The underlying ideas

The Swedish approach to the problem of tidying up after the banking crisis by transferring troubled debt to specialized asset management companies is often held up as an example for other countries to follow. The most unusual aspect of Securum was the great degree of independence given to the company, combined with the rather broad terms in which its assignment was formulated. The Swedish state, as owner, announced that the winding-up would be permitted to take considerable time and that it should proceed keeping the best interests of taxpayers in view. In all other respects, Securum's board and management were given a great deal of freedom in shaping the company's policies. Moreover, the board was dominated by experts, with representatives of the ministry and the political domain being a limited element.

Furthermore, the legal structure chosen was such that Securum's operations were not subject to the laws applying to financial institutions, particularly not the constraints imposed by the regulatory framework of banking legislation. The company was also allocated sufficiently substantial equity that the risk of the management needing to return to the owner and ask for more funds was virtually non-existent. Consequently, the material prospects of independence were good.

In several respects Securum can be regarded as the very image of an ownerless company whose operations run no risk of exposure to the trials of capital markets. In other circumstances, companies of this kind tend to be met with scepticism, as the concerns motivating the management are not necessarily the same as the concerns of the owners. The question is whether Securum was an exception to this rule.

Naturally, the degree of genuine independence is not determined merely by the financial strength of a company, or by legal structures or the composition of the board. Securum was the consequence of a crisis in which great wealth had been wiped out in a short time, new wealth was to be generated and taxpayers' money was invested on a large scale. It came into being as a result of the political consensus across party lines that marked the handling of the Swedish banking crisis. Such a company can only maintain its freedom to act independently as long as it retains the backing of the political parties and public opinion.

This being so, on a couple of occasions political debate and media attention did indeed take on significance for Securum's operations. One example of this is the criticism of the remuneration paid to leading personnel in the company. The decision to wind up the company more quickly than originally envisaged also appears to have been influenced by a politically coloured debate. In other respects, e.g. the alleged inclination to seek solutions in which companies were forced into bankruptcy, public criticism became most vigorous after Securum had concluded its activities. Yet on the whole, we may say that the politicians safeguarded Securum's independence and the company's management was able to act independently on most issues.

2. Is a special asset management company a good idea?

Economic forces

Various fundamental arguments for and against separating out loans in default and putting them in the hands of an independent asset management company exist. One conclusion that can be drawn is that the strength of a number of the arguments for an asset management company is closely connected with the decision to let the winding-up process take time. A simple alternative, which does not require any special organisation, would otherwise be to immediately auction off the loans, or else to auction off the collateral once this had been taken over. So let us first sum up our view of the choice of time frame.

Fire sales can have substantial costs. First, loans in default and the collateral underlying them are notoriously difficult to value in a situation of general crisis. This has to do with the fact that the maintenance of assets has often been neglected because the former owners have lacked adequate incentive to look after their assets in a situation where they were in any case very likely to lose them. Consequently, there is a risk that large amounts will be lost before the creditor has had time to assume control of the assets.

When assets are sold off quickly to external buyers, it can be difficult to get a good price since the seller (the bank or the asset management company) knows a great deal more about the condition and potential value of the assets than can credibly be communicated to a buyer. In other words, we have a classic case of asymmetric information, a state of affairs that we

know complicates efficient price setting in the market. One reason to delay liquidation can therefore be that it takes time to reduce the significance of this problem, by care and maintenance. In normal circumstances, when the number of bankruptcies is limited, this need not be a major problem, but with many bankruptcies to manage in a general banking crisis, it emerges as a substantial argument for not auctioning off all collateral at once. On the other hand, it is not an argument for letting the winding-up drag on over a period of 10 to 15 years – in which case other factors would play a role, factors whose significance is less easily assessed.

The second set of reasons for allowing the winding-up process to take time is connected with prospective price and liquidity developments on the assets markets. This is important above all if the assets affected are concentrated in a certain area, such as the property market in the case of the Swedish banking crisis. In conjunction with such an industry-wide crisis, demand is often curtailed by the inability of many potential buyers either to finance a purchase themselves or to raise financing by borrowing, because of a lack of creditworthiness at the very time that financial institutions are demanding more than usual in the way of collateral.

This tends to have three consequences. First, illiquidity makes assets cheap in bad times, which means that a seller can reasonably expect them to go back up in the longer term. Second, prices become extra sensitive to an increase in supply. A player planning to sell a substantial stock of properties therefore has more power over the market than usual, which enables him to increase his income by spreading sales over time. Third, fire sales, which push the price level down, risk simultaneously weakening the financial situation of other companies in the same industry. This in turn will entail the risk of further deepening the crisis in the financial sector.

On the basis of international experience of cycles in the property market, it is probably safe to say that it was sensible to allow the winding-up process to extend over a number of years. The assessment in 1992–1993 that property prices were far below the long-term equilibrium level was highly reasonable. Bearing in mind the weak financial position of many actors in the property market and the general uncertainty that seems to have held back many of those who were in a strong financial position, fire sales would probably have had a ripple effect and exerted further downward pressure on prices. This would have both cost the state money directly in the form of lower sales income and risked leading to further problems for other

financial institutions. It could also have led to a redistribution of wealth that might have been felt to be objectionable.

Having decided to let the winding-up process take time, there are a number of arguments in favour of constructing a special organisation for dealing with problem loans, even if there are also arguments for keeping the loans inside an intact banking organisation. First we have factors that above all relate to whether special units should be formed to manage the problem loans, but have nothing to do with whether these units should be departments within the bank, subsidiaries or completely independent companies. Establishing special units gives better opportunities for making use of the advantages of scale and specialisation. One argument against special units, however, may be a loss of opportunities for exploiting existing expertise within the bank.

In special units it may also be easier to build up an appropriate system of incentives. Against this may be set the view that banking operations are long-term by nature, and that incentives need to be linked not just to the handling of problem loans but to the overall history of the loan commitment, from the first decision to grant the loan to final liquidation – a link that would function better if the whole organisation were kept together.

Other factors are mainly relevant to the choice between separating the activity off into a company of its own and keeping it within the original banking group. One consideration here is the potential impact on the overall market valuation of the remaining healthy bank and the asset management company. Furthermore, the Banking Business Act places limits on the assets banks are permitted to own and the activities they are allowed to engage in.

All in all, the arguments both for establishing separate units and for organising them in the form of an independent liquidation company take on greater strength the longer the time planned for liquidation and the freer the mandate given for managing the assets taken over.

Hence, our conclusion is that the advantages of establishing a special asset management company are greater if the volume of loans in default is large and if there is a substantial need to let the process of liquidation take time. If only the first condition is met, it would be possible to auction off the loans at once, which would not require any major organisational changes. But if the plan is also to allow the process of liquidation to take time, a special

liquidation company such as Securum stands out as a good solution. The need for a drawn-out process of liquidation depends in turn on the volume of collateral relative to the underlying asset markets. Hence, the advantages were particularly great because the collateral assets managed by Securum were highly concentrated to the property market.

Legal forces

Over and above the economic aspects we have just discussed, legal issues are also relevant to the question of whether it is appropriate to establish a special asset management company. This is because the very activities such a company is expected to engage in are subject to the restrictions imposed by the operational regulations in the Banking Business Act, which aim to prevent banks from pursuing activities that are too risky. Typically, a bank may only take over collateral in order to manage a credit problem short-term, i.e. to give it breathing space so as to avoid panic selling of an asset held as collateral.

The idea of an asset management company with a long planning horizon is quite different. Its role is not merely to take over and reorganise collateral but also to take active management measures, such as acquiring supplementary property and managing the property and industrial companies of which it has become the owner in an efficient manner. The liquidation company, moreover, needs to be able to wait for the market to come round and choose a suitable time for liquidation.

A bank would probably not have been able to enter into various kinds of agreements on acquisitions and share purchases in connection with a reorganisation in the way that an asset management company could. In addition, it is quite clear that the Banking Business Act would have prohibited a bank from acquiring property to supplement the collateral. Even if the banks, in practice, were given a great degree of liberty during the financial crisis – though not the right to acquire supplementary property – they would not have been permitted to become actively involved, on a large scale, in property and industrial companies.

Transferring the loans to an independent group of asset management companies considerably broadened the scope for action. For one thing, a finance company (*finansbolag*) like Securum Finans was not subject at this time to the same restrictions on the right to take over and

manage collateral as a bank, and for another thing, the asset-holding companies to which the assets were transferred were able to act in precisely the same way as any normal property or industrial company whatever. Their activities, moreover, were completely beyond the supervisory powers of the Swedish Financial Supervisory Authority. One further major advantage was that Securum faced no equivalent to the rule in banking that any restrictions on the activities of the parent company apply equally to all other companies in the group.

The regulatory obstacle that was most apparent during the initial phase of the crisis was, however, the requirement that a bank should dispose of any collateral that it had taken over within three years. We must bear in mind that when Securum was established, it was said that the property market would take 10 to 15 years to recover. To be sure, the possibility of exemption did exist, but there was virtually no practical experience in this area, which made it difficult to judge the position the Financial Supervisory Authority, would take on a request to retain major holdings for more than three years.

In fact it turned out in retrospect that for the duration of the banking crisis, the Financial Supervisory Authority turned a blind eye to banks' compliance with the rules. In practice, the banks therefore had greater room for manoeuvre than could reasonably have been foreseen at the beginning of the crisis. Nevertheless, there was a latent dependence on the supervisory authority throughout: it was impossible to know when the authority would reactivate its supervisory role.

Thus, it can be said that the establishment of an asset management company created the maximum possible freedom for action. If the problem loans had remained in the hands of the bank they would have been treated as an activity alien to the bank's general operations, even when converted into shares or other assets. The management would have been subject to supervision and the demands for capital adequacy, etc., would have applied throughout to this activity too. By moving the loans to Securum and converting them into assets managed by special companies, it proved possible to conjure up a company that in principle was active solely in the property and industrial sectors and played by the same rules as other companies in the sector. The operation was rid of all associations with banking.

Consequently, from the point of view of freedom of action, the construction using an asset management company was a successful solution. The question then arises whether any

obvious disadvantages were associated with this solution. One uncertain factor arising from such a solution is a loss of continuity in the management of the loans and the process of recovery. To be sure, transferring the loans would make it easier to assess the losses incurred and hence the size of any damages to be paid by the party responsible for issuing the loan. However, we are sceptical about uncritical use of the values then assigned to the loans as a basis for any damages.

Impact on competition

It has been asserted – not least by other banks – that state commitments to Nordbanken and Securum distorted competition in the banking market. The basic argument here is that the support given under the auspices of the general bank guarantee was more far-reaching than was needed to fulfil the fundamental purpose of the bank support measures, namely, to guarantee the stability of the payments system. It is reasonable to suppose, the critics assert, that this purpose could have been achieved equally well by means of more limited support that would have guaranteed the short-term survival of Nordbanken, but no more.

This criticism can be countered by the argument that the extra injection of capital given to Nordbanken in excess of what was required for survival could be seen as an expression of the state's rational interest as owner. The question would then become why the state should not be allowed, like other owners, to invest so as to maximise the value of its enterprises. Adopting this point of view, the question becomes instead whether the state really acted as a rational value maximiser or whether it demanded less in the way of returns on its extra capital input than other banks did.

For several reasons, this is a question that is impossible to answer. For one thing, it refers to the requirements the state made in advance with regard to the investment, not the outcome after the event, which was greatly influenced by the general development of the economy. If, despite this, we focus on the returns that were actually achieved, it can easily be observed that Nordbanken – now part of the Nordea group – developed into a very profitable bank. Thus, in retrospect, the state appears to have obtained good returns on the money invested. Yet this does not mean that the returns are on a par with the demands made by the owners of other banks, which were more or less financially hamstrung in the wake of the banking crisis.

Consequently this does not answer the question as to whether the resources invested in Nordbanken gave better returns than equivalent resources invested in other banks.

Even if we tend towards the conclusion that the efforts made by the state on behalf of Nordbanken were the expression of a rational shareholder's interest, this does not imply that they were neutral from the point of view of competition. Here we may note, firstly, that in the short term these efforts probably had a favourable impact on local competition in the Swedish banking market, by enabling Nordbanken to remain on the scene as an independent actor. This conclusion applies at least if the alternative would have been a takeover of the bank's operations by its domestic competitors.

A more interesting question, however, is how the injection of capital into Nordbanken affected the structural transformation of the banking market in the Nordic countries, i.e. the impact on competition in a longer-term perspective. It is clearly apparent that the ample injection of capital made it easier for Nordbanken to play a leading role in this process. However, it is not easy to arrive at any very definite opinion about the resulting effect on competition in an increasingly international banking market.

The question we have discussed above is whether the result of the state support influenced competition in the banking market. Another angle is also possible. What impact does the fact that the state props up an actor that has failed have on dynamic competition in the market? In so far as historical results are of value in assessing future efficiency, this support has of course prevented resources from being redistributed from less to more efficient actors. The state has obstructed the process of creative destruction that is generally regarded as a key point in an efficient market economy. At least as long as the state remains one of the owners of a major bank, it is therefore more important to ask what signals this process sends in the event of future banking crises, than to attempt to assess Nordbanken's efficiency compared with other banks.

The question of the impact of the bank support on competition must also be weighed up in the light of the legal status of the support – both when it was introduced and in the event of introduction of similar support today or at some future time. The competition law that was in effect when most of the investments were made in Nordbanken was completely devoid of regulations on state support. The same thing is true of the law that entered into force in April

1993. In preparing the new legislation, however, the question of the conceivable effects of state support on competition was discussed for the first time in Swedish law, though the law was not considered applicable to bank support. Nor was the Bank Support Authority able to use the 1993 *Act on State Support for Banks and Other Credit Institutions* to tackle the issue of bank support in this case, since the support had been advanced before the regulations had entered into force. When the general bank support package was introduced at the end of 1992, the issue of the neutrality with respect to competition was raised in the Riksdag. Although statements were made pledging that this support would not be allowed to affect competition and that it should be tied to repayment requirements, these statements had no significance in practice.

However, since Sweden joined the EU the situation has changed and we now have competition legislation in line with EC competition law. How, then, would the investments in Nordbanken have been judged under EC law? In all likelihood, the EU Commission would have deemed the support to Nordbanken to be the type of state support that could have been open to attack by the EU. This has been the outcome in a series of other similar cases, such as the support given by the French state to *Crédit Lyonnais*. Having said that, on our assessment, the support could have been allowed if it appeared reasonable relative to the seriousness of the crisis, in other words, if it was designed taking into account the principle of proportionality. A highly probable outcome would have been that Sweden would have been compelled to discuss the situation with the Commission, which would have granted an exemption for the state support but would have made this exemption conditional on Nordbanken selling off parts of its healthy operations. This has been a common procedure in applying EC competition law. The bank receiving support would thus be forced to sell parts of its healthy operations to competitors to compensate and correct for the effects of the support.

Whether Nordbanken benefited from the bank support is a question that is only indirectly connected with Securum. After all, it depends on the volume of funds injected into Nordbanken, including the price paid by Securum for the loans that were taken over. On the other hand, this has little to do with the principle of establishing an independent asset management company or the amount of capital this company was given. However, it is conceivable that the fact that Securum was given so much capital may have affected competition on markets other than the banking market. Securum and its subsidiaries were of

course very active on the property market and some industrial markets. Backed up by a large amount of equity, deriving from the bank support, there was nothing to stop Securum from buying up competing companies. There have been examples of criticism directed against Securum for this very reason.

3 How was the idea of an asset management company implemented?

We have seen that there are strong reasons for establishing a special asset management company, assuming that the winding-up of the loans should be allowed to take a considerable time. The management of Securum was given a great deal of freedom in drawing up company policies. The company was also provided with very considerable financial strength. Bearing this in mind, let us now attempt to sum up our view of how Securum was organised and managed.

Managing an asset management company

The state, as owner, entrusted the affairs of the company to a board and a managing director, simultaneously denying itself the option of direct participation in organisation and economic management. To exaggerate only slightly, it could be said that this set-up “created” the classic shareholder-management principal agent problem, a problem that arises when a professional management team (with no shareholdings of its own in the company) is appointed to make decisions, while the shareholders solely contribute capital and hence risk-taking. Ownership and control were separated.

The state did not assume the role of an active owner. Nor can it be said that the capital market exercised any restraining effect on the management of the company. Generally speaking, the need for external funds can impose discipline on the management, but the executive of Securum had no need to worry about these considerations. This generated considerable leeway for action by the executive, which was also given substantial scope to take initiatives of its own without the interference of a “strong owner”. The advantages this may have entailed need to be set against the risk of the management – which possessed the power but

did not bear the economic consequences of its decisions – allowing itself to be guided by interests other than those of the owner (the taxpayers).

A corporate governance of this kind thus paves the way for conflicts of interest between the owners and management, and extensive theoretical and empirical writings demonstrate that such conflicts can be detrimental for the firm value. One of the most common agency problems is empire building – self-serving actions taken by managers to maximize firm size rather than market value. Management may also have a different attitude towards risk than the shareholders, and the time frame of management can deviate from that envisaged by the owners. In the case of Securum, the most obvious fear was that management would let the company become a growing state conglomerate rather than seeking to wind up affairs swiftly.

To mitigate costly conflicts of interests there might be a need for compensation contracts that align the interests of management with those of the owner. Such contracts should be designed so as to bring the planning horizon employed by the management and its attitude to risk into line with those of the shareholders, while giving management an incentive to use the resources of the company in the best possible manner.

The fact that Securum's assignment was to be carried out within a limited period of time was an additional complication. An organisation of this kind, in which appointments are by definition for a limited period, makes special demands on both personnel and pay policies. The employees could hardly be motivated by the prospects of an in-house career at the company. In such a company, the methods needed to motivate staff may differ from those used in companies whose operations are to continue on a more permanent basis. Linking performance to some form of bonus is one way of maintaining motivation levels among the staff for the planned duration of the organisation.

The idea of introducing incentive programmes for employees at different positions in the company encountered a lack of understanding on the part of the owners. The state had brought in a form of corporate governance that particularly called for such solutions but was unwilling to take the consequences. The board of Securum first discussed a proposal from external consultants concerning incentive programmes as early as November 1992. This proposal emphasised that incentive programmes were an important element in organising an asset management company. The board, however, was not wholly positive to such

programmes and the statement was made that “as a matter of principle, no promises should be made regarding bonuses”.¹ Nothing more seems to have been said about the issue until autumn 1993, when the need to bring in some form of performance-related compensation for Securum personnel was brought to the fore once more. A limited programme of incentives was not introduced in Securum Finans until spring 1994, when a large proportion of the loan stock had already been liquidated.

Similarly, there was little understanding on the part of the company’s owner of the need to attach people in leading positions more securely to the organisation. To be sure, at mid-year in 1994, the chairman of Securum’s board considered that he had received a mandate from the state secretary at the Ministry of Finance to draw up a proposal for ways of offering leading staff at Securum solutions that would attach them more closely to the group. However, it is clear from the subsequent debate in the press and the chain of events that led to the resignation of the chairman, that there were communication problems between the management of Securum and its owners, the Bank Support Authority and the Ministry of Finance.

In view of the great independence enjoyed by Securum and the limited role played by appropriate bonus systems, it is particularly interesting to study the manner in which Securum performed its tasks.

Liquidation of loans

Securum started out with a massive portfolio of loans in default as its most important asset. The book value of this portfolio came to some 50 billion kronor, the number of companies in the client register to about a thousand. The companies concerned were highly insolvent. The task was to determine whether and how firms could be reorganized with respect to both operation and financial structure and re-emerge as a going concern.

It was important to act quickly. A drawn-out solution to the financial problems of the companies would have been very expensive, as companies with a high degree of debt and looming payment problems often are unable to focus on key operations and investment decisions. It was not to be expected that the owners of the companies – with very little capital

at their disposal – would undertake profitable investments or even cover the day-to-day costs of maintaining their properties, since part of the profits would accrue to Securum and other creditors.

Moreover, there was reason to believe that the owners would stake their resources in risky projects, as the profits gained in the event of a favourable result would benefit them, while Securum would be saddled with the losses if the project turned out unfavourably. There were further reasons for minimising the period for which the fate of the companies was uncertain. Dealing with financial problems had become the owners' principal concern, while their real business operations had been neglected. Key personnel had, perhaps, departed for more secure employment and customers turned to more solvent suppliers, particularly if the products were associated with guarantees or other future service.

For all these reasons it was important to act quickly, and Securum did so. By the mid-point of 1994, large segments of the loan portfolio had been wound up. Of the 790 Swedish limited share companies in Securum's client register, 70 per cent were declared bankrupt or liquidated. More than half of the bankruptcies and liquidations occurred before the end of 1992/beginning of 1993, at which point Securum passed into direct ownership by the state. Though 70 per cent may sound like a very high proportion of bankruptcies, this has to be seen in the light of the very poor condition most of the companies were in when their loans were transferred from Nordbanken.

The average company in Securum's client register had a rate of return on total assets of 3.5 per cent, a figure that has to be regarded as far from sufficient to cover the returns required by lenders and owners. In addition, the great majority of these companies had a very high debt/equity ratio and their financial position was weak in other respects too. All in all, these indicators suggest that the probability of a typical Securum company becoming insolvent was in excess of 90 per cent. Even taking this conclusion into account, our analyses show that a relatively high proportion of the companies belonging to Securum's client register were declared bankrupt, compared with other companies with similar profitability and in a comparable financial situation. This conclusion holds even if we exclude the many bankruptcies that occurred before the commitments were formally transferred to the independent Securum in January 1993. Nevertheless, Securum appears to have pursued a consistent strategy for the liquidation of loans. Companies with low profitability, unpaid

interest, a low interest coverage ratio, a high debt/equity ratio and no “track record” filed for bankruptcy. The other companies were reorganised.

Thus, there is some foundation for the view that Securum companies ran a greater risk of bankruptcy than others, even though fairly marginal effects are involved. Moreover, since the number of companies in crisis was so large, it is impossible to rule out the possibility that individual companies that fell into Securum’s hands were automatically classified as companies in crisis and that the situation of these companies deteriorated as a result of a loss of confidence in the company on the part of suppliers, employees and clients; ending up in Securum’s client register may have caused the indirect costs for their bankruptcies to soar. However, we have no reason to believe that this was a common phenomenon.

In some cases Securum had good collateral for its loans. Did this influence the way Securum acted? Conflicts of interest between creditors with different priority rights are known to affect the chances of reorganisation. Creditors holding collateral may have an incentive to demand bankruptcy, even though the company is viable and other creditors, in common with the owners, would obtain a better expected result from reorganisation. In particular, this is the case when the value of the collateral at bankruptcy nearly coincides with the amount of debt. In such situations, a creditor holding collateral has nothing to gain and much to lose if the company continues to operate. However, we find no evidence of Securum preferring bankruptcy or liquidation to reorganisation in cases where the value of the collateral was close to the value of the receivables owned by Securum.

Since reorganisation is a better alternative than bankruptcy for owners and management, it is no surprise that Securum has been criticised for taking too hard a line. After all, the old owners lost all influence when the firm filed for bankruptcy. The two alternatives have been viewed in the public debate as fundamentally different. According to the popular view the focus on the survival of the banks entailed a high price for companies and a severe blow to employment. What basis really exists for this view?

Bankruptcy and reorganisation are alternative methods for solving the problems that arise when a company has become insolvent. For companies that lack future prospects there are few options other than to sell the company’s assets within the framework of a bankruptcy. Viable companies, on the other hand, can be given a chance to continue their activities via

either bankruptcy or reorganisation. Bankruptcy therefore does not always mean that a company's operations are wound up. On the contrary: bankruptcy is a common means of enabling companies to continue. The main bulk of companies that file for bankruptcy are sold to a buyer who then continues to run the company. This applies to many of the companies in Securum's client register. They quite simply lived on after their bankruptcy, though with new owners. The companies as such can hardly have fetched a high price. Nor is it easy to see any severe blows to employment. Instead it was the former owners who had to take the blow.

In practice it is not so simple to determine the value of a company's assets and as a result a company's owners and management can need time to be able to investigate whether there are other financiers who may step in. One way of giving companies time to explore their financial position is to temporarily protect the company from its creditors. If a problem did exist of too many bankruptcies during the financial crisis, with owners being forced to abandon their companies because of excessive intervention on the part of Securum and other creditors, it might be conceivable that the Business Reorganisation Act will mitigate these difficulties in future times of crisis. Under this Act, which entered into force in 1996, the enforcement of claims on a debtor is fundamentally prohibited for the duration of a company reorganisation, and as a general rule, bankruptcy proceedings cannot be instigated against the debtor company during reorganisation either.

Would the course of events have differed if this legislation had existed during Securum's lifetime? We do not think so. The new Act appears to be a failure. The number of companies reorganised along the lines now set out represents a very small proportion of the bankruptcies. Perhaps we should be grateful for this. A number of studies carried out in countries that have elaborate reorganisation legislation, such as the United States, show that many companies that should have been liquidated have been reorganised instead.

The turn-around of Securum firms

After the loan liquidation phase, efforts focused on measures aimed at generating value in the various asset-holding companies. What measures were taken, and how successful were they? One of the foremost problems of the companies that were taken over was that their former owners lacked the financial resources required for long-term ownership. Most of the industrial

companies had had such large-scale financial problems that the owners had been unable to devote sufficient time to the business. Where the properties were concerned, in some cases maintenance was so overdue that immediate investments in management and maintenance were essential. The asset-holding companies therefore focused their efforts on restoring an efficient financial and operating structure in the companies so as to enable energies to be redirected to their real business activities rather than their financial problems.

The restructuring measures encompassed both the activities and organisation of the companies and their financing. In many cases the organisational structure of the companies was changed, e.g. by replacing the managing director and making sharp adjustments in the composition of the board. One step in changing the financial structure was to reduce the debt/equity ratio, with Securum acquiring a substantial share of ownership of the company – in most cases, a majority of the shares. Most of the companies were owned by the management prior to restructuring. In cases where the old management remained in place but had been deprived of ownership, there was a risk of an adverse effect on management incentives. To counter this risk, various bonus systems were introduced for the management of many of the companies. At Addum and Borgkronan, for example, the managers were commonly given the option of buying back parts of the company.

The asset-holding companies were reorganised in various ways by mergers, acquisitions and sales of assets. In addition, extensive measures were taken both to improve productivity and product development and to adjust prices and product quality. The negative leverage effects deriving from insolvency ought to disappear if a new owner with strong capital resources takes over. The restructuring and new management forms given to companies ought similarly to lead to improved results. Were these expectations fulfilled? In some cases like Kramo and Daros the results improved dramatically, and even though not all companies were able to display such major improvements, our studies indicate that most companies reported improvements relative to other companies in the industry as soon as a couple of years after their reorganisation. The impact of restructuring on results has been sustained in some of the companies even after Securum has wound up its operations.

Liquidation of assets

It is unclear exactly how long the state originally imagined Securum would continue with its activities. The capital allocated to Securum, however, was calculated on the premise that liquidation of the assets could take a long time. The idea was that it should be possible to continue operations for a period of up to 15 years, even given negative assumptions about price trends for the company's assets.

As time passed, at different junctures – both before and after the problem commitments had been reviewed – the owner expressed the wish that the winding-up of the group should take place over a shorter period; a period of five years was mentioned. Nevertheless, there seems to have been some uncertainty about the issue of how much time the Securum group had at its disposal, and communications with the Ministry of Finance about this issue seem to have occurred in part via the media.

It emerges from the minutes of a Securum board meeting that the issue was “[brought] to a head” by statements by the state secretary at the Ministry of Finance to the effect that five years ought to be perfectly sufficient for winding up Securum's portfolio of loans.² As early as September 1995, i.e. less than three years after Securum had started its activities in earnest, the board of Securum presented a proposal to the effect that the group should be wound up by mid-year 1997, a timetable that was subsequently adhered to. Liquidation of the assets had already begun on a small scale in 1994 and 1995, but the pace was now stepped up during 1996 and early 1997. This process involved individual companies or properties, but also, in some cases, sales of large corporate groups either by launching them on the stock exchange or by private placements.

Securum's task was to sell the assets at the best possible price. Since most of the assets consisted of real estate, the consequences for the property market were also to be monitored. Was the right time profile chosen for the sales? Was the right method chosen for the sales? Did the assets fetch the best possible price given the choice of sales method?

The majority of the property sales – approximately 60 per cent – went through in 1997 and a further 25 per cent in 1996. The point in time selected for the sales is open to question, in the light of the price trend for property and property shares: in the following years, after all, both

property prices and stock exchange prices went up. In retrospect it is easy to say that the economic outcome for the state would have been better if the properties had been sold later.

The sale of Norrporten as early as 1994, for example, when the price level had only risen marginally from the bottom point recorded in 1992, must therefore be motivated by arguments other than a belief that the sale was being made at the best price. In 1996 and 1997 it was no longer equally obvious that the price level was below a long-term equilibrium position. At the risk of being accused of benefiting from hindsight, we still assert that the odds of continued price rises were still so good in 1997 that a somewhat more prolonged process of liquidation would have been reasonable.

Was the right method chosen for selling property? The pieces of property could be sold one at a time, they could be lumped together into bigger packages, or whole property companies could be sold. Securum used all three methods, but the larger sales of the stock of properties occurred by selling off whole property companies. Given the choice of sales unit, there were two alternatives: on the one hand, some form of auction procedure, or on the other hand, a direct sale after negotiations with one or more potential buyers. In Securum's case, there were no auctions at all, neither for individual properties nor for shares in property companies.

The methods used by Securum for selling properties therefore differ from the methods used in the United States, where the Resolution Trust Corporation, RTC, sold single properties, piecemeal or in packages, but not companies. To a certain extent, RTC also used auctions of varying design. In our assessment, Securum's choice of methods was sensible, at least if the intention was to prevent the liquidation dragging on over a long time. There can be no doubt that it would have been difficult to sell large stocks of properties in Sweden piecemeal, without depressing price levels. A stock exchange introduction, on the other hand, made it possible to sell a large stock of properties without much effect on prices, because this was a means of reaching a broader circle of investors, including investors who had no interest in owning properties as such. Particularly in a situation where a number of the traditional actors on the property market were still wrestling with liquidity problems, this may have been a significant factor.

But why did Securum avoid using auctions for some of its properties, in spite of the positive results experienced in the United States? It might be possible to make the case that the

prospects of a good result in an auction were less good in Sweden, as the circle of potential buyers would be so much smaller here, which might open the door to collaboration between buyers aimed at keeping prices down. The auction form might also make it more difficult to put together suitable packages of properties with a view to attaining better prices. Instead, Securum chose to sell individual properties and packages of properties following direct negotiations with selected potential buyers.

The question may be asked whether the shortening of the time frame that was set after a couple of years was reflected in a tendency to sell properties at low prices. Did Securum obtain reasonable prices in connection with piecemeal property sales? How did these prices compare with the prices prevailing in the property market otherwise? Here our analyses suggest that the prices in sales by Securum were somewhat lower than the prices in the market in general. Our analyses take into consideration the fact that properties sold in package deals generally fetched particularly good prices, with a price premium of close to 20 per cent.

Securum was also an actor on the stock market and carried out five stock exchange listings, four in Stockholm and one on the London Stock Exchange. Three of these listings were related to the property market. The initial public offerings carried out by Securum led to the realisation of substantial asset values, but they account for less than half the assets disposed of. Did Securum get as much money as possible out of its five public offerings?

Stock exchange launches are generally carried out at a slightly lower price than the rate established when the shares begin to be traded on the exchange. In the case of Securum's listings, however, the rebate was on average slightly negative, i.e. the shares were sold off at a premium, which is unusual in connection with new stock exchange listings. The aggressive initial pricing may be attributable to the strong position Securum occupied when the bid price was set in negotiations with the investment banks.

Norrporten was undoubtedly listed on the stock exchange at a poorly chosen time.

Considering the obvious uncertainty prevailing on the market at the time, Securum ought to have postponed the public offering. This view, moreover, was argued by Securum's advisers but to no avail. It was probably a complete mistake even to consider listing Norrporten – at the time a brand new establishment – on the stock exchange. We have shown not only that the management in general was well aware that this was the wrong time to choose, but also that

the profits could be expected to turn higher in the coming years because of measures taken by Securum. Consequently, Norrporten could have obtained a higher valuation at a later point. It is possible that political factors, and a need to show a willingness to sell assets, played an important role in the timing of Norrporten's introduction on the stock exchange.

The listing of Castellum on the stock exchange, in contrast, was initially delayed because of market turbulence and was not carried through before market conditions had improved. Here it can be noted that the sale could have been carried out at a price 18 per cent higher than the rate at which it was finally listed. Securum would then have obtained more money and sold a further 10 per cent of the company, the total effect amounting to 315 million kronor at the time of the stock exchange listing.

It is possible that Securum could have raised more money, but it has to be remembered that the public offerings carried out by Securum were not the only sales considered by the Swedish state and that they make up a relatively minor part of the total value of potential future privatisations. At the time in question, for example, the idea of listing Telia on the stock exchange began to be considered. It was estimated that if the Swedish state were to list Telia on the stock exchange, its value alone would be 15–20 times higher than that of all the companies listed by Securum on the stock exchange combined. There were a number of other candidates for privatisation besides Telia (e.g. AssiDomän, SAS, Vasakronan, Vattenfall, etc.). Bearing this in mind, we believe it was probably wise not to be too aggressive and thereby jeopardise the far larger values that might be at stake in future privatisations.

4. What was the effect on the bill to taxpayers and society?

A natural question, which many people ask themselves, is how much the banking crisis cost the treasury. A second, equally natural, question is what influence Securum's operations had on the cost.

In answer to the first question calculations have been made according to which the total cost to central government finances of combating the banking crisis amounted to 35 billion kronor. An answer to the second question has been given in the report in which Securum presented an account of its activities after concluding its mission. We read there:

The financial results achieved by Securum, including Retriva, can now be summed up. In total, the companies were capitalized with equity of SEK 27.8 billion, which was expected to be consumed over the course of the project. The capital was intended to cover anticipated, deferred credit losses and current deficits, primarily interest expenses, until the assets were divested. ... Now that the Securum project is reaching its conclusion, nearly 14 billion more will be paid back. The cost to taxpayers of the financial crises has therefore been reduced significantly compared with what had been expected when the crisis was at its worst point.³

One way of interpreting these figures is that the state expected the bill to come to 49 billion kronor, whereas the actual total was “only” 35 billion. This interpretation, though, builds on the assumption that the state really expected all Securum’s capital to be used up, whereas the fact of the matter was more likely that the amount of equity provided was generous enough to suffice even if developments turned out as unfavourably as possible. In that case, the repayment of 14 billion kronor is a result that needs to be compared with what could have been feared in the worst case, and therefore says little about how well Securum was run. After all, it is obvious that how much it was possible to repay depended on general economic developments. By this standard, the outcome would have looked less impressive if the general assessment of the economic trend had been more positive when the project started (and Securum had accordingly been allocated less capital) or if the dramatic cut in interest rates and economic recovery that occurred in the course of the project had failed to materialise. Another reason why playing with total figures means relatively little is that the time frame is rather arbitrary. For example, it would be easy to turn a negative figure of 35 billion into a positive number by extending the final date for the calculation from 1997 to 2000.

The analysis of different aspects of Securum’s operations that we have presented here furnishes arguments for a different and – in our opinion – more interesting way of assessing the outcome. They attempt to answer questions along the lines of: what would have been the impact on the outcome if this had been done instead of that? In some cases, e.g. where the liquidation phase is concerned, we have attempted to put our conclusions in quantitative terms. In such cases a figure such as 14 (or 35) billion kronor may be a natural point of reference. For example, by postponing the disposal of the properties for two years it would have been possible to return 16 instead of 14 billion to the state or to limit the total cost to central government finances (up to 1997) to 33 instead of 35 billion.

Irrespective of the figure of reference, the focus on government finances is open to question. To be sure, minimising the costs to government – or maximising the amount that could be repaid to the state when the company was wound up – was a natural operational objective to give Securum. But that does not mean that it is a natural general economic objective against which Securum's operations should be evaluated. The impact on the government budget is certainly relevant from a broader economic perspective, since high tax rates bring distortions of various types – the very effects of a high-tax society for labour and saving that are at the heart of the debate on fiscal policy. Consequently, there is a direct link between the costs to government and the cost to the general economy: the greater the burden on the budget, the higher the pressure of taxation and the greater the costs to the general economy. But this is not the whole picture.

There are several reasons why effects on the budget are an unreliable indicator of the consequences of the Securum project for the general economy. To be sure, certain items that affect government finances do influence the *efficiency* of the general economy simply because they affect the pressure of taxation. We have found, for example, that Securum stood up for its rights vis-à-vis former owners. This enabled Securum to bring about a redistribution of resources from these actors, to the benefit of the taxpayers as a collective, compared with what would have been the case if Securum had taken a softer line. We have also found a tendency for Securum to sell its properties at somewhat below prevailing market prices, which means that resources were redistributed to benefit the buyers, while the pressure of taxation ended up higher than necessary. In both these examples, Securum's actions therefore had an impact on the pressure of taxation, though without otherwise having any positive or negative effects on the efficiency of the economy.

Other items that affect government finances can simultaneously have a broader impact on the efficiency of the economy: they generate (or destroy) value. Where we have found that Securum helped to raise business profits at some of the companies it took over, our conclusion has also been that the total value of production in the economy has grown and there is a simultaneous positive effect on government finances. An item of this type therefore enters into calculations of the economy twice over – both directly by its effect on production and indirectly by the effect on taxes.

Measures that influence government finances also entail a redistribution of resources between the taxpayers as a collective and opposite parties who are at a more direct advantage or disadvantage. Securum's activities may have had important effects on the *distribution of income* in two respects above all. First, there is the line taken in relation to debtors. We have found indications that Securum was marginally more inclined than other lenders to let borrowers go into bankruptcy rather than renegotiating loans on softer terms. Part of the criticism of Securum's action in this respect could be interpreted as a reflection of a lack of adequate regard for the personal difficulties that a bankruptcy causes the borrower. A softer line would have favoured these borrowers at the expense of the taxpayer collective. In our opinion, it would have been unreasonable for the state to help bring about such a redistribution of income. A second redistribution of resources arises in cases where the asset management company sells off its assets at too low a price. We have found weak indications of this where the properties are concerned. Moreover, we cannot rule out the possibility of such effects where the sale of certain industrial companies is concerned, especially bearing in mind their subsequent growth in value.

It is natural to demand a bottom line for the cost to the Swedish economy of the banking crisis and the measures taken to fight it. But as we have said, a bottom line is hardly meaningful. Nor is it possible to boil the economic effects of Securum's activities down to a single number or even a few figures. We have attempted to give a systematic analysis and achieve quantification in limited areas. But when all is said and done, these quantitative results have to be considered along with assessments of a more qualitative type. We hope to have provided a basis for such an assessment.

¹ Minutes of board meeting, Securum AB, 19 November 1992 (our translation).

² Minutes of board meeting, Securum AB, 9 May 1994 (our translation).

³ *Securum AB 1992–1997*, English version, p. 2–3.