



**The Capital Structure of the Company –
The Regulator’s Perspective**

by

**Mr. Philippe Lambrecht
Legal Counsel
Banking and Finance Commission
Belgium**

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Introduction

Ladies and gentlemen,

It's a privilege for me to be a member of this panel. I would like to thank the OECD and the Swedish authorities, in particular my esteemed colleague Rolf Skog, for their kind invitation to give a few comments on the topic of the capital structure of the company.

As a member of the Belgian Banking and Financial Commission, I will try to address the subject taking into consideration the regulator's perspective.

My presentation will cover the following topics :

- 1) Relationship between investor protection and financial markets developments.
- 2) What should be the position of the law and of regulators towards innovative financial products and financing techniques?
- 3) Relationship between shareholders and investors.

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1. Relationship between investor protection and financial markets developments.

Summary of Professor Myers paper on that subject

- Effective law enforcement and strong shareholders' rights significantly higher ratios of GNP.
- Financial markets are more developed in common law than in civil law.

1) Effective law enforcement and strong shareholders' rights

a) Lack of effective law enforcement

Comparison effectiveness of Delaware Courts and continental courts.

- 1) Can we expect present commercial courts to become more efficient in the present lack of means they are suffering from?
- 2) If the answer is no, isn't it time to create specialised law enforcement bodies that can reach a rapid, efficient and correct decision in company law and financial law matters? Quid of private arbitration?

b) Strong shareholder rights

- By strong shareholder rights, the law and economics theory generally means rights providing effective value for shareholders. Now, I fully agree that this is very effective for financial markets. Is it, however, effective on a more general level : i.e. the general good level?
Are the interests of the shareholders the only interests to be protected in a company or does the rights of stakeholders also have to be taken into consideration? Our previous panel pointed out that there is room for employees in corporate structure.
- The whole debate rests on the economic model chosen to give companies access to capital funds. In continental Europe, the banking system is slowly, but certainly, losing ground against financial markets systems.

2) Common law versus Civil law

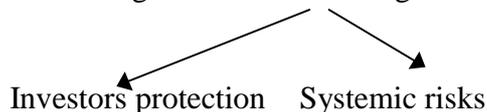
- I don't believe that there is a causality link between the nature of the legal system (common law or civil law) and the development of financial markets :
 - 1) Differences in development are due to economic and political choices more than to the law. In my opinion, the Belgian Stock Exchange has greatly suffered from three factors :
 - ❶ Dominant shareholder's structure
 - ❷ Easy access to banking loans
 - ❸ Competition for cash with the Government because of the high public debt.
 - 2) Today, the main force behind the development of financial markets is technology. An example Euronext. Euronext, i.e., the economic merger of the Stock Exchanges of Amsterdam, Paris and Brussels is possible because of the technology. It's because I.T. now permits to create one electronic central order book for all the shares listed on the three markets that Euronext is possible.
 - 3) Conflicts of law and multiple jurisdiction however can undermine the development of financial markets. These problems aren't typical of common law or civil law.



2. Financial innovations and financing techniques - what should be the position of the law and of the regulators in front of innovations?

1) Question of general policy

- What are the advantages and the dangers of new financing techniques?



- Should sophisticated products be only available for sophisticated investors? Should all companies have access to sophisticated new financial instruments?
- Can you issue anything as long as you properly inform investors?

2) Fashion effect and who benefits from these innovations

As prof. Myers rightly points out : intermediaries benefit more from these issues than companies or investors. What is the liability of those selling financial products to companies?

3) Buy backs under Belgian law

Article 620, 5° Belgium's Company Code provides that if a company wants to buy back some of her shares (with a limit of 10% of the capital), the company must extend her tender to **all** shareholders, unless the company is listed on a regulated market. In that case, the company may buy the shares on the Stock Exchange

buy backs on the Stock Exchange aren't considered against the interest of the shareholders.

The company must inform beforehand the Market authority of the Stock Exchange.



3. Relationship between shareholders and investors.

- Classically, a shareholder invests in a company, knowing that he risks to lose his money and that he will only receive dividends if the company makes benefits. A shareholder, at least in continental company law is supposed to have more in mind than just the return on his capital. He's supposedly animated by the "affectio societatis". He has rights in the company. He may attend the general meeting. He may question the directors, etc...

- An investor invests money and wants a return. He doesn't care what financial product he buys as long as the promised return is high and as long as the risk is not too important.

He will decide to invest in equity (stocks) if the interest rates are low and in debt if the interest rates are high.

He will invest in sophisticated financial instruments if the return appears attractive. His decision is based on the return that he expects and the risk he is agreeing to take.

Traditionally securities laws have been developed starting from company law and gradually migrating to financial markets law and securities regulation.

- I believe that once a security is treated on a financial market, it should be considered as a financial product and not only as a traditional share or bond governed by company law.

Accordingly, market characteristics such as capitalisation, liquidity, financial information, transparent shareholding structure, sound accounting rules, become as important if not more important, than company law characteristics such as voting rights and participation to the general meeting.

- While equality is very often presented as a cardinal principle between shareholders, one must admit that investors vary greatly one from another.

This remark leads to the distinction between small investors and professional investors.

Obviously there is a difference between a small investor and a large professional investment bank. They're not equal .

- But should they be treated equally?

My answer is yes, although I would advise positive discrimination in favour of small investors.

- The problem is, at EU level, that while everyone agrees on these principles, member countries apply them quite differently one from another.

- A few examples :

- no definition of "public",
- no definition of private issuing,
- no definition of professional investors,
- no European Public limited liability company,
- difference between official listing and other regulated secondary markets.

- Positive discrimination also means more protection for small investors (rules of conduct of investment firms and banks members of Stock exchanges).
- Finally, positive discrimination means better education of investors and efficient regulators defending small investors and adequately supervising primary and secondary markets as well as adequate information on all financial instruments.



Concluding remarks

- ✍ There is a need in Europe for effective law enforcement. A choice must be made between ideology and efficiency. Our rules are good, but we should make sure that they are respected.
- ✍ New financial instruments. Beware of those as a small investor! Know that a reverse convertible bond presents as much risk as a stock! Beware of names!
- ✍ Investor protection isn't only adequate information, it's also positive discrimination in favour of the public.

