INSEAD The Business School for the World® | Corporate Governance Initiative

INSEAD Alumni Association Luxembourg

EY Building a better working world

Institut Luxembourgeois des Administrateurs

Meeting Report

How can Good Corporate Governance contribute to the image of Luxemburg's Financial Centre?

INSEAD Alumni conference-roundtable in cooperation with EY and ILA
Luxemburg, April 30th 2014

Small is indeed beautiful… and competitive. However, it is essential for a country to have a true partnership between the people, politicians and business leaders, for therein lies its strength. Luxemburg's sound economic and socio-political model, mixed with humility and ambition, made it a strong financial centre in Europe. Indeed, it only recently has begun the transformation of its banking position and culture by foregoing bank secrecy, which is no longer acceptable in the modern world. Transparency is the first and fundamental step towards greater fair process in corporate governance. This change can be a force of competitive advantage, if Luxemburg will transform its narrative.

The INSEAD Alumni conference, co-organised by Luxemburg Institute of Directors (ILA) and Ernst & Young (EY), examines how good corporate governance can contribute to the image of Luxemburg's financial centre. This question is motivated by the combination of the power and size of Luxemburg in Europe's investment fund business, and the calls for improved governance in finance. The key note message is presented by **Professor Ludo Van der Heyden**, Mubadala Chaired Professor in Corporate Governance and Strategy, Director INSEAD Corporate Governance Initiative, followed by a panel discussion with **Marie-Jeanne Chèvremont**, Independent Director, Chair of ILA and former Managing Partner PWC Luxemburg; **Carine Feipel**, Attorney at Law and Independent Director; **Frédéric Genet**, Independent Director, former CEO at SGBT Luxemburg and KBL epb; and **Alain Kinsch**, Country Managing Partner EY Luxemburg. The panel is moderated by **Marc Gerges**, an independent media and communications expert.

An avid reader of history, Professor Van der Heyden investigates the emergence of the various actors of corporate governance from 17th century merchant England from where the word 'shareholder' was born. He tells the story of the Dutch East Indies Company that leads to the narrative of fraud by directors, of ultimate bankruptcy, and ultimately a government bailout. This is a chilling déjà vu of the recent financial crisis in the 21st century, reminding us of Mark Twain's favourite theory: *"No occurrence is sole and solitary, but is merely a repetition of a thing which has happened before, and perhaps often;"* echoed by Karl Marx that, *"History repeats itself, first as tragedy, second as farce."*

"Basically, things haven't changed much in the area of corporate governance," says Professor Van der Heyden, giving a brief overview of corporate governance and its key challenges and underlining that it is important to understand that governance arose as an answer to a question – in the specific case of merchant shipping it was the protection of shareholder interests. When discussing governance, one should always keep in mind the problem that a particular governance arrangement solves. Is it the insecurity of shareholders/investors? Is it that the firm that issues equity needs cash? Or is it the case that governments need cash? Who is governance for and what interests does a particular governance arrangement serve?

The question then for Luxemburg is the following: will corporate governance change its position in the world, and if so where does the country aim to be? Professor Van der Heyden cites the example of Delaware in the US, a region which focusses on providing effective services and support, including law and regulations, and offers an ideal context for US corporations. The small size of Delaware leads it to specialise and focus, using governance services as its main competitive factor. This leads Professor Van der Heyden to put across a paradoxical thought: Luxemburg's small size, though perceived a weakness, can in fact become its strength in the governance of the country, by more purposefully and cohesively bringing together people, politicians and business leaders to work harder in creating an exemplary and highly competitive financial landscape in Europe. *"What is so nice about Luxemburg is that being small makes it strong, with the stability of a political context close to business being a very important contributor to the country's competitiveness."*

Europe is highly competitive and a champion of value-add compared to the rest of the world. Among the 10 most competitive countries in the world, one typically finds eight European countries, with Switzerland, Luxemburg and Singapore on top, then the Nordic countries, and at the end of the list, USA. Remarkably, smaller countries are more competitive precisely because the triad of public-government-business is healthier and much more synergistic and effective than it is in larger countries. Stakeholders, actors, and regulators interact for governance performance that larger countries cannot match, partly because of diseconomies of scale and scope.

Luxemburg has a dominant position at the centre of Europe, previously anchored on bank secrecy and private wealth services, increasingly as a main actor in the European and global fund business. Professor Van der Heyden states that bank secrecy is no longer accepted in the EU and USA, and hence welcomes and congratulates Luxemburg's decision to abandon its former 'locational' advantage.

There is a lack of clarity now on the value added by the country's private wealth offer (beyond secrecy). Transparency is a great benefit for Luxemburg, making it more open to the rest of the EU and USA, and allowing it to be much more 'open' in its interactions with the rest of the world. In fact, Luxemburg could aim to be the financial centre for multinational holding companies in Europe, with first-rate financing, legal and auditing capabilities, good governance for corporate owners, including a favourable and fair government context in support of building a durable competitive position.

Luxemburg became a centre of fund business, due to its quick adaptation of legislation supporting fund business. The country moved quickly and intelligently; others, such as Belgium and UK could have easily followed but they did not, and now they are late due to Luxemburg's first mover advantage!

In sum, Professor Van der Heyden reiterates Luxemburg's great advantage of being small and united in support of a focused and enlightened government strategy favouring a best in class offer for a particular set of business, customer and investor segments. For Luxemburg, the challenge to succeed, post-banking secrecy, is easy with its 'can do' spirit.

The conference title question is further examined by the experienced panel:

What kind of governance is needed for a financial centre?

According to Alain Kinsch, Country Managing Partner EY Luxemburg, the primary objectives of a corporation are to maximise shareholder value, pay taxes, create jobs and contribute to the economy. "Good corporate governance with a well-functioning board creates the right mechanisms to reach these objectives, with regulators contributing to the basic governance framework." However," Kinsch adds, "at the end of the day, no matter what the processes, it is people who make decisions, and we need the right people to help grow companies without too much risk. We need to create a good corporate culture in the financial sector through the help of ILA and with partnerships with universities."

Professor Van der Heyden emphasises, "Today, if you want to interact with the rest of the world, you need to be transparent."

The difference between regulation and governance, or what is the regulator's role?

"Too much regulation kills governance," says Carine Feipel, Attorney at Law and Independent Director, *"however we do need regulation."* Feipel refers to OECD's definition of corporate governance: 'Procedures and processes by which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders - and lays down the rules and procedures for decision making'. Feipel concurs that regulations are also a set of rules made and maintained by an authority. *"So, we have two sets of rules that are complementary and look at an organisation from different angles, and both are important in aiming to ensure the safety of companies and soundness of their management."*

Having said that, Feipel admits that there may be a risk of too many regulations today especially for financial industry. *"There has been a tsunami of regulations over the past few years and more are coming, which might trigger legitimate concerns about the scope of these regulations and how to deal with them. Europe, 20 years ago, had regulations that were 10 pages long, and which are now 200 pages and it is becoming very difficult to know how to manoeuvre through these. And in particular, they have become so detailed that the liberal approach that contributed to the success of the financial centres in Europe is being squeezed out."*

Referring to Professor Van der Heyden's brief on how governance is about designing the appropriate frame for each company; Feipel adds the frame of regulations around it, warning that the two frames should not cross each other. *"Regulation is a frame within which good governance can take place, if the recommendations are not overly strict and do not impose too many burdens on organisations."*

Since the 1980s, Luxemburg has been able to find ways to implement the European directives and those from the investment funds industry, which are favourable to business. *"It is important that this trend continues in Luxemburg, but regulations are getting tighter and so it is a challenge for the country to find scope for flexibility and build the required expertise"* Feipel advises.

"In my view, the financial crisis was not caused by bad governance; there were other deeper issues in the organisations. Maybe better controls could have avoided some mistakes, but nevertheless, there must be some level of flexibility in how companies formulate their governance frame. It isn't a case of 'one size fits all'. Regulators will continue to play an essential role, but it is important to make the distinction that, though they can make sure that processes are present and implemented, regulators can't impose what these processes should be," assets Feipel.

Does locally influenced governance play a role in a globalised, international environment?

Frédéric Genet, Independent Director, former CEO at SGBT (Société Générale Bank & Trust) Luxemburg and KBL epb (European Private Bankers) says, *"In Luxemburg, the fact is that for most companies, the corporate headquarters are outside the country and therefore so is the major decision making, however if there is fair process, then you can implement good governance through all the subsidiaries."*

Genet agrees with the general discussions that Luxemburg's financial sector is in the process of transformation, especially in its investment funds and private banking activities. *"The bank secrecy culture, though useful 20-30 years ago, is now bad for the country's image and change is needed. We have the right tools, but very often the head office doesn't use them," Genet feels, adding, "We need to have a discussion about fair process between the local office and the holding company's headquarters, since everybody is working for the benefit of the firm and shareholders. However, as a director here, do you look at the firm as a global or local one?"*

Professor Van der Heyden encourages the audience to pursue this direction, *"Here is a huge opportunity for Luxemburg. More often than not, when there are problems, including fraud, the fault takes place at the corporate (headquarter or divisional) level, and not at the level of individual businesses (eg Parmalat or TYCO or Enron). Subsidiaries need to be adequately protected from pressures emanating from HQ. That is the shift in governance today, and Luxemburg can spearhead this change. So, if Luxemburg can incorporate good governance and transparency, at both the subsidiary and corporate levels, this will have a tremendous appeal to a world that is looking for more fairness. The Luxemburg system could be a differentiator for companies that have a great number of dealings with subsidiaries being* *located in different countries, with a clearer definition, including legally, of the relationship between the corporate centre and the subsidiaries. Furthermore, on a political front too, Luxemburg can be more active in steering for closer alliances with other smaller countries in the EU, bringing more fair process in the system. The country has produced a number of EU leaders in the last 20 years, including Thorn, Santer and Juncker."*

© Ludo Van der Heyden

Marie-Jeanne Chèvremont, Independent Director, Chair of ILA and former Managing Partner PWC Luxemburg, interjects, *"We would like to have holding companies based in Luxemburg, but it would be a stress on the financial sector, because the companies here have not yet organised their corporate governance satisfactorily enough to be really credible and to show the world that we can manage well. We have subsidiaries with a lot of activity here, but not necessarily the most effective boards who can influence the right strategies."*

Genet explains that when people are organised under a complex matrix of a big organisation, there can be blind-spots present in understanding what is happening in Luxemburg. *"For example, in my case, we had the sixth largest entity of the SGBT group in terms of net results, but only the CFO knew about this. We found that Luxemburg was an excellent location for SG Bank and Trust activities, and our business has profited as a result – relocating such services to this country from abroad. One implication of this is that banks are realising the need for independent directors to defend local interests against the dictates coming from corporate HQ."*

Feipel joins the animated panel discussion expressing the view that Luxemburg is populated by nominees or representatives of external shareholders, and stresses that local independent directors would bring value and new viewpoints to the board. She hopes that regulators would encourage this change within subsidiaries. This is the opposite of Luxemburg's offering 'private mailboxes and tax heavens' for foreign investors and companies – the country needs to resolutely embrace the call for value-add in its corporate services offer.

The deeper discussions touch upon the heart of governance and the spirit that is imparted into an organisation by people and culture. Professor Van der Heyden underlines how independent directors are a means to an end, giving the company the kind of governance it needs, which sometimes requires a local cultural context. He also puts forward a radical suggestion, *"Luxemburg can also decide to 'delocalise' and embrace the entire European community. For example, the real content regulation can be met by accepting 'real' services provided anywhere inside the EU – dropping the requirement of their physical presence in Luxemburg. This would be a paradigm shift for Luxemburgers. It could still apply to the directors overseeing business, to ensure that governance is done with the right 'spirit' – again something that does not require Luxemburg nationality."*

Chèvremont agrees, *"To justify our advancement, we must have a larger presence throughout Europe, because corporations are not only about the local employment but about where major decisions are made."*

How can good corporate governance influence Luxemburg's image and its financial centre's image?

Chèvremont continues the discussion by asking if Luxemburg companies can be more than just fiscal subsidiaries for international multinationals. She feels that, generally speaking, the country does not have a good image in Europe, especially amongst its neighbours, saying, *"Part of the problem is that we are small, and so like a minority group, we need to more strongly convince the majority that we have substance."*

"The issue of negative image is an innate insecurity in native Luxemburgers," Genet feels, "Even in neighbouring France, which views Luxemburg quite critically; the business community are still interested in working with the Luxemburg International Financial Centre - regarded as being a credible and professional business centre of Europe. In fact, the professionalism of this country is well recognised throughout Europe."

"The issue of negative image is an innate insecurity in native Luxemburgers," Genet feels, "image carried out by press or politicians is one thing, reality of image in the business community is another one, different and much more positive. The professionalism of this country is well recognised throughout Europe."

Luxemburg is quite unique in being a true international financial centre within Europe, with many nationalities on boards - this diversity facilitates broader views, clearer global understanding and agile adaptability. Yet, there is a realisation that banks do need more independent directors. Generally, all panellists agree that though professionally Luxemburg has a good reputation, the problem is more of a political and marketing one, which does impact business.

The need for a narrative regarding the what and why of 'Good Corporate Governance' in Luxemburg

The discussion ends with the call for a narrative regarding corporate governance in Luxemburg. Where does Luxemburg wishes to go, and what can a good governance system deliver for Luxemburg? What does Luxemburg want and what doesn't it want, and why? Of course the current narrative must include the recent decision of the country to drop bank secrecy.

This narrative needs to be that Luxemburg is an excellent centre for financial services based on a transparent business model and with outstanding corporate governance. A shift is needed in the Luxemburg narrative stressing that it is open for business to the world, from wealthy individuals to corporations. There is a need for further discussion on the idea of Luxemburg offering more substance in what its financial sector delivers to Europe and believes its narrative of being highly professional and ready to be a world player is a major change and now needs to be better communicated.

- Interview of Prof. Ludo Van der Heyden :[La force d'être plus raisonnable et plus humble](#) - **Paperjam, Luxemburg, 29 April 2014**
- Photo reportage of the conference : http://www.paperjam.lu/Governance30042014

INSEAD Corporate Governance Initiative
Bd de Constance 77309 Fontainebleau, France
www.insead.edu/governance