

# PRELIMINARY REPORT OF THE PANEL OF EXPERTS

FOR THE GENERAL MEETING OF 11 FEBRUARY

OF FORTIS SA/NV IN BRUSSELS

*This is a free and unofficial translation of the interim report dated 26 January 2009 which was drawn up by the Belgian college of experts in French (accompanied by a free Dutch translation) and has been prepared by Fortis for the sole purpose of facilitating the review of the interim report by its English-speaking shareholders. Fortis does not accept any liability for possible inaccuracies or discrepancies with the original French version, which will prevail in all circumstances.*

## Plan

### Reference nos.

#### **Foreword**

#### **Executive summary**

1-29

#### **Chap. 1 Introduction**

§ 1.1. Essential points of the judgement that relate to our mission 30-37

§ 1.2. Mission of the panel 38-43

§ 1.3. Diligence and procedure g44-47

§ 1.4. Preliminary nature of the report 48-49

#### **Chap. 2 Significant events prior to 26 September 2008**

§ 2.1. Developments in financial markets prior to 26 September 2008

§ 2.1.1. *Review of certain concepts* 50-60

§ 2.1.2. *Instability in financial markets* 61-64

§ 2.1.3. <i>Benchmarks for banking and insurance institutions as going concerns from January to October 2008</i>	65-73
§ 2.2. Developments in Fortis's financial situation	
§ 2.2.1. <i>General</i>	74-90
§ 2.2.2. <i>Solvency situation in September 2008</i>	91-93
§ 2.2.3. <i>Liquidity situation between 1 September and 25 September 2008</i>	94-104
<b><u>Chap. 3 Benelux plan of 27-28 September 2008</u></b>	
§ 3.1. Status of Fortis Bank's liquidity on 26 September 2008	105-113
§ 3.2. Intervention by the Belgian, Dutch and Luxembourg States	
§ 3.2.1. <i>Review of a few facts</i>	114-118
§ 3.2.2. <i>Details of the transaction</i>	119-129
§ 3.2.3. <i>Valuations used</i>	130-135
§ 3.2.4. <i>Our assessment of the valuations used</i>	136-146
§ 3.2.5. <i>Our conclusions on the possible detriment to the corporate interest</i>	147-148
<b><u>Chap. 4 Transactions of 3, 5 and 6 October 2008</u></b>	
§ 4.1. Developments at Fortis Bank between 29 September and 3 October 2008	
§ 4.1.1. <i>General</i>	149-151
§ 4.1.2. <i>Banking subsidiaries in the Netherlands</i>	152-155
§ 4.1.3. <i>Liquidity requirements</i>	156-158
§ 4.1.4. <i>Emergency funding</i>	159-163
§ 4.2. Transfer of Dutch activities to the Dutch State	
§ 4.2.1. <i>Details of the transaction</i>	164-170
§ 4.2.2. <i>Valuations used</i>	171-175
§ 4.2.3. <i>Our assessment of the valuations used</i>	176-181

§ 4.2.4.	<i>Our conclusions on the possible detriment to the corporate interest</i>	182-183
§ 4.3	Acquisition by SFPI from Fortis Holding of the second tranche of 50% of the shares of Fortis Bank	
§ 4.3.1.	<i>Choices to be made after the transfer of the Dutch activities</i>	184-198
§ 4.3.2.	<i>Valuations used</i>	199
§ 4.3.3.	<i>Our assessment of the valuations used</i>	200-204
§ 4.3.4.	<i>Our conclusions on the possible detriment to the corporate interest</i>	205-206
§ 4.4.	Transfer of Fortis Bank to BNP Paribas	
§ 4.4.1.	<i>Details of the transaction</i>	207-222
§ 4.4.2.	<i>Valuations used</i>	223-228
§ 4.4.3.	<i>Our assessment of the valuations used</i>	229-237
§ 4.4.4.	<i>BNP Paribas's funding support</i>	238
§ 4.4.5.	<i>Our conclusions on the possible detriment to the corporate interest</i>	239-241
§ 4.5.	Transfer of the shares of Fortis Insurance Belgium to BNP Paribas	
§ 4.5.1.	<i>Details of the transaction</i>	242-244
§ 4.5.2.	<i>Valuations used</i>	245-250
§ 4.5.3.	<i>Our assessment of the valuations used</i>	251-254
§ 4.5.4.	<i>Our conclusions on the possible detriment to the corporate interest</i>	255-256
§ 4.6.	Situation of Fortis Holding	
§ 4.6.1.	<i>Willingness of the Belgian government to protect the value of the shares</i>	257-259
§ 4.6.2.	<i>Willingness of Belgian government to safeguard the liquidity of the holding</i>	260-262
§ 4.7.	Creation of a fund for the benefit of small shareholders	263-268

## **Chap. 5 The bank's solvency and liquidity situation from 6 October 2008**

§ 5.1. The Bank's solvency and liquidity situation between 6 October 2008 and 12 October 2008	
§ 5.1.1. <i>Solvency</i>	269
§ 5.1.2. <i>Liquidity on Monday 6 October 2008</i>	270-272
§ 5.1.3. <i>Liquidity on Tuesday to Friday 7-10 October 2008</i>	273-280
§ 5.2. Performance of the bank's solvency and liquidity from 12 October 2008 to 12 January 2009	
§ 5.2.1. <i>Solvency</i>	281
§ 5.2.2. <i>Liquidity</i>	282-290
<b><u>Chap. 6 Conclusions</u></b>	291
§ 6.1. Our assessment of the financial terms and conditions of the transactions	292-293
§ 6.2. Lines of thought and recommendations	294-311

## **Appendices**

1. Abbreviations
2. The people we interviewed
3. Organisation charts of the Fortis group on 29 September 2008
4. Organisation charts of the Fortis group on 6 October 2008

## **Executive summary**

Lady and gentleman shareholders,

### **Introduction**

1. The Brussels Court of Appeal, in summary proceedings, appointed, by way of its judgement of 12 December 2008, a panel of experts to compile a report, the preliminary version of which should help you to take decisions on the items on the agenda of your meeting.
2. The judicial proceedings are being conducted in French, which is the language chosen by the shareholder applicants and thus is the language of the proceedings. Hence, the official language of our report will also be in French. However, a Dutch version will be provided for the convenience of Dutch shareholders.
3. According to the judgement, which was an emergency and provisional ruling, those decisions should seemingly have been submitted to your general meeting for approval in accordance with the Fortis Governance Statement, which has been endorsed by the Board of Directors of your company. The judgement of the court gives you the opportunity to voice your opinion of those decisions in retrospect.

You have thus regained a right and a responsibility that are of crucial importance to the future of your company.

4. The Brussels Court of Appeal thought it necessary to appoint a panel of independent and impartial experts to enlighten you in the context of your decisions.

Delivery of this panel's preliminary report at least ten days prior to the general meeting of shareholders will allow you to become acquainted with its contents before you attend the general meeting and consequently to be able to take informed decisions.

### **Our conclusions**

5. We confirm, insofar as that is necessary, the facts of the situation on the eve of 27 and 28 September 2008. Fortis Bank no longer possessed or had access to the liquidity it needed to meet its commitments and to carry out its banking activities.

All the evidence showed that external intervention was called for.

External assistance had been sought, unsuccessfully, from other financial institutions.

6. In this serious predicament, the board of directors of Fortis Holding, as a last resort, had to turn to the Belgian government.

A rescue plan was formulated during the weekend of 27 and 28 September 2008 to bail out your company and its group by means of substantial interventions by the Belgian, Luxembourg and Dutch governments in each of the three countries. The first two interventions were later realised. The intervention by the Dutch authorities failed to materialise, the Dutch government having decided to pursue a different course.

Nobody denies or can deny the imperative need for the support, which all those concerned hoped would be sufficient and decisive, provided by the subscription by the SFPI on behalf of the Belgian State to an increase in Fortis Bank's capital by way of the authorised share capital, which conferred 49.9% of Fortis Bank's shares on the Belgian public authorities.

The valuations made at the time of the first weekend were reasonable, bearing in mind that Fortis Bank was virtually in a state of cessation of payments and the exceptional context.

7. Immediately the exchanges opened after that weekend, however, hopes were dashed when the market failed to live up to expectations.

Moreover, the turnaround of the Netherlands forced a revision of the initial plan and brought an end to the scheme to maintain the group in its original state with the support of the three governments.

The sale of ABN AMRO, Fortis Bank Netherlands and Fortis Insurance was conceived in this context and was conducted on reasonable terms on 3 October. It ended the haemorrhaging of liquidity away from Fortis Bank to the benefit of its banking activities in the Netherlands.

State-based logic, which considers that state intervention in the absence of a private partner is absolutely necessary, regained its potency and importance.

We ask you to share our understanding and acceptance of the decision taken at that level and consequently to support the agreement concluded with the Dutch State on 3 October. We do not think that any renegotiation of certain aspects of the agreements with the Dutch authorities is called for. It is obviously not for us to rule this out.

We also think that the application of the conditions for the conversion of the MCS bonds should be analysed with the Dutch authorities in order to make sure that the points of view are identical.

8. Despite the ‘return’ of significant capital, resulting from the honouring of the agreement, the situation on the eve of the market opening on 6 October was very uncertain and extremely delicate for Fortis Bank, which continued to have a desperate need for considerable liquidity.

What could and what should have been done to comply with the provisions of European law (i) by the Belgian government in its capacity as reference shareholder of Fortis Bank and as guardian of the public interest and of the interests of depositors, customers and all Belgian taxpayers, and (ii) by the board of directors of Fortis Holding?

- a) Provide all Fortis Bank’s transactions with a state guarantee?
  - b) Fully nationalise the bank and pay symbolic compensation for the 50.1% of shares held by Fortis Holding in view of the situation of Fortis Bank, as demonstrated by Fortis Bank’s results for the past two quarters?
  - c) Facilitate the takeover of Fortis Bank by a bank with an international reputation?
9. Each of these propositions was subject to its own specific constraints and requirements within the framework of the convergent interests that had to be served, i.e. the financial stability of the country, the management of public debt, the safeguarding of taxpayers’ interests, the protection of the deposits of Fortis customers, the maintaining of jobs at Fortis Bank and respect for the shareholders of Fortis Holding.

The Belgian State’s preferred solution was for Fortis Bank to link up with a partner that was sufficiently sound to assure on its own the continuity of the bank’s activities and its present and future liquidity requirements. Only BNP Paribas, which had already expressed interest during Fortis Holding’s search for private partners and which continued to show interest, appeared to satisfy this criterion.

10. We consider that in the given circumstances, the decisions of 5 and 6 October concerning a new intervention by the Belgian State and the link-up with BNP Paribas, as well as the consequent agreements, were reached based on stringent but acceptable terms and conditions.

These transactions are in line with the corporate interest of the companies of the group, where the maintenance, continuity and even expansion of the activities of Fortis Bank have long been among the priorities.

11. Without bringing into question our approval in principle of the valuations decided at the time of the transactions concluded on 3, 5 and 6 October, our report highlights certain aspects of the formulas that we recommend be recalculated.

### **Our recommendations**

12. In accordance with the request included in the judgement of the Brussels Court of Appeal on 12 December 2008, we have formulated in our conclusions several lines of thought for interested parties and thus also for your general meeting.

The point for consideration to which we give priority is the restoration of value to the holding by re-integrating 25% of the bank's shares and retaining at least 25% of Fortis Insurance Belgium in the holding.

13. This plan naturally requires (i) the approval of the Belgian State, (ii) the consent of BNP Paribas to renegotiate the agreement protocol, and (iii) an increase in the holding's financial resources.
14. With regard to the new financial resources that the holding must find, we think that a part of the agreement with BNP Paribas must be renegotiated, notably the CASHES transaction which does not seem fair. On the one hand, Fortis Holding must bear the negative consequences of the outcome of the transaction, as regards both liquidity and a reduction in equity (impact: 2.35bn), while on the other BNP gains the benefit of retaining the CASHES bonds at their nominal value (3bn).

In our conclusions we suggest three ways (there are sure to be more) to renegotiate the CASHES transaction.

Another point for consideration in the search for new financial resources for the holding would be the renegotiation of the stake of BNP Paribas and/or the SFPI in the company in which the structured credits will be placed (SPV).

15. As mentioned in our conclusions, the transfer, amounting to 74.9%, of Fortis Bank and Fortis Insurance Belgium to BNP Paribas, seems the most appropriate solution.
16. We are not convinced that a stand-alone solution would be appropriate. Such a solution would also demand considerable new financial input on the part of the shareholders of Fortis Holding.
17. To conclude this executive summary, we wish to stress the fact that Fortis Bank is without doubt a 'systemic' enterprise in Belgium. In other words, its good (or bad)

health, not to mention a situation of defaulting on payments, has a considerable impact on the country's economic stability.

This gives the general meeting of shareholders on 11 February a very special dimension.

\*\*\*\*\*

## **Chapter 1 Introduction**

### **§ 1.1. Essential points of the judgement that relate to our mission**

30. The panel of experts, appointed by the 18th chamber of the Court of Appeal in its judgement of 12 December 2008 (item 5 of the dispositif), comprises:
- a) Two co-chairmen, Walter van Gerven and Guy Horsmans, emeritus professors of law at the KUL and at the UCL
  - b) and three members: André Killesse, honorary president of the Belgian Institute of Registered Auditors, Roland Gillet, professor at the Sorbonne and at the ULB, and Remi Vermeiren, former chairman and executive director of KBC.
31. As indicated in item 5 of the dispositif of the judgement, the mission of the panel of experts is prescribed by section 168 of the Company Code.

*This section permits the commercial court and the Court of Appeal ‘if there are indications of serious damage or the risk of serious damage to the interests of the company... at the request of one or more associates owning at least 1% of the votes that are attached to all issued shares (...), to appoint one or more experts [‘auditors’] with the mission of inspecting the books and accounts of the company, as well as transactions carried out by these bodies.*

32. In its capacity as a panel of experts entrusted with a mission in accordance with section 168 of the Company Code, the panel will *‘have full authority to organise its activities [but] will take care to observe the essential principles of independence and debate in general, and of good governance in particular’* (no. 116 of the dispositif). In this capacity, it *‘will be able to have placed at its disposal any document it indicates, to interview anybody that it designates and to undertake all steps for mediation or negotiation, if the need arises.’ ‘It will be at liberty to present one or more interim reports to the board of directors and shareholders, as well as to the auditors, and also to give them any communications or recommendations that it may consider appropriate.’*
33. This does not concern a *mesure d’instruction* in the sense of sections 962 onwards in the Judicial Code, and thus does not aim to contribute to the evidence or to enlighten the court with a view to resolving a dispute (no. 115 of the judgement) but on the contrary, to enlighten the shareholders.
34. Appendix 3 contains an organisational chart of the Fortis group on 29 September 2008, i.e. prior to the dates of the disputed decisions.

Our mission concerns only Fortis SA/NV (hereafter referred to as Fortis Holding), a company incorporated under Belgian law. It excludes Fortis NV, a company incorporated under Dutch law.

The shares of the two holding companies have been twinned in such a way that when a shareholder owns a Fortis share, he owns de facto a share in Fortis SA/NV and a share in Fortis NV. These companies are listed on Euronext Brussels and Euronext Amsterdam.

Appendix 4 contains an organisational chart of the Fortis group on 7 October 2008, taking into consideration the disputed decisions.

35. The panel is requested (in accordance with the terms of the dispositif of the judgement under 5) to produce an interim report *‘intended for the bodies of Fortis Holding SA/NV, which will equally be made available to all shareholders within 35 working days, beginning from the date of the present judgement’* – on 2 February 2009 in other words.

In addition *« ‘a final report will be filed with the Clerk of the Court by 15 May 2009’*.

36. The Court of Appeal (pp. 138-139 of the judgement) has also imposed the following temporary measures:

(i) *suspension of the decisions of the board of directors of the public limited company Fortis Holding, taken on 3, 5 and 6 October 2008*

(ii) *the mission entrusted to the two co-chairman of the panel to convene an extraordinary general meeting of shareholders to be held no later than 12 February 2009 with the object of deciding the legitimacy of the decisions that have been taken (only those shareholders who can show that they were shareholders on or before 14 October 2008 will be admitted to the meeting)*

(iii) *the ban, imposed on the SFPI to divest its holding in Fortis Bank to the benefit of any third party, being 241,620,557 shares, which will thus be frozen for a period that will legally expire on 16 February 2009. If this ban is not observed, a penalty of 5 billion euros must be paid to all the appellants jointly. This sum will be for the account of the SFPI and the Belgian State that it represents*

(iv) *during this period of ‘freeze’ BNP Paribas is obliged to continue such interbank relations as it maintains with Fortis Bank based on market conditions and according to the ‘at arms length’ principle’ (dispositif of the judgement under 4)*

37. The Court of Appeal has ordered that an extraordinary general meeting of shareholders be convened on or before 12 February. This will be held *‘with the object of dealing with the report of the board of directors, deliberation and, if wished, voting by the shareholders on the decisions taken by the board of directors on 3, 5, and 6 October 2008, as well as the agreements that were concluded when implementing those decisions.’*

The following decisions are involved:

- a) The sale of the shares of Fortis Bank Nederland (holding) to the Dutch State (for more details see no. 164 onwards, above)
- b) The acquisition by the FPIM of the remaining (50.1%) shares of Fortis Bank (for more details see no. 184 onwards, above)
- c) The transfer (contribution in kind) from the FPIM to BNP Paribas of 74.94% of the shares of Fortis Bank, (ii) the transfer of 100% of Fortis Insurance Belgium and (iii) the creation of a special purpose vehicle to accommodate certain structured products (for more details see no. 207 onwards, below).

### **§ 1.2. Mission of the panel**

38. The mission of the panel, defined in numbers 113-118 of the judgement, includes *'to give the bodies of Fortis SA/NV in general and the general meeting of shareholders their opinion of:*

- a) *financial and other terms and conditions concerning the sale to the SFPI of the stake of Fortis Brussels in Fortis Bank, and*
- b) *conditions concerning the transfer of assets of subsidiaries and sub-subsidiaries to the Dutch State and*
- c) *to BNP Paribas.*

*The experts also have to determine whether, in their opinion, these transactions were concluded under terms and conditions that were detrimental to the corporate interest of the companies of the group.*

*To that end, they will in any case (...)*

- d) *produce a comprehensive report on the financial situation of the companies of the group in terms of solvency and liquidity between 1 September and 12 October 2008*
- e) *give their estimate of the value of Fortis Bank during the capital increase of 28 September 2008*
- f) *establish the exact status of the banking subsidiaries of Fortis in the Netherlands between 29 September and 3 October 2008 in terms of funding, legal position and cooperation with third parties*
- g) *give their opinion of the value of the assets sold at market price on the day of their transfer*

39. Our mission likewise consists of *finding possible solutions* (judgement, no. 108) and *taking steps for mediation or negotiation*. (judgement, no. 116, al. 2).
40. It is not the task of the panel of experts to pronounce on questions of judicial interpretation of the dispositifs of the judgement.

However, taking account of the competences of the two co-chairmen with regard to the convening of the general meeting, we feel we should explain to the general meeting our interpretation of the voting procedure.

In accordance with the terms of the judgement of the Court of Appeal (dispositif under 3, p.139), the general meeting has been convened by the co-chairmen of the panel of experts for the purpose of '*dealing with the report of the Board of Directors, deliberation and, if necessary, voting by the shareholders on the decisions taken by the board of directors*'.

The court has not clarified explicitly what is meant by the words 'if necessary', nor precisely what the meeting should discuss and vote on.

That is the reason why we have formulated as comprehensively as possible each proposal on the specific transactions to be put to the vote and why before each of these proposals we have added a motion asking the shareholders whether they wish to vote on the transaction mentioned in the following item.

41. One of the principal difficulties of the present mission is that we must form an opinion in retrospect on economic transactions (notably the transfer of shares based on valuations) that were carried out in an exceptional context.

It is only possible to form an opinion on the aforesaid transactions under the express condition that one imagines oneself (or at least attempts to do so) in the circumstances then prevailing.

That is the reason why throughout the entire analysis of the transactions we attached particular importance to recalling the context of that time.

We have chosen to structure our report based on chronological order (this manner of proceeding makes it possible to assess information that was available at a given moment) instead of the classic structure based on the nature of the subject concerned.

42. The panel or some of its members have had numerous meetings with people who were likely to provide valuable information in the context of the mission (see appendix 2).

It should be clear that in the time available it was not practically possible to meet everyone whom we would have liked to meet.

43. It was not part of our mission to audit the figures presented to us. We have naturally inquired into the coherence and probability of the communicated information, but without checking this in the sense of an 'attestation'.

### **§ 1.3 Diligence and procedure**

44. In accordance with the instructions of the judgement, we have applied in the performance of our mission the principles of independence and good governance and in particular the adversarial principle.

We have, in this light, considered the advice of all parties and have taken note of the conclusions and the files that have been provided to us.

45. We have solicited from both Fortis SA/NV (a company incorporated under Belgian law) and Fortis Bank or Fortis Insurance Belgium all information that appeared useful to us, and have also received this information.

We would like to thank the staff of Fortis Holding, Fortis Bank and Fortis Insurance Belgium. They gave us their full cooperation despite the difficult circumstances.

The other people we talked to also readily made themselves available and helped us to achieve our task. We thank them also.

46. We have not appended the agreements, either definitive or in project-form (SFPI, Netherlands State, BNP Paribas), that relate to the transactions of 3, 5 and 6 October. We have naturally been able to study these and we shall summarise the essential points whenever it is necessary to the comprehension of this report.

The same applies to the minutes of meetings of the boards of directors or executive committees of the companies of the Fortis group.

47. Unless stated otherwise, all figures mentioned in the present report are expressed in euros (whereby the abbreviation ‘bn’ stands for billion).

### **§ 1.4. Preliminary nature of the report**

48. The present report, in compliance with the wishes of the court, is a preliminary report. The definitive report is foreseen for 15 May.

This report is thus necessarily incomplete compared with the report that is our mission to produce.

We have included in this report only those elements that we regard as essential to enable the general meeting of shareholders to come to an informed decision on the agenda items.

49. The present preliminary report has been produced with great urgency. We have had less than 35 days to analyse numerous documents and talk to as many people as possible as well as to the parties involved and their boards of directors.

This report has been made to the best of our knowledge at the current stage of our mission, using the information gathered for that purpose.

It expresses our unanimous opinion.

## **Chapter 2 Significant events prior to 26 September 2008**

### **§ 2.1 Developments in financial markets prior to 26 September 2008**

#### **2.1.1. Review of certain concepts**

##### a) Financial stability

50. A country's financial stability is an extremely complex subject and it is not within the scope of the present report to describe the underlying principles (for this we refer to the examinations by Messrs Quaden and Servais, on 7 and 8 October 2008, *Doc Ch.*, 1524/001, session 2008-2009).

However, we would like to emphasise briefly some elements of which certain parties involved in this affair seem to be barely aware.

51. A bank finances its loans and its investments in the first place with the aid of deposits, savings certificates etc. which originate from its customer base (private individuals, local businesses and so on).

In addition to these funds, which in principle are of a stable nature, a bank may also obtain funding (i) from other banks, (ii) from major institutions and multinational corporations or (iii) from the central bank. The availability of these funds is, in principle, less guaranteed, particularly at times of crisis.

Fortis Bank was traditionally overinvested in relation to the savings deposited by its customers and had to raise funds averaging 70bn (possibly backed by collateral or guarantees) on the interbank market, from institutions and possibly from the ECB.

52. A bank does not have a formal credit line with the central bank. There are various ways in which a bank can acquire funds during a certain period, but under the express condition that it provides collateral (stocks or other assets pledged as security). This collateral is accepted based on a certain percentage of its nominal value or its market value).
53. *Marginal lending facilities* are ways, in cases of emergency, to resort to the European Central Bank upon production of collateral and with penalising conditions. They are intended mainly to provide cover in situations where a bank is unable to settle its position in the interbank payment systems at the end of the day.

It is clear that a bank will not apply for a marginal lending facility unless this is absolutely necessary, for such an action is evidence of a very poor liquidity

situation and demonstrates that the classic ways of acquiring funding have proved inadequate.

54. ELA (*emergency liquidity assistance*) refers to very exceptional cash advances on a day-to-day basis, with extremely penalising terms (rising to Libor + 5% for advances in US dollars in the exceptional circumstances of September/October 2008) based on available collateral.

Since the creation of the ECB, the granting of ELA requires the prior approval of the Governing Council of the ECB (the 15 central bank governors). Once approved, the finance is provided for the sole responsibility and at the exclusive risk of the central bank of the country concerned.

No ELA has been granted by the ECB since its creation, or by the BNB in the previous thirty years.

Granting ELA is evidently a delicate operation for a central bank, since the quality of the collateral is likely to pose problems, as the best collateral will have already been used.

55. A state guarantee in support of an ELA, granted by a central bank, is also highly exceptional. In Belgium, this requires a specific act of parliament (act of 15 October).

In the same way, a state guarantee of interbank loans in order to make the market more liquid (i.e. the banks agree to lend to other banks) is an exceptional measure that has never had to be taken in either the United States or Europe in previous decades. The introduction of a state guarantee in Belgium has required an act of parliament (and the preparation of executive orders) as mentioned above.

56. ELA can be granted for only a very short period, because (i) section 101 of the Treaty on European Union prohibits the central banks from financing any public institution, including state-owned banks, and (ii) support for several weeks would signify the existence of a solvency problem (and not just a liquidity problem). And strengthening the solvency of a bank is not the task of a central bank.
57. Before the first signs of unrest appeared in the market in the summer of 2007, the markets experienced no real difficulties with financing each other and recourse to the central bank was a relatively rare occurrence.

Between September 2007 and September 2008 market conditions progressively deteriorated and the banks began to reduce the duration of their mutual loans to such an extent that the overnight loan became the norm. The bankruptcy of Lehman Brothers (on 15 September 2008) was a shock that dried up the interbank market in just a few days.

#### b) Management of public debt

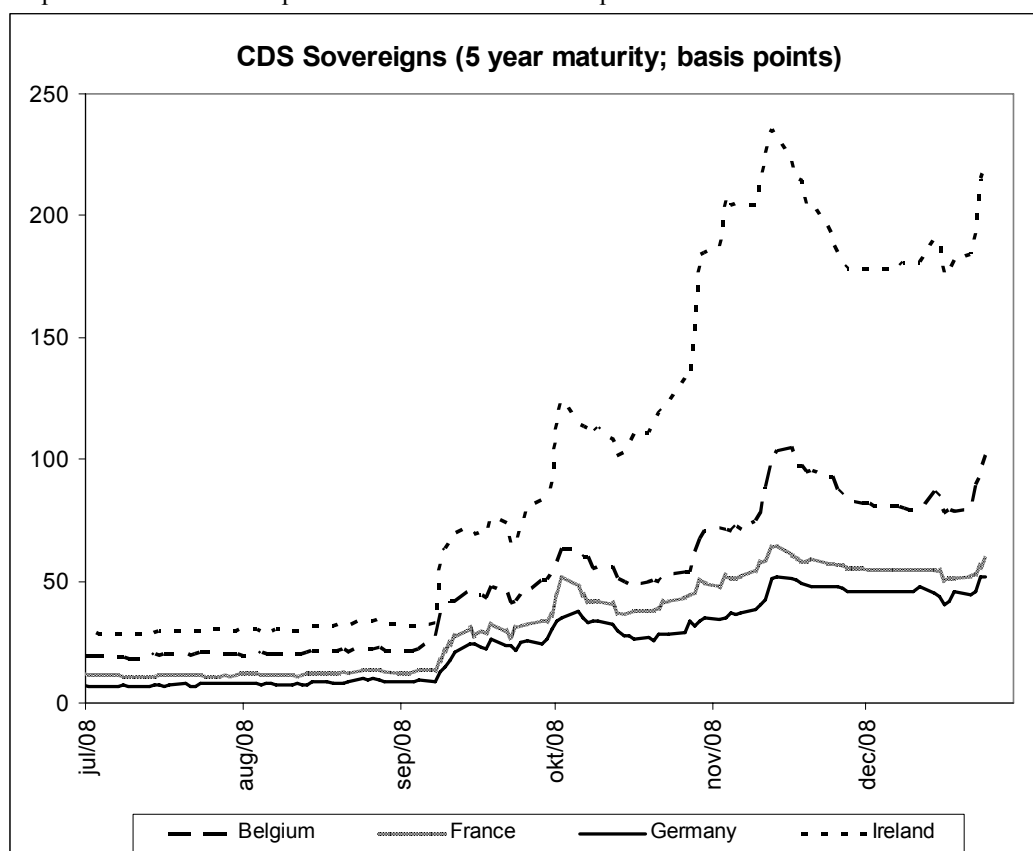
58. In addition to the problem of national financial stability, of which the consequences of the banks' need for liquidity forms only one aspect, each country is also sensitive to (i) the size of public debt in relation to gross domestic product (GDP) and (ii) to the cost of financing this debt.

In this regard, it should be noted that Belgium's public debt, although considerably reduced in recent years, is one of the biggest in the eurozone relative to GNP (only Italy and Greece are in a less enviable position).

The size of the public debt affects the cost of CDS (credit default swaps), or in other words the cost of hedging against a state defaulting on its payments. This high cost of CDS translates into a spread between the cost of financing the debt (at what interest rate must the state issue loans in order to attract savings?) and the benchmark for the European states (i.e. Germany).

59. The table below shows the movements in the CDS premium in some European countries. It can be seen that since Ireland (and to a lesser extent Belgium) announced (in October 2008) important measures to grant state guarantees, there has been a spectacular rise in the premium intended to cover against default by the state. This clearly demonstrates the market's lack of confidence in the capacities of the aforesaid state.

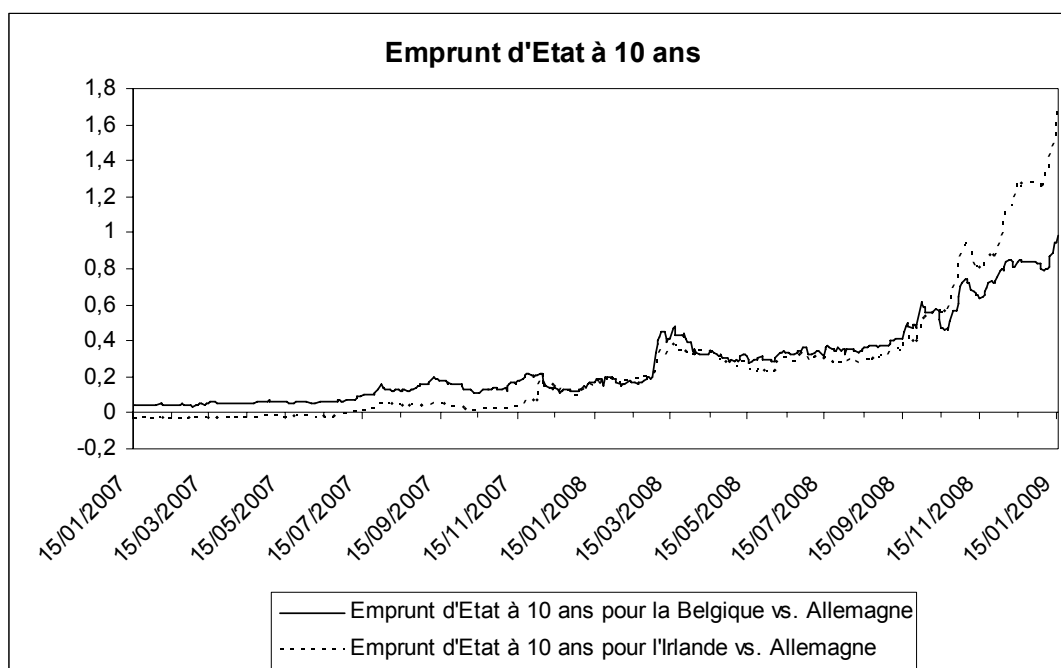
Graph: CDS in 2008: comparison between various European countries



60. The following table shows the spread between the cost of the bonds issued by the Irish and Belgian government, and the benchmark interest rate (bonds issued by the

German State). This table demonstrates the increase in the cost of public debt in Ireland and Belgium.

Graph: spread between the cost of bonds issued by the Belgian, Irish and German governments 2007 - 2008



### **§ 2.1.2. Instability in financial markets**

61. It seems unnecessary to describe here the origins of the financial crisis we have experienced. Enough has already been written on this subject.
62. The first signs appeared in February 2007. HSBC announced a loss of USD 10.7bn on its sub-prime portfolio and then the rating agencies downgraded their CDO ratings in July 2007.

The interbank market began to be increasingly selective in its choice of counterparties, the first European victim being the British Northern Rock in September 2007.

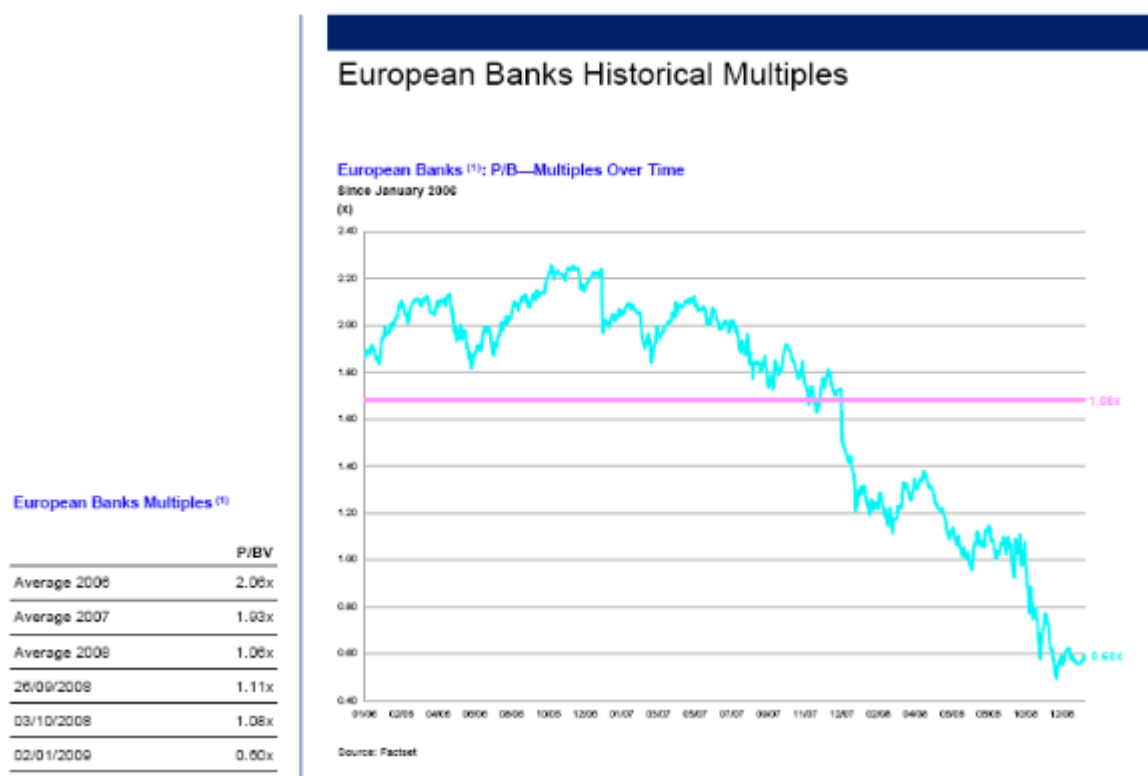
63. Another blow was dealt on 23 March 2008, when investment bank Bear Stearns (USA) was taken over by JP Morgan.
64. The subprime crisis escalated between April and September 2008, triggering a sharp fall in the prices of financial stocks. The crisis reached a peak in September when it became necessary to rescue several banks in the United States and Great Britain. The crucial point would undoubtedly be the bankruptcy of Lehman Brothers on 15 September.

**§ 2.1.3. Benchmarks for banking and insurance institutions as going concerns from January to October 2008**

a) The banking sector

65. The ratios used most frequently to determine the value of institutions in the banking sector are (i) P/BV (*price/book value*), the ratio between book value (equity) and the share price and (ii) P/E (*price/earnings*), the ratio between annual earnings and the share price.
66. The most frequently used index is the DJ (Dow Jones) Euro STOXX Banks ([www.stoxx.com](http://www.stoxx.com)). It goes without saying that this index began to nose-dive after the bankruptcy of Lehman Brothers (15 September).

67. The following table shows the performance of the P/BV ratio from 2006 to 2008



68. The following table, originating from the datastream database, gives an overview of the banks' share prices on 3 October 2008. It consists of two parts. The first contains a cross-section of banks that have not been affected (or not to any great extent) by the crisis (at least at this time – several of these banks will probably be added to the other part of the table in future) and the second part lists a cross-section of banks that have been affected by the crisis.

**Table price/book value 2008 to 3 October 2008**

<b>As of 3/10/2008</b>	<b>Price to book value 2008</b>
BNP Paribas	1.26 x
SG	1.18 x
CASA	0.76 x
CIC 'A'	0.41 x
KBC	1.24 x
ING	1.12 x
COMMERZ	0.62 x
DEUTSCHE BANK	0.76 x
D. POSTBANK	1.01 x
ERSTE GROU	1.23 x
UNICREDIT	0.68 x
INTESA	0.95 x
MPS	0.79 x
BANCO POPOLARE	0.58 x
SANTANDER	1.35 x
BBV ARGENTARIA	1.70 x
BCP	0.92 x
HSBC	1.49 x
BARCLAYS	0.98 x
NORDEA	1.30 x
<b>Average</b>	<b>1.02 x</b>
<b>Median</b>	<b>1.00 x</b>

<b>As of 3/10/2008</b>	<b>Price to book value 2008</b>
NATIXIS	0.35 x
DEXIA	0.92 x
FORTIS	0.39 x
ALLIED IRISH BANKS	0.66 x
AIB	0.78 x
BOI	0.67 x
ILP	0.53 x
HBOS	0.44 x
RBOS	0.50 x
DANSKE BANK	0.86 x
<b>Average</b>	<b>0.61 x</b>
<b>Median</b>	<b>0.59 x</b>

*Sources: Datastream, IBES*

From the market situation on 3 October 2008 it appears that the average P/BV ratio of a bank 'affected by the crisis' is approximately 60% while the P/BV of an 'unaffected bank' is 100%.

69. The following table gives an overview of the P/E ratios (price/earnings ratio) of various European banks at the end of September 2008.

**TRADING COMPARABLES**  
**European Banks Trading Comparables**

	P/E	
	2008 E	2009E
	4.3	3.6
ING	5.7	5.2
KBC	9.8	8.1
Dexia	5.4	4.5
Average Benelux Banks	7.0	5.9
Median Benelux Banks	5.7	5.2
Crédit Agricole	10.5	7.6
Société Générale	10.6	8.5
BNP Paribas	9.8	8.8
Natixis	nm	4.8
Deutsche Bank	11.5	7.0
Commerzbank	6.1	5.7
Santander	7.7	7.1
BBVA	7.6	6.9
Unicrédit	6.4	5.7
Intesa	8.2	7.7
HSBC	7.1	6.4
RBS	4.9	5.6
Barclays	8.1	7.7
HBOS	4.7	4.6
Lloyds	7.6	6.5
UBS	nm	9.0
Crédit Suisse	25.8	9.7
Average European Banks	8.8	6.9
Median European Banks	7.6	7.0

Source: Factset as on 3 October 2008

This table shows that the average P/E in the sector was 7.6 on 3 October 2008.

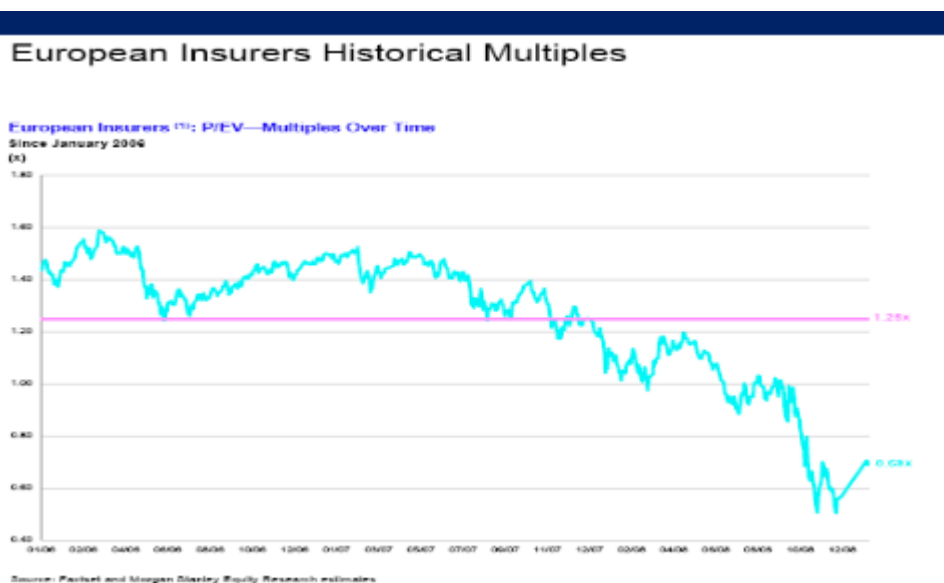
**b) Insurance sector**

- 70.** The publication of embedded value by companies in the insurance sector has been common practice for years. Groups like AXA, Allianz, ING, Fortis and others

publish this information in an appendix to their annual report (a 24-page report entitled 'Embedded Value 2007' is available on the Fortis website).

In brief, embedded value corresponds to the net worth of a life insurance company without taking account of goodwill. It is calculated as the sum of adjusted net asset value and the present value of future profits on existing insurance policies after the deduction of cost of capital.

71. The table below shows the performance of the P/EV ratio (price/embedded value) from 2006 to 2008.



Source: Factset,

72. This table shows that at the beginning of October 2008 the share prices of the Europe's principal insurance companies amounted to between 0.6 and 0.8 times their embedded value.
73. The most recent report (2007) on Fortis Insurance's embedded value states (p.13) that this amounts to € 12,411 million, divided as follows:
- a) € 5,706 million Fortis Insurance Belgium
  - b) € 5,706 million Fortis Verzekering
  - c) € 1,000 million Fortis Insurance International

The report is available on the following website:

*Fortis.com/investor relations/presentation/7 March 2008/report embedded value*

This embedded value is sometimes increased by a multiple of the profit of the non-life sector.

## **§ 2.2. Developments in Fortis's financial situation**

### **§ 2.2.1. General**

#### **a) The ABN AMRO transaction**

74. We think it is unnecessary, certainly in the context of this report, to go into the ABN AMRO transaction in detail. We will mention only a few essential elements that have influenced the liquidity and solvency of the Fortis group.
75. In October 2007, a consortium consisting of Fortis, Royal Bank of Scotland (RBS) and Banco Santander acquired the shares of ABN AMRO. Fortis's stake in the purchase price amounted to around 24bn.

The deal was more or less unanimously approved by the general meetings of shareholders held in August 2007 and also received approval from the regulators in both the Netherlands and Belgium, as well as from the European Commission.

76. The acquisition of part of the activities of ABN AMRO has undoubtedly had major consequences for the bank's solvency ratio.

It was in fact foreseen that in the course of 2008-2009 the solvency ratio would decrease in proportion to the integration of activities and the deduction of goodwill connected to the takeover. Fortis Bank thus had to maintain this ratio (look-through approach) at the level of the target for June 2009 (date of the full integration of ABN AMRO) in order to satisfy regulatory requirements (Basel 1).

The additional solvency requirement, related to the acquisition of a part of ABN AMRO's activities, amounted to 26.2bn (assuming core Tier 1 ratio of 6 %) and can be summarised as follows:

- a) deduction of goodwill and other intangible assets: 19.4bn
- b) amortisation of other intangible assets: 2.8bn
- c) solvency related to the financing of the acquired assets (risk weighted assets): 4.0bn

This requirement (26.2bn) exceeds the price of the acquisitions (24bn) because in addition to the payment of the purchase price, it also needs to cover the funding of the activity and its planned expansion.

77. The solutions to meet these requirements were:
- a) capital increase: 13.2bn
  - b) issuance of financial instruments: 7.8bn
  - c) sale of assets: 4.8bn
  - d) group leverage: 3.4bn;
  - e) operating results 2008 and 2009
78. The downturn in the stockmarkets and the deterioration in the confidence of all operators in the course of the first six months of 2008 made it more difficult for Fortis to realise certain envisaged transactions to finance the takeover of ABN AMRO. For instance, delays occurred in (i) the sale of other assets that had been planned for months, (ii) the sale of non-essential assets of ABN AMRO and (iii) the Chinese authorities' approval of the acquisition by Ping An of 50% of Fortis Investment Management for a sum of 2.15bn.
79. The market climate is becoming increasingly difficult (see no. 61 above):
- a) impairments must be taken on structured credits
  - b) financial instruments are becoming difficult to place
  - c) the transactions required by the European Commission (EC remedies) in order to maintain competition in the market will have to be made on less favourable terms than projected in 2007. For example, the proceeds of the sale of commercial banking activities (Hollandse Bank Unie) to Deutsche Bank were not as high as expected (estimated loss: 0.9bn)
  - d) movements in share prices have resulted in downward adjustments to financial assets
  - e) operating results are declining

Fortis decided at the end of June 2008 to carry out a series of measures aimed at strengthening the solvency plan (expected improvement of 8bn).

These measures included (i) raising capital of 1.5bn via a book-building exercise (shares issued at €10), (ii) sale and lease-back transactions worth 1.5bn, (iii) issue of non-dilutive capital instruments for 2bn, (iv) sale of non-strategic assets for 2bn, (v) non-payment of interim dividends (impact: 1.3bn) and (vi) payment of the 2008 dividend in shares.

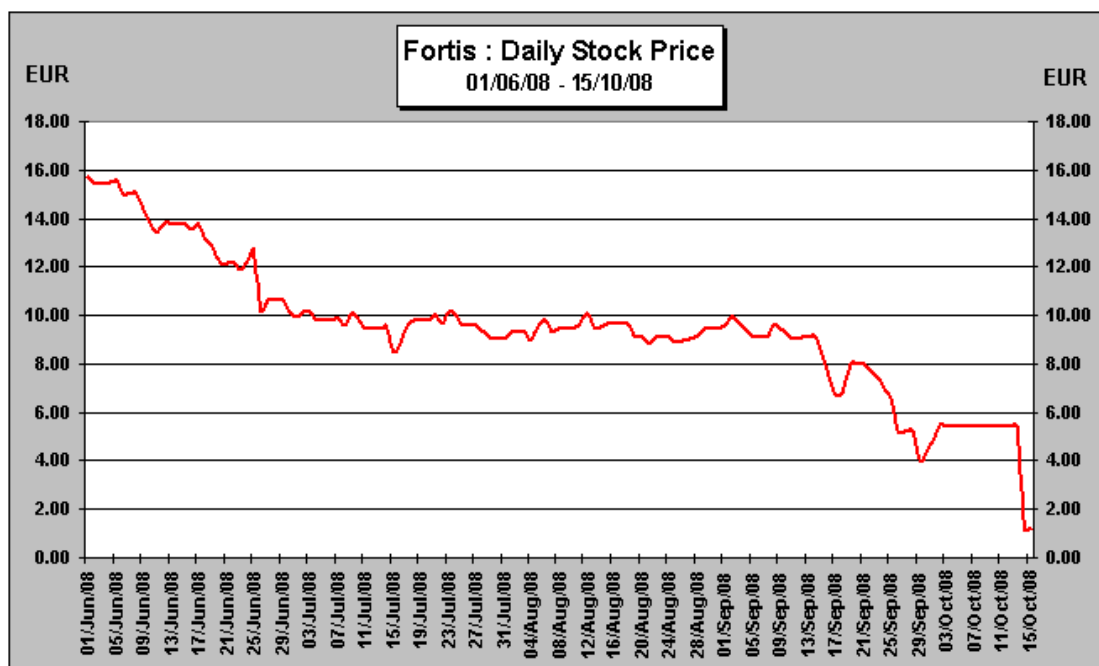
80. On the day of the announcement, the share price tumbled 20% in a single session, dipping from €12.50 to €10.

The market remained in a state of turmoil in the subsequent days and the share price continued to fall further, prompting the departure of CEO Jean-Paul Votron on 11 July 2008.

The instability of Fortis's management (three CEOs in three months) would not facilitate the realisation of the solvency plan adopted at the end of June and would continue to preoccupy both the markets and the Belgian government during the decisive weekends at the end of September and beginning of October.

81. After stabilising slightly in July and August, the share price continued to fall and the rating agencies further downgraded Fortis shares.

The table below shows the performance of the Fortis share price during the period.



82. In conclusion, the ABN AMRO deal (i) was initially considered an interesting proposition, particularly as regards the acquisition of low-risk activities (retail customers, SMEs, asset management, etc.) and (ii) should have strengthened the group's liquidity (deposits were estimated to exceed the funding requirement by 25bn). Ultimately, the deal proved to be an enormous problem for Fortis on account of (i) the price paid (ii) the execution of the solvency plan and (iii) operating risks related to the integration of the acquired activities of ABN AMRO.

The fixed focus on achieving a satisfactory solvency ratio by 2009 acted as a veritable straitjacket that prevented Fortis from adapting its strategy to changing

market conditions. Whatever the market conditions, Fortis must endeavour to strengthen its equity at any cost.

b) Crisis related to certain structured products (subprime loans)

83. It is not within the scope of the present report to explain the differences between types of structured credits, the quality of which can vary tremendously; the quality of the underlying debtor obviously being the most important factor.
84. To appreciate the importance of the structured credit portfolio held by Fortis, we think it is useful to compare this, purely for information purposes, with the portfolios of other Belgian banks on 30 September 2008, and also make comparisons with the equity of the respective banks on 31.12.07 and 30.06.08:

## Bank Peer (European) Comparison: Asset Exposures

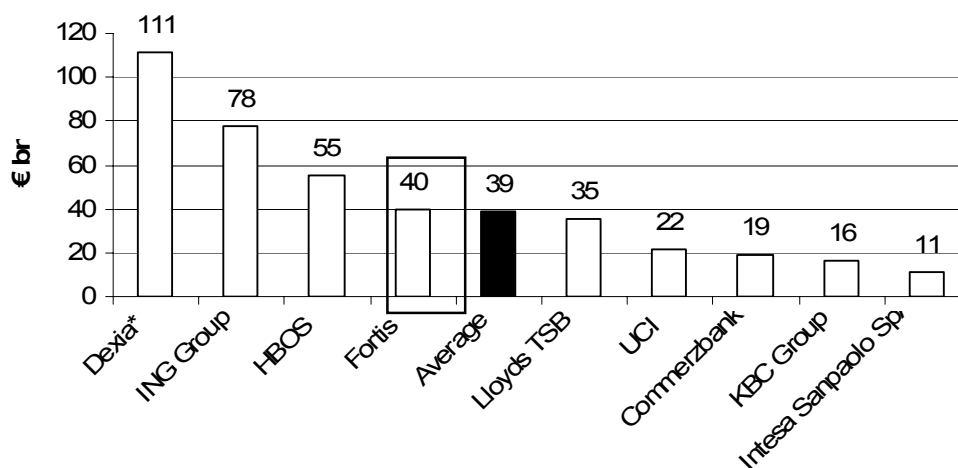
Disclosed Structured Credits (net exposure)

(Figures closing Q3 '08)

€ bn (figures closing Q3 2008)					
	Disclosed Structured Credits (net exposure)	as % Shareholders Equity 31.12.07		as % of Tier 1 30.06.08	
Dexia*	111	677%	16.4	793%	14
ING Group	78	197%	39.5	300%	26
HBOS	55	248%	22.2	177%	31
Fortis	40	117%	34.1	160%	25
<b>Average</b>	<b>39</b>	<b>154%</b>	<b>25.3</b>	<b>186%</b>	<b>21</b>
Lloyds TSB	35	282%	12.4	250%	14
UCI	22	52%	42.4	54%	41
Commerzbank	19	118%	16.1	100%	19
KBC Group	16	87%	18.4	114%	14
Intesa Sanpaolo SpA	11	21%	52.3	42%	26

\*includes € 96 bn insured ABS through FSA

### Bank Peer (European) Comparison Disclosed Structured Credit (net exposure)



Sources: Morgan Stanley, ECB, S&P and Moody's

In the light of such comparisons it is very difficult to formulate an opinion on the importance of a structured credit portfolio, as the nature of the products and the underlying risks vary considerably.

85. It is not part of our mission to detail the structured credit portfolio, the history of these acquisitions, their possible impact on previous accounts and the relevance of the impairments recorded in 2007 and in the course of 2008.

It should be noted that Standard & Poor's justified its decision to downgrade Fortis's rating by referring to:

- i. its surprise at the necessary impairments in the CDO portfolio, which make Fortis Bank one of the hardest hit banks in Europe
- ii. the fact that the portfolio of other structured products is of good quality, but is too large in proportion to total assets

On 30 June 2008, the gross value of the structured product portfolio was some 43bn, which, after impairments, came down to a net value of 41.7bn.

Of this 41.7bn net value, only 1.9bn (net of impairments) concerned a subprime portfolio of which the underlying debtor was based in the United States (US subprime CDO portfolio; see *consolidated interim financial statements* 30.06.08, p. 8).

#### c) Shockwave in the financial markets

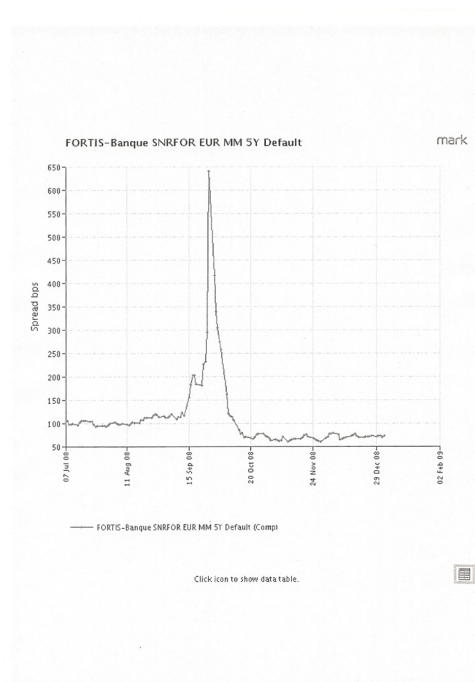
86. On 15 September, the financial markets were crippled by the bankruptcy of Lehman Brothers. Fortis published a press release on its exposure. That is of no significance.
87. On 26 September, CBFA firmly advised Fortis to explore all useful strategic options to remedy the situation.
88. On Friday 26 September, Fortis's management published a press release announcing an acceleration of the sale of assets.

The management called a press conference, but the financial markets (i) had lost confidence in Fortis's communications and (ii) were also in a general state of panic. In this context, Fortis was punished severely; its share price fell from € 6.53 on 25 September to € 5.20 at close of trading on 26 September.

89. By 26 September the markets had lost confidence in Fortis to such an extent that the cost of hedging default by Fortis (CDS or credit default swaps) climbed to astronomical levels. The cost was more than 600 basis points against 270 on the previous day. That means that a lender of a sum of €10,000,000 would have had to pay as much as €600,000 to cover against Fortis defaulting on the debt!!!

It should be noted that the cost of this cover in the first six months of 2008 was around 90 basis points.

The graph below shows the performance of the CDS premium for Fortis Bank.



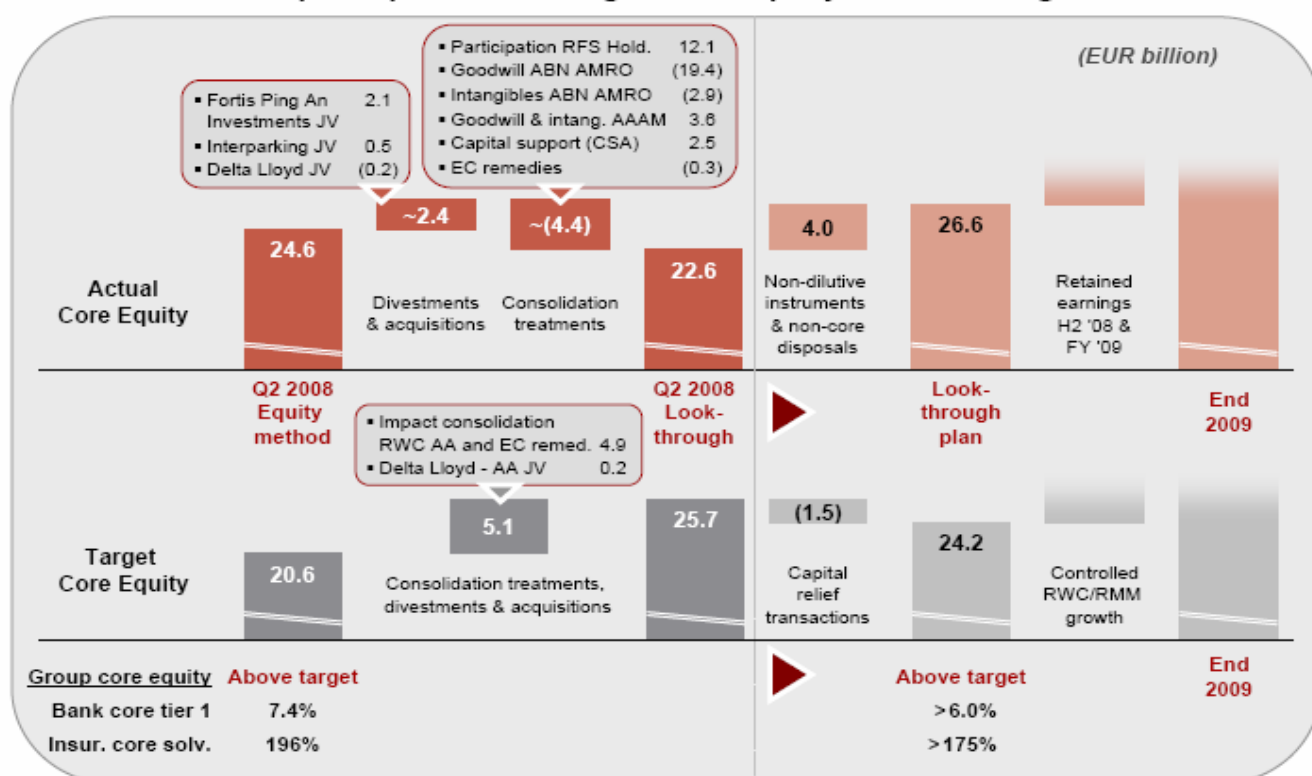
90. In the light of the preceding events, Fortis was confronted by a combination of negative elements on Friday 26 September:
- i. in the course of that one day, Fortis lost access to the overnight interbank market, where in normal times Fortis raised liquidity of approximately 15 to 20bn in the course of the day
  - ii. the bank's institutional clients began to withdraw sizeable amounts from their deposits
  - iii. at some branches, private clients withdrew savings deposits, which harmed the bank's image, although these withdrawals had only a marginal impact on Fortis Bank's liquidity
  - iv. by the end of the day, Fortis had mobilised all its buffer capital for use as collateral in order to obtain liquidity from the European Central Bank and in the repo market
  - v. Fortis for the first time had to resort to the marginal lending facility granted by the BNB for an amount of 5.4bn
  - vi. forecasts of liquidity requirements, and consequently Fortis Bank's ability to be able to continue to operate on the morning of Monday 29 September, and the days thereafter, necessitated the urgent intervention of a third party

It became evident that it was imperative that exceptional measures should be taken before the markets opened on Monday 29 September.

## § 2.2.2. Solvency situation in September 2008

91. In accordance with the decision of the Court of Appeal we give below some brief comments. More detailed statements will be made at the final report stage.
92. The last information on the solvency ratio was released on 4 August when the results to 30 June 2008 were published. The forecast for expected solvency (look-through method) is given below and is also available on the website: [Fortis.com/investors relations/presentations/4 August 2008/presentation](http://Fortis.com/investors%20relations/presentations/4%20August%202008/presentation), p. 22).

### Look-through method – Execution of capital plan to bring core equity above targets



Fortis first half-year 2008 results | 4 August 2008 | 22

93. The table shows that the core equity target (*look-through* ratio) for June 2009 amounts to 25.7bn and that the estimate of the core equity that will actually be achieved on that date (assuming certain hypotheses are realised) is 22.6bn. The plan announced on 26 June that foresaw a 9bn increase in core equity (see no.79 above) should enable (i) the absorption of the shortfall and (ii) the creation of a certain buffer against future developments.

### **§ 2.2.3. Liquidity situation between 1 September and 25 September 2008**

#### **a) General**

94. As we have already mentioned in the introduction (cf. no. 41 above), we have opted to compile our report in chronological order. The question posed by the Court in relation to the liquidity situation between 1 September and 12 October is answered in various parts of the report in line with the chronological development of the transactions:
- a) the period of 1 - 25 September is analysed below
  - b) the situation on 26 September follows below (see nos. 105 onward, below)
  - c) the period 29 September - 3 October follows below (see nos. 156 onward, below)
  - d) the period 6 -12 October follows below (see nos. 270 onward below)
95. To appreciate the liquidity situation of Fortis Bank, we proceeded to analyse a table of the consolidated movements of the liquidities of the banking arm. A table covering the period between 1 September 2008 and 12 January 2009 was provided.
96. It must be emphasised that the liquidities relating to the Dutch activities are included in the analysed table up to the date of their transfer to the State of the Netherlands, being 3 October.
97. The table that we have analysed is a consolidated table of the Fortis banking group (liquidities have been monitored in a centralised manner), in other words, without differentiating between the deposits and requirements of Belgium, the Netherlands, Luxembourg and other countries in the world where the group operates (particularly the United States).

The aforesaid table gives for each day (i) estimates of the liquidity requirements established at the start of the day, and (ii) the actual amounts obtained per funding category and by type of lender, divided into the following categories:

- a) *unsecured funding*: funds obtained from other banks (interbank market) without collateral or counterparty
- b) *secured funding*: collateral-backed funds raised in the interbank market and at the central banks
- c) *eligible collateral* available at the start of the day
- d) movements in the deposits of companies and institutions placed with the group's banks
- e) movements in the deposits of *retail and private banking* at the group's banks

98. It is generally important to remember that the Fortis group has a structural funding requirement between a month and a year (*net liquidity gap*) in the order of 70bn (74bn op 31 December 2005, 66bn op 31 December 2006 and 67bn op 31 December 2007) (see consolidated financial statements 2007, p. 91).

This structural requirement was principally (60 to 65bn) attributable to the banking arm's Dutch activities. In fact, Fortis Bank Netherlands had only a limited share of the market for (personal and business) customer deposits (one of the objects of the takeover of certain ABN AMRO activities was to help remedy this situation, while the group has historically been (particularly because of Mees Pierson) a major provider of finance (energy sector, commodities, shipping, primary brokers, etc.) in the Netherlands. To sum up, the Dutch subsidiary lent out more money than it took in on deposit.

It was normal for the parent company to provide the funding related to this management decision. The parent, Fortis Bank, extended a more or less permanent cash advance of around 60bn to its subsidiary Fortis Bank Nederland.

#### b) Liquidity situation between 1 and 25 September

99. During the period between 1 and 25 September the liquidity situation was characterised by the following elements.
100. The deposits of institutionals and companies (*wholesale funding*), as well as those of personal customers (*retail and private banking*), were progressively eroded over the period. Withdrawals over the entire period mounted up to nearly 8bn.
101. The projected intraday liquidity requirement (not to be confused with the structural funding requirement referred to earlier, see no. 98 above), established at the start of the day, was on a rising trend throughout the period and reached a maximum of 19bn on 25 September.
102. Classic funding from the European Central Bank (tender principle) increased constantly and reached 40.7bn on 25 September, a rise of 13bn on 1 September. Since this funding is backed by collateral, the stock of collateral shrank throughout the period.
103. Funds raised in the interbank market (intraday) without collateral climbed constantly to 24bn on 25 September, an increase of 17bn on 1 September.
104. To sum up, the liquidity situation of Fortis's banking arm gradually deteriorated during this period, particularly because of the gradual erosion of wholesale funding and deposits at private and retail banking, which created an ever-greater dependence on the interbank market and the European Central Bank.

## **Chapter 3 Benelux plan of 27-28 September 2008**

### **§ 3.1. Status of Fortis Bank's liquidity on 26 September 2008**

105. On the morning of 26 September the funding requirement to be covered before the end of the day was estimated at 19.8bn, despite classic funding (tenders) of 40bn extended by the European Central Bank (an increase of 19.5bn on 1 September and more than 25bn higher than the average for the first months of the year).
106. Funds raised with or without collateral on the intraday interbank market in the course of the day decreased sharply: they amounted to 14.8bn, which was 9.6bn lower than the funds raised on the previous day and 7.7bn lower than the average of the funds raised in the previous four days.
107. Deposits of institutions and companies (wholesale funding), although stable between 22 and 25 September, diminished by nearly 6bn in the course of the day.

Personal deposits (retail and private banking) showed a fall of 0.9bn.

108. For the first time in its history, Fortis Bank reported a liquidity deficit to the National Bank of Belgium at the end of the day and had to resort to a marginal lending facility, amounting to 5.4bn. This emergency credit line is extended with a penalising surcharge of 1% on the ECB's classic interest rate and must be backed by collateral.
109. The emergency credit line of the National Bank of Belgium – Emergency Liquidity Assistance – was still not available.

N.B. (see no. 54 above): the granting of this exceptional temporary emergency line requires, besides assets to act as collateral, the sanction of the Council of Governors of the European Central Bank. These matters were treated with great urgency over the weekend by all the parties concerned, which resulted in the provision of ELA as from the morning of Monday 29 September.

110. By the end of the day Fortis Bank had utilised all its collateral accepted by the market, including its strategic or emergency reserve (i.e. buffer).
111. On the evening of 26 September the estimates for Monday 29th showed a projected liquidity requirement in the order of 25 to 30bn, a significant proportion of which was in dollars. We will return later (see no.156 below) to the way in which liquidity effectively performed on Monday 29th. It should also be noted that an estimate for the following day made in the evening before can vary in the course of the night owing to many different factors, including the performance of markets in different time zones from Europe.

112. It should be emphasised that the marginal lending facility, unlike emergency liquidity assistance, which can be backed by collateral of a very variable nature (real estate, for example), can only be guaranteed by collateral that the ECB considers eligible. Owing to the lack of suitable collateral, it was consequently impossible to increase the size of the marginal lending facility. In the absence of sufficient interbank credit, ELA appeared to be the only potential source of liquidity in the very short term.
113. Taking account of these factors, there is absolutely no doubt that Fortis Bank underwent a very acute liquidity crisis on 26 September that clearly threatened the continuity of the banking arm and as a consequence also the continuity of the holding company itself.

In other words, unless Fortis Bank found an urgent solution during the weekend, it would be in a state of cessation of payments on Monday morning.

In view of these factors, the alarm signal that Fortis's management sounded to the regulatory authorities and the government was absolutely necessary.

## **§ 3.2. Intervention by the Belgian, Dutch and Luxembourg States**

### **§ 3.2.1. Review of a few facts**

114. The Fortis management was unable in the course of the weekend to submit to the government a plan for a capital increase either by existing shareholders or by other financial institutions.

On Friday and Saturday 26 and 27 September Fortis contacted various financial institutions and set up a data room to allow access to essential information.

Contact was made with ING, BNP Paribas, Santander, HSBC, KBC, Société Générale, Crédit Agricole, Deutsche Bank, Aegon and Munich Re.

115. Only ING and BNP Paribas expressed verbally to the government their interest in acquiring shares in Fortis Holding at a price between €1 and €2 per Fortis share, subject to certain conditions notably with regard to the structured product portfolio.

The Belgian government considered the offer of the private parties to be insufficient and decided, in concert with the Dutch and Luxembourg authorities, to investigate the acquisition of a limited stake in the bank by means of a capital increase. This was intended to restore confidence in the markets, avoid paralysis of the payment system (in Belgium, at any rate, Fortis is pre-eminently a systemic organisation) and to safeguard the savings of depositors.

116. Apart from the liquidity-related problems, there was also the acute question of solvency. The management's announcement on 26 June of a solvency requirement of 8bn (look-through approach) had sparked considerable unrest in the market and an attempt to restore confidence was necessary.
117. A state guarantee of interbank loans did not seem to be the right answer and was not seriously considered at this stage.

The essential question regarding a state guarantee of interbank loans was obviously how this would affect the cost of public debt (see nos. 58 onward, above). Moreover, the implementation of such measures is much more complicated than it seems. Not only must new legislation be passed, but also the agreement of the European Commission must be sought, and then the legal procedures must be implemented (procedure estimated at two months at least).

Some observers have stressed that the Belgian State did provide such help to Dexia a few days later (on 9 October). The context of that intervention, however, seems to be fundamentally different from the Fortis situation. The shareholders had a plan for a capital increase, the liquidity requirement was not comparable, the solutions that the French State wished to impose had to be taken into account, etc. It is not within the scope of the present report to describe all the different circumstances.

The State also decided to guarantee the ELA granted to Fortis Bank by the BNB, given the size of the ELA in relation to the BNB's own equity. This guarantee did not become effective until legislation was passed on 15 October.

118. In view of the importance of Fortis's situation to financial stability, not only in Belgium, but also throughout Europe, Jean-Claude Trichet, president of the European Central Bank, and Christine Lagarde, representing France's presidency of the EU, took an active part in discussions about a rescue package for the bank.

### **§ 3.2.2. Details of the transaction**

#### a) General

119. Contrary to what some people thought they could expect, it proved impossible during the weekend of 27-28 September to put together a rescue package for a unified Benelux group, while retaining a strong holding company, whose capital would be increased by all three states and in which each state would take a minority stake. The respective governments soon stated that they did not wish to invest in a holding company.

It would also have been possible to envisage that the three states would intervene at Fortis Bank, which was simultaneously (i) an operating company (activities in Belgium and abroad) and (ii) the parent company of the Dutch and Luxembourg banking operations.

The political will to intervene in the bank of their own country nevertheless existed in all three states, primarily with regard to financial stability and the protection of national savings.

The intervention of the Belgian State at Fortis Bank level not only had a direct impact on the bank's Belgian activities it also gave the Belgian State an indirect stake in the Dutch and Luxembourg companies.

120. The authorities were prepared to restore solvency in the hope that (i) the main reason for the lack of confidence in Fortis would then disappear, and (ii) to enable Fortis to again raise liquidity in the market.
121. The 'Benelux Plan', approved by the board of directors of Fortis on the night of 28-29 September and announced in a joint press release by the three governments on Monday 29th, and in a press release by Fortis before the markets opened, can be summarised as follows.

#### b) Activities related to Fortis Bank

122. As regards the activities related to Fortis Bank (Belgian activities, certain foreign activities, 100% holdings in the Dutch and Luxembourg subsidiaries), the Belgian State took a 49.93% stake in Fortis Bank (by means of a capital increase underwritten by the SFPI) for the sum of 4.7bn.

In addition, the BNB consented to conclude an Emergency Liquidity Assistance Agreement (ELA) with Fortis Bank, intended to assure the liquidity of the banking activities.

The press release made no mention of the decision to extend ELA that same day, since that information, by virtue of the organic law concerning the BNB and legislation concerning the ECB, was strictly confidential.

#### c) Activities relating to Fortis Bank Luxembourg

123. As regards the activities related to Fortis Bank Luxembourg, the Luxembourg State decided to lend Fortis Banque Luxembourg S.A. (a 99.92% owned subsidiary of Fortis Bank) the sum of 2.5bn in the form of a mandatory convertible loan. This type of financial instrument qualifies as equity Tier 1.

The Luxembourg State would, after conversion, hold 49.9% of the capital of the Luxembourg bank. More precise details are given in the term sheet concluded with the Luxembourg State.

124. The Luxembourg State was also keen to ensure that two 'local' assets (on the one hand a stake in the steel engineering company associated with the former Arbed, named Paul Wurth SA, and on the other, a stake in the Luxembourg Stock Exchange) would not be later divested by the group. It stipulated that the term sheet should contain a provision that these assets would be transferred to the Luxembourg State for the symbolic sum of one euro.

These assets appear in the balance sheet of Fortis Bank Luxembourg valued at respectively €2,600,000 and €188,000 and at an 'equivalent value' (in equity) of respectively €4,000,000 and €5,000,000. The amounts concerned are thus insignificant, but they should still have been included in the calculation of the value of Fortis Bank Luxembourg at the time of the valuation related to the mandatory conversion of the loan.

The sale of the two assets for the symbolic sum of one euro thus appears completely logical.

125. The Luxembourg State, at a general meeting held on 15 December (the convening notice appeared in the Memorandum of 27 November) converted an amount of 2.4bn into shares in order to acquire 49.9% of the bank (which was renamed Banque Générale de Luxembourg on the day of the capital increase) and retained an amount of 100m in the form of a subordinated loan.
126. Since the decisions relating to the Luxembourg activities were not reviewed during the transactions of 3, 5 and 6 October, it is not within the scope of our mission to analyse the divestment by the Luxembourg State to BNP Paribas of a part of its equity stake in Fortis Bank Luxembourg (16.67% of the 49.9% owned).

#### d) Activities related to Fortis Bank Netherlands

127. As regards Fortis Bank Netherlands, the Dutch authorities announced they would acquire, for the sum of 4bn, a stake of 49.9% in the capital of Fortis Bank Netherlands (Holding) N.V., a 100% subsidiary of Fortis Bank (and which itself owned the companies of Fortis Bank Netherlands and the stake in the activities of ABN AMRO).
128. Fortis decided at the end of the negotiations with the governments to abandon the ABN AMRO transaction and to seek a buyer for its 33% stake in RFS Holding. This rapid announcement was intended as an attempt to reassure the markets.

ING at the end of the weekend had declared its interest in acquiring ABN AMRO and was granted exclusivity of negotiation for a period of 15 days. Figures for a takeover of assets were quoted, but were not confirmed in writing.

129. The Dutch State's acquisition of a 49.9% stake in Fortis Bank Netherlands (holding) for a sum of 4bn led to a valuation, before the capital increase, of 4bn for 100% of the shares of Fortis Bank Netherlands only, because the Dutch State, while adding to the capital of Fortis Bank Netherlands (holding), had to accept shares that were not entitled to income from the sale of the stake in RFS Holding.

The intervention of the Dutch State would ultimately never be realised.

### **§ 3.2.3. Valuations used**

130. In accordance with the mission entrusted to us by the Court (see no. 8 above), we give below our opinion of the value accorded to Fortis Bank at the time of the capital increase on 28 September 2008.

131. The 49% stake taken by the Belgian State in Fortis Bank led to a valuation of 4.7bn for 100% of the shares in Fortis Bank before the capital increase.

As detailed in the special report by the board of directors on 29 September 2008, the valuation of 4.7bn was calculated using the top-down valuation method. This method determined the value of Fortis Bank:

- a) based on the market capitalisation of Fortis Holding at close of trading on 26 September (12.2bn)
- b) plus the effect of the double leverage (7.6bn)
- c) minus the estimated value of the insurance arm (15.8bn)

Based on this method, the value of Fortis Bank was calculated at 4bn ( $12.2 + 7.6 - 15.8$ ) or €16.53 per share.

132. The double leverage effect (7.6bn) corresponds to the value of the funds that were raised in the market by the group's listed holding company by means of various financial instruments and which were invested in the capital of the banking and insurance subsidiaries, particularly banking (90%).

This double leverage includes some of the debt of Fortis Holding (9.8bn) that enabled advances to be made to subsidiaries, which then converted them into capital (Tier 1 or Tier 2 according to the situation).

133. The value of the insurance arm was determined on the basis of embedded value, the benchmark for this sector (see nos. 70 onward, above).

The value obtained on this basis (15.8bn) corresponds to once the embedded value (12.4bn for life insurance) to which an amount of 3.4bn must be added in order to take account of the non-life business (approximately six times the annual result of 0.5bn).

134. Negotiations between the management of Fortis Holding and the Belgian government led ultimately to an amount of 4.7bn (instead of 4bn). This solutions allowed (i) use to be made of the maximum amount provided by the procedure for authorised capital and (ii) the issuance of shares above net asset value in accordance with sections 596 and 598 of the Company Code.

Since all the shareholders (Fortis Bank was not 100% owned by Fortis Holding) were not asked to subscribe to the capital increase reserved for SFPI, this amounted to a curtailment of their preferential subscription rights. In this respect, sections 596 and 598 of the Company Code prescribe that the issue price of shares must at least equal the net asset value per share and that a report must be produced by the board of directors and by the auditors.

This increase in Fortis Bank's capital involved the issue of 241,305,490 new shares at a price of €19.48 per share (4.7bn divided by 241,305,490 shares). This was higher than the net asset value per Fortis Bank share, which was estimated at €16.53 per share (see end of no. 131 above).

135. In their report, the auditors concluded that they had discovered no evidence to suggest that the issue price, based on a conventional valuation, would not have been at least equal to net asset value. They added that the absence of an immediate improvement in the financial situation and the lack of an urgent restoration of confidence could have significantly depressed net asset value.

### § 3.2.4. Our assessment of the valuations used

#### a) Prior considerations

136. It seemed to us that it would be interesting to compare the value of 4.7bn accorded to Fortis Bank (operating company for Belgian activities and certain foreign activities and parent company of the Dutch and Luxembourg subsidiaries) with the value accorded to the two subsidiaries.

137. The valuations were determined based on the following principles:

- a) the willingness to enhance (*in look through*) Fortis Bank's solvency by at least 7 to 8bn, representing the shortfall announced by the management on 26 June
- b) the market capitalisation of Fortis Holding, which stood at 12.2bn on Friday 26 September
- c) a certain pragmatism associated with the need to act quickly, which allowed the use of authorised capital.

138. Valuations were set at 4.7bn for FBB, 4bn for FBN and 2.5bn for FBL. Realising that the board of directors had justified the valuation by means of a method based on market capitalisation, it seemed interesting to look at these values from the perspective of price/earnings ratios.

139. The P/E (price/earnings ratio) of each entity can be briefly outlined as follows:

	Value	Annual profit	P/E
FBB	5.5	1.1	5

FBN (without ABN AMRO)	4.0	0.8	5
FBL	2.5	0.4	6

A P/E (price/earnings ratio) of 5 to 6 is obviously less than the 2008 average for the sector on 26 September (the average amounts to 7.6; see no. 69 above), but Fortis was not in a position to achieve the average at that time!

It should also be stressed that Fortis Bank remained confronted by a 7-8bn shortfall in its equity, mentioned in its solvency plan at the end of June 2008, which was only partly offset by the 1.5bn capital increase at the end of June. The decision taken during the weekend of 27/28 September to sell ABN AMRO must have reduced the capital requirement, but only on condition that the sale would offer the opportunity to recoup some of the goodwill paid.

The value of Fortis Bank, parent of the banking activities, must therefore logically be reduced by this solvency shortfall. That gives a negative figure of 2bn (5 -7).

**140.** Two other factors must be included in this line of reasoning.

The first is the valuation of RFS Holding's stake in ABN AMRO, because the valuation of Fortis Bank Netherlands excludes any proceeds from this divestment. A potential buyer quoted a figure of 5bn during the weekend, but withdrew the following day.

The second factor is the impairments that had necessarily to be recognised in the accounts in order to restore market confidence. The management of Fortis announced impairments amounting to 5bn on Monday 29th (press release of 28th).

**141.** These combined factors give a total value for the banking group approaching 4.5bn:

- a) 5.5 for FBB
- b) + 4 for FBN
- c) + 2.5 for FBL
- d) - 7.5 linked to solvency shortfall
- e) + 5 linked to the anticipated proceeds from the sale of ABN AMRO
- f) - 5 impairments

The figure of 4.5bn is close to the 4.7bn at which the banking group was valued in the context of the capital increases.

In other words, the value of the parent company depended solely on its subsidiaries.

## b) Our opinion

- 142.** We are of the opinion that in the given circumstances (company in state of cessation of payment and faced with the absolute necessity of extremely urgent negotiations in the space of a weekend and in a banking market that was very depressed), there is absolutely no point in referring to (or even making comparisons with) market values, or principles of fair value or any other valuation method that would generally be pertinent and applicable to a going concern in 'normal' times.

In such circumstances the transaction price can only be the result of difficult negotiations between parties interested in bailing out a company in difficulties, and based on criteria that most often include below par ratings, particularly because of the urgency and gravity of the situation..

- 143.** We consider that the parties have taken account of the market value of Fortis shares on the day of the transaction when calculating the value of Fortis Bank.

At any given moment, the market price is at least an indicator of market sentiment regarding the value of the shares.

The top-down method, taking account of embedded value, used for insurance constitutes an acceptable method of approach.

This top-down method leads irrefutably to the conclusion that the bad performance of the market capitalisation is entirely due to the banking arm. This principle seems to us fully justified in the present case because the serious difficulties of the banking sector necessitated the urgent intervention of the government.

- 144.** We are of the opinion that there is no economic justification for comparing the value set for the calculation of the proceeds of the capital increase (4.7bn for the value of the bank as a whole), with the book value of the bank at the same moment.
- 145.** We also note that the European Commission, in its advice of 3 December 2008 with respect to the analysis of restructuring aid to Fortis Bank and Fortis Bank Luxembourg (no.38, p.10), concluded that the subscription to the capital increase contained an element of aid insofar as not a single private investor was prepared to match the price offered by the Belgian and Luxembourg States (nos. 33-42).
- 146.** In conclusion and taking into account the exceptional and extreme circumstances that we have described extensively above, we are of the opinion that the chosen valuation (Fortis Bank valued at 4.7bn) is reasonable and acceptable to the shareholders.

### **§ 3.2.5. Our conclusions on the possible detriment to the corporate interest**

147. In Belgian company law, the corporate or social interest is a key concept that remains largely undefined, particularly when it refers to the ‘corporate interest of the companies of the group’.

That does not detract from the fact that legal doctrine and modern judicial practice agree that the corporate interest is not synonymous with only the ‘interests of the shareholders’. Corporate interest is a much wider concept. It encompasses the interests of all those who have an immediate interest in the survival, and thus the profitability, of the company or of the group to which the company belongs. Even those writers who define corporate interest in narrower terms confirm that the executive committee or the board of directors has an obligation to take account of interests other than those of the shareholders when taking decisions that affect those other interests.

It is clear that in the context of a group that operates in the banking and insurance sector the general interest will play a more important role than in other sectors, for the sake of the protection of depositors or savers, of the credit sector in general and of financial stability. This conception is also reflected by the judicial decisions given in the present case. The president of the commercial court thus took into account ‘the incalculable consequences for the depositors and savers, and hence the consequences for the Belgian economy as a whole’, while the Court of Appeal wanted to know whether the decisions of the board of directors ‘effectively safeguarded the best interests of the company and its shareholders and even those of all stakeholders’.

148. As regards the decisions taken by the Belgian State on the night of 28/29 September when the survival of the bank and of the group itself, as well as the stability of the Belgian financial system were at stake, we consider that those decisions were taken in the general interest and that in the words of the judgement of the Court of Appeal, were certainly ‘not detrimental to the corporate interest of the companies of the group’ notably Fortis Holding and Fortis Bank, but on the contrary.

## **Chapter 4 Transactions of 3, 5 and 6 October 2008**

### **§ 4.1. Developments at Fortis Bank between 29 September and 3 October 2008**

#### **§ 4.1.1 General**

149. There was no escaping the facts from Monday 29th onwards: the massive intervention by the three States had failed, to the surprise of all those involved in the weekend, to sufficiently restore confidence in the financial markets.

Fortis shares tumbled by 23 % to end the day at €3.97.

Some reasons for the collapse of the share price and for the persistent lack on confidence that can certainly be mentioned are:

- a) the reaction of analysts, who were particularly worried about the new structure of the group. Each state wished to intervene only as regards the banking activities in their own country, which would lead to a de facto dismantling of the group and oblige the group to form national structures in future. This was contrary to the policy of an integrated Benelux group (organised along business lines and not geographical zones) that had been pursued to date
- b) the announcement by ING on the Monday (see ING's press release of 29 September) that it had decided to abandon its analysis of the takeover ABN AMRO
- c) the fact that Moody's, Standard and Poor's and Fitch downgraded the ratings for almost all entities of the group on Monday 29th and Tuesday 30th, despite the interventions of the weekend. These lower ratings led to a significant reduction in the availability of classic (wholesale) sources of finance from parties (fiduciary trusts, institutions investors, banks, etc) whose policy it is to lend only to debtors with a sufficiently high credit rating
- d) the announcement at the beginning of the week that the Paulson plan in the United States had been rejected, which intensified the mistrust and nervousness in the markets.

In those circumstances we may wonder if the market would have been reassured, or on the contrary become more anxious, had it been aware of the solution to the liquidity problems via ELA.

150. We must also not refrain from mentioning that despite the intervention of the three States, all the rating agencies recognised by the financial markets had no hesitation in downgrading Fortis Bank!
151. This uncertain climate triggered a further bank run and a rise in the price of the CDS (credit default swap) (assessment of the risk of non-payment), which climbed to more than 650 basis points, a situation that was almost identical to that of the previous Friday (see no. 89 above).

#### **§ 4.1.2. Banking subsidiaries in the Netherlands**

152. In accordance with the judgement of the Court of Appeal (judgement no. 114), we need to address the situation of the banking subsidiaries between 29 September and 3 October.
153. The Dutch banking subsidiary was a consumer of funding (see no. 98 above), due to the very structure of its activities (more money lent to businesses than held on deposit).

The parent company's balance sheet reported almost permanent advances of large sums (around 50 to 60bn) to its Dutch subsidiary.

154. As regards the funding from the central banks, we note that the support from DNB, for three days, amounting to 7bn, was largely inferior (while collateral of around 40bn was available, although of an uncertain quality) to that of the NBB. We must also point out that in such a highly integrated group as Fortis, local funding requirements in any country do not necessarily reflect the activities of that country. And besides, it is logical that in any group, the parent company will subsidise subsidiaries.
155. Based on preliminary analysis, the run on the bank by its Dutch clientele in the course of the week in question does not seem significant.

We note, however, that in the course of the period between 30 June and 30 September 2008, withdrawals by clients (retail and corporate) amounting to approximately 11bn were recorded, equal to about 15% of retail and corporate deposits.

#### **§ 4.1.3. Liquidity requirements**

- 156.** Despite the ‘classic’ funding extended by the ECB in stable amounts of 43 to 47.1bn, in the course of the week the projected liquidity situation revealed a funding requirement that was growing by the day:
- a. on 29 September, 21.9bn (estimate of 25 to 30bn on evening of Friday 26th reduced because of repo transactions carried out on Friday for settlement on 29 September)
  - b. on 30 September: 43.8bn
  - c. on 1 October: 53.5bn
  - d. on 2 October: 64.2bn
  - e. on 3 October: 65.1bn

being a deterioration of more than 43bn between Monday and Friday.

- 157.** The intraday or overnight funds that Fortis Bank managed to raise on the interbank market diminished by almost 50% compared with Friday 26 September and fluctuated between 3.4bn and 7.7bn in the course of the week, against an average of 22.5bn for the four days preceding 26 September.
- 158.** The massive withdrawal of deposits by institutions and companies (wholesale funding) first noticed on 26 September continued and reached 19bn by the end of the week. Personal customers (retail and private banking) also made sizeable deposit withdrawals, amounting to 5.1bn.

#### §4.1.4 Emergency funding

- 159.** Besides ‘classic’ funding’ from the ECB, Fortis Bank also had to (i) call on the marginal lending facility of the National Bank of Belgium and the discount window of the US Federal Reserve for amounts of 10.8bn to 15.1bn, against 5.4bn on 26 September, and (ii) request to use the emergency credit lines (emergency liquidity assistance) of the National Bank of Belgium (NBB) and the Dutch central bank (DNB) for increasing amounts in the course of the week, namely:

- a. 14.8bn (NBB) on 29 September
- b. 50.5bn (NBB) as from 30 September
- c. 51.3bn (NBB) on 1 October
- d. 51.7bn (NBB) and 7bn (DNB) on 2 October
- e. 54bn (NBB) and 7bn (DNB) on 3 October

**160.** By the evening of 3 October, Fortis's emergency funding totalled 11.4bn.

This amount of 72.4bn (i.e. 11.4bn marginal lending facility and 54bn emergency liquidity assistance from the BNB and 7bn emergency liquidity assistance from DNB) was provided at a much higher cost than in the interbank market.

The additional cost of the emergency funding (ELA), compared with the cost of 'normal' funding from the ECB, amounted to €28m in the space of a week.

On the same date, since Fortis Bank had used up almost the entire ELA extended on the Friday, the available ELA balance, after all available assets had been pledged as collateral, including assets fundamental to the pursuance of activities, amounted to only 5.1bn. The leeway for liquidity management was therefore extremely poor in comparison with the average withdrawal of deposits seen in the course of the week (4.4bn) relating to wholesale funding and Retail & Private Banking.

**161.** As regards the ELA lines, it is important to stress that they were granted:

- a. against the pledge of operating assets (buildings, for example) that are essential to the pursuance of activities
- b. and they could obtain the aforesaid amounts thanks only to an increase in the debt/collateral ratio usually accepted by the BNB. This was in principle 60% but was raised to 70% in the course of the week. This relaxation of collateral criteria allowed further ELA lines of 10bn to be extended to Fortis Bank on 30 September.

**162.** When the emergency lines of the BNB (72bn) are added to the ordinary lines (see no. 156 above) of the ECB (47bn), funding from the central banks approached 120bn on 3 October.

**163.** On the evening of 3 October, the managers estimated the liquidity requirement for Monday 6 October at approximately 65bn. They hoped to receive the sum of 50bn (12.8 + 34) from the Dutch authorities in the very near future, but this was by no means certain. They also needed to take into account the disappearance of Retail and Private Banking deposits related to Fortis Bank Netherlands (deconsolidation), estimated to amount to some 15bn.

The cash to be received in the very near future (approximately 50bn) after the separation of Fortis Bank Netherlands (12.8bn) and the repayment of the short-term advance (34bn) was therefore insufficient to cover the funding requirements.

The managers saw no alternative in the short term other than to resort to the ELA. The receipt of the sum of (approximately) 50bn only partly answered the liquidity problem, and was insufficient to redress the situation in the short term.

## **§ 4.2. Transfer of the Dutch activities to the Dutch State**

### **§ 4.2.1. Details of the transaction**

164. On the Monday, ING's decision to abandon the takeover of ABN AMRO shook the financial world.

At the beginning of the week there was some confusion between the Belgian and Dutch authorities on the interpretation of the agreements of the weekend.

On Wednesday 1 October the Dutch parliament underwent a stormy session. Certain politicians clearly expressed their readiness to take over ABN AMRO and the Dutch activities (bank and insurance) in general.

Minister of Finance Wouter Bos said he was aware of the need to rescue the 'healthy' part of the group's activities. Belgian Prime Minister Yves Leterme had to refute this.

165. On Thursday 2 October DNB announced that it intended to place Fortis Bank Netherlands 'under trusteeship' as from the following day (emergency procedure). That same day Minister of Finance Wouter Bos announced that he would not proceed with the originally planned capital increase of 4bn.

166. According to information that we have been able to glean, the representatives of the Dutch authorities began the talks by proposing an amount of 9bn for all the Dutch activities (including ABN AMRO and Fortis Insurance). You will remember that a few days earlier a sum of 4bn had been negotiated for 100% of Fortis Bank Netherlands (excluding ABN AMRO) (see no. 127 above).

Fortis's adviser (Morgan Stanley) drew up a document that showed an amount of 22bn was a more reasonable basic valuation basis.

167. After several stages in the negotiations on Thursday 2nd and Friday 3rd, the parties agreed on a total amount of 16.8bn

168. As regards the advances of Fortis Banque to Fortis Bank Netherlands, the agreements were as follows:

- a) an amount of 34bn (short-term advance) to be repaid immediately
- b) an amount of approximately 10bn to be repaid in the short term
- c) an amount of 16bn (long-term advance) to be converted into negotiable financial instruments guaranteed by the Dutch State

169. The breakdown of the sum of 16.8bn was decided in the course of the weekend.

An amount of 12.8bn was attributed to the banking activity (8.8bn for ABN AMRO and 4bn for the remainder of Fortis Bank Netherlands) and 4bn to the insurance activity.

This breakdown was naturally not neuter since the beneficiaries of the sale of the two activities were not the same companies. The proceeds of the sale of the banking activity went to Fortis Bank (at that time still 50% owned by Fortis Holding), while the proceeds of the sale of the insurance activity went entirely to Fortis Holding.

170. The sum of 16.8bn (12.8bn for Fortis Bank and 4bn for Fortis Holding) and the advance of 34bn were disbursed by the Dutch State on Monday 6 October (see no. 272 below).

#### **§ 4.2.2. Valuations used**

171. As mentioned above (see no. 166 above), negotiations were carried out with the help of documentation urgently prepared by Morgan Stanley. We have been able to analyse these documents.

The Morgan Stanley document drafted at the beginning of October led to a possible valuation of 22.3bn, based on market conditions at that time and from the viewpoint of a going concern.

Another document, dated April 2008, leading to a then valuation of 32bn, mentioned in the minutes of the Fortis board meeting of 3 October (p. 3), was rapidly disregarded as irrelevant because the market had changed since April 2008. The further collapse of banking and insurance share prices in just a few months was convincing evidence of this (see nos. 67 and 71 above). The difference between the two documents is that the ratios (P/BV and P/EV) used in October are obviously lower than those applied in April, reflecting the changes in the market.

The two Morgan Stanley documents (April and October 2008) are based on the same approach, namely the sum of the parts. This approach, which consists of adding up the values of the entities of a group (be it book value, a multiple of annual profit or embedded value – for an explanation of these terms, see nos. 65 and 70 above) without reference to the share price, obviously differs fundamentally from a top-down approach, which determines the value of an entity of the group by

subtracting the value of the other entities from the market capitalisation of the listed company (normally the parent company).

172. The figure of 22.3bn, based on normal market conditions and from the viewpoint of a going concern was reached in the following manner:

- a) Fortis Bank was valued at 1.2 times book value, being 9.3bn (7.7 x 1.2)
- b) ABN AMRO (taking account of the funding between Fortis Bank and RFS holding) was valued at 7.1bn based on complex calculations taking account of book value, expected synergies (3.3bn) and the impact of the accounting losses due to the deconsolidation
- c) Fortis Verzekering was valued at 0.9 times embedded value (embedded value amounted to 5.7bn on 31.12.07) plus the capitalisation of non-life profits and minus a few adjustments, giving a total of 5.9bn.

173. The ratio of 1.2 times book value used by Morgan Stanley (they acted as advisor to the seller) for the banking activity seems to us on the high side for that time.

Taking the average ratio at that time (let's say 0.8) we arrive at a value of 6.1bn for the bank instead of 9.3bn.

174. Given that the negotiations culminated in the figure of 16.8bn, the final result thus amounted to 75% of a 'normal' valuation on a going concern basis.

If we apply this coefficient of 75% to the two activities, we get:

- i. for the bank: 12.3 (75% of 9.3 + 7.1)
- ii. for insurance: 4.5 (75% van 5.9)

175. Some observers consider that the bank/insurance ratio adopted in the Dutch transactions (12.8bn to 4bn) seems odd when compared with the same ratio derived from the transactions related to the Belgian activities that were decided in the first weekend, namely a figure of 4.7bn for the bank compared with a total of 12.2bn for the holding company).

Such a comparison is not pertinent or at least three reasons:

- a) the valuation applied that first weekend was based on a top-down approach that 'penalised' the banking activity (see no. 171, above), while the sum of the parts approach used here gives each entity a proportional weight
- b) the first ratio refers to a bank in relation to an insurance company, while the second refers to a bank in relation to a holding company
- c) the valuation made that first weekend referred to Fortis Bank and its Dutch and Luxembourg subsidiaries. Here, however, only the Dutch banking activities are concerned.

### **§ 4.2.3. Our assessment of the valuations used**

176. As regards the exceptional circumstances surrounding the negotiations and the write-downs to be applied, particularly on account of the urgency and severity of the situation, we refer the reader to our comments formulated above (see no. 142 above).
177. Taking account of the particularly difficult and extreme context (threat of emergency procedures, extremely tense liquidity situation etc., see no.163 above), we consider reasonable the adopted valuation (Dutch activities valued at 16.8bn), which de facto corresponds to 75% of the going concern value.
178. As regards the figure attributed to the banking activity, namely the sum of 12.8bn, this must, in our opinion be compared with the amounts of 6.1bn for Fortis Bank Netherlands (see no.173 above) and 7.1bn for ABN AMRO (see no.172 above), namely 13.2bn.

Knowing that the separation of Fortis Bank Netherlands into an independent entity is an important element that must impact a going concern valuation (costs of the spin-off from Fortis Bank and the integration with ABN AMRO) gives further credence to our opinion that the obtained price of 12.8bn is reasonable.

179. We note that the value attributed to Fortis Verzekering, namely 4bn, corresponds to 70% of the embedded value (5.7bn end 2007), while within a few days BNP Paribas agreed to pay the sum of 5.5bn for the shares of Fortis Insurance Belgium, which had an identical embedded value (5.7bn).

We must, however, state that in the course of 2008 Fortis Verzekering had had to contend with litigation relating to profiteering policies (i.e. unit-linked insurance products with excessive fees and charges), which led to an additional provision of 0.5bn (an amount of 0.25bn already appeared on the balance sheet as at 31.12.2007).

180. As regards the breakdown of the amount between the banking activity on the one hand (12.8bn) and the insurance activity on the other (4bn), we have established that a breakdown of 12.3bn to 4.5bn would have been a priori more logical (see no.174 above).

Given that Fortis Holding owned at that moment 50.01% of Fortis Bank and (indirectly) 100% of Fortis Verzekering and also in the knowledge that the valuation of the insurance company could be affected by the provision made in respect of the profiteering policies (see no.179 above), it does not seem opportune to continue to dwell on this issue. A revision of the breakdown of the price would ultimately have only a very limited impact.

181. Without calling into question our assessment of the reasonable nature of the valuations, we think that the application of the conversion conditions of the MCS bonds should be scrutinised together with the Dutch authorities in order to ensure that the viewpoints are identical. We will come back to this point (see no.258 below).

#### **§ 4.2.4. Our conclusions on the possible detriment to the corporate interest**

182. We have explained above (see no.147) what in our estimation should be understood by the term corporate interest in a group like Fortis.
183. With regard to the decisions of the board of directors of Fortis Holding and Fortis Bank on Friday 3 October 2008 to consent to the sale to the Dutch authorities of (i) the subsidiary Fortis Bank Netherlands (holding) and (ii) the subsidiary Fortis Verzekering for a total sum of 16.8bn, we consider that these decisions were taken in the general interest and, in the terms of the judgement of the Court of Appeal, that they certainly were not ‘detrimental to the corporate interest of the companies of the group, notably Fortis Holding and its subsidiaries, but on the contrary.

#### **§ 4.3 Acquisition by SFPI from Fortis Holding of the second tranche of 50% of the shares of Fortis Bank**

##### **§ 4.3.1. Choices to be made after the transfer of the Dutch activities**

184. After the sale of the Dutch arm of the Fortis group, the Belgian Government in theory had three options:
- 1) option 1: to maintain the status quo, in other words to retain its 50% stake in Fortis Bank;
  - 2) option 2: to increase its stake in Fortis Bank to 100%
  - 3) option 3: to sell the majority of Fortis Bank shares to another bank

We disregard here the insurance arm, which was not in difficulty and needed no intervention. We discuss below (see nos. 242 onward, below) the context of the transfer of the shares of Fortis Insurance Belgium.

185. The government chose the third option. We attempt below to analyse the criteria on which they based their decision and the effect of this choice on the position of the shareholders of Fortis Holding.
186. The global financial climate clearly remained extremely uncertain and vulnerable at the beginning of October. We do not know whether at the time the representatives of the Belgian Government took a pessimistic view of that climate and its outlook but if they had, that pessimism would certainly be justified by the facts.

**187.** Despite the improvement in Fortis Bank's situation due to the sale of the Dutch entities with respect to solvency (which gained 10%) and liquidity (the return of the funding to Fortis Bank Netherlands amounting to 72bn, less customer deposits of 15bn at the previously consolidated FBN), the situation of Fortis remained rather worrying and at the very least uncertain, mainly because of the following factors:

- a) the only partial elimination of the sums to be financed by the ECB and the BNB, which mounted up to around 120bn at their highest point (ELA + Marginal Lending Facilities + ECB) (see no.162 above)
- b) the persistent run on customer deposits (wholesale and retail) at Fortis bank, totalling 24.1bn in the week of 29/9 – 3/10 (see no.158 above) and fears that this run on, in principle, stable deposits would be ongoing
- c) the negative reaction of the financial market and all the rating agencies to the interventions of the States in the weekend of 27/28 September.

**188.** The following additional factors should also be taken into account:

- a) The virtual certainty that in view of the weakness of the financial markets the government and the BNB would soon be forced to support another Belgian bank
- b) the political and economic consequences of a decision to support a bank for financial stability and the management of public debt

To appreciate the aspects of financial stability and economic policy, we need to take the following factors into account:

- i. the importance of liabilities on the balance sheet. Fortis Bank's debt (even after the elimination of FBN and FBL) stands at approximately 600bn, about twice the size of Belgium's gross domestic product
- ii. given the already very high debt/GDP ratio of the Belgian State, the implicit or explicit grant of guarantees to the banking sector could put pressure on the credit rating of the Belgian State and consequently also on the cost of funding government debt

**189.** The sale of Fortis Bank to a foreign bank had the following disadvantages:

- a) the decision centre of a major national bank would move abroad. In this regard, we note that Belgium has already seen several major decision centres relocate abroad, particularly to France
- b) the probable loss of financial knowhow due to the transfer of certain activities to Paris and the adverse effect of this on Brussels as a financial centre

These disadvantages would be partly offset by:

- a) the integration of Fortis Bank in a large international group, giving Fortis's employees and clients opportunities for further development
- b) the fact that a foreign bank, certainly if it is based a neighbouring country, would not buy a Belgium bank in order to subsequently neglect it. In our estimation, the fears sometimes expressed, particularly with regard to the funding of Belgian companies and SME, have little relevance.

190. The consequences for the shareholders of the choice between the various options can be summed up as follows:

191. The first option (to retain a 50% stake) was practically excluded for the shareholders, given that Fortis Holding had necessarily to sell the balance of its 50% holding in Fortis Bank in order to avoid liquidity problems.

192. As for the price that the shareholders would have received for the banking subsidiary (and possibly for the insurance subsidiary), the choice of one or other alternative (sale to the State or sale to a private company) should in principle be neutral. A public authority must not and may not pay more than a private company would do. That would be to the detriment of all taxpayers, while benefiting some of them, i.e. the shareholders of the company insofar as those shareholders are Belgian and pay taxes in Belgium.

193. The European authorities also guard against member states ever paying more than a private company would be prepared to pay. Any exceptions in principle concern state aid that can be justified only by the circumstances referred to in section 87 (3) (b) of the EU treaty.

In this regard we note that the European Commission (see its decision of 3 December) qualifies the interventions of the Belgian State as state aid. The State has, according to the EC, paid more than a private company possessing the same information would have paid. The EC has nevertheless approved the interventions of the Belgian authorities on the basis of the necessity 'to remedy a serious disruption in the economy of a member state' (decision of 3 December nos. 68-69).

194. As regards ways for (or the right of) the shareholders to recoup a part of their loss arising from the collapse of the share price, a public authority must, as is the case when setting the price of the transaction, in principle not adopt a more flexible attitude than a private company would do. Based on socio-political considerations, however, the political authority would probably be able to accept the adoption of solutions that offered shareholders the opportunity to recoup a part of their loss, in cases where the activity of the company had just recovered. But in that hypothesis, the shareholders would in return have to agree to share in any new losses.

195. This reasoning seems particularly pertinent to options 1 and 2, namely the two stand-alone cases (Fortis Bank becomes a 50%-owned subsidiary of the SFPI).

While it is true that a stand-alone solution did hold out prospects of recovery, principally because Fortis's value had already fallen to a very low level at the time of the transactions, it is also true that this option also entailed more risks. And in a scenario where a political authority opts for this alternative to the potential benefit of the shareholders, then the latter should, in our opinion, share the risks and the necessary investment to develop the company.

Only in a scenario where the intervention of the State with the intention to safeguard financial stability is realised to the clear and disproportionate detriment of the shareholders would it be fair and just for the government to accord to the shareholders unconditional compensation or opportunities to recoup their losses. The precise aim of the present report is to enlighten you on whether or not this has been case.

196. We consider the government acted logically and coherently when it took the decision in the weekend of 4 and 5 October. Since its intervention was motivated by the preservation and operation of the financial sector, the government gave priority to the alternative that best permitted it to achieve its objectives, namely to transfer Fortis Bank to a sound private company.
197. In the context of the assessment of the choice between a link-up with a sound private partner or maintaining the equity stake via the SFPI (stand alone), it seems to us useful to underscore the investment (capital and debt) by the Belgian State, namely 14.9bn (9.4bn for Fortis Bank + 2.5bn for the SPV + 3bn for funding the SPV). This is a very sizeable sum when compared, for example, with the investment of the biggest economy in the world (US) in the biggest bank in the world (Citigroup), which amounts to 35bn.

The Belgian State has taken into consideration that fact that BNP Paribas is undoubtedly a sound international bank that enjoys the best ratings. At the time it was one of the three highest rated banks in the world by Standard and Poor's. Its financial base was able to cope with funding Fortis Bank's liquidity requirement.

198. Insofar as the particulars of the transactions are reasonable for the shareholders and the authorities are, if necessary, prepared to endeavour to eliminate any weak points and/or to let the shareholders share in the recovery of their company, the choice made by the government in the weekend of 4 to 4 October seems to us logical and acceptable.

The government's decision to link up Fortis Bank with a sound partner was one of the options arising from the recommendations of the CBFA, which on 26 September had requested Fortis to investigate the alternatives, one of which was to link up with a major player in the sector.

We note that if Fortis had itself been able to find a suitable partner, it would very probably have achieved an identical structural result. One may wonder whether the terms would have been less favourable, since the presence of the Belgian State very probably conferred an atmosphere of confidence and stability to the talks that took place that weekend.

### **§ 4.3.2. Valuations used**

199. In accordance with the mission entrusted to us by the Court (see no.38 above), we give below our assessment of the value assigned to Fortis Bank upon the transfer of 50.01% of Fortis Bank shares by Fortis Holding to the SFPI for the sum of 4.7bn on 6 October 2008.

We will not here give any further details of this valuation, which we feel is closely connected to the valuation negotiated with BNP Paribas that same weekend.

Since the valuation of the bank is described above in the context of the transaction with BNP Paribas, it would be superfluous to repeat it here.

### **§ 4.3.3. Our assessment of the valuations used**

200. As regards the exceptional circumstances in the context of the negotiations and the write-downs that had to be applied, particularly on account of the urgency and the gravity of the situation, we refer the reader to our comments formulated above (see no.142 above).

201. The payment of a price of €4.7bn which, added to the first amount of 4.7bn from the previous weekend, gives a total of 9.4bn, seems to us entirely consistent with the sum of 11bn negotiated with BNP Paribas (see no.225 above).

202. We think it unnecessary to wonder about the virtual gain realised by the SFPI on the difference between the purchase of the Fortis Bank shares (based on a value for 100% of the shares equal to 9.4bn) and the transfer of those same shares to BNP Paribas (based on a value of 11bn for 100% of the shares), which, according to some people, would have given the SFPI a 'profit' of 1.2bn (75% of 1.6bn).

This reasoning cannot stand up to economic analysis for several reasons:

- a) to complete the transaction SFPI was not only forced to finance 24% of a SPV (being 2.4bn), but also to extend a loan of 3bn to that same SPV. The SFPI thus runs a risk of 5.4bn linked to the good performance of a portfolio of structured products, selected on the basis of their poor quality. The European Commission referred to this additional support as a significant element of the purchase transaction (see its decision of 3 December 2008, no.63)
- b) a cash sum is not as such comparable to the same amount received in shares in the company of the buyer that are subject to a lock-up clause

- c) the majority of the above-mentioned shares are indeed frozen for two years under a lock-up clause

We are thus not entirely convinced that the Belgian State, through the SFPI, would have got such a good deal as some people would have us believe.

- 203. The payment of a price of 4.7bn by the buyer was in fact necessary to respond to concerns about (i) wanting to preserve some value in the shares of the holding company and (ii) allowing the holding company to meet an urgent need for liquidity.
- 204. To conclude, we think that the total investment of 9.4bn (of which the sum of 4.7bn goes Fortis Holding) is a reasonably acceptable figure given the extreme circumstances at that time.

#### **§ 4.3.4. Our conclusions on the possible detriment to the corporate interest**

- 205. We have already explained (see no.147 above) what in our estimation is understood by corporate interest in a group such as Fortis.
- 206. As regards the decisions by the boards of directors of Fortis Holding and Fortis Bank on 5 and 6 October 2008 to go ahead with the sale of 50.01% of Fortis Bank shares to the SFPI, we consider that these decisions were taken in the general interest and that in the words of the judgement of the Court of Appeal were certainly not ‘detrimental to the corporate interest of the group’, notably Fortis Holding and Fortis Bank, but on the contrary.

## **§ 4.4. Transfer of Fortis Bank to BNP Paribas**

### **§ 4.4.1. Details of the transaction**

#### **a) General**

**207.** The transaction decided on 4 and 5 October consisted of the retention of a blocking minority at the SFPI (25.01%) and an exchange of shares. The SFPI will transfer 74.94% of the shares of Fortis Bank to BNP Paribas, thus increasing its capital, in exchange for new shares in BNP Paribas.

This transfer will be paid for with new shares in BNP Paribas with a ‘dividend 2008’ coupon attached.

**208.** Although BNP Paribas is a large concern, we must emphasise that Fortis Bank Belgium represents about 40% of its size. The takeover of a bank the size of Fortis, over a weekend and in conditions of extreme urgency, inevitably presented significant risks to the acquiring company, which it has endeavoured to minimise as much as possible.

**209.** At the beginning of the negotiations BNP Paribas did not want to go beyond a financial input of 13bn.

You will read below that at the end of the weekend’s negotiations BNP Paribas’s investment amounted to 17.7bn (11 for FBB + 5.7 for FIB + 1 for the SPV), approximately two thirds of which was in shares and one third in cash.

**210.** The transaction concluded with BNP Paribas involves a transfer of Fortis Bank shares (74.94%). This ties in with other transactions briefly described below:

- a) the transfer of part of the structured credit portfolio to a separate entity (special purpose vehicle)
- b) the purchase of the shares of Fortis Insurance Belgium by BNP Paribas
- c) the termination of a contract, called a ‘relative performance note’, between Fortis Holding and Fortis Bank, associated with the so-called CASHES bonds

**211.** Fortis Bank shares will be transferred in two stages. The first stage involves 54.55% of the shares in the form of an authorised capital procedure, the second is for 24.39% of the shares in the form of a capital increase to be approved by the general meeting of shareholders of BNP Paribas.

**212.** The transaction is subject to a lock-up clause. This means that the SFPI cannot sell its BNP Paribas shares (at least the first tranche of 54.55%) for a period of two years.

213. Following the signing of the Memorandum of Understanding on 10 October, the question arose of an unrealised capital gain, concerning Fortis Bank, with regard to the quality of the debtor (the Dutch State) of a financial instrument worth 10bn. We will come back to this later (see no.222 below).

b) Creation of a special purpose vehicle (SPV) for certain structured products

214. At the end of the negotiations, the parties agreed to lodge part of the structured credit portfolio in a separate special purpose vehicle. (SPV).

The parties agreed that the SPV would take over from Fortis Bank a set of structured credits worth 10.4bn in net book value, to be chosen by BNP Paribas prior to 30.11.08 from a list amounting to 11.2bn, appended to the Memorandum of Understanding

We note that the estimated figures are based on the situation on 31 August 2008 and that the larger part of this portfolio is denominated in USD and GBP. The impact of the exchange rate of these currencies is obviously an important matter for consideration (see the impact of 1bn around mid November, 66% of which is for the account of Fortis Holding; press release of 14 November, p.6).

This vehicle will be financed (either in capital, or by an advance of funds) for 66% by Fortis Holding, 24% by the SFPI and 10% by BNP Paribas.

The formation of a separate structure for poor-quality structured credits is a rather common phenomenon (see examples of bad banks) because it (i) reassures the purchaser and (ii) gives him the opportunity to concentrate on tasks that are more important than the management of these toxic products.

c) Takeover of the CASHES

215. Articles 4.10 and 4.11 of the Memorandum of Understanding of 10 October between BNP Paribas, the SFPI and Fortis Bank contain the principles associated with the CASHES transaction. Given the complexity of this transaction it was necessary to detail its consequences in an addendum to the memorandum. That addendum has so far not been signed.

We attempt to briefly explain the problem with the CASHES below.

216. The CASHES are a very complex financial instrument, which were used in the context of the plan to improve Fortis Bank's solvency (see no.77 above).

They concern perpetual bonds issued by Fortis Bank in December 2007 for a total amount of 3bn, convertible into 125,313,283 shares in Fortis Holding (at an exercise price of €23.94). The interest rate on these bonds is equal to the Euribor three-month + 2%.

These financial instruments cannot be redeemed in cash. They can only be redeemed by conversion into Fortis shares on the initiative of the investor.

In order to have readily available the Fortis shares necessary to cover these commitments, Fortis Bank has acquired in advance 125,313,283 Fortis shares at a price of €18.75 per share for a total amount of 2.35bn, by means of a capital

increase in Fortis Bank underwritten by Fortis Holding and issued to cover the needs of this transaction.

The difference between the nominal value of the bonded debt (3bn) and the value of the Fortis shares (2.35bn) acquired to cover the conversion of this debt, which amounts to 0.65bn, tallies with the conversion premium payable by the subscribers to the CASHES.

217. In line with Fortis Bank's accounting principles, both the Fortis shares and the CASHES have been marked to market. As the consequence of an agreement between Fortis Holding and Fortis Bank, the affect of the fluctuations in value, whether symmetrical or not, of the shares of Fortis Holding and the CASHES has been neutralised at consolidation level (by a contract known as the 'relative performance note'), so there is no impact on either solvency or the profit and loss account.

218. Such financial arrangements are easier to set up when the two parties are both part of an integrated group, because such a contract requires considerable mutual confidence.

In the context of the separation of Fortis Holding and Fortis Bank, BNP Paribas, with the aim of severing the ties between the two companies as much as possible, wished to abandon this mechanism and terminate the above contract prematurely.

Based on the negotiated agreements (see Memorandum of Understanding) Fortis Holding must pay the sum of 2.35bn to Fortis Bank, as the dissolution of the contract means that Fortis Bank will have to take a charge for the loss related to the Fortis Holding securities.

219. The parties have also agreed that any future returns linked to the price of the Fortis shares that Fortis Bank holds will be credited to Fortis Holding (*total return swap*).

220. On the other hand, no capital gain has been realised on the CASHES bonds. The potential gain arises from these bonds being quoted well below par (quoted at 40% of par value in October 2008), so any repurchase can generate a substantial gain.

221. To sum up, Fortis Holding (the transactions having been suspended since the court judgement) must pay Fortis Bank the sum of 2.35bn and will become the economic beneficiary (loss or profit) of the price performance of the Fortis shares held by Fortis Bank.

As regards the book value of Fortis Holding (financial statements), the end of the CASHES transaction will entail a reduction in book value estimated at 2.35bn when the said transaction is booked (entry in the accounts remains suspended due to the court judgement).

#### d) Potential gain linked to quality of the debtor

222. The conversion of part (10bn out of a total of 16bn) of Fortis Bank's long-term advances to Fortis Bank Netherlands into financial instruments guaranteed by the Dutch State has generated a potential gain for Fortis Bank (the creditor), thanks to the revaluation of these financial instruments (following the improvement in the debtor's credit rating. An amount of €600 million has been mentioned in the press

The amount is extremely difficult to estimate since it is, for example, linked to the bond price, which is itself linked to the size of the CDS premium (credit default swap) with respect to the Dutch State. Given the current uncertainty in the financial markets, it is very difficult to predict the course of the CDS.

The Memorandum of Understanding, signed on 10 October, gives no specific guidance on this matter. The parties (BNP Paribas, Fortis Bank and Fortis Holding) have already held informal talks with a view to negotiating an agreement whereby the unrealised gain generated by the improvement in the debtor's credit rating will be attributed to Fortis Holding.

#### **§ 4.4.2. Valuations used**

223. The valuation of Fortis Bank was carried out based on an estimated book value on 30 June 2008.

This book value had to be rapidly reconstructed in just a few hours (so called pro forma document), since obviously no balance sheet existed without the Dutch activities on that date.

It is obvious that it was necessary to know the price of the shares of Fortis Bank Netherlands (holding company owning Fortis Bank Netherlands and the stake in RFS Holding) transferred to the Dutch State, when the book value of Fortis Bank, 'reconstructed' on 30 June 2008, was calculated during the weekend's negotiations. That price had a major influence on the calculation since it generated a loss that was essentially due to the ABN AMRO transaction.

The Belgian State informed BNP Paribas that for the purposes of calculating the book value of Fortis Bank, the sale of the shares of Fortis Bank Netherlands (holding) should be valued at 12.8bn.

The transfer of the Dutch activities (16.8bn) had an impact on the balance sheet of Fortis Bank amounting to a reduction of 8.7bn in shareholders' equity (22.9bn instead of 31.6bn; see appendix 4 to the Memorandum of Understanding of 10 October 2008 between Fortis Bank, the SFPI and BNP Paribas).

224. Once the book value was established, Fortis Bank was valued at 70% of book value. The average ratio (P/BV) of reputable and healthy banks was 100% at that time, while for banks in less good health the ratio was 60% (see no.68 above).

**225.** The manner in which BNP Paribas calculated the value of Fortis Bank was explained to financial analysts in Brussels on 6 October (see p. 26 of the documentation provided to analysts).

The book value according to the pro forma situation on 30 June 2008 amounted to 31.7bn, adjusted as follows:

- a) addition of 4.7bn (capital increase by SFPI)
- b) deduction of 4.4bn (goodwill and intangible assets relating to asset management activities etc.)
- c) deduction of 11.9bn (goodwill ABN AMRO)
- d) addition of 5.1bn (transfer of Dutch activities for 12.8, less an amount of 7.7 for the goodwill of ABN AMRO in the books of Fortis Bank Netherlands)
- e) deduction of 9.4bn (miscellaneous adjustments).

The adjustments to the value of 9.4bn are based partly on the reconciliation of certain valuations with BNP Paribas's accounting principles and can be summed up as follows:

- i. impairment of the structured credit portfolio: 3.2bn for the contribution to the SPV
- ii. deferred taxation United States: 1.5bn (asset reduction due to the change in shareholdership)
- iii. impairment of credits: 0.7bn (calculated on the basis of exposure to certain sectors)
- iv. impairment of the equity portfolio: 0.6bn (portfolio realised by Fortis Bank during September)
- v. revised provisions for pension funds: 0.8bn
- vi. impairment of asset management: 0.7bn
- vii. etc.

This results in a book value adjusted by an amount of 15.7bn, which multiplied by a coefficient of 70% gives a value of 11bn.

**226.** On the Monday it became apparent that certain elements had been forgotten during the rapid calculations of the weekend, including a write-down on the subsidiary Fortis Banque Luxembourg (impact of €600 million, being the difference between the book value of the equity stake and the price at which the Luxembourg State

would convert the bond loan) and adjustments to probable losses on the divestment of non-strategic assets (1bn).

These adjustments bring the book value of Fortis Bank to 14.1bn (instead of 15.7bn), which means that, at that moment, the transaction took place based on 80%, not 70%, of the book value.

At that stage, there was still no question of the CASHES.

227. All these adjustments ‘negotiated’ in the course of the weekend were necessarily calculated at a flat rate in the light of information provided in a context of extreme urgency.

Even so, our mission, also performed in a state of urgency, does not consist of verifying the validity of these adjustments.

228. Given that Fortis Bank in its entirety was valued at an amount of 11bn, the contribution of 74.94% of the shares corresponds to a value of 8.243bn, which will be remunerated by the assignment of new BNP Paribas shares, issued at a price of €68 per share.

As the following graph shows, the price of €68 is the price on the day of the agreement between the parties. It is somewhat higher than in the preceding days, but the average for the preceding weeks is lower.

Graph: Performance of the BNP Paribas share price between 1 January and 6 October 2008



#### § 4.4.3. Our assessment of the valuations used

- 229.** As regards the exceptional circumstances in the context of the negotiations and the write-downs that had to be applied particularly on account of the urgency and severity of the situation, we refer the reader to the comments formulated above (see no.142 above).

A valuation based on 80% of the book value, bearing in mind the prevailing circumstances and the very delicate situation of the bank, seems to us a fairly reasonable proposition given the circumstances at that time, but nevertheless stringent in view of the significance of the applied adjustments.

From the conclusions reached by independent bodies at that time (see no.68 above), it appears that the average P/BV ratio of a ‘crisis-hit’ bank amounts to approximately 60% and that of a ‘non-crisis-hit’ bank 100%.

This 80% valuation must however be qualified if the CASHES transaction is taken into consideration. We will return to this later (see nos. 233 onwards, below).

- 230.** It is undoubtedly true to say that it is impossible to tell from a bank’s market valuation the extent to which a reduction in value is a reflection of necessary write-downs on the net assets of that bank.

We may therefore be surprised by the severity of the adjustments that BNP Paribas has applied to Fortis Bank’s book value, but on the other hand:

- a. the purchaser did not have time to carry out a due diligence and the price could not be made the object of a representations and warranties clause
  - b. at the time of the negotiations the parties to those negotiations could not know the extent of the bank run during the week of 29 September to 3 October
  - c. there were serious concerns about the impact of the loss of synergies with Fortis Bank Netherlands and Fortis Banque Luxembourg, which has become Banque Générale du Luxembourg
  - d. substantial costs were foreseen relating to the disintegration of the business model that allied Fortis Bank with Fortis Bank Netherlands and Fortis Banque Luxembourg
- 231.** We note that the European Commission stressed that ‘a ratio of 70% is consistent with the ratio observed in the sale of other banks in difficulties that have taken place recently (EC decision of 3 October, no.60 and footnote, no.19).
- 232.** We are, however, surprised that the contribution of Fortis Bank shares was compensated on the basis of the BNP Paribas share price with no thought of a discount, given that:
- a) payment in shares instead of payment in cash
  - b) a two-year lock-up clause for two thirds of the securities.

In our view, a discount in the order to 15% would have been more in line with conditions that often apply to such types of transactions in shares instead of cash.

The BNP Paribas shares would then have been valued at around €58 instead of €68.

We realise that in the then-prevailing circumstances, the contributors were certainly not in a strong enough position to obtain compensation for their contribution based on a BNP Paribas share price that was below the market price.

233. As regards the transaction concerning the CASHES, we consider that it was unfair that Fortis Holding had to pay out an amount of 2.35bn without being able to recoup a part of that sum by realising the capital gain inherent in the under-par price of the CASHES.

The Belgian State (through the SFPI), after the public announcement of the agreement reached on Monday morning, had to agree to a renegotiation of the agreement in order to resolve the CASHES situation. This question had indeed not been raised during the weekend's negotiations. It should also be stressed that this type of transaction is particularly complex and rare in the banking sector. It should come as no surprise that the impact of this transaction did not come to light in the course of negotiations over two densely packed days.

That being said, the operative clauses in the Memorandum of Understanding on the CASHES transaction, which had to be negotiated at the last moment without much room to manoeuvre, do not appear to be equitable in our view.

234. We see three ways in which this agreement could be made more equitable.
235. The first solution, which seems to us absolutely desirable (and also by far the most simple) involves allowing the contract (relative performance note) to continue. In that case, Fortis Holding would not need to pay the sum of 2.35bn to Fortis Bank and the contract would remain in force. This would also mean that the price paid by BNP Paribas would remain at the reasonable ratio of 0.8 times book value. Owing to the CASHES transaction the ratio of 0.8 became de facto 0.6.

Assuming that the contract relating to the CASHES cannot be renegotiated, a second option would be for the parties to negotiate the allotment of the proceeds of a public bid for the CASHES at, for example, 40% of nominal value. The market seems interested in such a transaction.

236. This second solution can itself take two forms. The first would apply an accounting approach. This transaction would generate a profit of approximately 1.2bn for Fortis Bank, which Fortis Holding and Fortis Bank could share. The part that would go to Fortis Bank would compensate for the loss of Tier 2 funding acquired on attractive terms thanks to the CASHES transaction.

Another way of allotting the proceeds of the buyback transaction would be to base it on cash flows instead of applying an accounting approach. This would lead to a cash inflow for Fortis Holding from the moment that the difference between the amount that Fortis Bank receives (2.35bn) and the amount that is paid to redeem the CASHES (to be seen as the offer price in relation to par value) was divided between Fortis Bank and Fortis Holding in a set ratio.

237. As regards the potential capital gain (difficult to estimate) on the financial instruments guaranteed by the Dutch State (see no.222 above), we consider that logically this should go to Fortis Holding, since the document signed by the Dutch State and Fortis Bank was negotiated by the representatives of Fortis Holding (at that time the parent company of Fortis Bank) and the Dutch State.



#### **§ 4.4.4. BNP Paribas's funding support**

238. The assessment of Fortis Bank's link-up with BNP Paribas is certainly not confined only to aspects concerning the valuation of the shares of the two companies.

As regards liquidity in particular, BNP Paribas's support of the funding of Fortis Bank's activities is discussed below (see nos. 271, 276 and 287 below).

As regards the other factors that help to improve funding, we note that (i) the improvement in solvency thanks to the separation of Fortis Bank Netherlands (holding) and (ii) the link-up of Fortis Bank with BNP Paribas have contributed to a reduction in the cost of the CDS premium (credit default swap) which has fallen (figure of 9 January) to 75 basis points for Fortis (compared with 115 for ING, over 300 for Dexia and more than 200 for KBC). You will recall that the premium had climbed to 600 basis points at the end of September (see no.89 above).

#### **§ 4.4.5. Our conclusions on the possible detriment to the corporate interest**

239. We have already explained (see no.147 above) what in our estimation should be understood by the term corporate interest in a group like Fortis.

240. The board of directors of Fortis Holding has not formally commented on the transfer of a part (74.94%) of the shares of Fortis Bank by the SFPI to BNP Paribas.

The board of directors of Fortis Holding has had to comment on the transactions concerning Fortis Holding, namely the funding of the SPV, the CASHES transaction and a few other complementary.

Fortis Holding signed a Memorandum of Understanding with BNP Paribas on 10 October.

241. As regards the decision of the board of directors of Fortis Holding on 5 and 6 October 2008 to assent to the transactions concerning Fortis Holding, we consider that this decision was taken in the general interest and that in the words of the judgement of the Court of Appeal was certainly 'not detrimental to the corporate interest of the companies of the group', notably Fortis Holding and its subsidiaries, but on the contrary.

#### **§ 4.5. Transfer of the shares of Fortis Insurance Belgium to BNP Paribas**

#### **§ 4.5.1. Details of the transaction**

**242.** It must first of all be emphasised that Fortis Insurance Belgium is not in any financial difficulty, on the contrary, and that the divestment of its shares was proposed essentially with the aim of resolving the funding problems of Fortis Holding. BNP Paribas has declared its interest in a possible takeover for obvious reasons of real and significant synergies between the two activities.

BNP Paribas is a group that also has a strong presence in the insurance sector, where it realises annual turnover of 18bn (2007 annual report of BNP Paribas Assurances, p. 42), more than double the turnover of Fortis Insurance Belgium (7bn).

**243.** The activities of Fortis Bank and Fortis Insurance Belgium are closely allied to each other.

The two entities are bound by a very strict contract that does not expire until 2017.

Fortis Bank is the 'contributor' of approximately 50% of the 'life' revenues and 20% of the 'non life' revenues of Fortis Insurance Belgium.

**244.** BNP Paribas wanted subsequently to formulate a general offer for all of the activities in Belgium, for the following reasons:

- a) Fortis's very well developed experience in bancassurance was interesting to BNP Paribas (this model is less common outside Belgium)
- b) the insurance business could act as an enticement to retain or attract banking customers (retail or corporate)
- c) the dismantling of the Belgian and Dutch banking activities (and perhaps part of the Luxembourg activities) poses an enormous challenge and it is not expedient to impose a further gap (limited by the contract the binds the two entitles) between banking and insurance activities.

## § 4.5.2. Valuations used

245. As mentioned above (see no.70 above), it is standard practice in the insurance sector to publish an annual report on embedded value.
246. We have already mentioned (see no.73 above) that the embedded value of Fortis Insurance according to the 2007 report (p. 13) amounts to €12.4bn, broken down into:
- a) 5.7bn for Fortis Insurance Belgium
  - b) 5.7bn for Fortis Verzekering
  - c) 1.0bn for Fortis Insurance International
247. As regards the unrealised gains on the real estate portfolio or on subsidiaries such as Interparking, these are naturally taken into account when the embedded value is calculated.

The real estate portfolio of Fortis Insurance Belgium is worth approximately 3bn (consolidated financial statements 2007, p.145) and is owned directly by the insurance company and not by its subsidiary Fortis Real Estate. The latter is essentially an asset management company serving the group and third parties. Fortis Real Estate has a stake in Interparking.

The buildings that are the property of Fortis Insurance Belgium are naturally treated as assets covering technical reserves, (acting as a guarantee of the reserves safeguarding the interests of policyholders).

248. One specific factor governing the valuation of Fortis Insurance Belgium is that is very dependent on Fortis Bank. The maintenance of a strong bond between the two entities is thus an essential element of the valuation and simultaneous negotiations on the two entities increases their potential value.
249. We have seen (see no.72 above) that the value of insurance companies was not brilliant at the beginning of October 2008. The share prices of the main insurance companies of Europe amounted to 0.6 to 0.8 times embedded value.
250. In the all-encompassing context of the weekend's negotiations (bank, structured credits, pricing the transfer of the Dutch banking activities, liquidity requirements of Fortis Holding, etc.), the parties decided to set the price for Fortis Insurance Belgium based on an amount equal to one times the embedded value, being a higher price than the market average.

We shall not dwell here on the variable part of the price (between €225m and €450m) on top of the sum of 5.5bn related to the realisation or non-realisation of the Interparking transaction

The embedded value of Fortis Insurance Belgium, amounting to 5.7bn on 31.12.07, was finally brought down to 5.5bn, taking account of the positive and negative

adjustments (notably to the structured credit portfolio). It is not appropriate to go into this further here.

### **§ 4.5.3. Our assessment of the valuations used**

251. As regards the exceptional circumstances in the context of the negotiations and write-downs that must be applied, particularly on account of the urgency and gravity of the situation, we refer the reader to the comments formulated above (see no.142 above).
252. We consider that the price of 5.5bn for the total shares of Fortis Insurance Belgium was an excellent price in the circumstances prevailing at that time.
253. It is surprising to see the difference in treatment between Fortis Insurance Belgium (transferred for a sum of 5.5bn) and Fortis Verzekering Netherlands (transferred for a sum of 4.0bn) while the embedded value of both companies (coincidental figures!) on 31.12 .07 was exactly the same, namely €5,607 million.

We should, however, not forget the litigation on the profiteering policies referred to above (see no.179 above).

Given that Fortis Holding is the beneficiary in both cases, it is better to evaluate the transaction as a whole (the transfer of both companies, as the transactions of the weekend had to take into account so many parameters that there is no point in comparing one transaction with the other.

254. To sum up, we consider that in the very exceptional circumstances where there was a question of rescuing not only a bank, but also a holding company, each of which had liquidity problems, the total price of 9.5bn for both insurance companies (Belgium + Netherlands) was reasonable, when compared to an embedded value of 11.2bn. This price represents 84% of the embedded value, which is in line with (and even slightly better than) the then prevailing market conditions.

During the first weekend a total amount of 15.8bn was attributed to the insurance business (see no.133 above) based on the top-down method. To make a comparison, the figure for Fortis Insurance International must first be deducted, which can be roughly estimated at 1.8bn. The amounts to be compared will then be 11.2bn on the one hand and 14bn on the other. The difference can be explained by the fact that on the first weekend an estimate was involved (one times the embedded value, plus the capitalised profit of ‘non-life’, and with no adjustments), while in the second weekend negotiations were held, in the course of which the purchasers wished to make adjustments and quoted the price they were prepared to pay.

#### **§ 4.5.4. Our conclusions on the possible detriment to the corporate interest**

255. We have explained above (see no.147 above) what in our estimation should be understood by the term corporate interest in a group like Fortis.

As regards the decision of the board of directors of Fortis Holding on 5 and 6 October 2008 to assent to the sale of the total shares of Fortis Insurance Belgium to BNP Paribas, we consider that this decision was taken in the general interest and that in the words of the judgement of the Court of Appeal was certainly ‘not detrimental to the corporate interest of the companies of the group’, notably Fortis Holding and Fortis Insurance Belgium, but on the contrary.

#### **§.4.6. Situation of Fortis Holding**

##### **§ 4.6.1. Willingness of the Belgian government to protect the value of the shares**

256. The share price stood at €5.42 just before the weekend of 4 and 5 October.

The negotiations held in the course of the weekend were influenced, at least partly, by the government’s wish to ensure the share price (at least a price based on book value) would remain on the day after the transactions at a level as close as possible to the market valuation on 3 October.

257. Having summarily analysed the movements in the Fortis’s book value, we thought it would be useful to briefly describe the MCS.

Mandatory convertible securities (MCS) were issued by Fortis Bank Netherlands for an amount of 2bn and must be converted into Fortis Holding shares at a price of €18.74 per share by the end of 2010. Fortis Bank Netherlands will compensate Fortis Holding for the issuance of these shares with shares in Fortis Bank Netherlands.

It is clear that Fortis Bank Netherlands would incur a loss by subscribing to Fortis Holding shares at €18.74. This loss could be reduced by Fortis Bank Netherlands either buying, in the market and at the current price, the shares in Fortis Holding that it will need to redeem the MCS, or redeeming the MCS at a lower price. Whether this alternative is possible in the light of the existing contract is a matter that requires further scrutiny.

Moreover, the Dutch government would not be interested in Fortis Bank again becoming a shareholder of Fortis Bank Netherlands.

Each solution has disadvantages for one or other party and entails legal risks.

The parties concerned should probably have worked out a compromise, which may have led to an improvement in the solvency and cash flow position of Fortis Holding.

258. Without the impact of the CASHES (a decision that was taken after that weekend), Fortis Holding's book value on 06.10.08 would indeed have approached 12.5bn (or €5 per share if the number of shares are rounded up to 2.500,000,000).

Pro forma book value (estimate: see press release of 14 October, p. 6 and 12) amounted to 7.4bn on 30.09.08 after the CASHES effect, and approximately 9.8bn before the CASHES effect.

Part of the difference between the amounts of 9.8bn and 12.5bn should narrow in future due to two factors:

- a) the MCS should contribute to an increase in the book value of Fortis Holding in 2010 (see press release of 14 October, p. 10) owing to the issuance of shares by Fortis Bank Netherlands (holding). The amount is difficult to estimate at present time, as numerous legal and financial factors are involved
- b) the improvement in the quality of the debtor (Dutch State) of bonds payable by Fortis Bank should eventually, in the context of renegotiations with Fortis Bank, generate a profit for Fortis Holding, the size of which is also difficult to estimate at the present time..

#### **§ 4.6.2. Willingness of the Belgian government to safeguard the liquidity of the holding**

259. The liquidity situation of Fortis Holding on 30 June 2008 was a net position of 0.1bn (see press release of 14 October, p. 9) to which an additional 2.3bn was added in the third quarter (issue of commercial paper and Euro medium-term notes (EMTN)), giving an initial situation of 2.4bn.

260. The income and the liquidity requirements resulting from the transactions of the two weekends (these transactions have been suspended) can be summarised as follows:

- |  |       |
|--|-------|
| a) Initial situation:                        | + 2.4 |
| b) transfer of 50.1% of Fortis Bank Belgium: | + 4.7 |
| c) transfer of Fortis Verzekering:           | + 4.0 |
| d) transfer of Fortis Insurance Belgium:     | + 5.5 |
| e) repayment of debt as a result of          |       |

transfer of assets (event of default):	- 9.4
f) funding the SPV	<u>- 6.9</u>
Total	0.3

261. When the additional problem of the funding of the CASHES (2.4bn) emerged during the weekend, it was evident that Fortis Holding did not have the funds to finance these instruments.

Fortis Holding was faced with a liquidity shortfall of 1.9bn (0.5bn in cash, minus 2.4bn) and also had to maintain a buffer in order to absorb exchange rate fluctuations, which could have possibly added to the funding of the SPV.

The Belgian State then decided to extend to the SPV via the SFPI, a maximum loan of 3bn in order to help Fortis Holding. Fortis Holding's funding of the SPV decreased from 6.9bn to 3.9bn.

This loan is completely 'non recourse' for Fortis Holding, meaning both the principal and the interest are payable by the SPV. The SFPI thus runs an additional risk on the structured credits lodged in the SPV.

#### **§ 4.7. Creation of a fund for the benefit of small shareholders**

##### a) Details

262. Some days after the announcement of the transaction with BNP Paribas, the government announced its intention to 'pay out' to the shareholders of Fortis Holding any gains on the shares of BNP Paribas received in exchange for the 74.94% of the shares of Fortis Bank transferred by the SFPI. To implement this process, a coupon 42 will be issued.
263. The intention is to lodge the BNP Paribas shares owned by the SFPI in a fund until 2014 and then to verify whether the SFPI can recoup the principal of its investment, plus (i) the interest paid on the debt contracted in order to finance the purchase of the shares of Fortis Holding, calculated at the five-year OLO interest rate (4.11%) and (ii) a risk premium of 2%.
- On this basis the SFPI, which invested 9.4bn in October 2008, would recoup an amount of approximately 12.65bn in 2014.
264. It was also established that the remuneration per share should not exceed €8.96, being the sum of the average of the share price at the end of June (€10) and the average of the share price at the beginning of October (€1.04).
265. Only natural persons who were shareholders on 1 July 2008 would be entitled to the coupon, up to a maximum of 5,000 shares per person..
266. Based on the estimates that the cabinet and the Minister of Finance made at that time (it was around 10 October and the share price of BNP Paribas was still hovering around €68), the share price is expected to grow annually by 10% and so is the dividend, judging from the 2003 to 2007 financial years. According to these hypotheses, the BNP Paribas share price could reach almost €100 in 2014 and dividend per share €5.24 (compared with the €3.25 expected for 2008). This would result in a return of 14.6bn for the SFPI, which means a surplus of 14.6bn. This could be paid out to the holders of the coupons.

If the average growth of the share price and the dividend is limited to 7% instead of the expected 10%, there will be no return left over for the shareholders because this growth will barely cover the interest on the funding and the risk premium.

b) Our opinion

267. It is not part of our remit to judge whether or not the Belgian State should revise the terms of this ‘indemnification’ accorded to certain shareholders.

Assuming that the Belgian State does decide to do this, we suggest a couple of lines of thought:

- a) for what reason would a distinction be made between shareholders who are natural persons and the rest?
- b) the premium could be reviewed

## **Chapter 5 The bank's solvency and liquidity situation from 6 October 2008**

### **§ 5.1. The bank's solvency and liquidity situation between 6 October and 12 October 2008**

#### **§ 5.1.1 Solvency**

268. We refer the reader to § 5.2.1 (see no.281 below).

#### **§ 5.1.2. Liquidity on Monday 6 October 2008**

269. In the course of Monday 6 October, the 60bn requirement was gradually covered by the receipt of the payment of 50bn from the Dutch State. However, taking account of the decrease in deposits (*Wholesale and Retail & Private Banking*), which at the end of the day amounted to 22.9bn, 15bn of which originated from the departure of Fortis Bank Netherlands from the group (deconsolidation), Fortis Bank, despite the receipt of the sum of 50bn, still had to resort to ELA for an amount of 19.7bn.
270. As from 6 October BNP Paribas, although negotiations had not yet concluded, provided Fortis Bank with intraday funding to the value of 9.4bn, whereas previously this intraday funding had been close to zero. The level of this intraday funding gradually rose in the course of October.
271. On the evening of 6 October Fortis Bank had lost deposited funds amounting to 47bn (*Wholesale and Retail & Private Banking*) (including the afore-mentioned 15bn), compared with the stock of deposits available at the end of the day on 26 September.

#### **§ 5.1.3. Liquidity on Tuesday to Friday, 7-10 October 2008**

272. As regards the liquidity situation between Tuesday and Friday, 7 to 10 October, we refer to the following factors.
273. The advances accorded by the central banks (apart from the emergency credit lines) were stable and amounted to 42.4bn to 48.1bn.
274. The projected liquidity situation improved as from Tuesday 7 October and showed a funding requirement that was clearly lower than on the preceding days. The

estimated requirement fluctuated between 11.5bn and 18.2bn in the course of the week.

This improvement was due to:

- i. deceleration in withdrawals of deposits
- ii. funding received from BNP Paribas (9.4 to 18.3bn) and
- iii. receipt of the payment of 50bn from the Dutch State on 6 October

**275.** The advances extended by BNP Paribas represented more than 70% of Fortis Bank's interbank funding in the course of the week, against 3.5% in the course of the previous two weeks. These advances were provided without the pledge of collateral.

**276.** Withdrawals from deposits started to slow on Tuesday 7th.

Personal deposits (Retail & Private banking) stabilised in the course of the week of 7 to 10 October (withdrawals amounted to 0.7bn), while withdrawals by institutions and companies (wholesale funding) continued and amounted to 6.6bn.

**277.** In the two weeks to 10 October Fortis Bank lost deposit volume (retail and wholesale) of around 40bn (or 25% of total volume). The impact of the disappearance of the Dutch activities from the equation (approximately 15bn) has already been mentioned (see no. 163 above).

**278.** In view of the above factors, the emergency advances were markedly reduced:

- a) the marginal lending facilities with the central banks were no longer used
- b) the ELA of 7bn granted by DNB was not renewed after 7 October
- c) the ELA granted by the BNB was sharply reduced and then cancelled on 10 October. The ELA fluctuated between 6 and 12.7bn in the course of the week, compared with an average of 44.5bn in the previous week
- d) The ELA in fact ceased to be renewed as soon as BNP Paribas managed to raise dollar funding to meet the requirements of Fortis Bank. Dollars were hard to find in the market. The initial funding secured by BNP Paribas on the Monday was mainly in euros and only secondarily in dollars.

**279.** It is clear that without the important complementary funding from BNP Paribas in the course of the week of 6 to 10 October, the emergency credit lines (ELA) would have had to be maintained from day to day, because the cash inflow (€50bn) resulting from the divestment to the Dutch State was insufficient to restore the Fortis Bank's liquidity.

## **§ 5.2. Performance of the bank's solvency and liquidity from 12 October 2008 to 12 January 2009**

### **§ 5.2.1 Solvency**

280. The management (see press release of 22 January 2009) confirms that Fortis Bank had a Tier 1 core ratio of approximately 10% at the end of 2008.

At this stage of the report we have been unable to analyse the performance of solvency in the fourth quarter. We will come back to this in the definitive report.

### **§ 5.2.2. Liquidity**

281. As regards the performance of liquidity in the course of the period under review, we will confine ourselves here to mentioning a few essential elements.

282. Deposits relating to wholesale funding and Retail & Private Banking showed a slight erosion between 12 October and 12 January, which came down to a decrease in these deposits of approximately 6bn over the period.

283. Classic funding from the ECB (tender principle) remained high, fluctuating between 42.6 and 50.3bn. These figures are still much higher than the average funding from the ECB during the first months of the year (January to August), which amounted to 22bn.

284. Throughout the period the projected liquidity situation established at the start of each day showed a deficit that had to be made up in the course of the day. This requirement averaged 12.8bn during late October (varying between 3.7 and 26bn according to the day) and averaged 6.4bn (varying between 1.5 and 12.7bn according to the day) between 1 November and 12 January.

285. Liquidity during the period was influenced particularly by the conversion of the long-term debt of Fortis Bank Netherlands owed to Fortis Bank into short-term debt for an amount of 16m, namely:

- a) the sum of 6bn was repaid in cash on 21 October, which had a direct effect on liquidity
- b) the sum of 10bn was converted into long-term bonds issued by the Dutch State on 26 November, and this increased the stock of collateral that the ECB considers eligible (the long-term credit that Fortis Bank advanced to its subsidiary Fortis Bank Netherlands was not considered eligible collateral by

the ECB) and consequently made it possible to obtain additional funding from the ECB.

- 286.** The funding extended by BNP Paribas was very important throughout the period under review (October to January).

This funding fluctuated between 19.6 and 34.9bn between 13 October and 3 December.

Subsequently, between 3 December and 12 January, the funding amounted to 2.3 tot 11.9bn.

BNP Paribas provided the majority of the funding in the period under review. It represents more than 80% on average of the unsecured interbank market.

It should be emphasised that this funding declined considerably in December and even more so in January.

- 287.** The support of BNP Paribas from 6 October onwards was provided on normal market terms and conditions (at arm's length) and these terms and conditions were not modified subsequent to the date of the judgement of the Court of Appeal.

- 288.** As was the case in the week of 6 to 10 October (see no.299 above), it is evident that had not BNP Paribas maintained its financial support, Fortis Bank would have had to request the National Bank of Belgium, between 12 October and 12 January, and at least in October and November, to continue its emergency credit lines (*marginal lending facilities* or ELA).

In other words, despite the repayment by Fortis Bank Netherlands of its long-term debt of 16bn, the liquidity situation remained difficult in October and November 2008.

- 289.** The situation improved appreciably in January 2009 and the need for BNP Paribas's support declined considerably.

For the sake of clarity, it should also be stressed that we only looked at movements on the liability side of the balance sheet when assessing the performance of funding and liquidity requirements and their components.

Asset movements will naturally also affect the funding requirements.

Assets, according to the information in our possession, shrank by approximately 20bn in the course of the final quarter of 2008

## **Chapter 6 Conclusions**

290. The mission entrusted to us by the Court of Appeal consists, at the present preliminary stage of the report, mainly of (i) assessing the financial terms and conditions of the transactions agreed by the board of directors of Fortis Holding on 3, 5 and 6 October (giving our opinion) and (ii) attempting to come up with possible solutions.

### **§ 6.1. Our assessment of the financial terms and conditions of the transactions**

291. Given

- a) the evident inability of Fortis Bank to continue to function at end September / beginning October 2008
- b) the absolute necessity to protect Fortis's customers, the Belgian financial system and the Belgian economy
- c) the uncertainties and the urgent situation at that moment

we are of the opinion that the decisions taken by the board(s) of directors of Fortis, based on agreements concluded as a result of negotiations between the Belgian Government and various other parties, can be considered logical and reasonable and that they are not detrimental to the corporate interest of the companies of the group, including Fortis Holding and Fortis Bank.

292. In the course of the first weekend (27 and 28 September) Fortis Bank was in a virtual state of cessation of payments, which created serious liquidity problems for Fortis Holding.

As regards the second weekend (4 and 5 October), we are likewise of the opinion that Fortis Bank remained in a virtual state of cessation of payments, since it was no longer capable of meeting its commitments on the morning of Monday 6 October. That was only possible thanks to the joint intervention of the NBB and BNP Paribas.

The intervention of the Belgian State was thus absolutely necessary and as soon as the State had intervened (the Belgian State, through the SFPI, invested 14.9bn), it is logical that it opted for the solution that seemed most appropriate to (i) assure the financial stability of the country, (ii) safeguard the coherent management of the public debt and (iii) protect the long-term future of Fortis Bank due to the link-up with a major international bank.

## **§ 6.2. Lines of thought and recommendations**

### **a) General**

293. It should first and foremost be emphasised that the board of directors of Fortis Holding had absolutely no leeway to renegotiate any significant element of the concluded agreements. Only the Belgian State had the means to do this.

We wish to stress that the rejection of the transactions of 3, 5 and 6 October and the consequent agreements would have been a bad decision in our eyes, since there was no really credible alternative. Such alternative could only be considered with the collaboration of the Belgian State. To make matters clear, we must state that Fortis Holding does not today have the resources to come up with any other solution.

294. We are also of the opinion that a distinction should be made between the divestment of the Dutch activities on the one hand and the transfers to BNP Paribas on the other.

295. In accordance with our conclusions on the price obtained for the divestment of the Dutch subsidiaries (see no.177 above), we consider that any renegotiation of particular aspects of the agreements with the Dutch authorities is unnecessary. It is naturally not for us to rule this out.

We feel, however, obliged to stress that a return of Fortis Bank Netherlands to Fortis Bank does not appear to be realistic, since the funding of the activities of Fortis Bank Netherlands, amounting to approximately 60bn, by Fortis Bank (with or without the help of the Belgian State) would be extremely delicate and would risk creating a new crisis of confidence in Fortis Holding.

We do, however, think that the application of the conditions for the conversion of the MCS bonds should be scrutinised with the Dutch authorities in order to ensure that identical interpretations. We have already explained this (see nos. 181 and 258 above).

296. As for the transactions agreed on 5 and 6 October, we propose analysing the hypotheses that are the most conceivable.

They are the following:

- 1) maintaining 25.1% to 50.1% of the shares of Fortis Insurance Belgium in Fortis Holding and the SFPI's contribution of 25.1% of the shares of Fortis Bank in Fortis Holding
- 2) holding company becomes stand-alone
- 3) bank and insurance become stand-alone

We believe that the first hypothesis is the most appropriate.

**297.** For each of the hypotheses, we shall attempt to define Fortis Holding's financial requirements for achieving the respective solutions.

b) a stake in Fortis Insurance Belgium

**298.** The first hypothesis can be summarised as follows:

- a) the link-up with BNP Paribas continues and the SPV is formed
- b) Fortis Holding retains 25.1% up to a maximum of 50.1% of Fortis Insurance Belgium
- c) The SFPI transfers its 25.01% stake in Fortis Bank to Fortis Holding by way of a capital increase

We estimate that the financial requirements of Fortis Holding according to this hypothesis are in the range of 1.5bn to 2.8bn, depending on the shareholding retained in Fortis Insurance Belgium (25.1% to 50.1%).

We think that this liquidity should be sought first and foremost by maintaining the contract related to the CASHES transaction since, as we have stressed in the report (see no.231 above), the operative clauses on this transaction are not equitable.

Although BNP Paribas paid a relatively reasonable multiple (80%) for the net assets, given the circumstances of early October, it must also be stressed that BNP Paribas (i) applied considerable adjustments to the equity of the bank and (ii) was able to eliminate a significant part of the risks on structured products. Consequently, it seems to us reasonable that BNP Paribas accepts a review of the CASHES transaction or its stake in the SPV, or a combination of both.

**300.** We have formulated in this report three ways to modify the CASHES transaction (see no.234 above). We ask the reader to refer to the relevant passages

**301.** As regards the stake of BNP Paribas in SPV, this could be enlarged by 15%, for example, or even 20%.

Another solution would be for BNP Paribas to extend a 'non recourse' loan, as the SFPI does at the moment, for an amount of 1bn, say.

**302.** Another way to improve Fortis Holding's situation would be to change the destination of the potential gain linked to the financial instruments guaranteed by the Dutch State (see nos. 222 and 237 above). We are of the opinion that it is fairly logical that this gain should accrue to Fortis Holding since the document signed by the Dutch State and Fortis Bank on 3 October was negotiated by representatives of Fortis Holding (at that time majority shareholder of Fortis Bank) and the Dutch State.

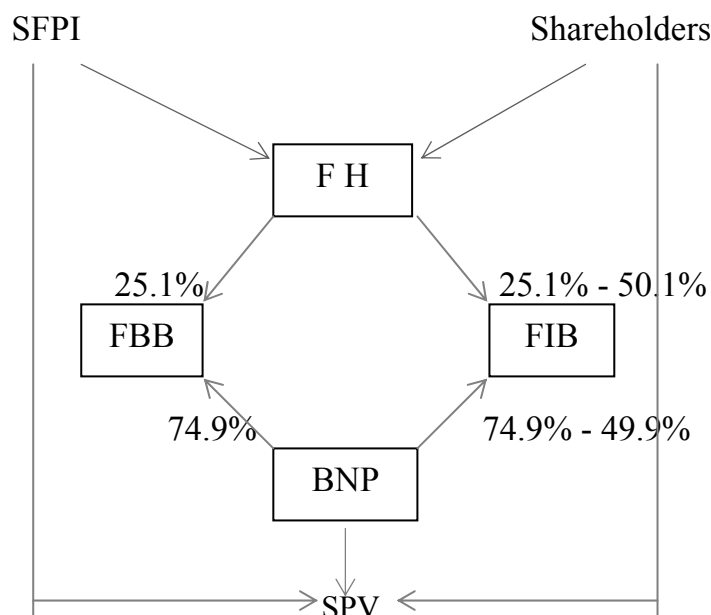
The size of this potential gain is very difficult to estimate and we cannot confirm the amount of €600m quoted in the press.

**303.** Thanks to the improvement in its liquidity position, Fortis Holding would be able to sell only a stake of 74.9% (or of 49.9%) in Fortis Insurance Belgium to BNP Paribas.

Subsequently, the SFPI could transfer its 25.1% of Fortis Bank's shares to Fortis Holding as a capital increase and receive shares in Fortis Holding in exchange.

The respective proportion of the holding company's shares held by the SFPI and by private shareholders will naturally depend on the manner in which the remuneration for the SFPI's contribution of Fortis Bank shares is calculated.

The organisation chart of the group would in that case appear as follows.



**304.** In the context of the negotiations involved in such a solution, the following points must also be considered:

- a) the SFPI's transfer of its shares in BNP Paribas to Fortis Holding, for example compensated by shares to which are attached special voting rights at the general meetings of both BNP Paribas and Fortis Holding, and with special modalities for the distribution of dividend
- b) a renegotiation of certain modalities of coupon 42, or even its cancellation pure and simple

b) Holding company becomes stand-alone

**305.** The second hypothesis (the holding company becomes stand-alone) naturally necessitates the shareholders succeeding in convincing the Belgian State (i) to renounce the memorandum of understanding signed with BNP Paribas, and (ii) of the pertinence of the stand-alone hypothesis. This would be structured as follows:

1. the SFPI transfers 100% of its Fortis Bank shares to Fortis Holding
2. the SFPI and possibly the shareholders underwrite a capital increase of approximately 2.5bn by Fortis Holding in order to facilitate the funding of the SPV, to retain 100% of Fortis Insurance Belgium, and to possess the necessary resources to develop subsidiaries
3. the SPV, which owns 10.4bn in structured assets, is retained and shareholding and funding are divided between Fortis Holding and the SFPI.

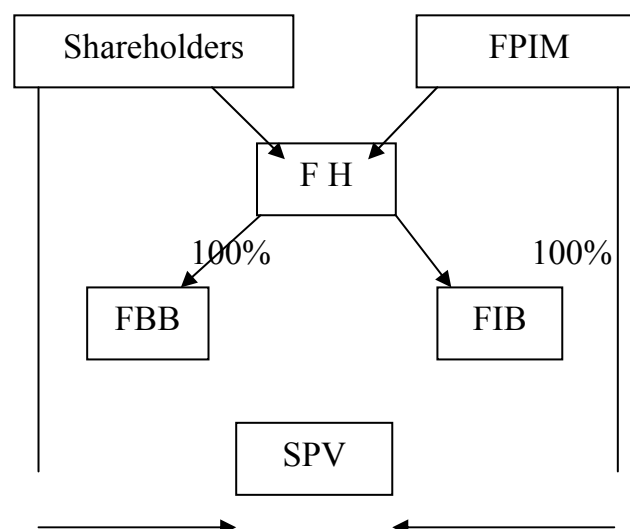
**306.** In this hypothesis Fortis Holding no longer possesses a buffer (i) to successfully conclude investment projects, (ii) to cope with any additional funding requirements of the SPV, related to the trend of the dollar and the pound sterling and (iii) for its operating costs.

This buffer could be found in the repayment by Fortis Bank to Fortis Holding (via Fortis Brussels) of a loan of 1.1bn (see article 4.9 of the memorandum of understanding concluded with BNP Paribas). This repayment requires the approval of the regulatory authorities.

**307.** It will be noted that the share purchase agreement, concluded between the SFPI and Fortis Holding, contains specific operative clauses on the setting up of the SPV assuming that the BNP Paribas memorandum of understanding is not finalised. It is unnecessary to provide all the details here.

**308.** The valuation of the various companies in these transactions and the level of the participation (shareholding and funding) of the SFPI in the SPV must naturally be negotiated. The value of the companies as calculated at end September / beginning October would naturally constitute a logical basis for negotiation.

**309.** In this hypothesis, the structure appears as follows:



c) Operating companies become stand-alone

310. Another possibility (third hypothesis) concerning a stand-alone structure would be the retention by the SFPI of its 100% stake in Fortis Bank and the acquisition by the SFPI of 100% of Fortis Insurance Belgium.

In this hypothesis, Fortis Holding remains in the position it would be in if the transaction with BNP Paribas did not go ahead as foreseen in the memorandum of understanding.

This alternative does not seem interesting because it creates no value for Fortis Holding and requires additional investment by the Belgian State.

#### d) Our opinion

311. Of the three possible hypotheses, we think the most reasonable and the most appropriate is the first (BNP Paribas acquires a 75% stake in the banking and insurance activity).

BNP Paribas is a sound partner that makes it possible to contemplate a major undertaking in the financial industry without massive investment by the Belgian State.

At the end of our preliminary activities we are even more convinced that a massive intervention by the State to rescue one or more banks is an extremely delicate operation that on the one hand, certainly allows an important decision centre to remain in the country, but which, on the other hand, may not meet with the hoped for success as far as the financial industry is concerned and may also prove very disadvantageous to the national economy in general.

It is not irrelevant to note that even though the situation in each country is always specific, Ireland, the first 'small' country to grant significant state guarantees to several banks, has been penalised heavily since October. Within just a few months, the country has had to raise interest rates on government bonds because the public began to doubt its ability to repay its debt. At the time of writing this report, we have learnt that Ireland is about to abandon part of the plan it announced in October because the national situation is currently so problematic. It should also be stressed that Ireland's public debt amounted to just under 25% of its gross domestic product at the end of 2007.

In this complex economic debate, the amount of public debt relative to gross domestic product and the size of banking institutions relative to the size of the country and the size of the central bank are the determinant factors.

\*\*\*\*\*

Produced in Brussels on 26 January 2009

Guy Hormans

Walter Van Gerven

Remi Vermeiren

André Killesse

The panel of experts advises that Roland Gillet is unable to sign this report for reasons connected with his official responsibilities as a professor in France.

## **Appendix 1: Abbreviations**

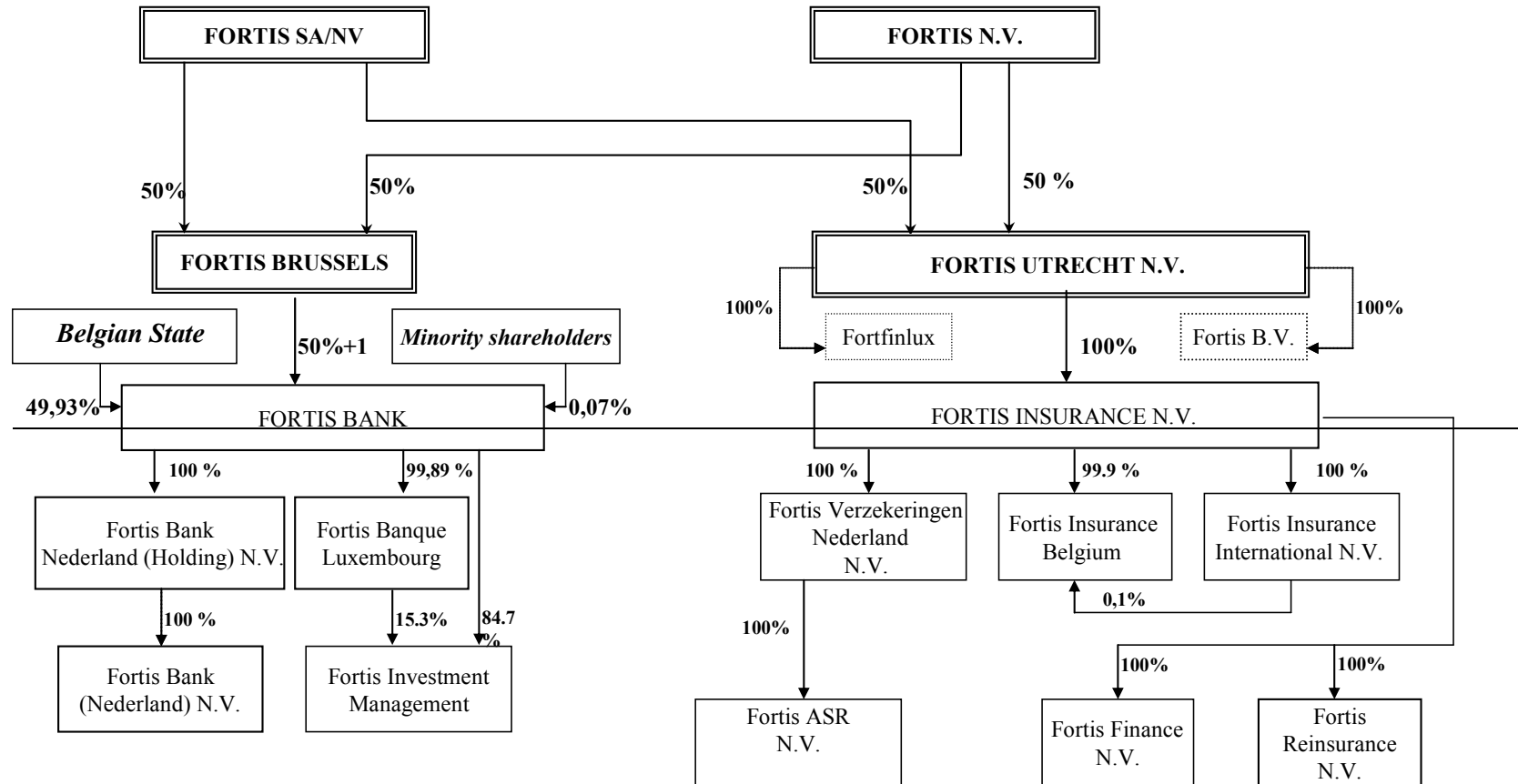
- AFM: Netherlands Authority for the Financial Markets
- ECB: European Central Bank
- NBB: National Bank of Belgium
- BIS: Bank for International Settlements
- CBFA: Banking Finance and Insurance Commission
- CDO: Collateralised Debt Obligation
- CDS: Credit Default Swap
- CEO: Chief Executive Officer
- DNB: De Nederlandsche Bank
- ELA: Emergency Liquidity Assistance
- FED: Federal Reserve of the United States
- KUL: Katholieke Universiteit Leuven
- bn: billion
- SPV: special purpose vehicle
- SFPI: Federal Participation and Investment Company
- UCL: Université Catholique de Louvain
- ULB: Université Libre de Bruxelles

## **Appendix 2: people interviewed**

1. Steering Committee: Luc COENE, Wim COUMANS, Jean HILGERS, Françoise MASAI, Peter PRAET, Pierre WUNSCH.
2. Herman DAEMS, adviser to the Belgian Government
3. BNB: Guy QUADEN, Governor, and his staff
4. CBFA: Jean-Paul SERVAIS, Chairman, Rudi BONTE, member of the Management Committee, and their staff
5. Jan-Michiel HESSELS, Vice Chairman and Acting Chairman of the Board of Directors of Fortis
6. Philippe BODSON, member of the Board of Directors of Fortis
7. Karel DE BOECK, CEO of Fortis
8. Filip DIERCKX, Chairman of the Executive Board of Fortis Bank
9. Supervisors of the services involved at Fortis Holding and Fortis Bank
10. BNP Paribas: Mr De VARENE, international head of Corporate Finance, and his staff
11. Morgan Stanley: Dominique LANCKSWERT, Managing Director, and his staff
12. DEMINOR: Pierre NOTHOMB, Managing Director
13. VEB: Messrs SLAGTER and LEMMERS
14. Messrs MODRIKAMEN, DEHAENE, BONHIVERS and ARNAUDTS, counsel to the appellants
15. Messrs NELISSEN GRADE, LEFEVRE, POTTIER and COLIN Linklaters, counsel to Fortis
16. Messrs MEYERS and RUZETTE, counsel to BNP Paribas
17. Messrs DIEUX, TILQUIN, WILLERMAIN, SIMONART and BOULARBAH, counsel to the SFPI
18. Mr D'HAENENS, counsel to a shareholder
19. Gert NOELS, Chief Economist
20. Paul DE GRAUWE, Professor of Economics at the KUL
21. Koen SCHOORS, Professor of Economics at Ghent University

**Appendix 3: organisation chart of the Fortis group on 29 September 2008**

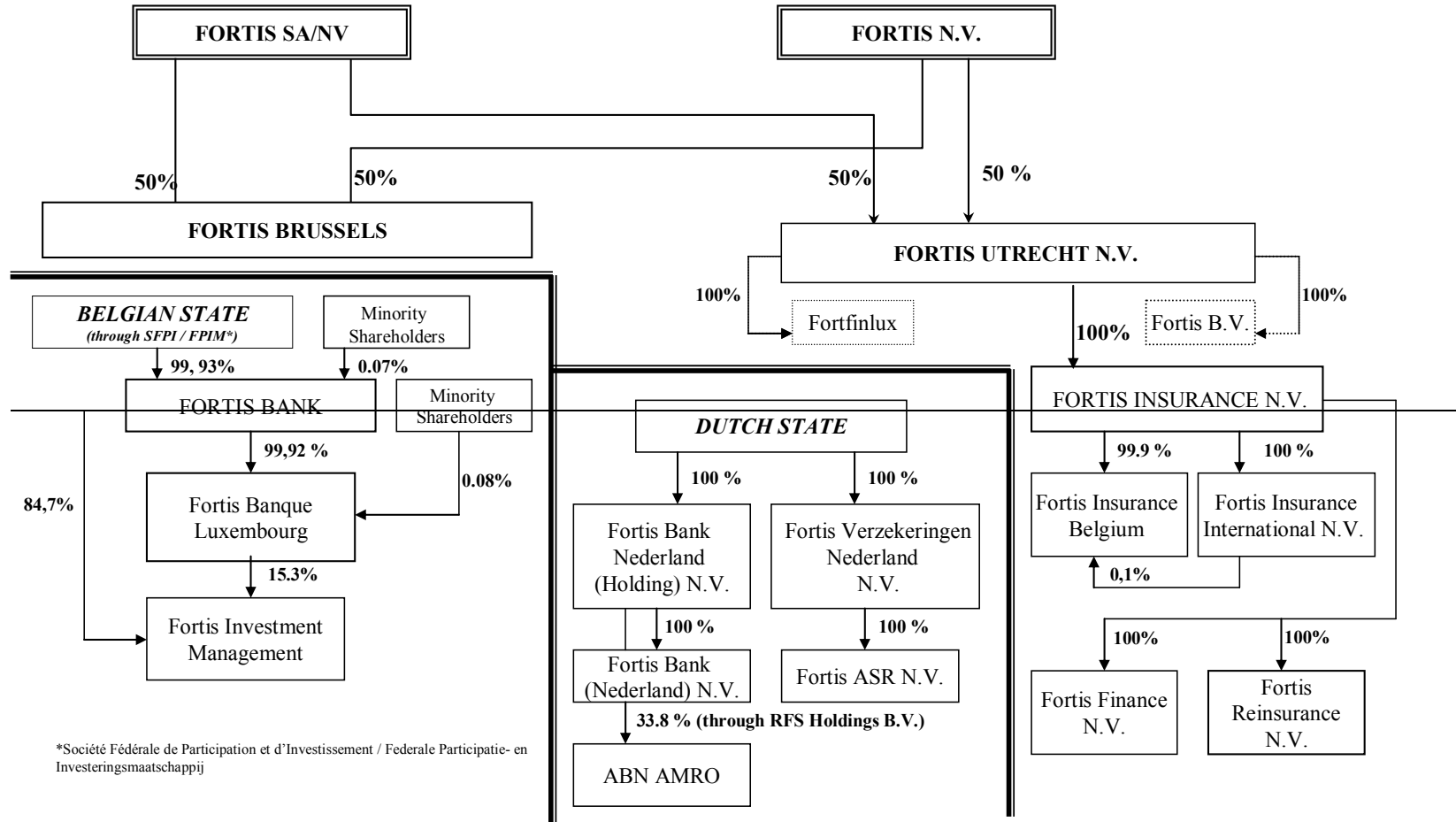
**GLOBAL STRUCTURE FORTIS**



29 September 2008

**Appendix 4: organisation chart of the Fortis group 6 October 2008**

**SIMPLIFIED GLOBAL STRUCTURE FORTIS**



6 October 2008