

## **Covid-19 bailouts, then what?**

There are growing clamours to attach all manner of terms and conditions to Covid-19 induced government bailout packages for companies across different industries. Adding covenants for this, that, and the other and doing this on the fly will be hard for stretched finance ministries. It could also result in overly complicated bailouts with unintended consequences.

We need to disentangle the steps that must be taken in an immediate crisis with longer term questions about how governments should use new stakes in companies over time. We are in this for the long-haul and should plan accordingly. For example, RBS was bailed out in October 2008 and the UK government is still the majority shareholder.

The only conditions that matter right now are those that ensure taxpayers don't get ripped off, while also ensuring that bailed out companies are not so indebted that it will be impossible for them to repay bailouts, restructure, and renew.

The conditions on bailed out companies should be simple: unless bailouts in the form of government low interest loans are paid off quickly or clearly can't be repaid, say within three to five years, they should convert to equity. Further, when debt is converted to equity these ownership stakes should not have lesser privileges than other share classes.

It is easy to envisage a situation where a large number of bailed out companies cannot repay their debts or restructure in the medium term. There will then be many more companies that are minority and majority government owned and these will be in both public and private markets.

This is when government needs to manage stakes in companies in a way that seeks to actively achieve broader societal objectives, as well as profitable exits from successfully restructured companies.

A key principle should be government being an active owner and doing so in a way that is consistent with government policy. In the UK this might very well be a legal obligation (see the recent court ruling on Heathrow's third runway), though it may need further clarification through the courts or through changes in legislation.

Consistency with UK government policy means consistency with the Climate Change Act (2008) and our new net zero emissions target (2019), as well as the 25 Year Environment Plan (2018) and new ambitious [plans](#) to decarbonise transport. Translating these and other very ambitious policies into active ownership in practice will become an important implementation challenge for government.

Here government can learn a lot from large institutional investors and adopt frameworks already being implemented by leading UK pension funds, such as the Brunel Pension Partnership (with c £30bn of assets), and some of the world's largest investors, such as the Norwegian Global Pension Fund (with well over \$1 trillion of assets) and Legal & General Investment Management (with c. £1 trillion assets under management).

These investors set out their expectations of investee companies, including expectations that boards are aware of environmental risks and impacts, and have strategies to manage them. They communicate their expectations to companies and require material environmental risks be incorporated into planning, risk management, and reporting. They promote, and will over time increasingly require, investee company alignment with environmental targets. They also ask companies to disclose their environmental risk exposure, impacts, and management strategies through standardised frameworks, such as the Task Force on Climate-related Financial Disclosures (TCFD). Further, these investors join collaborative engagement efforts with other investors to maximise their influence. These are all things government can require and should implement as an active owner.

Another key principle, as well as a potential legal obligation, is the proactive management of stranded asset risks across the portfolio of minority and majority owned government companies. Again, government can learn a lot from large institutional investors who are increasingly integrating environmental risk management into company and asset valuations and setting targets for reducing portfolio environmental risk.

A lesson that government can also learn is from the banking sector, who are increasingly offering sustainability-linked loans to companies. These incentivise a borrower's achievement of ambitious, predetermined sustainability performance objectives. The objectives, such as reducing energy use, also reduce credit risk. This means the lender can share some of that reduction in credit risk with the borrower, creating a win-win where the borrower secures a lower cost of capital and the lender makes more money.

Government should help to massively scale sustainability-linked loans so that companies, irrespective of whether they are bailed out or not, can use them to restructure their finances. Reducing risk for the company itself, for example by helping companies become more energy efficient, also reduces risks facing everyone, by reducing future climate impacts.

Every company is different and bespoke arrangements will need to be made for each. UK Government Investments (UKGI) is responsible for managing UK state owned companies and its job after the bailouts will increase significantly. It will almost certainly need more people and expertise, and it will need to quickly adopt best practice on active ownership and stranded asset risk management from within the UK and internationally. This job of building capacity and developing plans for implementation at UKGI can start today and probably has started already.

By being an active owner consistent with its own policies, by proactively managing risks across a new portfolio of government assets, and by accelerating the availability of financial products that can help all companies successfully transition, we can use a temporary increase in government involvement in the economy to make our economies more resilient, productive, and sustainable for the long term.

These are not one-offs but permanent changes in practice. Forcing through requirements on firms fighting for survival today is not how we will successfully reshape companies and industries for the better over time. We need a longer-term

view of the forthcoming bailouts as they could be a semi-permanent feature of our economy for decades to come.

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**This appeared first at BusinessGreen.com on 31st March 2020:**  
<https://www.businessgreen.com/opinion/4013308/covid-19-bailouts>