Reputation Review 2009

Oxford METRICA

REPUTATION REVIEW

OXFORD METRICA

CONTENTS

INSTITUTIONS FALTER

BOARDS & BALANCE SHEETS

"CORPORATE REPUTATIONS ARE UNDER CONSIDERABLE ATTACK, PARTICULARLY IN THE FINANCIAL SECTOR. THE RESEARCH EVIDENCE POINTS TO AN OPEN AND DIRECT DIALOGUE BY CEOS. THIS IS NO TIME TO HUNKER DOWN AND IGNORE THE PROBLEM. SUCH AN APPROACH IS COSTING SHAREHOLDERS VALUE AND THE BESIEGED CEOS THEIR JOBS" *– Oxford Metrica Chairman Dr Rory Knight*

The reputation event landscape continues to be dominated by the subprime mortgage market crisis. This issue of the Reputation Review provides an update of the fallout across the financial sector and focuses on the firm-specific impact on two global giants, UBS and AIG.

The table below lists the twenty financial institutions with the largest subprime-related asset writedowns and credit losses. Also shown is the capital raised by these firms to bolster their balance sheets and restore their ability to lend.

Firm	Writedown & Loss US$bn	Capital Raised US$bn
Citigroup	42.9	44.1
UBS	38.2	28.6
Merrill Lynch	37.1	17.9
AIG	20.6	20.0
HSBC	19.5	3.5
IKB Deutsche	15.9	13.1
Royal Bank of Scotland	15.2	24.0
Bank of America	15.1	20.7
Morgan Stanley	14.1	5.6
JPMorgan Chase	9.8	7.8
Credit Suisse	9.6	1.5
Washington Mutual	9.1	12.1
Credit Agricole	8.3	9.1
Lehman Brothers	8.2	13.9
Deutsche Bank	7.6	3.2
Wachovia	7.0	10.5
HBOS	7.0	7.8
Bayerische Landesbank	6.7	-
Fortis	6.6	1.0
Canadian Imperial	6.5	2.9
TOTAL	**305.0**	**247.3**

Source: Bloomberg, 18 June 2008

The combined writedown for the twenty institutions worst hit is over US$300 billion. Almost US$250 billion of capital has been raised successfully in response. As the Q2 reporting season approaches, it is unlikely that these will prove to be the final numbers.

As well as the balance sheets, the Boards of Directors have been hit hard. In other sectors too, it is rare for an incumbent Chief Executive to retain his or her position amid such a reputation crisis. The table on the right lists some prominent leadership casualties from the subprime crisis; twelve of the twenty firms in the previous table are represented.

The list is sobering and includes some of the most highly respected names in the financial services industry. The departures serve as a stark reminder of the inextricability of a firm's reputation and that of its leader.

Date	Executive	Position	Firm
22-Feb-07	Bobby Mehta	CEO	HSBC, North America
22-Feb-07	Sandy Derickson	President & CEO	HSBC Bank USA
5-Jul-07	Peter Wuffli	CEO	UBS
30-Jul-07	Stefan Ortseifen	CEO	IKB Deutsche
5-Aug-07	Warren Spector	co-President	Bear Stearns
30-Oct-07	Stanley O'Neal	Chairman & CEO	Merrill Lynch
4-Nov-07	Charles Prince	Chairman & CEO	Citigroup
29-Nov-07	Zoe Cruz	co-President	Morgan Stanley
3-Jan-08	William Hunt	CEO	State St Global Advisors
9-Jan-08	James Cayne	CEO	Bear Stearns
1-Mar-08	Werner Schmidt	CEO	Bayerische Landesbank
1-Apr-08	Marcel Ospel	Chairman	UBS
2-Jun-08	Kennedy Thompson	CEO	Wachovia Corp
2-Jun-08	Kerry Killinger	Chairman	Washington Mutual
12-Jun-08	Joseph Gregory	President & COO	Lehman Brothers
15-Jun-08	Martin Sullivan	CEO	AIG
11-Jul-08	Jean-Paul Votron	CEO	Fortis

CEO PETER WUFFLI'S SUDDEN DEPARTURE SIGNALLED UNSETTLED TIMES AHEAD FOR THE BANK

EXPOSURES AT UBS

EXPANDING BUSINESS & RISK

On 3rd May 2007, Swiss bank UBS closed its Dillon Read Capital Management hedge fund unit, reporting CHF150 million (US$124 million) in predominantly subprime losses for the first quarter. Driving the losses were the hedge fund's holdings of speculative second mortgages, known as 'second liens', originated by lenders such as New Century Financial (reported in our last issue of Reputation Review). The Dillon Read division was launched on 30th June 2005. Restructuring costs to reabsorb the business were US$314 million in the second quarter when Dillon Read's losses widened to CHF230 million (US$188 million).

On 6th July, CEO Peter Wuffli's sudden departure signalled unsettled times ahead for the bank and the possibility of further losses. On 1st October, investors' fears were realised as CHF4.4 billion (US$3.8 billion) in writedowns were reported, along with significant management changes and 1,500 job losses (7 per cent of the investment banking staff). The writedowns were on trading positions in US subprime residential mortgage-backed securities. However, the bank sought to draw a line under its recent losses and said that whilst it expected further writedowns, "numbers like US$8 billion are not expected".

In the event, the writedown reported on 10th December was US$10 billion. To restore its capital base and crucial Tier One capital ratio, the bank also announced a CHF13 billion (US$11.5 billion) capital injection from the Singapore government (CHF11 billion) and an undisclosed Middle Eastern investor (CHF2 billion). Full-year 2007 results revealed losses related to the US residential mortgage market of US$18.7 billion.

On 1st April 2008, UBS announced an additional US$19 billion of writedowns on US real estate and related structured credit positions, the resignation of Chairman Marcel Ospel and a fully underwritten rights issue of CHF15 billion to strengthen the bank's Tier One capital.

Two days later, former CEO Luqman Arnold's investment group, Olivant, wrote a letter as an activist investor (controlling over 0.7 per cent of shares) to the non-executive Vice-Chairman of UBS. Arnold expressed concern over,

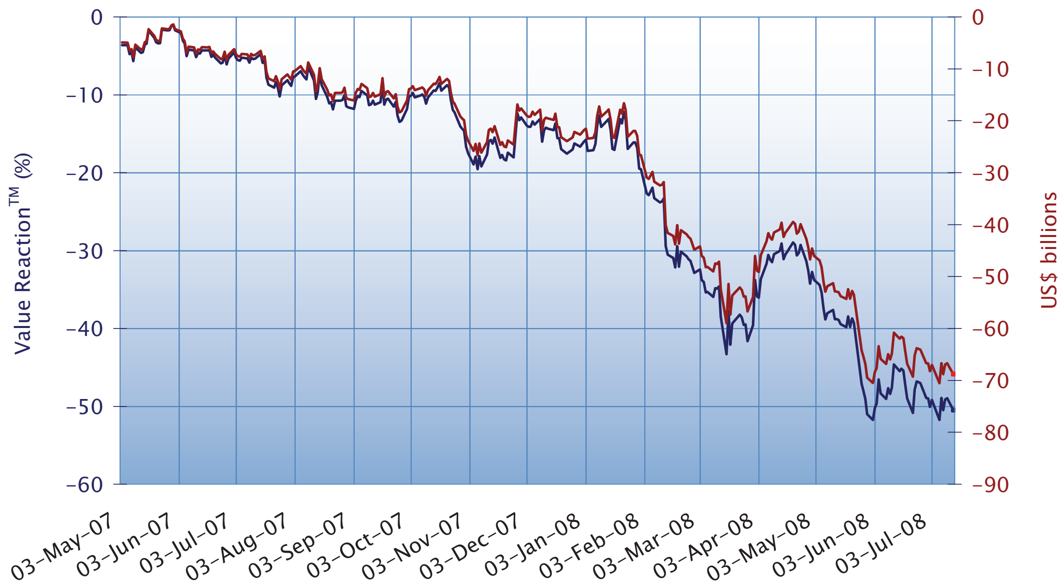
> *"the developments at UBS and their impact on the reputation and share price of UBS" and his stated purpose was, "to set out a clear programme for rebuilding UBS's shareholder value and reputation".*

The proposed programme centred on governance and structural changes to UBS. Ospel replaced Arnold with Wuffli as CEO on 18th December 2001 over differences in governance and strategic direction.

On 13th June, UBS completed its CHF15.97 billion (US$15.2 billion) rights offering successfully. The next graph shows the performance of UBS' share price and the MSCI Financials index since the announced closure of Dillon Read Capital Management.

THE VALUE IMPACT

Risk-adjusting the returns and removing the sector-wide movements from UBS' performance produces a clearer picture of the value impact from the subprime crisis on UBS. This is provided in the following graph, where a Value Reaction™ of zero indicates a performance in line with investor expectations.



As shown, the value impact on UBS is 50 per cent, over and above the sector's overall decline, and equivalent to US$70 billion in lost value.

UBS' own retrospective analysis of its subprime losses and writedowns suggests that a risk management overhaul is required. The opportunities brought by UBS' rapid expansion into investment banking clearly brought with them additional operational and reputation risks which require diligent management. As stated by UBS Chairman Peter Kurer,

> *"We shouldn't fool ourselves. We can't pretend that there has been no reputational damage".*

It is also likely that much of UBS' own candid critique is applicable to many other financial institutions. The challenge is there for firms to embrace the management of their reputation risks alongside those operational.

AIG Accounting

CLARITY IN COMMUNICATION CRUCIAL

On 8th August 2007, American International Group (AIG) reported a fall in second-quarter revenues at its consumer finance unit that was triggered by subprime mortgage losses. Despite assurances from the insurer, investors were concerned by AIG's US$98.5 billion exposure to asset-backed securities and collateralised debt obligations (CDOs) that included residential mortgages.

Third-quarter results revealed post-tax realised losses of US$600 million which included permanent impairment to AIG's portfolio of mortgage-backed securities. The losses were not as severe, however, as the billions of dollars of writedowns announced by some of the investment banks. On 5th December, CEO Martin Sullivan sought to reassure unsettled investors that AIG's exposure to the subprime crisis was "manageable".

Fears that former CEO Maurice 'Hank' Greenberg may sell his 12 per cent stake in AIG sent the shares downwards on 18th January 2008. The decline is exacerbated on 11th February when AIG's auditors report a "material weakness" in the insurer's valuation of its credit default swap portfolio and prompt a US$4.88 billion writedown. At the end of the month, AIG reported a US$5.29 billion fourth-quarter loss - the largest in its 89-year history – stemming from a US$11.12 billion writedown related to its credit default swap portfolio. In addition, the insurer recorded a US$2.63 billion capital loss in its investment portfolio and a US$643 million charge to its Financial Products (AIGFP) unit's available-for-sale investment securities.

On 8th May, AIG reported its second record quarterly loss; US$7.81 billion. Included in the loss was a US$9.11 billion charge related to AIGFP's credit default swap portfolio. An additional US$6.09 billion loss was recorded for its investment portfolio. AIG announced plans to raise US$12.5 billion in new capital to replenish its balance sheet and, on 22nd May, reported that US$20 billion had been raised successfully. The same day, a Florida pension fund filed a lawsuit against AIG for providing false reassurances over the insurer's exposure to subprime mortgage debt.

On 9th June, three major shareholders (with a combined shareholding of approximately 4 per cent) wrote to AIG's Board to express their dissatisfaction with the firm's performance; in particular, its risk controls and the damage to investor confidence. In a similar vein to Arnold's letter to UBS, the investors wrote,

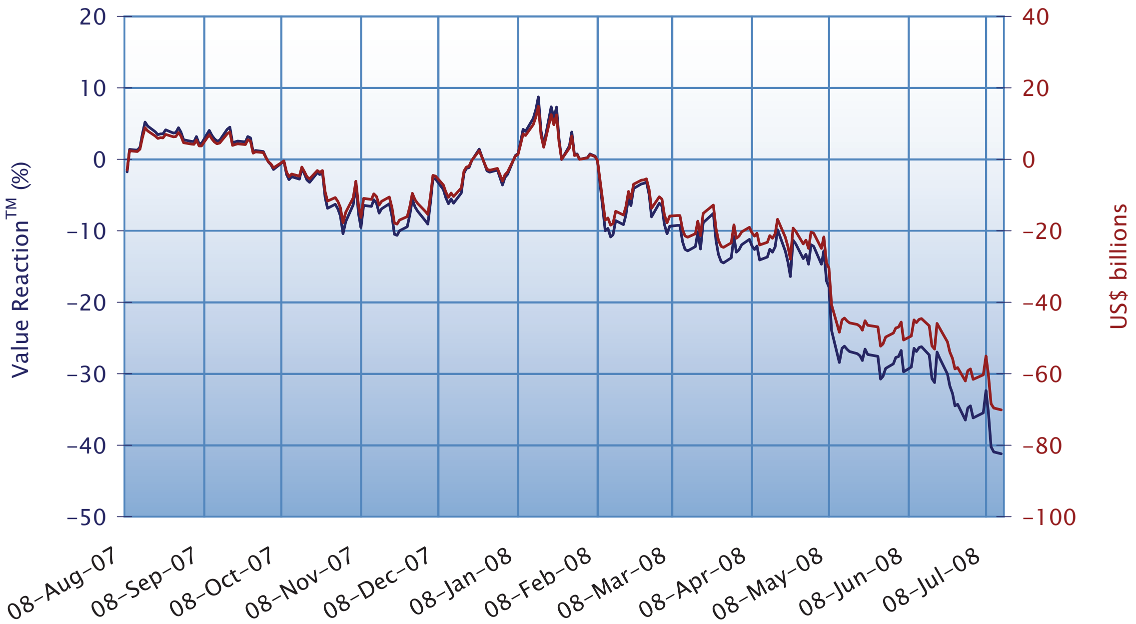
> *"We are determined to see this company take steps to prevent further erosion of its financial position and reputation".*

On 15th June, CEO Martin Sullivan resigned after 36 years at the firm. AIG named Chairman Robert Willumstad to the additional position of CEO.

The next graph shows AIG's share price performance alongside the performance of the MSCI Financials index since the first losses due to subprime were reported.

ON 15TH JUNE, CEO MARTIN SULLIVAN RESIGNED AFTER 36 YEARS AT THE FIRM

The Value Impact



The graph above shows AIG's share price, risk-adjusted and with industry effects removed.

The initial assurances provided by the firm go some way to maintaining investor confidence but, when the "material weakness" is discovered by auditors PricewaterhouseCoopers in the firm's accounting systems, the fall in value is swift. The next steep value shift occurs on the announcement of the second quarterly loss on 8th May.

Part of the challenge for Chairman and CEO Robert Willumstad will be to form a clear view of the risks carried and to communicate this effectively and candidly to investors.

The cases profiled in this issue of the Reputation Review demonstrate that even two such venerable institutions as UBS and AIG can falter. These examples highlight particularly the importance of appropriate risk measurement and control procedures, and of clear and timely communication to the markets, in maintaining and protecting corporate reputation and value.

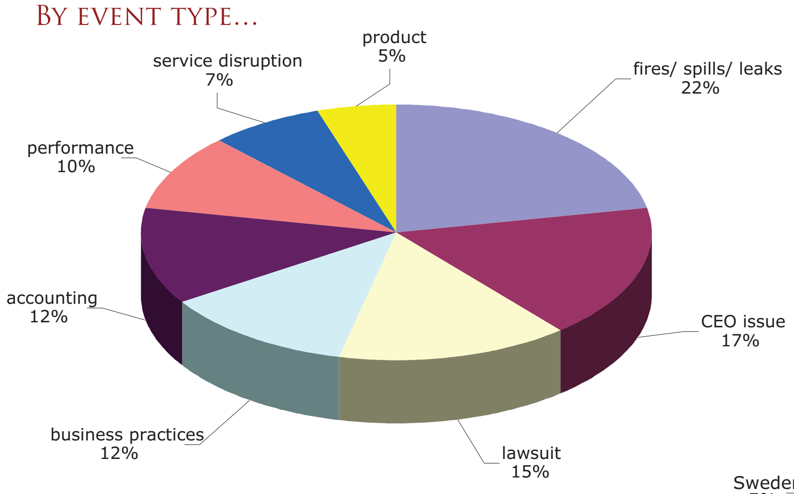
SELECTED REPUTATION EVENTS
SECOND QUARTER 2008

Date	Company	Event	Detail
1-Apr-08	EADS	business practices	French regulators allege evidence of insider trading
1-Apr-08	UBS	performance	Subprime losses spiral by £10bn in Q1 to total £19bn
1-Apr-08	Westmoreland Coal	accounting	SEC probe for accounting errors
4-Apr-08	Neste Oil	fires/ spills/ leaks	Porvoo refinery catches fire during planned maintenance outage
4-Apr-08	Deutsche Telekom	lawsuit	Class action; perceived falsehoods over 3rd IPO tranche in June, 2000
4-Apr-08	ExxonMobil	fires/ spills/ leaks	Fire at a hydrotreating unit at 150,000bpd refinery in Torrance, CA
7-Apr-08	ev3	CEO issue	Chairman/President/CEO resigns following slow integration of sales forces
8-Apr-08	Boston Beer Co	product	Recalls 550,000 cases of 12oz bottles of Samuel Adams beer; may contain glass
9-Apr-08	MoneyGram Int'l	lawsuit	Investors perceive materially false and misleading statements
14-Apr-08	Berkshire Hathaway	CEO issue	Chairman & CEO of General Re unit resigns following the convictions of 4 former GenRe executives
15-Apr-08	Nippon Oil	fires/ spills/ leaks	Fire breaks out in empty oil tank at 180,000bpd Muroran refinery
16-Apr-08	3M Co	lawsuit	Age discrimination lawsuit may become class action on behalf of 6,000 former employees
18-Apr-08	Societe Generale	CEO issue	Chairman and CEO resigns CEO role following unauthorised trading scandal
24-Apr-08	Siemens	business practices	Head of healthcare division resigns amid new revelations about bribery practices
28-Apr-08	Acces Co	accounting	Accounting irregularities found for 2005 financial year; president resigns
2-May-08	Holly Corporation	fires/ spills/ leaks	Fire on a flare line connected to alkylation processing unit; Woods Cross Refinery, Woods Cross, UT
2-May-08	Investools Inc	business practices	SEC inquiry related to presentations made by the company
8-May-08	AIG	performance	Reports biggest quarterly loss in company's history; 2008 Q1
10-May-08	Ineos	fires/ spills/ leaks	Fire breaks out after oil spilled on to piping; Grangemouth oil refinery, Scotland
20-May-08	Franklin Bank Corp	business practices	SEC probe related to lending practices; CEO resigns
21-May-08	Moody's Corp	product	Lawmakers demand investigation into mistakenly inflated ratings due to computer glitch
22-May-08	AIG	lawsuit	Florida pension fund files lawsuit against AIG & 4 top officials, including CEO, for misleading assurances
23-May-08	General Motors	service disruption	Slump in auto market and recent strike against GM and key supplier
26-May-08	Infineon Technologies	CEO issue	CEO resigns; diverging opinions on future strategic direction
27-May-08	Tata Motors	fires/ spills/ leaks	Leak in the chlorine filtration facility of the water supply system; Jamshedpur township, India
29-May-08	Qantas	service disruption	34 flights cancelled; industrial action over pay by 120 engineers, Melbourne airport
2-Jun-08	Skymark Airlines	service disruption	Cancels 10% of scheduled flights in June due to shortage of pilots
3-Jun-08	Reliance Industries	fires/ spills/ leaks	Explosion at Panna-Mukta oil and gas field, western India
3-Jun-08	Apache Energy	fires/ spills/ leaks	Explosion rips through offshore gas plant; western Australia
5-Jun-08	Crystallex Int'l Corp	CEO issue	CEO resigns over struggle to develop Las Cristinas mine in Venezuela
6-Jun-08	AIG	accounting	SEC probe into value of contracts linked to subprime mortgages
9-Jun-08	Petroplus	fires/ spills/ leaks	Valve explosion leads to fire; Antwerp, Belgium
10-Jun-08	Foster's	CEO issue	CEO resigns amid earnings downgrade writedowns on underperforming wine assets
15-Jun-08	AIG	CEO issue	CEO resigns amid historic regulatory issues and subprime writedowns
16-Jun-08	EADS	lawsuit	Lawsuit by US investors seeks class action status alleging securities fraud & insider trading
19-Jun-08	SAS	performance	Abandons plans to sell loss-making Spanair unit due to tough market
19-Jun-08	Lehman Brothers	lawsuit	Lawsuit by US investors alleging misleading statements and withholding material information

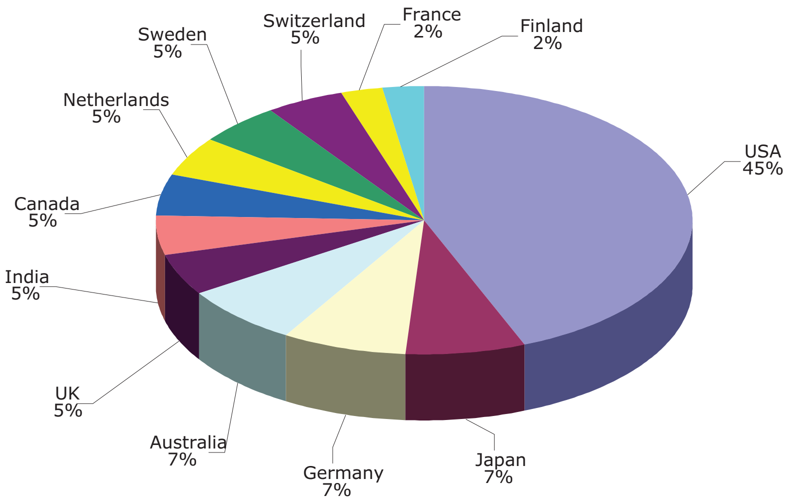
Date	Company	Event	Detail
20-Jun-08	Nortel Networks	accounting	Former CEO faces criminal charges over past accounting scandal
24-Jun-08	Futuris Corp	performance	Shock profit downgrade; reduced demand & higher interest rates
26-Jun-08	SAS	business practices	Agrees to pay US$52m fine relating to US probe involving cargo subsidiary
27-Jun-08	MoneyGram Int'l	accounting	SEC inquiry into financial statements surrounding MoneyGram's investments; CEO resigns
30-Jun-08	Taylor Wimpey	performance	Anticipates US$1.3 billion writedown in the value of its assets amid housing downturn

END NOTES

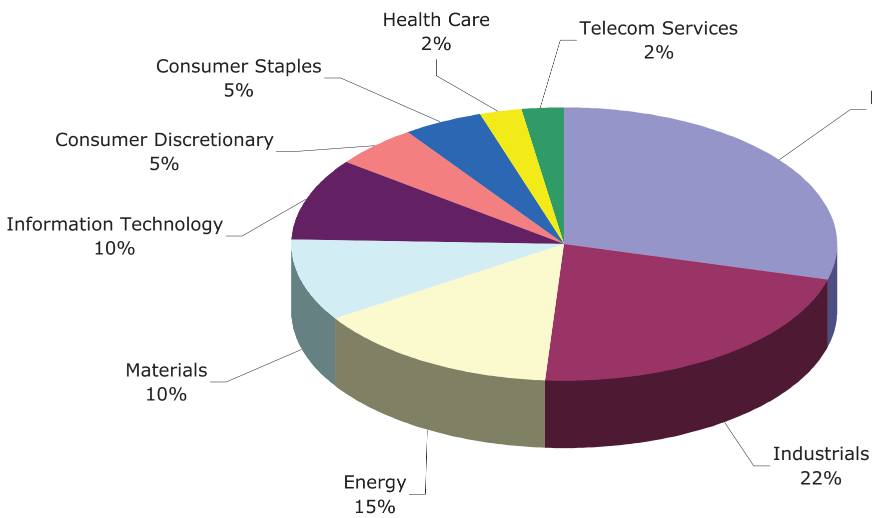
BY EVENT TYPE...



BY PARENT COUNTRY...



BY SECTOR...



OXFORD METRICA

REPUTATION REVIEW

OP ED

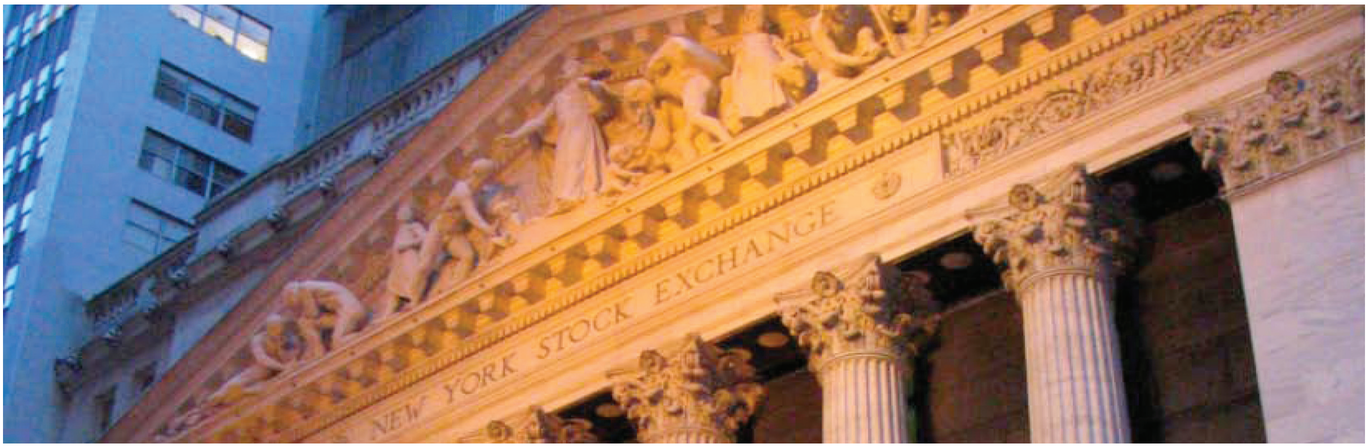
PETER HIRSCH

PARTNER AND GLOBAL AFFAIRS DIRECTOR AT PORTER NOVELLI

Twelve months into the current economic downturn, we are starting to see the pressure to tighten up the bottom line by cutting costs. Aggressive (and understandable) cost-cutting, however, brings with it a potential increase in reputation risk.

Corporations are facing extraordinary challenges brought on by cost push inflation in raw materials and transportation costs. As The Wall Street Journal recently reported, food companies are making subtle and not so subtle changes to their products in response. Hershey is substituting vegetable oil for a portion of the cocoa butter used in some of its chocolates. Spice maker McCormick & Co. is supplying food makers with cheaper Mexican oregano and shipping garlic concentrate instead of cloves. Changes like these across the spectrum will increase the reputation risk to manufacturers as consumers react to changes in flavour. It's happened before: as the Journal reports, Campbell Soup reduced the amount of meat in its chicken noodle soup in the 1990s and suffered meaningful sales declines when consumers resisted the change. We suspect it will not be long before cost cutting measures in other industries procedure their share of reputation injuries.

These economic pressures make it even more important for senior management, and Chief Executives in particular, to be vigilant in their reputation management. With careful planning, it is a time for building a bedrock of reputation resources which will strengthen the resilience of one's corporate reputation and enhance long-term shareholder value performance.



REPUTATION REVIEW

Reputation Review is a quarterly publication focusing on issues concerning corporate reputation. It is aimed primarily at Corporate Boards with the objective of keeping directors informed of the evidence of the impact of corporate reputation on the performance of the business. In short to enable directors to help build and protect their corporation's reputation as a means of creating value.
Reputation Review is published by Oxford Metrica Press.

SUBSCRIPTION

Single subscription $200 pa

Multiple (5 or more) $100 pa per subscription

4 issues per annum

HOW TO SUBSCRIBE

reputation@oxfordmetrica.com

ONLINE

http://www.reputationreview.co.uk

About Oxford Metrica

Oxford Metrica provides clients with tailored business analysis and counsel, designed and delivered to enhance the client's commercial success. Our approach is driven by commercial relevance and based on rigorous independent research. Evidence-based intelligence informs all our work.

Our proprietary databases, research methods and worldwide network of expertise is placed at the disposal of our clients in the services we provide. We support Chief Communications Officers concerned with corporate reputation. Our service is founded on pioneering research in reputation and our unique database of thousands of reputation events over thirty years.

Reputation Review is published annually by Oxford Metrica Press on developments in corporate reputation. It provides a useful overview of reputation events with commentary from leaders in the field.

www.oxfordmetrica.com