# Companies’ access to finance: a European action plan

## Executive Summary


The financial crisis continues to inflict severe disruptions on the global economy and has already led to an abrupt retrenchment of trade, investment and business activity across Europe. The current state of economic paralysis is a direct consequence of a severely deteriorated environment for corporate finance and a heightened degree of risk aversion.

Unless additional actions are taken to improve access to finance for a broad range of companies, a further escalation in the crisis could be expected in coming months as rising default risk and financial sector losses lead to a new round of financing restrictions.

This report, prepared by a group of leading experts, proposes key recommendations which are far-reaching but practical and conducive to a rapid return of self-sustaining activities by commercial banks and capital markets.

**The key messages are the following:**

- Central banks, including the European Central Bank, to engage in the outright purchase of short-term debt instruments issued by corporations;
- Governments and the European Investment Bank to increase the scope of risk-sharing guarantees offered to ease financing restrictions;
- Governments to reduce payment delays, cut administrative burdens and implement targeted fiscal measures;
- Governments, the European Commission, central banks and regulators to take initiatives to revive securitisation and credit derivative markets;
- European Commission and governments to strengthen a common approach to support commercial banks in distress, maintaining a level playing field and allowing the necessary restructuring of the banking sector to operate under market conditions.

BUSINESSEUROPE is convinced that Europe can pull itself out of this crisis, but it will need to use all its leverage and coordinate its actions, including with international partners. The proposals spelled out in this report will set the conditions for a rapid return of confidence and should be implemented urgently.



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## INTRODUCTION

The interventions of governments and central banks after the intensification of financial market tensions in September 2008 have been decisive in maintaining liquidity and reducing systemic risks in the financial system, but they have not until now restored access to, or reduced the cost of, capital for non-financial corporations.

An extreme reassessment of credit risks since the outset of the financial crisis - illustrated by the exorbitant cost of insuring corporate default risks on capital markets (see Chart 1) - continues to take its toll on companies of all sizes and across sectors.

In a deepening recession (see Chart 2), financing difficulties - deriving from malfunctioning credit channels, distressed commercial banks and a generalised increase in risk aversion - are taking critical proportions and risk intensifying further:

- Despite central banks' nominal interest rates reaching historically low levels, the real cost of financing for European companies has further increased since September 2008 and is too high to stimulate an economic recovery (see Chart 3).
- Beyond cost considerations, access to finance has virtually dried up for the more indebted companies and those considered at higher risk because of their cyclical or industry-specific exposure to the crisis.
- International trade and supply chains have been considerably disrupted by the reduced coverage and increasing price of credit insurance for both export and domestic commercial transactions.

**Chart 1**
Cost of insuring risk of default on corporate bonds or loans
Source: BUSINESSEUROPE based on European Markit iTraxx credit default swaps.

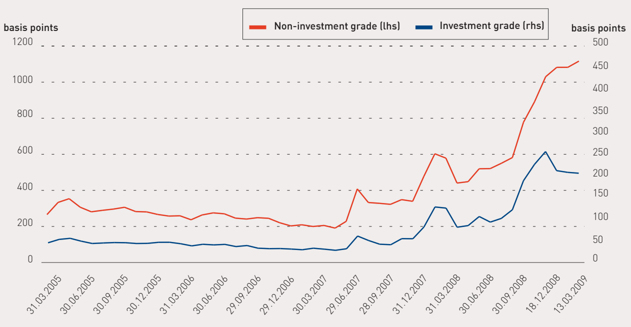
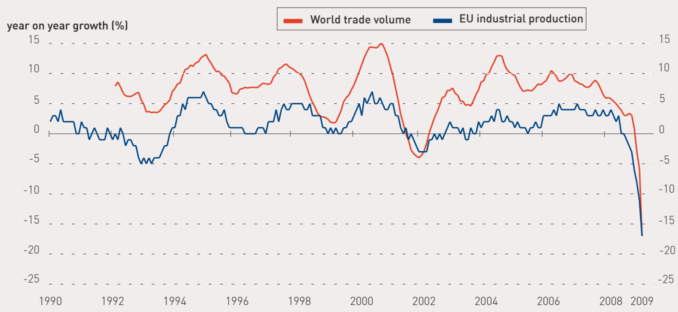



**Chart 2**
Unprecedented decline in EU industrial production and in global trade
Source: BUSINESSEUROPE based on Eurostat and CPB



- Against the background of massive state interventions in the financial sector and persistent mistrust between financial institutions, distortions in cross-border banking activities are increasingly visible in Europe (see Chart 4).

- There is today a distinct threat of a self-feeding spiral of rising defaults and growing losses in the financial sector leading to a full-blown credit crunch.

To stop a further escalation, BUSINESSEUROPE calls on European decision-makers to endorse and rapidly implement a European action plan to boost companies' access to finance and reduce its cost. The European business community considers this vital for the success of the EU recovery plan agreed in December 2008.

On the basis of proposals by an advisory taskforce[1] - composed of experts from small and large companies, commercial banks and think tanks and chaired by Jean-Paul Betbèze, Chief Economist of Crédit Agricole - BUSINESSEUROPE has endorsed recommendations aimed at providing immediate relief for companies of all sizes and sectors, keeping in mind the following objectives:

→ Maintain a level playing field at European and international level;

→ Apply market-oriented measures ensuring a rapid return to self-supporting activities by commercial banks and capital markets;

→ Be conducive to financial and macroeconomic stability in the face of unprecedented economic headwinds;

→ Make sure that exceptional policy interventions are temporary and defined with a clear exit strategy;

→ Be compatible with sustainable public finances.

**Chart 3**
Cost of financing still at high level
Note: Real cost of financing for euro-area non-financial corporations
Source: BUSINESSEUROPE based on ECB


**Chart 4**
Abrupt reduction in cross-border financing
Note: Cross-border lending between euro-area financial institutions
Source: BUSINESSEUROPE based on ECB


1 See list of members on page 15

## RECOMMENDATIONS

Having closely examined current and prospective financing difficulties facing European companies (see page 7), several concrete actions are put forward to expand the supply of credit and liquidity in the short term, to alleviate financing needs for companies and to support banks and capital markets in an effective way[2]. Exceptional and temporary policy interventions requiring a defined exit strategy are indicated with a star.

### Expanding the supply of credit and liquidity in the short-term

**1*** Central banks to engage in the outright purchase of promissory notes issued by corporations (bills of exchange or drafts, commercial paper, certificate of deposits, short-term notes, etc.). Eligibility criteria should be broad and reflect the structure of national markets as well as the need to ease the cost of financing for large and small companies alike. Asset-backed securities, in particular those backed by trade receivables and SME loans, should also be considered for direct purchase by central banks;

**2*** Governments to provide temporary guarantees for the issuance of corporate bonds, against a fee reflecting an appropriate evaluation of the emitter's credit default risk;

**3** Governments together with the European Investment Bank (EIB) and European Investment Fund (EIF) to improve and expand risk-sharing guarantees for bank lending.

### Reducing financing pressures on companies

**4*** Governments, with the support of the EIB and the EIF, to provide co-insurance and re-insurance for business-to-business credit linked to both external and domestic commercial transactions;

**5** Governments to advance administrative burden reductions, to accelerate repayment of VAT and other tax refunds and to fight late payments, in particular by public authorities and state-owned companies. The Commission's proposal for a recast of the "late payments directive" should rapidly be adopted and implemented;

**6*** Governments to implement temporary loss carry-backward provisions in the area of corporate taxation and accelerated depreciation schemes for new investments.

### Supporting innovative small and medium-sized enterprises

**7** Governments to consider tax incentives for business angels investing in SMEs as well as tax reliefs for innovation and training;

**8** Governments together with the EIB to fast-track measures to develop equity and mezzanine finance and to adopt the JEREMIE scheme supporting SMEs;

**9** European Commission to boost the size and attractiveness of the "Competitiveness and Innovation Programme" (CIP), reducing administrative hurdles and easing access to available funds.

2 See additional notes on recommendations on page 12

## Restoring confidence in key markets shaping companies' access to finance

**10** European System of Central Banks to create the necessary incentives to re-launch interbank lending by setting more dissuasive conditions on deposit facilities offered to commercial banks and by developing a central counterparty clearing process for the interbank market;

**11** European Commission, governments and central banks to establish and promote the widespread use of central clearing systems in order to restore confidence in credit default swap (CDS) markets;

**12** Regulators and issuers to restore securitisation markets by (i) increasing transparency of the underlying claims, (ii) establishing a stronger link between the originator and the securitised credit portfolio through retention of an appropriate portion of the riskiest tranches of the transaction and (iii) improving the rating process for securitised products.

## Supporting commercial banks' capacity to supply credit

**13*** European Commission and governments to strengthen a common approach to supporting commercial banks in distress, privileging targeted, proportionate, cost-effective and reversible measures such as public guarantees for hybrid or subordinated debt;

**14** European Commission to enforce EU state aid rules in order to maintain a level playing field and limit market distortions, ensuring that behavioural and restructuring conditions for publicly supported banks reflect the extent of state interventions and support credit availability;

**15** Commercial banks to be fully transparent in disclosing their precise financial situation, their exposure to impaired assets and provisions for future expected losses;

**16** Commercial banks to carefully consider the use of new financial reporting rules that allow moving certain financial instruments from trading and "available for sale" categories to loans and receivables, thereby replacing fair value accounting by amortised cost accounting.

Implementing these recommendations would improve access to finance and reduce its cost, hence throwing a lifeline to millions of European companies and freeing resources for investment to sustain competitiveness in the recovery.

# Further considerations

To instil a rapid return of confidence, the following considerations also deserve special attention by European policy makers.

→ **Fighting financial protectionism**
It is critical that Member States proceed in close collaboration to prevent competitive distortions and to fend off financial protectionism, which would lead to long-lasting damage to financial and economic integration. The European Commission, with the help of the European System of Central Banks, should establish a close monitoring of cross-border financial activities and take action in case of serious cross-border distortions.

## State aid rules and market failures

Current state aid rules provide ample opportunities for governments to support companies in the current crisis, subject to public finance constraints. The Commission should nevertheless continue to make sure that the application of EU state aid rules adequately responds to systemic market failures. For instance, while a suitable price for public guarantees to support access to finance should appropriately reflect the credit risk of the recipient borrower / debt emitter, such risk is currently being over-priced as a result of malfunctioning capital markets.

The European Commission has an important role to play in discussing with Member States how to set the right fee structure for state guarantees, accounting in particular for the illiquidity premia on the credit default swaps market.

Regarding the specific treatment of impaired assets, publicly supported "bad banks" may appear an appealing solution to restore confidence in the banking sector, but it creates enormous practical challenges, may precipitate further state interventions and has considerable effects on public finances. If implemented, such measures require close coordination among EU Member States and strict enforcement of state aid rules to avoid competitive distortions. Bank nationalisation should always be considered a last resort option.

## Financial market reforms and the recovery

With a banking sector on the mend, highly developed, well-functioning and regulated financial markets will be particularly crucial for companies' access to finance in coming years. Ongoing financial market reforms will have to strike a good balance between better regulation and stronger oversight so that room is allowed for financial innovation and for the appropriate reward of entrepreneurship.

In particular, the need to durably reinforce financial stability and better control risk should not stifle the access to finance of emerging and most innovative firms which hold the key to a sustained recovery in the EU. Investors who are willing to take risk against an appropriate remuneration should be allowed to do so. In this regard, the evaluation of investment risks and investor protection need to be reinforced, including through a better and more consistent rating process.

This might also allow the healthy segment of securitisation markets to recover after an indiscriminate collapse since the eruption of the financial crisis. These instruments often constitute a central element of corporate finance and any improvement in their liquidity will have a direct impact on banks' lending activity.

## De Larosière report offers sensible solutions

The de Larosière report on banking supervision and regulation in the EU brings forward sensible proposals to move towards stronger cross-border oversight while leaving intact national supervisory structures. It is particularly important to extend cross-border oversight to all unregulated actors and to more clearly attribute final responsibility. We strongly support the Commission in its request for implementation and urge the Council to set a clear timetable for transition towards an effective oversight structure.

## Europe in strong position to lead international discussions

Financial integration has contributed substantially to the fast pace of globalisation. International coordination of financial market reforms is essential to prevent extraordinarily high levels of financial stress and risk aversion from permanently hampering global trade and investment flows.

In the context of the G20 process, the EU should take the lead by way of example and bring our international partners to advance balanced market reforms based on principles of transparency, better risk management, enhanced cross-border oversight and internationally comparable accounting and capital requirements rules.

All the measures proposed in this report could be coordinated with our G20 partners, which would enhance their effectiveness and ensure a level playing field.

## KEY FINDINGS

The financial crisis continues to severely impair the capacity of banks and capital markets to supply credit to companies of all sizes at affordable conditions. The very notion of credit risk, which lies at the core of the financial system, has been fundamentally distorted by the collapse of complex financial markets, including credit derivatives.

A dramatic deterioration in financing conditions since September 2008 has already led to a significant retrenchment of capital spending, business activity and trade at both European and global level. In the euro area, the exposure of the corporate sector is reinforced by a relatively high level of indebtedness, with the liabilities of non-financial corporations (excluding equity) reaching around 130% of GDP compared with 90% in the US. Increased leverage in recent years stemmed from rising investment rates and the fall in risk premia in 'peripheral' countries following the inception of monetary union.

The balance sheets of commercial banks continue to be under severe strain. Financial rescue plans have not yet succeeded in restoring commercial banks' capacity to lend and intermediate on capital markets or their willingness to lend to each other. Moreover, as institutional investors remain tied up with illiquid assets of little but unknown value (so called "toxic assets"), they have sold off assets on more liquid and regulated markets, with negative repercussions for bond and equity market valuations.

In this context, financing conditions for companies have deteriorated substantially, irrespective of the source of external financing:

→ **Equity markets at standstill**
Raising capital through stock issuance or initial public offering (IPO) has become wholly unattractive, with European stock markets having lost around 5.250 billion euros in capitalisation since August 2007 (see Chart 5.1). On average, only 4 new IPOs have been raised each month on Euronext since September 2008 compared with a monthly average of almost 12 in 2006 and in 2007. Throughout last year, stock markets underperformed with, on average, 32 million euros raised per issuance compared to 70 million in 2007 and 150 million in 2006. Business angels have also become more reluctant to invest money in higher-risk projects, when their own asset base has decreased significantly with declining stock market and property values.

**Chart 5 .1**
Cost of raising equity
Source: BUSINESSEUROPE based on Eurostat

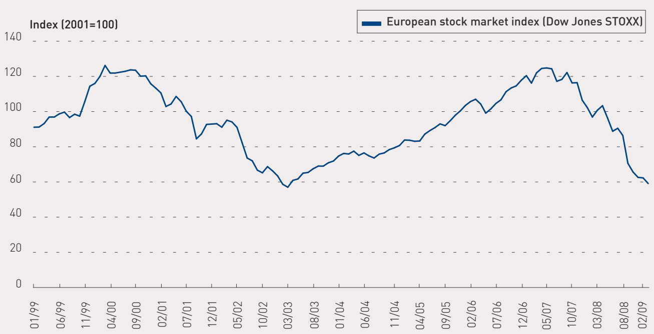
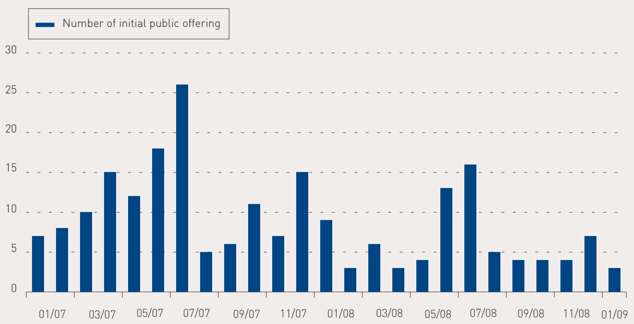



**Chart 5 .2**
Access to equity market
Source: BUSINESSEUROPE based on Euronext



## Difficult access to commercial paper and other short-term debt markets

Access to the market for commercial paper and other short-term debt instruments has remained difficult since the start of the year. Spreads for best rated companies – mirroring tensions on money markets – have come down from historically high levels but remain 85 basis points above the EONIA reference rate (see Chart 6.1). For lower-rated companies (A2/P2 and below), spreads have remained higher and access to the market mostly restricted. Issuances in the market for euro commercial paper, euro certificate of deposit and euro short-term note have decreased rapidly – by one third since August last year (see Chart 6.2).

**Chart 6.1**
Cost of issuing short-term debt
Note: Spread over EONIA Swap, 3 months maturity
Source: BUSINESSEUROPE based on ECB, Euroclear, Bloomberg

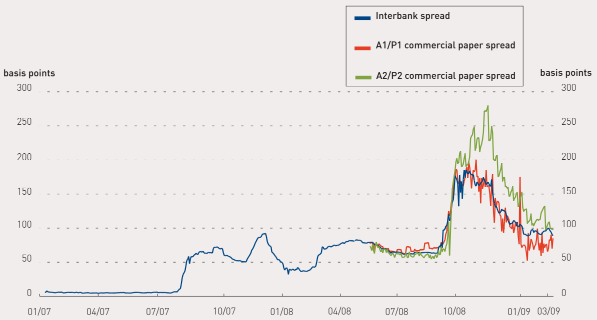
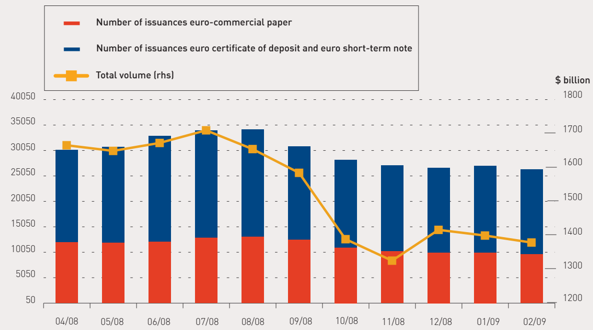



**Chart 6.2**
Access to short-term debt market
Source: BUSINESSEUROPE based on Euroclear




## Corporate bonds market closed for non-investment grade companies

Following very difficult conditions since September 2008, corporate bond issuances have picked up since the start of the year, supported by best rated companies tapping the market in high volumes. However, the cost of debt financing remains elevated. Average-rated companies (BBB) currently pay around 500 basis points above the German bund while spreads for high yield issuers reached an astounding 2,000 basis points (see Chart 7.1). The corporate bond market is closed for non-investment grade companies (below BBB-) and for investment grade companies with higher cyclical exposure (see Chart 7.2).

**Chart 7.1**
Cost of issuing corporate bonds
Note: Spread over German Bund, 5-7 years maturity
Source: BUSINESSEUROPE based on Markit

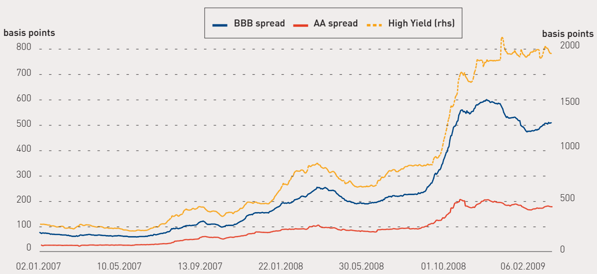
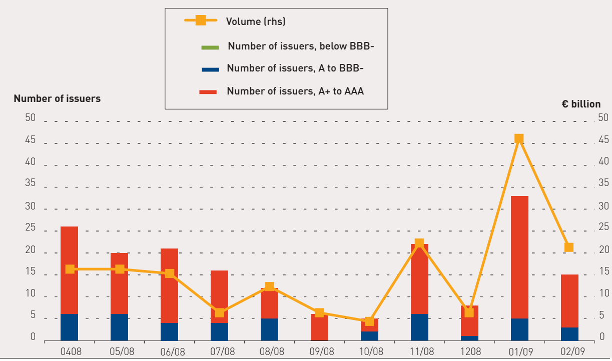



**Chart 7.2**
Access to corporate bond market
Source: BUSINESSEUROPE based on Crédit Agricole



Corporate bond yields and debt financing instruments more generally are strongly influenced by conditions on credit default swaps (CDS) markets, which have considerably worsened since September 2008 (see Chart 1). The index of investment grade borrowers' CDS is quoted at 217 basis points mid-March 2009 versus a level of 124 basis points a year earlier. This is equivalent to an increase of 93,000 euros per year to protect 10 million euros of bonds against default over five years. The index of 50 mostly junk rated borrowers' CDS – an indicator of market sentiment towards corporate credit – was quoted as high as 1093 basis points mid-March. This means it costs more than 1 million euros a year to protect 10 million euros of (non-investment grade) bonds against default over five years.

## Tighter bank lending conditions

In most EU countries, companies continue to rely predominantly on bank lending for their external financing. Lending conditions have considerably tightened in recent months and will continue to do so according to recent surveys by the ECB (see Chart 8.1) and the Bank of England. Factors behind the tightening are diverse but mainly stem from increased margins on riskier loans in the euro area, spreads on loans and non-interest charges in the UK. Credit tightening seems to affect larger companies more, although conditions have deteriorated recently for SMEs. Loans to non-financial corporations have decelerated, particularly for maturities up to a year and over 5 years (see Chart 8.1) despite evidence of sustained and even increasing credit demand in recent months (see Chart 8.2). This alludes to supply side constraints behind the deceleration in loan flows and to crowding out effects on most creditworthy companies.

The breakdown of securitisation markets also has significant consequences for the liquidity of banks of companies alike and negatively affects the supply of auto, real estate, equipment and SME loans. Following the demise of Lehman Brothers in September 2008, structured credits, asset-backed securities have been at the centre of a crisis of confidence that has affected the entire financial system.

**Chart 8.1**

Bank lending conditions for non-financial corporations in the euro area

Source: BUSINESSEUROPE based on ECB

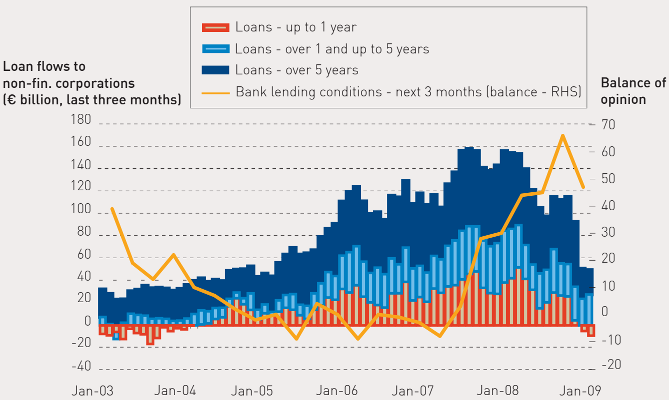
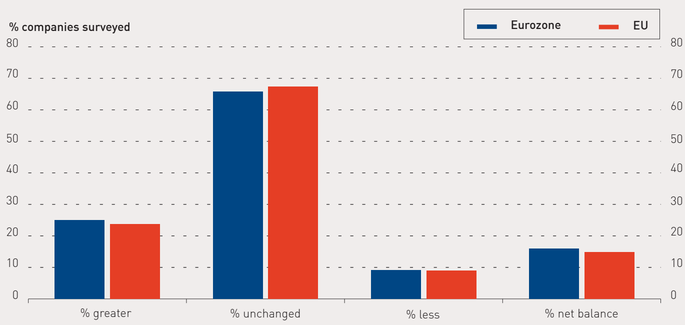



**Chart 8.2**

Sustained credit demand

Note: Demand for credit compared to 3 months ago

Source: BUSINESSEUROPE based on Markit. Credit conditions survey in manufacturing, undertaken in January 2009 among 2,000 EU companies (1,400 in euro area)



### Pressure on working capital from lack of trade credit and increasing payment delays

Short-term financing in the form of trade credit is also important, amounting on average to more than 15% of total financial assets for non-financial corporations with much higher levels reached in some Eastern and Southern European economies (see Chart 9.1). The credit-insured debt of the customer can be viewed as collateral by lending institutions and hence support bank lending. As default risks have been fundamentally reassessed in recent months, private credit insurers have cancelled their coverage on several countries and sectors and restricted their coverage on others. This represents an increasing challenge for both domestic and export-oriented businesses and is a further drain on liquidity. The situation is aggravated by increasing payment delays. Based on a sample of ten EU countries, payment delays have risen from 12.7 to 15 days from March to December 2008 (see Chart 9.2), with almost 50% of administrations paying later than the national average.

**Chart 9 .1**
Trade credit and advances for non-financial corporations
Source: BUSINESSEUROPE based on Eurostat (2007 data)

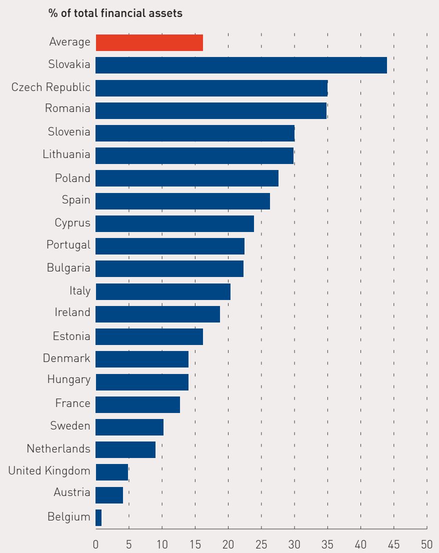
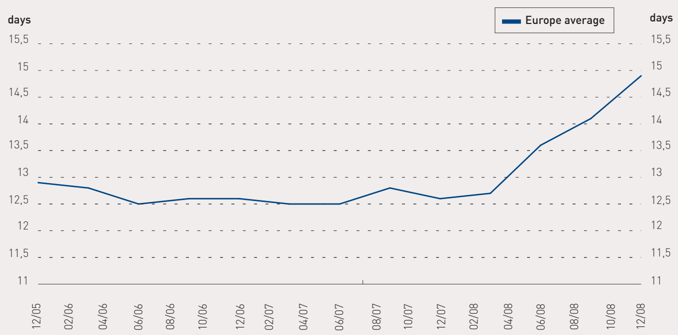



**Chart 9.2**
Payment delays
Source: BUSINESSEUROPE based on Altares 2008




### Further deterioration of credit conditions expected in coming months

The above analysis only gives a static view of the difficult financing environment in which European companies have evolved in recent months, while there are currently deepening concerns in the business community about future access to finance. For instance, it seems that the spike in corporate bond issuance in January and February 2009 has been triggered by best-rated companies seeing a temporary window of opportunity to access bond markets in spite of the high cost of issuance, fearing heightening constraints in coming months.

In this regard, high volumes of sovereign bond issuances, which are expected to double this year in Europe (reaching 1,000 billion euros), will likely contribute to important bottlenecks on capital markets and crowding-out effects for corporate debt financing.

Finally, the recession will intensify credit restrictions for a growing number of companies in coming months, with the pace of credit rating downgrades reaching its highest level in over a decade (Chart 10.1). This will lead to a self-feeding spiral of financing difficulties leading to a growing pace of corporate bankruptcies (see Chart 10.2). In turn, rising credit defaults will intensify losses in the financial sector (which according to the IMF would reach at the global level 2,200 billion dollars), lead to increased capital requirements and hence further reduce banks' capacity to lend and intermediate on capital markets.

In the face of an ongoing financial market crisis, the business community strongly believes that the most effective way to fight the recession and to set the conditions for a swift recovery is to support more directly companies' access to finance in a targeted and well coordinated way.

**Chart 10.1**
Rating drift
Note: Rating drift calculated as upgrades minus downgrades/rated issuers
Source: Credit Agricole based on Moody's

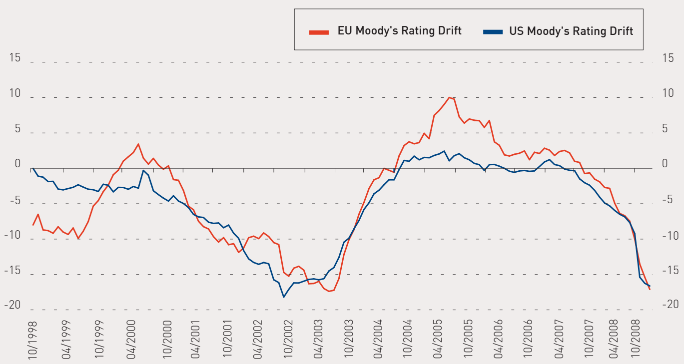
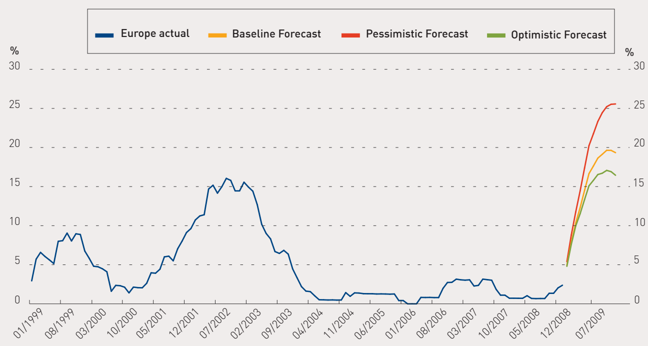



**Chart 10.2**
Credit defaults
Note: Europe 12-month speculative-grade default rate
Source: Credit Agricole



## ADDITIONAL NOTES ON RECOMMENDATIONS

### Direct purchase of short-term corporate debt by the ECB

In the ECB's case, eligibility criteria for the outright purchase of promissory notes should be consistent with its extended collateral policy and be particularly mindful of the diverse sources of short-term financing for corporations across euro area Member States. For SME financing, it would be helpful if the ECB could also directly purchase asset-backed securities, including those issued under EIF guarantee to enhance SME loans' securitisation. This would improve banks' refinancing capacities, would support bank lending to SMEs and help restore securitisation markets. An increase in the capital base of the ECB might be considered to accommodate an heightened exposure to credit default risks without having to set up a complex system of government guarantees to be coordinated between the 16 euro-area Member States. The exit strategy from non-standard monetary policies should be communicated in a clear, transparent and timely manner.

### Public guarantees for corporate bond issuances

The fund would provide, against a fee, a partial or full guarantee to investors in case of default. A market price has to be established for the fee, reflecting the real credit standing or default risk of the bond issuer. An average CDS price of the issuer during the past 12-18 months could be used as a proxy, plus an adjuster. The adjuster could be based on the secondary market pricing/performance of other issues of the issuer, if available. All corporations irrespective of their rating should have access, i.e. should be able to apply for such a guarantee. The duration of the guarantee should correspond to the maturity of the corporate bond and the maturity horizon defined within EU state aid guidelines.

### Extended EIB risk-sharing guarantees

The EIB announced in October 2008 that it was preparing more sophisticated risk-sharing products for intermediary banks to reach SMEs for which commercial banks considered the risk too great or the security provided to be insufficient. In present circumstances, the EIB ought to consider extending eligibility criteria to both SMEs and larger corporations. The EIB also identified the need for working capital to be brought into a modernised global loan product. The EIB should progress as a matter of urgency its work on bringing these products to the market.

### Support for trade credit insurance by governments and EIB

The EIB should work with national authorities to help develop co-insurance and re-insurance of trade credit, ensuring a level playing field across the European internal market. Such support scheme would be temporary and guarantee additional credit risks where credit insurers have reduced their limits. Private credit insurers and/or export credit agencies could be used to channel the co-insurance to companies. A temporary framework for state aid should be adopted to allow for credit co-insurance where market failures occur. It should (1) make temporary redefinition of non-marketable risks in cooperation with export credit agencies in the case of exports and main insurance providers in the case of domestic and intra-EU trade; (2) ensure that sectors or markets identified as non-marketable in one Member State would be accepted as such by all Member States. The provision of guarantees for trade credit insurance through the EIB will require a widening of eligibility criteria to include working capital.

## Reduced administrative burden through e-invoicing

One of the three key Commission proposals for reducing administrative burdens in the EU is the equal treatment of electronic and paper invoicing, which should facilitate the uptake of e-invoicing and generate cost savings of up to 30 billion euros. However, implementation is only foreseen by 2013. Governments should consider today to implement equal treatment by removing specific requirements for the issuance of e-invoices. This has been done for instance in the Netherlands a few weeks ago and is long-established practice in the Nordic EU Member States.

## Fight against late payments of public administrations

Late payments, especially of public authorities, pose a direct threat to business activity. In some Member States, current average payment delays and outstanding amounts are unacceptable. BUSINESSEUROPE therefore supports the Commission's recast of the late payments directive and its intention to include short deadlines within which all public authorities and bodies – at the European, national, regional and local level – should pay suppliers' invoices. This will provide real relief if adopted rapidly by EU institutions and implemented in all Member States.

## Temporary loss carry-backward provisions

Temporary loss carry-backward provisions in the area of corporate taxes allows companies to carry back this year's losses over profits made in the previous year/years and thereby get a tax payback until the provision expires. Example: this year's American Recovery and Reinvestment Plan allows a 5-year carryback of operating losses of small businesses incurred in 2008.

## Tax incentives for business angels

This could be done in the form of an income tax discount for investments in SMEs and exempt investment gains from taxation if held for several years as is currently the case in the UK.

## JEREMIE scheme and SME financing

JEREMIE can provide additional sources of finance for SMEs during this period of restricted access to finance. However, implementation of this initiative has been slow and unsatisfactory. Several shortcomings have been identified so far. Firstly, the use of JEREMIE is dependent on the will of the regional managing authorities on whether to allocate structural funds towards this instrument. Secondly, procedures are time-consuming and difficult to be introduced. Implementation costs are also non negligible. Finally, there is a clear lack of information regarding financial engineering instruments. The Commission should simplify the legal provisions of JEREMIE and Managing Authorities should take more advantage of the large potential of this instrument.

## EU Competitiveness and Innovation Programme

The CIP is one of a series of key programmes that will be implemented in parallel and complement each other in achieving Community objectives in the fields of research, cohesion, the environment, education and training. The CIP is designed to be complementary to the 7th Framework Programme for Research and Technological Development (FP7). However, access to funds has been difficult due to a series of administrative requirements. This has held back the success of the CIP. Enhancing the CIP would allow for a better support of innovative investments and be complementary to EIB/EIF measures.

## Re-launch inter-bank lending through clearing system

Building on the catalyst role of the ECB and the operational support of the Eurosystem (if feasible the European System of Central Banks could be involved), a sort of European Interbank Collateralised Market (EICM) could be set up. The initiative would, nonetheless, remain a private sector response. In addition to the traditional secured (repo) market, the EICM could entail some form of default risk-sharing. This might require further developments in terms of market infrastructure (i.e. collateral manager, trading platform and central clearing counterparty-CCP).

## Restore confidence in credit default swap markets

The widespread use of central clearing systems would restore confidence in credit default swap markets. The netting of all positions against the clearing house would eliminate counterparty risk which in the long term would lead to better pricing due to the omission of a counterparty risk premium. To facilitate the organised trading and clearing of the CDS market, the European Commission in consultation with market participants should also work towards standardised contracts, margin payments and settlement of daily profits/losses.

## Restore securitisation markets

Despite the massive distortions on securitisation markets, these instruments will continue to be a central element of corporate finance. Securitisation is a vital component of banks' business models and strengthened for instance the supply of credit to SMEs. In recent years, securitised products have become increasingly complex. To reactivate securitisation markets, issuers must simplify structures and offer detailed information about the underlying claims and collaterals. Furthermore, it is essential that originators retain some liability in order to regain market confidence. Investors must be able to assume that the originator of the securitised product has an ongoing interest in verifying the solvency of the borrower. Finally, a better quality of rating for securitised products is essential. Credit rating agencies should make a clear distinction between the rating of portfolios and vehicles and the rating of classic corporate debt or government debt, where changes in the rating depend on the issuer.

## Public guarantees to support commercial banks

Guarantees for short-to medium-term debt issuance by the banking sector should be designed to allow for a reduction of fees, e.g. through the use of appropriate collateral and centralised issuance. Government support for the issuance of hybrid or subordinated debt allows banks to improve their solvency and extend lending activities at relatively low costs. Central banks and national regulators should agree on a common methodology and comparable assumptions to operate financial stress tests in commercial banks and to develop comparable evaluations of their solvency.

## Use of new financial reporting rules

The use of new financial reporting rules allows moving certain financial instruments from trading and "available for sale" categories to loans and receivables. Such reclassification can avoid unrealised fair value losses needing to be charged to income for instruments that are no longer intended to be traded in the short term. Example: Deutsche Bank - after reclassification - the fair value charges to income were limited to a 1.2 billion euros write-down, instead of 2 billion in the third quarter of 2008.

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**Disclaimer**

The members of the Task Force participated in extensive discussions in the course of several meetings, and submitted comments on earlier drafts of the report. Its contents convey the general tone and direction of the discussions, but its recommendations do not necessarily reflect a common position reached by all members of the Task Force. Nor do they represent the views of the institutions to which the members, the Chairman or the rapporteur belong.

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