BUSINESSEUROPE

SPEECH

27 September 2010

THE EUROFI FINANCIAL FORUM 2010
BRUSSELS, 28-29 SEPTEMBER 2010

ADDRESS BY PHILIPPE DE BUCK, DIRECTOR GENERAL

What are the facts:

A. The Economic Situation has improved

- The summer brought relatively **good news for the European economy**. Growth has been stronger than expected and domestic demand is gradually strengthening. In this context, we foresee that growth in the EU could reach up to 2% this year.

- The stress tests also showed limited **risks of immediate instability** in the European banking sector, and interest rates **remain low in** most parts of the EU.

B. Banks are not willing / able to extend lending to companies

- But **access to finance remains a major concern** for the sustainability of this upturn, especially now that companies will need to gear up for **new investments**.
- Lending to **corporations is still registering negative growth rates** (in euro area, down 1.1% in August 2010 compared with August 2009). **By contrast**, household lending is again growing at healthy rate (in euro area, 2.9% year-on-year in August), and **loans to government** were **growing at record levels** (in euro area, 7.4% year on year in August). This may indicate that **risk appetite for corporate loans is very limited among banks** at the moment, and that large **public financing needs are already crowding out capital availability** for companies.
- This feedback loop is **especially intense in Europe, where companies depend highly on bank intermediation** for their access to finance. As demand for capital intensifies, companies will find it increasingly difficult to obtain credit, especially if **securitisation markets remain dysfunctional, hindering banks' ability to free up capital** for new lending.

C. The sovereign debt crisis is having an impact on companies' finance

- We have clearly observed during the Greek debt crisis saga this Spring a significant tightening of credit conditions, **as banks have found it increasingly difficult to access wholesale funding and liquidity.** This is affecting companies' financing conditions throughout the value chain, and SMEs in particular.

BUSINESSEUROPE

What should we learn from this:

- There is an immediate and tight link between the health of public finances, financial sector balance sheets and investment conditions for companies.
- So, **although economic conditions have clearly improved in recent months, a protracted credit squeeze** remains a very tangible risk for this recovery in 2011 and beyond.

What are the challenges ahead:

- In this regard, we think four issues are of fundamental importance looking forward:

  1) Timing and conditions of the exit from exceptional support measures in the financial sector;
  2) Necessary drive for smart consolidation strategies in the public sector;
  3) Balanced agenda of financial markets reforms;
  4) And development of alternative sources of financing for companies.

Let me illustrate the last two issues

1) Financial Market Reform

- **BUSINESSEUROPE supports regulatory initiatives** that resolve the regulatory failures that led to the financial crisis. We think in particular that the reform of European financial supervision agreed by the Parliament and Council is a very significant step forward.
- But to regain confidence, **reforms must strike the right balance** and be mindful of their consequences for non-financial companies.
- **Basel III** is a case in point. Tighter capital rules for banks are clearly needed but this will obviously **lead more restrictive lending conditions** for companies and greater reliance on market financing.
- We think it was right to propose transitional arrangements for implementing the new Basel III standards**.**
- However, we are still concerned about certain aspects of the proposals, including **new liquidity requirements** that could create an additional bias in favour government debt as opposed to private sector securities, which is considered more risky.
- This will interact with other **prudential rules**, **such as those linked to Solvency II, which also discourage investment in riskier assets such as equity and favours government debt.**
- New accounting rules will also impact on capital allocation such as requirements to bring securitised loans on to banks' books and rules related to the way financial institutions account for bad loans.
- A**nother example is new requirements** for EU companies with private equity shareholders **that are currently being discussed and which may discourage**

investors from investing long-term risk capital at a time when we need such partnerships to generate employment and economic growth.

- Recently, the **Commission also presented proposals to increase transparency and resilience of derivative markets**. The **purpose** is to increase transparency to detect risks to financial stability, and **reduce the risk exposure that banks have with each other** through derivatives contracts.

- **BUSINESSEUROPE supports this**, and is pleased that **exemptions are provided for contracts that are used to hedge commercial risk,** subject to certain limits because proper risk management is vital for the credit rating of companies which determines the cost of liquidity and financing.

- **Smart regulation must ensure that the right solutions are found and that policies are effective and proportionate in their scope and nature**. **Comprehensive impact assessments** must therefore be carried out which address the **cumulative impact of different pieces of regulation**.

2) Alternative sources of finance

- At present, **external funding is still difficult to obtain**, and the additional effect of banking sector restructuring and prudential financial regulation, imply that **the lending capacity of the banking sector will be negatively affected over the medium term**.

- **Alternative ways of supporting access to finance need to be developed**, increasing the access of SMEs to capital markets, devising better tax incentives for investors, and attracting long term investments in Private Public Partnerships (PPPs). This would facilitate financing difficulties during the recovery, and would reduce corporate indebtedness for the future.

- Access of SMEs to capital markets could be broadened by **facilitating pooled access of SMEs to bond markets**.

- Also, most tax systems favour debt over equity finance, as interest is deductible against corporate profits, but dividends and capital gains are not. **Neutrality for financing choices could be by granting tax advantages to equity financing**.

- Providing **tax incentives for venture capital and business** angels is another tool that would facilitate access to finance by start-ups and SMEs. This could be done for instance in the form of income tax breaks and exemption for capital gains from investments if held for several years. Of course, this will have limited effects if, on the other hand, regulation of private equity becomes overly restrictive.

- Finally, **to meet the immense financing needs for infrastructure** over the next 10 to 20 years, **PPPs are crucial**, especially given the need to consolidate public finances. In order to attract **attract more investment capacity** towards these projects, it is necessary to **adjust the financial requirements to the specificities of long-term investments**, and to attract new financial partners such as private equity and investment funds.