



**COUNCIL OF
THE EUROPEAN UNION**



Contribution to the European Council

*2911th ECONOMIC and FINANCIAL AFFAIRS
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- I. A coordinated European response for growth and jobs

The EU economic outlook has been deteriorating since the last European Council. Economic activity in the EU as a whole has contracted in the third quarter of 2008 and could contract further in the fourth quarter. Consumer and business confidence are very low. In such a context, we are committed to taking all necessary actions to restore confidence, financial stability and growth.

Financial markets and especially inter-bank markets are still not functioning properly. Member States need to be able to swiftly implement the measures decided in the financial sector, in the framework defined at the October European Council, so as to improve the conditions of credit to companies and households. This will, together with ECB action, progressively contribute to alleviating tension on financial markets.

The recent decrease in commodity prices is welcome both for households and firms. Still, more transparency on oil markets is required. We welcome the Commission's proposal to establish a weekly statistical summary of the commercial stocks in the Community as part of its directive proposal on stocks of crude oil and/or petroleum products, and look forward to its timely implementation, based on the usual cost-benefit analysis.

The rapid slowdown of inflation, stemming from rapidly diminishing commodity prices and reduced inflationary pressures in the economy, is also a welcome support to consumer purchasing power. Inflation expectations over the medium-term have been decreasing and are well anchored in line with price stability. Against this background, the ECB has already cut interest rates by 100 basis points.

P R E S S

We agree that decisive action is needed both at the EU and national levels in order to sustain demand and investment, so as to avoid negative self-reinforcing developments, and in order to contribute to restoring higher growth and employment in the European Union.

In this context, and with a view to preparing the discussions at the European Council on 11-12 December, we discussed and welcome in principle the Commission communication of 26 November on a "European Economic Recovery Plan", as a good basis for designing a comprehensive, consistent and coordinated European response, taking into account the specificities of Member States, and we agree that a package in the magnitude of 1.5% of GDP would provide a significant stimulus to our economies.

A coordinated European policy response

We agree that our actions will have to be taken swiftly, in a consistent and coordinated manner, while maintaining confidence in the sustainability of our public finances.

While taking into account the particular situation of each Member State, a coordinated approach, based on common principles, will increase the effectiveness of the actions taken.

In addition to monetary policy and measures taken to stabilise the financial sector, fiscal policies have an important role to play in stabilising the economy. Member States should let the automatic stabilisers play fully, as they are powerful in the EU and contribute to sustaining demand. In addition, further measures are warranted. They should be framed against the background of national economic situations, notably taking into account the margins of manoeuvre and measures already announced.

We should also acknowledge the specific case of those Member States, in particular outside the euro area, which are facing significant external and internal imbalances, where budgetary policy should essentially aim at correcting such imbalances.

We agree that these measures should build on the following principles:

- they should be timely, temporary, targeted and co-ordinated. To this end, we agree that, while designing a fiscal stimulus, Member States could choose from a "menu" of targeted measures on the revenue and expenditure side, which are likely to have greater impact in supporting activity in the short-run, and avoid negative cross-border spill-overs;
- they should be adapted to the specific situations and challenges of each Member State;
- short-term fiscal stimulus should be consistent with prudent medium-term fiscal strategies. Implementing this strategy will temporarily result in higher deficits. The Stability and Growth Pact provides for flexibility, which will have to be used judiciously. Extraordinary circumstances combining a financial crisis and a recession justify a co-ordinated budgetary expansion in the EU. However, higher deficits will have to be reversed and medium-term objectives pursued in a time frame consistent with the recovery of the economy, so as to avoid a permanent deterioration of the budgetary positions. The long-term sustainability of public finances should be ensured in accordance with the Stability and Growth Pact.

Taking into account their different situations, Member States can choose among a variety of targeted public expenditures and tax measures to provide a short-term fiscal stimulus.

The macro-economic slowdown does not call for slowing down or backtracking reforms. On the contrary, and in view of the effects of the financial crisis on the real economy, emphasis should be placed in particular on reforms. Measures to address the short-term crisis should be consistent with our longer-term strategy embedded in the Lisbon Agenda, and with openness and free trade. In particular, measures improving the functioning of markets and lowering costs, stimulating innovation and productivity, strengthening the marginal incentives to work through for example lower taxes and social contributions where appropriate, improving the competitiveness of our economies, should be considered.

A coordinated European response should also build on European instruments

We welcome the key contribution European institutions can make at EU level.

We agree, in particular, on the importance of appropriate financing to SMEs, climate change and energy, infrastructure and key sectors particularly hit by the current slowdown, within the current ceilings and headings of the financial perspectives.

In this respect, we welcome the EIB additional financial support to the economy of up to EUR 31.2 billion in 2009-2010, increasing annual investments of the EIB to EUR 60–65 billion. The EIB should ensure that these funds will benefit the whole Union, and will be disbursed in a timely fashion, while sharing risks.

These funds will provide additional support to SMEs and “mid-cap” companies, which are more likely to suffer from the current situation. They will also support further investment in the field of energy, climate change and infrastructure. In particular, as part of a European Clean Transport Facility, which doubles the amount available to this sector, we welcome the fact that the EIB will offer specific support to facilitate their transition to cleaner car technologies by the automotive manufacturers and their supplier industry. We welcome the progress report of the working group established in Nice and encourage it to take the necessary steps to enlarge the possible investor base, including the private sector, while starting to launch the equity fund Marguerite - the 2020 European Fund for Energy, Climate Change and Infrastructure. The working group should report on its achievements by mid 2009.

The EIB and the EBRD will also increase their present level of financing in the new Member States.

We stand ready to support an increase in capital of the EIB, through the incorporation of its reserves, in 2009.

Finally, within the current financial perspectives, we are ready to consider speedily the proposal by the Commission to bring forward projects financed by the EU structural funds. In addition, initiatives at EU level in favour of SMEs (Small Business Act) are welcome. Community resources, particularly the European Social Fund and the European Globalisation Adjustment Fund, should continue to support employment-related measures through simplified procedures and accelerated implementation at European, national, regional and local levels. The EU can also provide an impetus for investment and growth through trans-European energy inter-connections, broadband and other infrastructure projects, in particular by implementing the right regulatory framework.

- **II. Restoring financial stability, enhancing financial supervision and deepening the integration of the internal market**

The Council (Ecofin) has worked actively to set a coordinated EU response to the financial crisis, through legislative and non-legislative initiatives. The objective was to address concretely and in a coordinated manner the consequences of the financial turmoil in the short-term on the EU financial sector. The Council (Ecofin) also gave an impulse to the ongoing efforts aimed at improving the European supervisory and regulatory framework.

Much has been achieved but work will need to be pursued, particularly since the crisis has not yet been abated. In particular, the EU will have to vigorously pursue its work to enhance financial stability and to improve the European supervisory and regulatory framework, amending and updating the existing roadmaps where necessary. In addition, it should work to keep its critical role at international level, in the wake of the G20 Summit.

1. Ensuring the rapid and coordinated implementation of the short-term measures taken in response to the financial crisis

In the wake of the European Council of October 15-16, which defined a common framework for action, Member States worked on the implementation of this framework at national level so as to stabilise the financial sector. Overall, these plans amount to EUR 1,800 billion in government guarantees and EUR 280 billion in recapitalisation schemes.

In order to restore financial stability, Member States should ensure that all agreed measures are swiftly and fully implemented so as to meet the urgent need to improve the functioning of the credit market and to restore credits to companies and households We have agreed on a common framework at EU level for the pricing of guarantees defining minimal benchmarks. The Council urges the Commission to issue guidance for precautionary early recapitalisation in order to sustain credit: (i) that clarifies the principles and conditions governing the different types of recapitalisations, in the spirit of the European Council conclusions which stressed the difference between distressed and non-distressed banks and taking into account the recommendations of the European Central Bank; and (ii) that allows recapitalisation measures to be implemented quickly and flexibly in the Member States.

In the current exceptional circumstances, the Commission should allow for flexibility in the implementation of state aid commitments of Member States. In this context, the Council urges the Commission, before the European Council and after further discussion with Member States, to adopt guidance on recapitalisation measures. The Council insists in particular on the following elements, which are key for the success of the support schemes and for restoring the functioning of the financial markets and increasing credit to the economy:

- a clear distinction should be made between fundamentally sound and distressed banks;
- this distinction should notably apply to the pricing of recapitalisations and dividend policy, in line with the ECB's recommendations. It is important not to discourage capital-raising from private investors, and to replace in due time state capital;
- decisions by the Commission should be fully consistent with the objective, shared by all, to ensure that banks provide appropriate financing to the real economy;
- restructuring measures are not expected from fundamentally sound and viable banks benefiting from recapitalisation measures.

The Council invites the Commission to work closely with the ECB on these aspects.

It is a matter of priority to safeguard that the measures in the common framework function properly, particularly the guarantee schemes which could help bring down the cost of financing for the financial institutions to the benefit of households and companies. Therefore, the Council (Ecofin) urges the Commission to promptly review the functioning of guarantee schemes and recapitalisation measures in Member States and submit recommendations on how to enhance their effectiveness.

In order to step up the protection of individual savings, the Council (Ecofin) has reached a political agreement for revising the directive concerning deposit guarantee schemes: the agreement reached would lead to a reduction of the current pay-out delay from 2011 onwards, increase the minimum level of coverage up to EUR 50,000 from July 2009 onwards, and harmonise – subject to a Commission report concluding whether it is necessary - the level of coverage at EUR 100,000 by end 2011. **The Council is committed to reaching an agreement with the European Parliament before the end of the year in order to ensure a rapid entry into force of the directive.**

The Council (Ecofin) stresses, that until the financial stability has been fully restored, the actions related to the resolution and management of financial crisis remain the top priority within the EU. Therefore, the Ecofin Council will continue to monitor market developments closely and invites the Economic and Financial Committee to stand ready to propose further coordinated policy action at the EU level.

2. Further improving transparency on the markets

Improving transparency is essential to restoring confidence on financial markets. Banking institutions have made progress in 2008 to release exhaustive and comparable financial information related to their exposures, losses and write-downs arising from the financial crisis. Nevertheless, qualitative disclosure on valuation techniques still has to be improved. The Council encourages the industry to pursue its initiatives regarding the improvement of investor information and transparency in the securitisation market and on consistent and comparable implementation of CRD under Pillar III. **The Council calls for further progress in these areas and asks the Commission and CEBS to report on the progress achieved on transparency of financial institutions in Spring 2009.**

In order to strengthen their transparency and responsibility, the Council agreed on the need to put into place a European oversight of credit rating agencies. **The Council welcomes the legislative proposal of the Commission and is determined to find an agreement on it before Spring 2009.**

More generally, improvements of valuation standards are also needed as revealed in the context of the crisis. The Council welcomes the revised framework for reclassification of financial assets and the guidance on the application of fair value measurement when markets become inactive published by the IASB, which can be considered fully consistent with the conclusions reached at EU level on the same matter. It reminds the IASB of the issues recently raised by the Commission and urges the standard-setter to give urgent consideration to these and, where appropriate, to come forward with the technical solutions as requested in time for the publication of year-end results. Further improvements in market valuation together with assessing the implications for risk management practices by banks will be needed and can be expected in 2009. **More broadly, and in line with the G20 decisions, the Council will examine the progress achieved and the need for further action concerning the IASB governance reform to ensure that there is appropriate accountability to the public authorities.**

3. Strengthening the prudential rules, the risk and crisis management framework and the European supervisory framework

The Council agreed on a general approach on two crucial prudential directives - CRD in the banking sector and Solvency II in the insurance area. This will provide a reinforcement of the prudential rules in the financial sector and a better management of risks. In the insurance field (Solvency II), the new risk-sensitive prudential requirements will provide incentive for good risk management and better taking into account risks taken by insurance undertakings. In the banking sector, **the CRD directive enhances the management of liquidity risk, improves the quality of banks' own funds through the definition of consistent rules concerning hybrid instruments, and reviews the large exposure regime. It also sets a deadline (2012) for uniform formats, frequencies and dates of reporting for banks. Lastly, the CRD** also addresses the concerns raised by the "originate to distribute model" by making sure that originators retain a proportion of risks and that investors have a thorough understanding of the financial product they are buying.

Both directives enhance the supervision of cross-border financial groups, with the introduction of colleges of supervisors and an increased coordination between supervisory authorities on key decisions.

Definitive adoption of these two directives before the end of the current Parliament mandate is of a high priority in the EU response to the financial crisis.

In addition, the Council agreed on strengthening and improving the functioning of the EU committees of supervisors: **their decision making will be facilitated by the possibility to adopt measures by qualified majority voting, coupled with a "comply or explain" mechanism. The Council welcomes the Commission's commitment to modify by the end of the year the decisions on the Committees, so as to assign them specific tasks, such as, for example, mediation, providing non-legally binding recommendations and guidelines, and training and staff exchange. These new tasks are already included in the CRD and Solvency II.**

Convergence between supervisors will be enhanced by the modification of national mandates of supervisors at the national level to ensure that they are able to take into account the EU dimension in the performance of their duties, including having regard to the financial stability concerns in other Member States. This is foreseen both in the CRD and Solvency II.

Further steps are needed in 2009 to complement these improvements in order to further strengthen financial stability:

- **to remedy potential undue pro-cyclical effects of the prudential and accounting rules:** the Council (Ecofin) expects the European working group on pro-cyclicality, consistent with the FSF and Basel Committee work, **to deliver a first outline by end 2008 leading to a first report by March 2009 to be finalised no later than mid 2009. On this basis, the Commission is invited to consider a possible proposal of legislative action by the Commission by end 2009;**
- **to ensure that the executive pay system provides the right incentives to avoid excessive risk-taking or a shortening of time horizons, especially in the financial industry. The Council has encouraged Member States to implement the existing Commission recommendation.** A number of measures have been taken recently at national level to address this issue. **The Council (Ecofin) asks the Commission to update its recommendation** so as to promote a more effective control by shareholders, and encourage a stronger link between pay and performance, including on leaving pay ("golden parachutes");

- **to enhance preparedness on financial crisis management:** improvements are needed to allow for better cross-border crisis management when facing general/systemic crises. In particular, consistency between national tools and rules for asset transferability should be considered. **The Council welcomes the intention of the Commission to deliver a white paper on early intervention by mid 2009;**
 - **to mitigate counterparty and operational risks and improve transparency in the Credit Default Swaps (CDSs) market:** it is essential to shift the operations of this market from bilateral to CCP clearing. **The Council welcomes the positive step taken by the Commission to accelerate work and make progress in early 2009;**
 - **to further improve our supervisory framework and enhance the Lamfalussy process:** the Council is looking forward to the upcoming recommendations of the high-level group on supervision established by the Commission and chaired by M. de Larosière, in March 2009, in view of considering further actions in this field by the end of 2009;
 - **to ensure safe and sound European post-trade infrastructures in order to prevent systemic risks from spreading over the financial system, and to increase transparency on the OTC derivatives markets.**
- 4. The Council will undertake work so as to ensure that EU positions on a renewed international financial architecture are well founded and reflected in the months ahead**

The EU has played a key role in initiating a debate at the international level.

Looking ahead, several of the issues identified as needing further work at the G20 level are issues on which the EU has already developed, or is currently developing, common views.

The Council (Ecofin) will provide inputs on the key issues, including thorough analytical work on the underlying reasons for the systemic financial crisis, **by mid- March 2009, so as to contribute to the work undertaken in relevant international financial institutions and by the G20 finance ministers.** Also, in line with the work carried out at an international level in various fora, the Council (Ecofin) will continue to fight against illicit finance risks arising from non-cooperative jurisdictions, and to fight against tax havens.

The Council requests that the EFC start working in particular on the following issues and to report back to the Council:

- by January/February 2009
 - reviewing the adequacy of the IMF's resources and the IMF lending instruments in the light of short-term policy needs related to financial packages to be developed by the IMF;
 - IMF relations with other fora and IFIs;
- by March 2009
 - an overall assessment of progress made with the key short-term work priorities outlined in the report, and an assessment of the causes and lessons of the present and previous financial crises in further detail; and, on the basis of these, and taking into account the overall financial stability situation in the markets, propose updated short-term and long-term work priorities;
 - standard setting and surveillance of financial institutions at global level as set out in the Declaration of the G20 summit and the Council's (Ecofin) roadmaps;
 - progress in sharing information with non-cooperative jurisdictions;

- in the course of 2009
 - strengthening of IMF surveillance, including how the IMF should develop early warning mechanisms which would build on swift identification of systemic vulnerabilities thanks to a stronger integration of bilateral and macro-financial surveillance and on strengthened joint IMF/World Bank Financial Sector Assessment Programs (FSAP);
 - reviewing the mandate and governance of IFIs.
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