

COMMISSION OF THE EUROPEAN COMMUNITIES

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FINANCIAL ENGINEERING

(Communication from the Commission to the Council and
the European Parliament)

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In its official work programme for 1986, the Commission announced that it would be taking a series of initiatives in the field of financial engineering. The purpose of this communication is to set out the reasons for developing financial engineering on a Community scale, to explain the significance of this activity, and to say what the Commission intends to do.

1. Significance of financial engineering : adjusting to changes in the economic and financial environment

Changes and innovations in national financial markets in recent years have led Member States to refashion their assistance schemes so as better to adapt them to their national requirements.

These developments in financial markets (internationalisation, despecialization, disintermediation) have a European impact because of the growing extent to which separate economies are coming together and the drive to establish an integrated economic and financial system in Europe. An approach therefore needs to be made at Community level similar to that in Member States to match the supply of finance to transnational needs.

Being subject to similar budgetary constraints as those in Member States, this new initiative is not intended to expand sources of Community funding, whether involving the budget or market borrowing; the aim is rather to re-examine the ways and means of Community help, placing greater emphasis on the spirit of enterprise and on the working of market forces.

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(1) Cf. Commission Communication on Financial Integration, doc. COM(83) 207 final of 18 April 1983.

To achieve the Community's major objectives, the Commission must take account of this development. In so doing, it is seeking to make the resources available better suited to the real needs of European economies. This is what the Commission means by "financial engineering". Through it, the Commission plans to exert an effect on private capital which is both catalytic and multiplier.

2. Financial engineering's task : devising tools that are suited to the new environment

Private capital in Europe is relatively plentiful but too often it is invested in purely financial operations that are self-perpetuating and self-propagating with speculation their driving force. We need to reverse this trend and to channel European capital into financing the investment which the Community needs.

Financial engineering must make it possible to satisfy funding needs that are not satisfactorily met by the market. With this in mind, the Commission is planning a threefold approach designed (i) to make the best possible use of the Community dimension through the "Community multiplier effect", (ii) to make maximum use of the Community law-making and budgetary activity and (iii) to exploit as effectively as possible its capacity, which is recognised by the market, as an operator in its own right.

The Commission is planning to promote the use in Europe of a whole range of schemes to provide firms with the financial services they need and to facilitate the implementation of European scale projects. This will mean :

- enabling a greater volume of funds to be lent for priority investment by SMEs;
- improving the provision of equity capital by providing inducements to set up investment companies (e.g. high-technology projects);
- helping set up guarantee funds to encourage the temporary acquisition of equity investments in innovative projects;

- facilitating the change of conventional EIB loans into non-recourse or limited recourse loans; this new form of EIB activity will be made possible through guarantees based on the Community budget;
- helping large-scale projects raise adequate volumes of capital by making a budget contribution in the form of equity capital; this is designed to trigger the assembly of financial packages;
- helping establish service agencies (mainly financial services but also consultancy, help with setting up abroad, finding partners);
- signalling a political priority conferring a number of advantages ("declaration of European interest" for large-scale projects).

This is the set of tools that the Commission plans to use in devising tailor-made solutions that meet the new needs for investment funding in the Community.

3. The aim of financial engineering : support for Community priorities

Financial engineering is not an end in itself. Its purpose is to help attain the Community's major objectives : unifying the internal market, stimulating technological progress and job creation, improving industrial competitiveness and integrating the outlying regions.

However, three priority needs are currently at the centre of the Commission's preoccupations : reviving the spirit of enterprise, industrial renewal and strengthening the Community's basic facilities. In the light of these needs, there are three areas in which financial engineering is needed.

3.1. Reviving the spirit of enterprise : financing of SMEs

The Commission has explored a number of new approaches to this problem. A few years ago, it embarked upon some decidedly innovative measures : the financing of innovation and the development of a genuinely European venture capital activity.

The task will be to continue and expand those measures, which are aimed : at increasing the supply of funds lent to finance SMEs' capital investment (NCI IV); at providing access to credit for firms whose financial standing is

too low to provide the necessary security (development of mutual guarantee machinery); at increasing the equity capital of SMEs (promotion of European venture capital) or at providing them with the financial and other services they need in order to grow. The announcement that the Institutions of the European Community specialising in long-term credit have set up a European Financial Engineering Company (EFEC) to serve SMEs heralds a first success for an initiative launched by the Commission.

These measures will also do much to speed up the dissemination in all Member States of financial innovations that have been successfully tried out in a number of them. Lastly, some of the measures could be extended beyond the territory of the Community so as to step up investment by SMEs in third countries, particularly in the form of joint ventures; work on this is already under way in the context of the cooperation agreements concluded with the ASEAN countries and with the southern Mediterranean countries (1).

3.2. Industrial renewal : financing high technologies

Equity capital is the best form of finance for projects that are situated midway between research and industrial application. Yet, the provision of equity capital is particularly difficult to organize if the project is the result of international cooperation or if it is a long way back in the chain which runs from research to industrial application. Wide-ranging joint research programmes are however being part-financed by the Community or undertaken with its collaboration within a broader framework such as Eureka. The projects making these programmes are at the research stage or at the pre-competitive development stage, for which grants are the appropriate form of finance since their success is too uncertain. Against this, no specific mechanism exists for projects that represent the industrial follow-up to those programmes.

To overcome this particular difficulty, the Commission has sounded out the financial community and professional circles and has found confirmation of the relevance of new financial packages. These would be based on the setting up of investment companies (EUROTECH CAPITAL), with exclusively private capital, and the establishment of a guarantee scheme (EUROTECH INSUR) that would be publicly and privately funded and would back up the EUROTECH CAPITAL companies. The favourable response with which these suggestions have met and the prospect of early establishment of the first EUROTECH CAPITAL company open the door to the institution of the guarantee scheme that would complete the machinery.

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(1) see COM(86) 603 final.

3.3. Strengthening the Community's basic facilities : financing of large-scale infrastructures

The focus here are large-scale infrastructure projects of European interest, for which a large amount of capital has to be assembled in special forms and using special procedures.

The Commission intends to call for a redistribution of roles in the promotion, financing and management of such projects and for an improvement in the environment for private investors so as to encourage the provision of private capital. The new role that the Community could play will be threefold :

- to provide the requisite conditions for large-scale projects to emerge and be launched; by making a budget contribution towards the cost of the necessary feasibility studies and preparatory work, the Community would act as a pump-primer as this would help demonstrate a project's viability; by issuing a "declaration of European interest" it would publicly demonstrate its support for a project; by making a budget contribution at the seed capital stage, it would exert a leverage effect and would make it easier to raise the necessary volume of equity capital;
- to improve the environment for private investors : in order to make them more attractive to the public, securities issued by bodies carrying out large-scale projects would have to be able to circulate freely within the Community and would have to be accorded appropriate tax treatment;
- to mobilise the market through a new form of Community assistance by using the Community budget to give the EIB a guarantee on its loans. The guarantees would be in a form tailored to the risks involved, and the loans would be made either out of the EIB's own resources or from those borrowed by the Commission. The Community would thus become involved in "project financing" techniques : these have enabled a number of large-scale projects to be implemented by sharing the risks among the parties to the financial package.

3.4. For each one of the above priority needs, the Commission will be presenting the Council with a communication setting out the details of the arrangements outlined above. These communications will be drafted in the light of the reactions of interested parties in Member States.

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4. The budgetary impact of a financial engineering activity

The Community's financial engineering activity does not in any way eliminate the twofold need for
(i) continued budgetary stringency and
(ii) closer coordination and enhanced effectiveness of its financial instruments. On the contrary, it will help to meet that need.

However, a minimum degree of budgetary support is required to carry it out. Detailed proposals to this end were made by the Commission in the preliminary draft budget for 1987. At the present stage in the procedure, the extent of the new measures to be undertaken in this field cannot be gauged exactly. The Commission's main concern is that effective impetus should be given to the dynamics of financial engineering.

The Commission hopes that, under the budget procedure, it will be given the resources it needs to launch this initiative.

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I. Quelle est la justification principale de la mesure ?

Faciliter le financement des PME, des hautes technologies et des grandes infrastructures d'intérêt européen.

II. Caractéristiques des entreprises concernées

En particulier :

- Y a-t-il un grand nombre de PME ? Oui pour les volets "PME" et "hautes technologies"; pour les grands projets, la pratique de la sous-traitance permet d'intéresser indirectement beaucoup de PME;
- Note-t-on des concentrations régionales ?
Sans objet.

III. Quelles sont les obligations imposées directement aux entreprises ?

Aucune.

IV. Quelles sont les obligations susceptibles d'être imposées indirectement aux entreprises via les autorités locales ?

Sans objet.

V. Y a-t-il des mesures spéciales pour les PME ?

Oui.

- Lesquelles ?

Mesures destinées à faciliter le financement des projets d'innovation ou de développement des PME.

VI. Quel est l'effet prévisible ?

- sur la compétitivité des entreprises ?
Positif.
- sur l'emploi ?
Positif.

VII. Les partenaires sociaux ont-ils été consultés ?

- Avis des partenaires sociaux.

Non, mais s'agissant de grandes infrastructures et de PME, les partenaires sociaux ont demandé, lors de leur dernière réunion à Val-Duchesse, avec insistance que tout soit fait pour faciliter la réalisation de tels projets.