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Brussels, 02 August 2019

EBF Response to the FSB Evaluation of the Effects of Financial Regulatory Reforms on SME Financing

General remarks:

As we mentioned in the reply to the previous FSB consultation on the effects of financial regulatory reforms on SME financing, we would like to reiterate the following:

SMEs are the main components of the corporate landscape in Europe. The financing mix of SMEs in the EU differs quite substantially from other jurisdictions around the globe and entails varied specificities. More specifically, bank loans are the most important and demanded form of SME financing in Europe.

In such an environment, the impact of regulatory measures in such an SME-filled environment need to be carefully calibrated as to avoid unintended consequences. Regulatory measures taken at European level can be strongly felt. Continued regulatory support to bank financing of the economy is critical to ensure proper financial intermediation and risk management.

The new regulatory reforms might put SME exposures at a disadvantage with regards to other alternative uses of capital in the banking sector. This might be an unintended consequence of the vast regulatory overhaul that has put the banking sector worldwide on a much stronger footing overall (higher need for collateral, long-term loans becoming more difficult etc.).

More concretely regarding the FSB report:

We believe the report acknowledges that due to the important data and methodological challenges and the difficulty to isolate the effects of macroeconomic conditions from the effects of financial regulation at a global level, the analysis does not identify material and persistent negative effects on SME financing in general, although there is some differentiation across jurisdictions.

Although this is a valuable conclusion, we think that one of the main shortcomings of the report is that it is necessary to analyze a full economic cycle to arrive at more meaningful conclusions at a global level, and this has not happened yet for a large number of relevant

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jurisdictions. In our view, the analysis carried out would be premature and should be repeated in the future.

Therefore, we believe there would be merit in the FSB to engage in a more detailed analysis in certain jurisdictions and regions. This would provide an incomplete picture at global level, but the effects of the different drivers identified in the report would be more clearly explained and assessed, because, as the report says, there is no-size-fits-all pattern for all jurisdictions.

Methodologically, we understand that the conclusion that a one-size-fits-all patter for all jurisdictions cannot be outlined demonstrated that the impact of reforms on SME lending depends on country-specific factors.

In particular, the study shows that in countries hit by an economic downturn during the reform implementation period, the pace of lending was reduced for both SMEs and other firms. This seems to be a strong evidence that regulatory reforms and supervisory actions in recent years are proven to be highly procyclical. This aspect is not provided the appropriate attention by the FSB;

As we more clearly state in our answers to question 7, we understand that the methodology of the empirical analysis could be improved.

In the first place, the criteria applied for identifying banks exposed to the reforms raise concerns. Identifying as "more exposed" the banks in the bottom quartile of the distribution of capital ratios (ex-ante) and as "less exposed" all the remainder, leads in aggregate estimates to paradoxical results, since capital shortfalls are not considered.

The more sophisticated empirical analysis available, i.e. the one based on granular bank firm level data for six jurisdictions, shows significant (in our opinion) evidence of negative effects on SME lending, both temporary and persistent. This is not appropriately highlighted in the text.

Finally, the report acknowledges that often it is easier to analyze the effects at local level. We think it would be a good idea if the FSB could engage in a more detailed analysis covering certain jurisdictions and regions. For example, providing in a separate Annex a list of national practices where there is a clear positive or negative effect on SME financing, explaining briefly each one and the main driver. We find the list of policies listed in Annex B too descriptive and lacking an assessment of their actual impact on the local market. This way the effects of the different drivers identified in the report could be more clearly assessed.

SME financing trends

1. Structure of SME financing: Does the report accurately describe the characteristics of SME financing provided by banks and other financial institutions? Is there any aspect of SME financing that merits additional analysis?

With regards to considerations regarding the structure of SME financing, we would like to mention that we understand that the information that we provided in our answer to the previous FSB consultation still holds true, yet it would merit to be contrasted when the next end of year SAFE survey is published by the EC.

Nevertheless, we would like to indicate that SME sectors in some countries do not comprise only SMEs, but also many family-owned companies with more than 50 Mio. € turnover. If you take them into account as well, the market shares of "local banks" and "SIB" change dramatically. The same holds true when you look at who finances the so-called "hidden champions". It is of utmost importance to see that the family-owned SMEs are financed by a diverse banking sector, comprising different sorts of banks – including SIB. Together, they provide all sorts of loan supply and services. SIBs are indispensable in this market for the financing of SMEs.

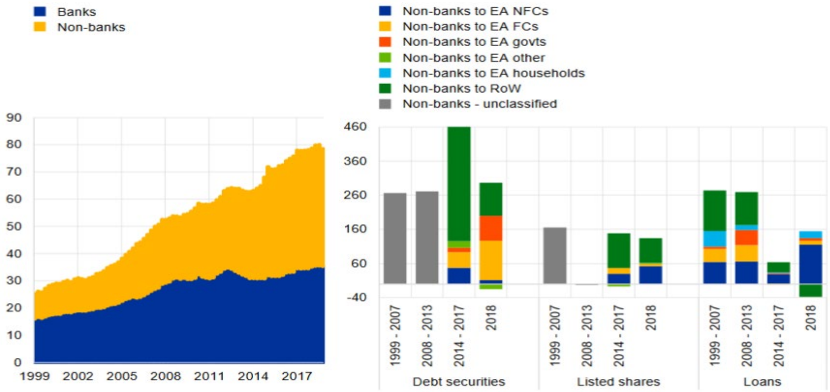
SIBs are in most cases the main providers of financing both for SMEs and in general for NFCs.

In addition to these considerations, we think that, at least in Europe, it would be interesting to analyse the profitability of SME lending for banks and other non-bank providers in order to explicit another avenue where regulatory requirements put at a competitive disadvantage banks vis-à-vis non-banks, and the critical impacts this would have on Level Playing Field considerations.

Taking a look at the latest data coming from the ECB Financial Stability review 2019, we can clearly see how the non-bank financial sector in the euro area keeps growing and providing increased financing to NFCs.

Chart 4.1
The euro area non-bank financial sector continues to grow and provide financing to the real economy

Growth of non-banks' financial assets (left panel) and financing flows to the real economy (right panel)
(Q1 1999-Q4 2018; left panel: € trillions; right panel: average annual flow in € billions)



Sources: ECB (euro area accounts and balance sheet data of individual sectors) and ECB calculations.
Notes: In the left panel, the non-bank financial sector includes investment funds, money market funds, financial vehicle corporations, insurance corporations, pension funds and remaining other financial institutions. The total financial sector includes the non-bank financial sector and MFIs (central banks are excluded). In the right panel, average annual flows are computed as the average cumulated quarterly flows of investments by investment funds, insurance corporations, pension funds and remaining other financial institutions.

Source: ECB Financial Stability review 2019

2. Trends: Are the SME financing trends presented in this report comprehensive? Are there other important trends that should be considered for inclusion?

As we introduced in our answer to the question above, we see as a critical trend the increased amount of financing to NFCs in general and to SMEs in particular that non-banks have in the economy.

This companies benefit from high flexibility and digital reach to companies in order to provide financing. As time passes, these companies either become part of a bank's value chain or supply additional / complementary financing like crowdfunding. In some cases, the financing can also have a substitution effect from traditional bank lending, but there is not enough information to better assess these implications.

The following figures complement the information provided by the ECB in the chart above, providing non-flow information on the market volume evolution of Alternative Finance providers.

Figure 1: European Online Alternative Finance Market Volumes 2013-2017 in €billions (Including the UK)

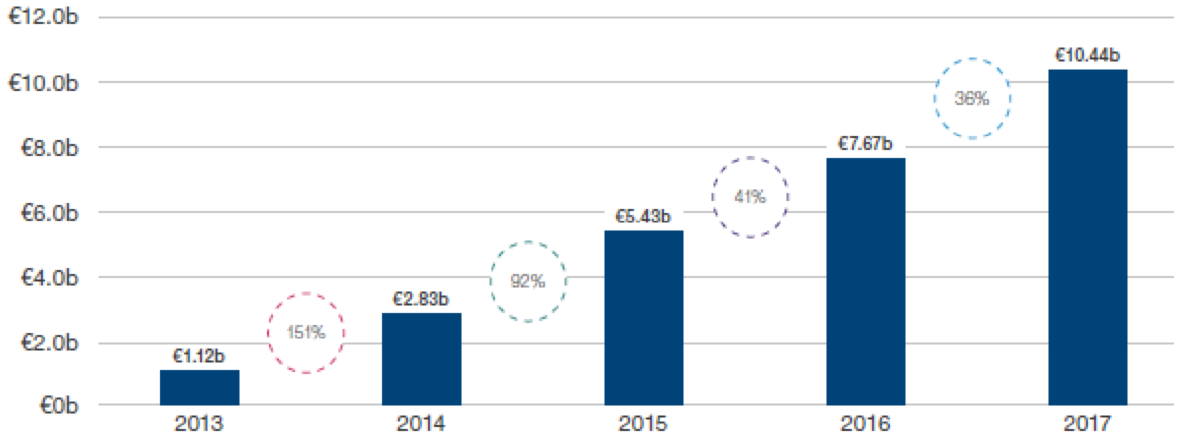
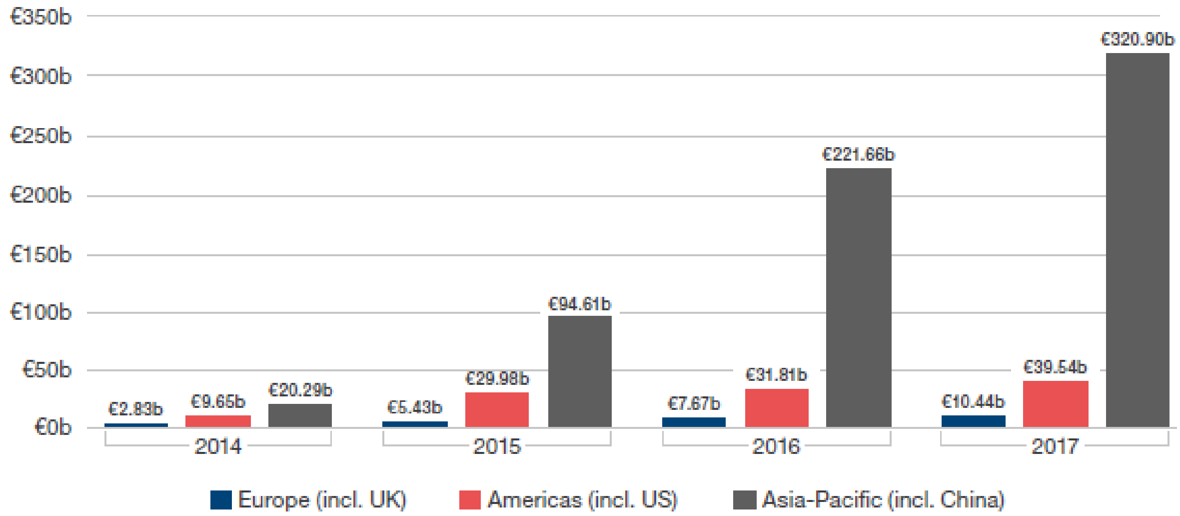


Figure 3: Regional Online Alternative Finance Market Volumes 2014-2017 (€billions)



Source: Shifting Paradigms: The 4th European Alternative Finance Benchmarking Report, Cambridge 2019

We can see that the growth of the market volume of non-bank finance providers has increase constantly every year since 2013. Figure 3 above also represents quite precisely the reality in Europe compared to the other regions, confirming the information contained in the SAFE survey and other publications: bank financing still is the most relevant form of financing for European SMEs.

Regarding the kind of financing they provide to corporates, alternative finance providers in Europe mainly provide debt financing, which reflects the need of diversification of sources of funding that smaller and more innovative SMEs may have.

Figure 13: Total Online Alternative Business Funding Volumes (Excl. UK) 2012-2017 (€millions)

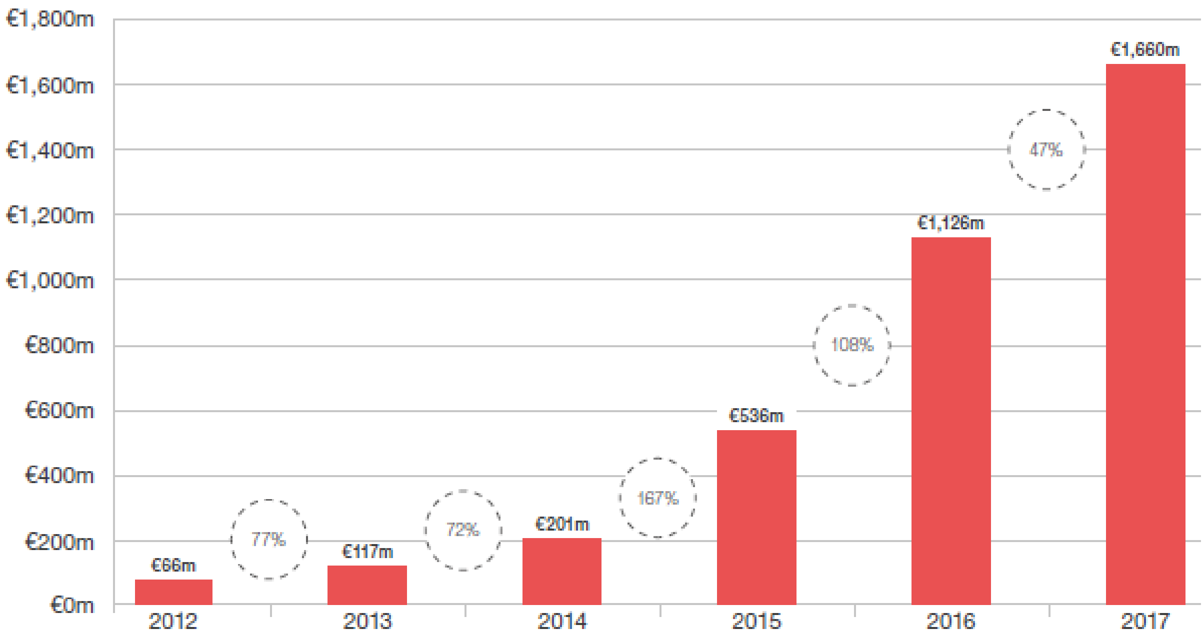
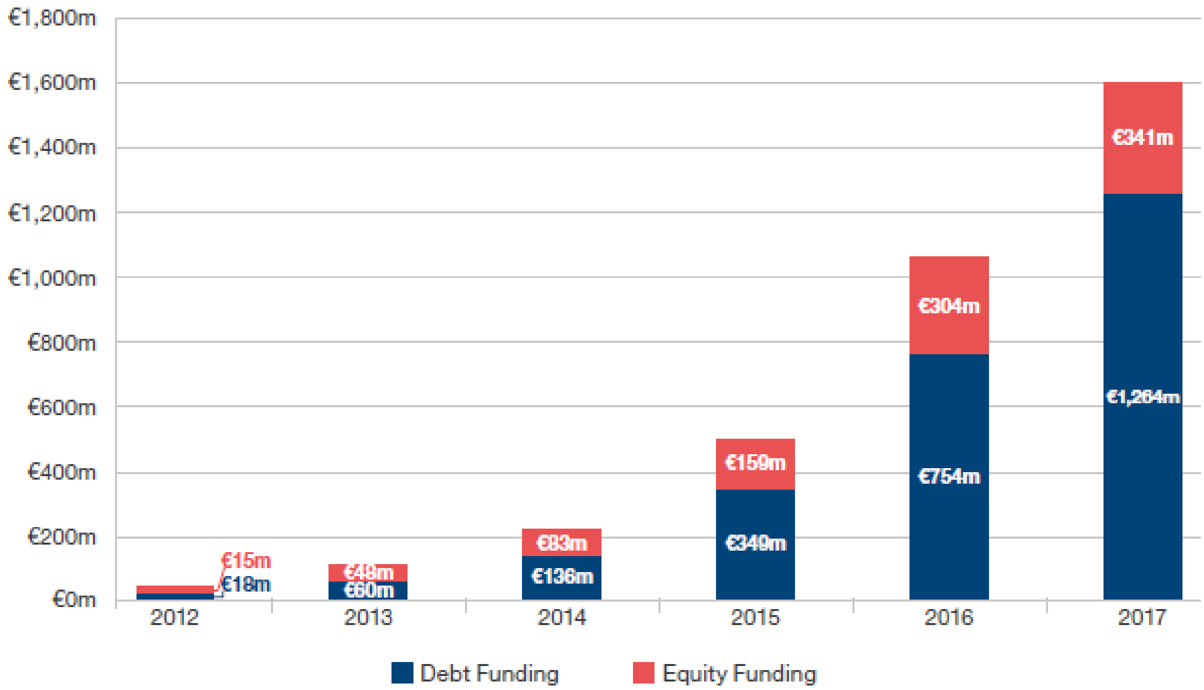


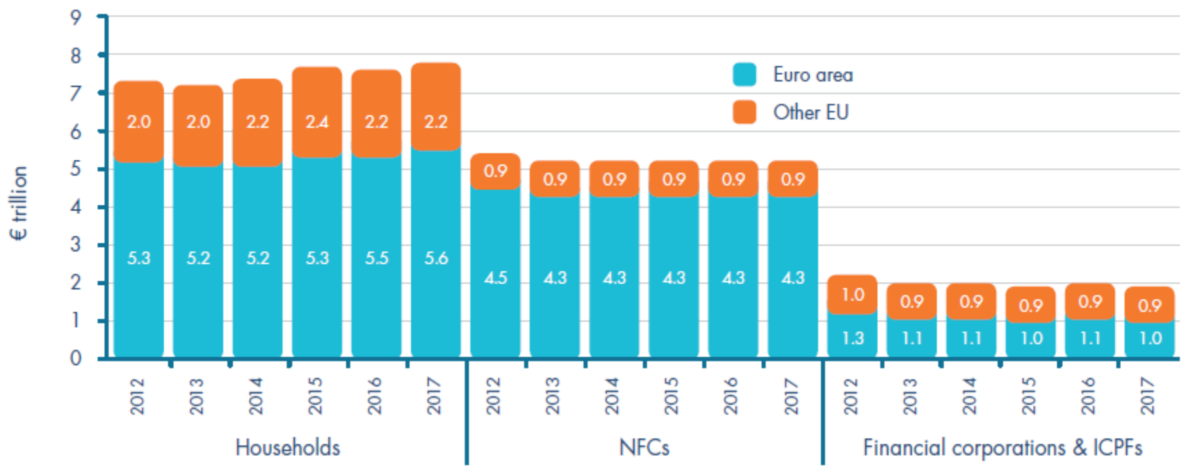
Figure 14: Debt vs Equity Online Alternative Business Finance 2012-2017 (€millions)



Source: Shifting Paradigms: The 4th European Alternative Finance Benchmarking Report, Cambridge 2019

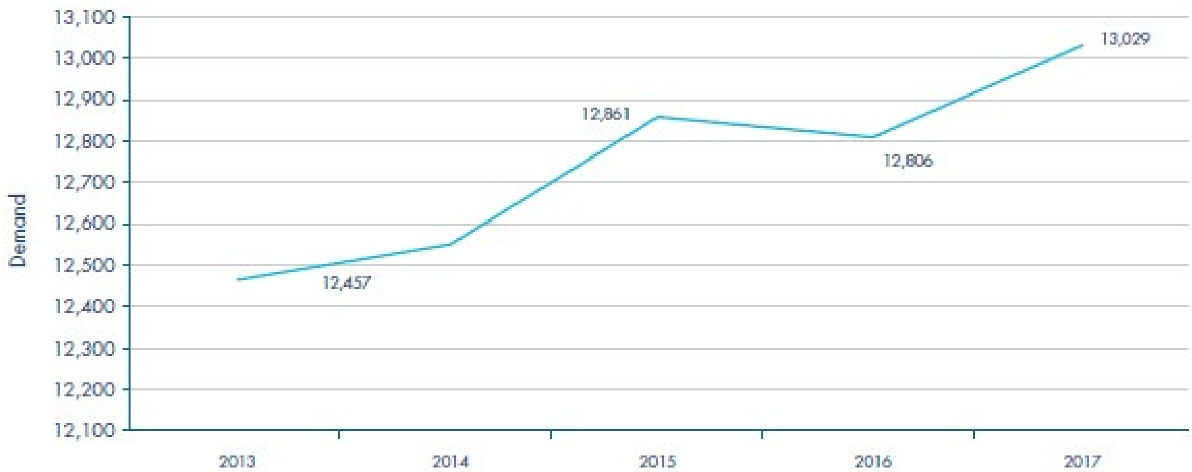
When compared to traditional bank financing, we can see that numbers are still very small, yet we understand that increasing challenges can be posed as alternative finance providers grow exponentially, especially covering the smaller ticket transactions.

Loans by counterparty sector



Source: EBF Facts & Figures 2018.

Outstanding loans to non-financial corporations and households in EU



Source: ECB Data – EBF own calculations.

In order to better understand the drivers behind banks' relationships with fintech and the substitution effects that can be perceived by incumbent institutions, we refer to the EBA report on the impact of fintech on institutions' business models launched in 2018.

Figure 1. *The main drivers for having a relationship with FinTech companies and/or products/services*

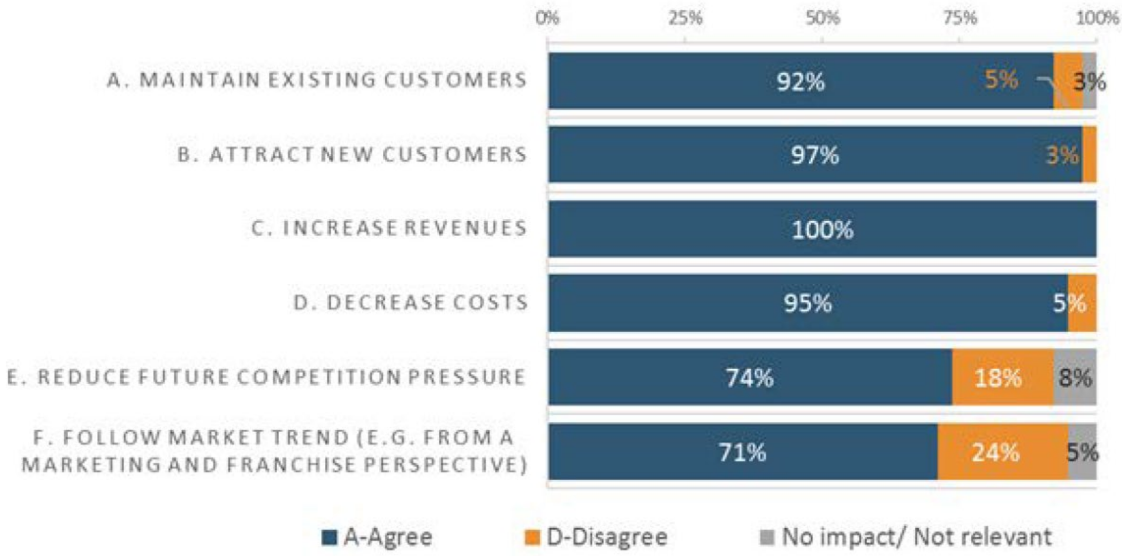
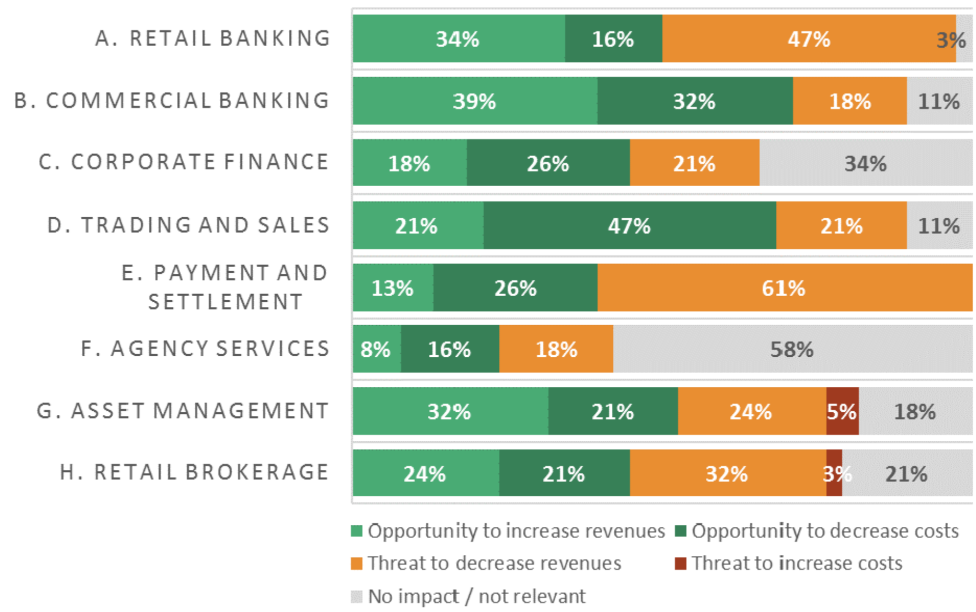


Figure 2. *How do you see FinTech firms affecting the current business model (business lines) of your bank?*



Source: EBA report on the impact of fintech on institutions' business models

Banks primarily see FinTech-enabled products and services as a key driver for business growth — all banks consulted expect FinTech to increase revenues, and 97% of incumbent institutions hope it will help to expand their customer base. Incumbents also identify costsaving opportunities and possible improved ways of retaining existing customers (92%). 95% of incumbents responded that they currently had an ongoing relation with a Fintech firm. 92% responded that they formed commercial partnerships with Fintech firms to offer new products/services. At the same, time they are active internally; 84% set up/sponsor Fintech incubators/accelerators.

3. Drivers: Are the drivers of SME financing described in this report comprehensive? How important have demand versus supply factors been for SME financing across jurisdictions and types of firms? Are there other important drivers that should be considered in the evaluation?

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Financial regulations

4. Regulation vs other factors: Does the report accurately describe the importance of financial regulatory reforms relative to other factors in terms of their impact on SME financing?

Table 1: Regulations or standards identified as potentially relevant to SME financing

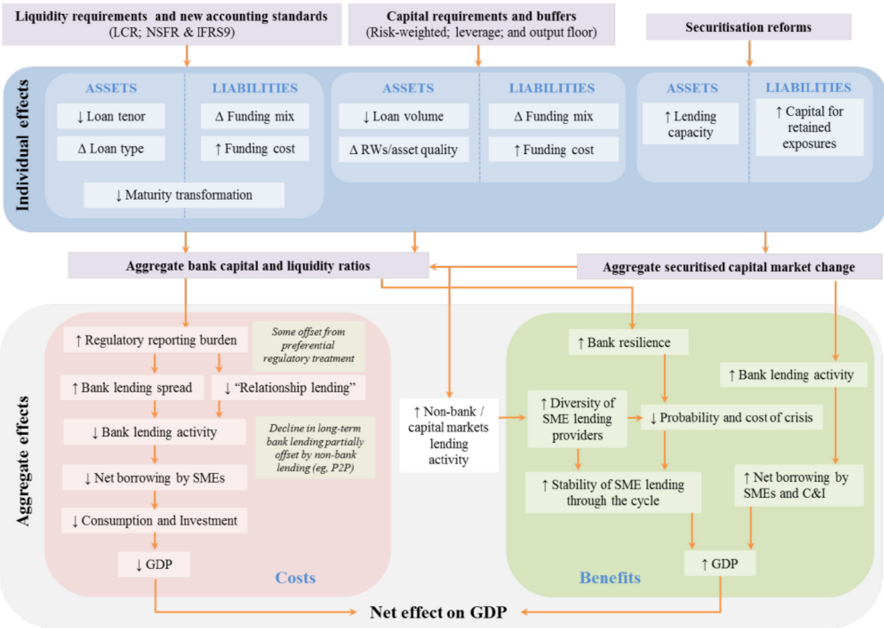
Reform area or sector	Element of regulation or standard	Agreed phase-in (completed) date for G20 reforms	Implementation status of FSB/BCBS members[31]
G20 reforms			
Banks (Basel III)	Risk-based capital	2013 (2019)	Fully implemented
		2022 (2027)	N/A at this stage
	Securitisation framework	2018	Partly implemented
	Leverage ratio	2018	Largely implemented
		2022	N/A at this stage
	Liquidity Coverage Ratio (LCR)	2015 (2019)	Fully implemented
	Net Stable Funding Ratio (NSFR)	2018	Partly implemented
	Framework for G-SIBs	2016 (2018)	Fully implemented
Accounting standards	IFRS 9 / CECL (US)	Effective from 2018-2021	N/A at this stage
Non-G20 regulations			
Banks	National / regional regulations (e.g. EU SME supporting factor, stress tests)	N/A	N/A

Note: Only those regulation or standard elements that are most relevant for SME financing are included, so the list is not comprehensive. Green cells refer to reform areas that have been subject to quantitative (regression) as well as qualitative analysis; other areas have been analysed qualitatively. Grey cells refer to reform areas where implementation is at an early stage or has not yet begun. See Annex C for details.

We would need an analysis covering more comprehensive data to better understand the relevance of each of those reforms.

5. Basel III reforms: Does the report accurately describe the transmission channels through which Basel III reforms impact bank financing to SMEs? Are there other major transmission channels that the evaluation has not considered?

Graph 10: Stylised representation of possible transmission mechanisms of regulatory requirements to SME lending and economic activity



It might be worth pointing out that the FSB chart above (Graph 10) indicates, among the effects of reforms in the field of capital requirements and buffers, only a possible decline in loan volume (deleveraging) and variation in asset quality, while possible rise in interest rates are not present. By the way, this effect is mentioned in the document (see paragraph 4.1.1. […] studies assumed that more stringent regulatory requirements increase the funding costs of financial institutions, which they, in turn, pass on to borrowers through higher lending spreads […]).

6. Other relevant reforms: Does the report accurately identify financial reforms other than Basel III that might have an effect on SME financing? Through what channels do these reforms function? Please elaborate.

SME Supporting Factor:

In the first place, we would like to reiterate our comments regarding the importance of the SME supporting treatment in Europe. While we understand that the FSB mentions both an EBA and an academic study that challenge the benefits provided by the SME supporting factor, we would like to reiterate not to understate its importance, given the specific bank financing conditions present in Europe.

Given the fact that lending to SMEs is by default more diversified (smaller companies are active in all sectors of the economy and are at all stages in their development and funding escalator) and it is an important driver of innovation competition and growth in an economy, capital requirements for SME exposures should be lowerto ensure an optimal bank financing of SMEs. The signal sent through the supporting factor encourages support and engagement from a wide range of financiers while avoiding an over-concentrated market.

The importance of measures that maintain or expand the SME supporting factor to ensure access to finance to SMEs and encourages its adoption at international level. Indeed, it is important to consider that the scope of application of the risk weight proposed by the Basel Committee for SME exposures (85%) is limited to unrated SMEs and remains much smaller than the scope of application of the current EU SME supporting factor, which also applies to retail SMEs or SME exposures secured by a mortgage on commercial properties.

In order to further support our claims, we would like to draw your attention to the following findings:

A recent paper by economists from Banque de France[1] finds significant positive effects of the SME Supporting Factor (SME SF) on credit volumes.

In this study the authors find evidence showing that the SF has been effective in supporting bank lending to targeted SMEs. First, they show that eligible exposures have increased by 5% to 10% on average as compared to ineligible exposures after the implementation of the SF (vs. before the reform) depending on the specification. In the most conservative estimation including group specific trends, they still find that the SF has boosted eligible exposures by 2%. This average effect is corroborated to various robustness checks. They find that the magnitude of the effect of the SF has increased over time: the effect is almost zero in the first year after the entry into force of the SF but it has then intensified to reach a magnitude of 8% to 10% two years after the entry into force. At the same time, they do confirm that the trends of eligible and ineligible exposures did not diverge in a significant way before the reform. They identify this effect by exploiting the €1.5m limit for the bilateral exposures and conduct a diff-in-diff analysis tackin the exposure of SMEs above the €1.5m threshold as a control group. The analysis conducted by the EBA in 2016 ("EBA report on SMEs and SME supporting factor", March 2016) was arguably less likely to identify the causal effect of SME SF due to the nature of the data used. The control group in their analysis was made of large enterprises whereas there is clear evidence that the credit dynamics of those firms can markedly differ from the one of SMEs.

In addition, a dedicated analysis by one of our members has been performed to assess the positive effects of the SME supporting factor (SME SF). The effects have been assessed by studying the evolution of some key variables for SME financing, compared to larger firms, before and after the application of the SME SF. The main findings of the study are the following:

- **Lending volumes**. Based on data on the Euro Area from the ECB statistics[2] the flow of new lending granted to SMEs shows a more positive trend compared to other firms. First, in the aftermath of the financial crisis, the trend in new lending to SMEs turns positive soon after the introduction of the SME SF, long before the trend in new lending to larger firms. Secondly, the latest figures (cumulated 12-months flow of new loans as of May 2019) show that new lending to SMEs is 20%

[1] Sandrine Lecarpentier & Mathias Lé & Henri Fraisse & Michel Dietsch, 2019. "Lower bank capital requirements as a policy tool to support credit to SMEs: evidence from a policy experiment," EconomiX Working Papers 2019-12, University of Paris Nanterre, EconomiX

[2] ECB Statistical Data Warehouse, monthly figures of 12-months cumulated new business. Loans below 1 million euro are assumed to be loans to SMEs, according to the approach followed by the EBA in its assessment.

higher than it was in 2013 - before the SME SF - while for larger firms is only 4% higher than it was in 2013.

- **Cost of borrowing** (Interest rates). Still based on ECB statistics for the Euro Area, the gap between interest rates applied to SMEs and to larger firms have been studied. The gap, fairly wide before the application of the SME SF, reduced significantly over the whole period of application of the SME SF. More precisely, it declined from around 1,5% prior to introduction of the SME SF to 0,8% as of May 2019.

- **Access to credit**. The third variable studied is the trend in access to bank financing (share of negative outcome to applications for bank loans)[3]. In this respect, both SMEs and larger firms show better access to finance in the period following to the application of the SME SF, but the improvement for SMEs is larger than for the latter. More precisely, even if the SMEs still show a higher share of negative outcome, the gap to larger firms reduced by more than 20%

Moreover, as part of the "finalization of Basel III", the introduction of the output floor could, according to our estimates[4], lead to an increase in the cost of credit for SMEs between 0.15 and 0.67 percentage points. In other words, the average interest rate on new loans to SMEs would increase by 10 to 40%. Assuming the removal of the SME supporting factor, the rise in the cost of borrowing could reach 0.88 percentage points in the worst case, which would represent a 55%.Overall, the quantitative evidence reported shows that following the introduction of the SME SF there has been an improvement in the availability (both in terms of lending volume and conditions for access) and cost of SME loans. This improvement can be seen in comparison with both previous trends and the dynamics of larger firms. These evidences suggest that the capital relief applied to exposure towards SMEs has had the desired effect, improving the conditions for their access to bank finance.

Other financial reforms:

We would like to mention the reforms concerning the treatment of non-performing loans recently undertaken in the EU. We would like to draw special attention to the regulation on minimum loss coverage requirements (so-called calendar provisioning). This regulation imposes strict requirements in terms of accounting provisioning or capital deductions on NPLs in banks' balance sheets, depending on the vintage in non-performing status and the collateralisation of the position. This could have at least two effects on SME financing. First, the severe treatment for unsecured exposures which turn NPLs is likely to determine a tightening in credit conditions and namely a higher request for collateralisation – that the FSB acknowledges to be an obstacle to SME financing. Secondly, the time pressure is likely to discourage banks form providing forbearance measures to SMEs (and other clients) experiencing temporary liquidity difficulties - where time might be needed before the exposures are cured - while the bank has to provide prudential coverage (so it could find more convenient to proceed with the enforcement of collateral).

[3] Based on the ECB SAFE survey "Survey on the access to finance of enterprises".
[4] Please see the Annex

Evaluation approach

7. Methodology: Is the analytical approach used to evaluate the effect of reforms appropriate? Are there other approaches to consider for this evaluation?

The methodology applied for the quantitative assessment of the effects of the reforms, focused on the 2010 Basel III package only, seems to show some weaknesses. The empirical analysis is based on a model (the "baseline approach") aimed at estimating the effects of the reforms on banks' financing to SMEs. More precisely, the model considers the evolution of SME financing before and after the Basel III reforms. To identify the effects of measures, the sample banks are divided into two groups, depending on their exposure to the reforms (ex-ante). This is to compare the effects of the reforms for the two groups[5]. Classification of banks in groups is based on the levels of their capital/liquidity ratios before the reforms. A bank is identified as "more exposed to the regulatory change", if its capital or liquidity ratios are below a threshold set at the bottom quartile of the distribution for all banks. Otherwise it is considered "less exposed" (control group). The composition of the two groups remains constant over time.

In order to assess the methodology, it is important clarifying that **the effects of regulatory reforms are estimated only in relative and not in absolute terms**. The underlying assumption is that "more exposed" banks are more likely to be affected by the reforms and should therefore show stronger effects on SME financing. Anyway, if "more exposed" banks show higher reduction in SME lending compared to the control group, this does not imply that less exposed banks are not affected by the reforms. This clarification is provided by the FSB itself.

In our opinion, **this represents a weakness of the study.** Indeed, taking it to the extreme, this implies that if the effects of the reforms were huge for both groups (i.e. SME lending declined sharply for both groups) the study would conclude that the reforms had no impact on SME financing.

This paradox puts into question the criteria applied for identifying banks exposed to reforms. Identification based on the ranking (i.e. percentiles of the distribution) does not consider all available information, namely the severity of the reforms. If the reforms require such a higher level of capitalisation that also banks in percentiles of the distribution higher than the bottom quartile need to raise capital, the relative positioning of banks might not be the better indicator of exposure to the reforms. Other indicators, e.g. the presence of a capital shortfall to the post reform capital target level, could be more appropriate. Under such approach, all banks showing a capital shortfall (in absolute terms or exceeding a threshold), should be considered exposed to the reforms, irrespective of their relative positioning in terms of capitalisation compared to other banks.

The FSB mentions elements limiting the comparability of results among jurisdictions. Firstly, in some jurisdictions, at the time the reforms were implemented, similar measures were already into force, or policies were enacted aimed at enhancing access to finance for SMEs. Both cases would result in underestimating the effects of the reforms. This point is significant as, for example, measures such as in the EU the SME Supporting Factor – that came into force in conjunction with the Basel III reforms – could have contributed to significantly limit the extent of possible restrictions in credit supply. In other words, the study investigates the net effect of the reforms, while the relevant information would be to disentangle the effects of the two.

[5] The existing gap in credit trends between the two groups is rightly considered.

In addition, banking sectors show substantial differences among jurisdictions (e.g. in terms of relative importance of banks' financing to SMEs, of average size and concentration of the banking industry). Moreover, availability of figures differs widely among jurisdictions, and sometimes also within jurisdictions if there are different sources of data. Empirical analysis is based on figures from 15 different databases. Four out of these 15 databases cover several countries, while the others – relating to single jurisdictions – show more granular data (for both banks and firms).

Analysis based on cross-country databases shows only weak evidence of a negative impact of reforms on the growth of SME lending in countries where, before the reforms, banks were less capitalised. This evidence is valid only for some countries and not for all the sample. Further analysis shows that the effects of reforms are relatively stronger for jurisdictions affected by an economic crisis. In these countries, after the reforms, credit to SMEs and to corporates declines, irrespective of the level of banks' capitalisation. ("*Preliminary findings also suggest that the effects were amplified in jurisdictions undergoing a macroeconomic downturn in the reform implementation period*"; indeed, "*…short-term and long-term credit were negatively affected in jurisdictions with less capitalised banking systems relative to other jurisdictions. Robustness analyses indicate that the effects might have been stronger in countries hit by a macroeconomic crisis. In these jurisdictions, lending to SME and total corporate declined in the post-reform period and independently from the fact that their banking systems were relatively more or less capitalised*")

Although not explicitly addressed by the FSB, in our opinion this point is pivotal as **it confirms that, on the one hand, reforms have procyclical effects (i.e. they hit more severely countries experiencing difficulties) and, on the other hand, that this systemic effect represents a bias of the proposed approach**. Indeed, if SME financing is affected irrespective of banks' capitalisation, this put into question the FSB approach (relative analysis), where effects of the regulatory reforms are acknowledged only if credit trends of "more exposed" banks significantly differ from those of better capitalised banks.

The study discriminates between "persistent" – i.e. lasting for the entire period observed after the reforms – and "temporary" effects of the reforms. The quantitative assessment tends to conclude that reforms determined only a temporary slow in the pace of SME lending – and, in some jurisdictions, tightening in the cost of credit and collateral requirements[6].

The within-country analysis, based on more granular data, both at bank level and at bank firm level, shows a more articulate picture as to the effects of capital measures on SME financing. Reference is made to the results in the blue and red boxes in the table below, showing the output of econometric analyses performed by the FSB. For each analysis (the rows of the table), the number of countries is indicated where negative and statistically significant effect on SME financing is found (black square, meaning that reforms led to a decline of SME financing in that country), where no effect is found (white triangle) or where the effect is positive (black circle). The effects on corporate financing are illustrated in the same form in the right block.

[6] These effects seem to be driven by the capital measures, while the introduction of the liquidity ratios (LCR and NSFR) and the leverage ratio seem not to have determined significant impacts.

Table 3: Effects of Risk-based capital (RBC) reforms – SME and non SME lending growth

Results of within-country satellite analyses - By type of data, region, advanced versus emerging markets, average 2010-2017 GDP growth

Results indicated with: ● positive (at the 10% level); ■ negative (at the 10% level); △ not significant

	Credit growth to SMEs		Credit growth to corporates			
			Total corporates		Non-SME	
	Transitory	Persistent[1]	Transitory	Persistent[1]	Transitory	Persistent[1]
Cross-country						
FSB questionnaire data	■	△	△	△		
Satellites by type of data						
Bank Level	■■■■ △△△△△ ●●	■■ △△△△△△△△△	■■ △△△△△△ ●●●	■■ △△△△△△△△ ●	■■ △△△△△△△ ●	■■■ △△△△△△△△
Bank Firm level (based on balanced sample)	■■■■ △△	■■■■ △△	■■■ △△ ●	△△△△ ●	■■■ ●	■ △△ ●
Satellites by region (based on bank-firm level data where applicable)						
Americas	■ △ ●	■ △△	● △△	△△△	△ ●	△ ●
Asia	■ △△	■ △△	■■ ●	■ △△	■■ △	■■ △
Europe	■■■■ △	■■■ △△△	■■■ △△	△△△ ●	■■■ △	■ △△△
Satellites by Advanced versus Emerging Markets (based on bank-firm level data where applicable)						
Advanced economies	■■■■■ △△△ ●	■■■■ △△△△△	■■■■■ △△△ ●	■ △△△△△△ ●	■■■■■ △△△	■■■■ △△△△
Emerging markets	■ △	■ △	△ ●	△△	●	●

The analysis on bank-level data (blue box) shows that, in 4 out of 11 jurisdictions, temporary significant negative effects of capital measures on SME financing are observed. In 2 out of 11 cases, the effects are persistent over the entire post-reform period. It might be worth noting that for non-SME corporates, effects are persistent in 3 out of 11 cases.

Anyway, considering bank firm level data (red box) – allowing for better identification of effects, also according to the FSB – the findings of the empirical analysis show far more penalising results, in particular with respect to SME financing: in 4 out of 6 countries, significant negative effects of reforms on SME financing – both temporary and persistent - are found.

In Europe (orange box), temporary significant negative effects of reforms on SME financing are found in 4 out of 5 countries – in 3 out of 6 persistent effects are found. A significant presence of these effects is observed also when studying advanced economies (green box – temporary effects in 5 out of 9 cases and persistent effects in 4 out of 9 cases).

In short, our criticism is focused on the following:

- the study shows that a one-size-fits-all pattern for all jurisdictions cannot be outlined, since the impact of reforms on SME lending depends on country-specific factors. In particular, the study shows that in countries hit by an economic downturn during the reform implementation period, the pace of lending was reduced for both SMEs and other firms. This seems to be a **strong evidence that regulatory reforms and supervisory actions in recent years are proven to be highly procyclical.** This aspect is not provided the appropriate attention by the FSB;

- **the methodology of the empirical analysis seems to be questionable.** In particular, the criteria applied for identifying banks exposed to the reforms raise concerns. Identifying as "more exposed" the banks in the bottom quartile of the distribution of capital ratios (ex-ante) and as "less exposed" all the remainder, might lead – and actually leads in aggregate estimates – to paradoxical results, since capital shortfalls are not considered. Indeed, if the reforms imply – as actually happened – a huge increase of capital requirements, also better capitalised banks would show capital shortfall with respect to regulatory/supervisory targets. In this case, using the relative positioning of the bank as an indicator of bank's exposure to reforms seems not very meaningful;

- in addition, the more sophisticated empirical analysis available, i.e. the one based on granular bank firm level data for six jurisdictions, shows significant (in our opinion) evidence of negative effects on SME lending, both temporary and persistent. This is not appropriately highlighted in the text.

- It would be easier to assess the analytical approach if the FSB had also engaged in a more detailed analysis covering certain jurisdictions and regions, because the effects of the different drivers identified in the report would have been more clearly assessed. As the report recognizes, QE supporting measures (as TLTRO in the EMU and UK) can be possible confounding factors in the assessment.

8. Cost-benefit considerations: Do you have any comments on the considerations of social costs and benefits of the reforms with respect to SME financing?

FSB conclusions tend to emphasise that the evidence collected suggest for "more exposed" banks a temporary slow in the pace of SME lending – and, in some jurisdictions, tightening in the cost of credit and collateral requirements. These effects seem to be driven by the capital measures, while the introduction of the liquidity ratios and the leverage ratio seem not to have determined significant impacts.

Also based on the findings of the qualitative analysis, the consultative document emphasises, in front of a negative impact on credit supply in the short-medium term, a long-term positive impact, since better capitalised banks would foster financial stability and growth. These benefits are supposed to outweigh the initial costs. It is worth noting that it is only assumed, but not demonstrated with dedicated analysis, that the positive impact in the long term would outweigh the negative impact on SME lending in the short-medium term.

Hence, we would be cautious regarding these considerations because it would be necessary to analyse a full economic cycle to arrive at more meaningful conclusions at global level, and this has not happened yet for many of relevant jurisdictions. In our view, the analysis carried out would be premature and should be repeated in the future.

Effects of reforms

9. Effects of G20 reforms on SME financing: Are the findings in the report about the effects of G20 reforms implemented to date (particularly the initial Basel III package agreed in 2010) on SME financing consistent with your own experience? Is there any additional information to support (or contradict) these findings?

It would make more sense to define long term as '5years and more'- as in the ECB statistics. Also, Financial market regulation threatens to squeeze traditional maturity transformation activities out of banks' balance sheets. This could compromise their ability in the future to take on long-term risk (5 years and more).

'Can we provide data from the EU to give an answer to this question?'

Reiterating our comments included in our response to the previous FSB consultation, evidence suggests that SME finance was not at the core of the financial crisis bursting in 2007. In actuality, EU SMEs made a significant contribution to the recovery and subsequent expansion of the EU economy following the crisis. They accounted for 47% of the total increase from 2008 to 2017 in the value added generated by the non-financial business sector and for 52% of the cumulative increase in employment in the sector. In fact, their contribution exceeded what would have been expected on the basis of their relative importance in the economy[7].

Decisions taken at European level to alleviate the unwarranted overall pressure on SME lending up to that point in time, were critical, and show the critical correlation of effects that can be felt along the system.

Continued regulatory support to bank financing of the economy is critical to ensure proper financial intermediation and risk management that the banking sector critically holds. However, the new regulatory reform might put SME exposures at a disadvantage with regards to other alternative uses of capital in the banking sector. This might be an unintended consequence of the vast regulatory overhaul that has put the banking sector worldwide on a much stronger footing overall.

As stated above, banks have a very important responsibility in channelling funds to the real economy. Despite the fact that allocated capital has indeed increased under Basel III, banks have not transmitted these impacts 1:1 to SMEs.

In restraining volumes and market shares: banks have "sanctuarised" their domestic SME franchises, remarking their role as responsible lenders, financing the real economy (SMEs are the backbone of European economy), sometimes under increased pressure from governments. But the capital hit was real, and had to be absorbed by other, arguably less core, or more agile businesses, such as large Corporates and capital markets businesses. This aspect must be considered, as otherwise, it seems that there was no impact at all.

According to *ad hoc* questions in the latest ECB Bank Lending Survey, supervisory or regulatory action (especially CRR/CRDIV) had, on average, a net tightening impact on banks' credit standards for SMEs in the last few years and are expected to tighten in the next months. In addition, supervisory or regulatory action had a broadly neutral impact on credit margins for loans to enterprises but lead to a strengthening of banks' capital position.

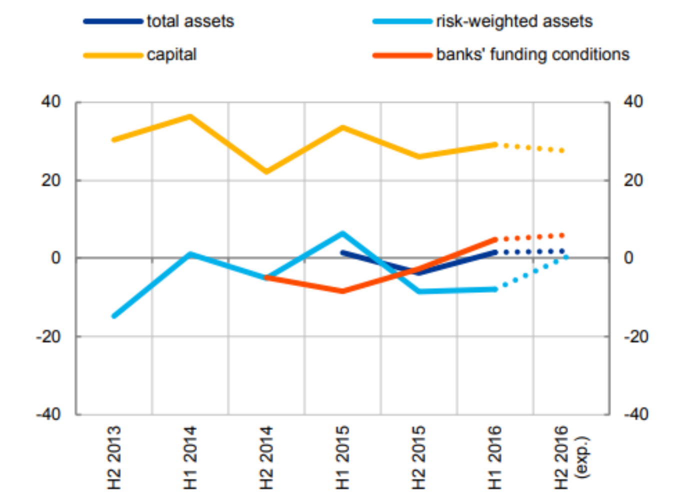
[7] Annual Report on European SMEs 2017/2018, p.62

Euro area banks expect regulatory or supervisory action to lead to a further strengthening of their capital position and to have a tightening impact both on credit standards and credit margins across all loan categories.[8]

We highlight that these conclusions are generic and, even though important, are based on aggregate and sample data, which nevertheless might include divergent point of views among Euro Area members.

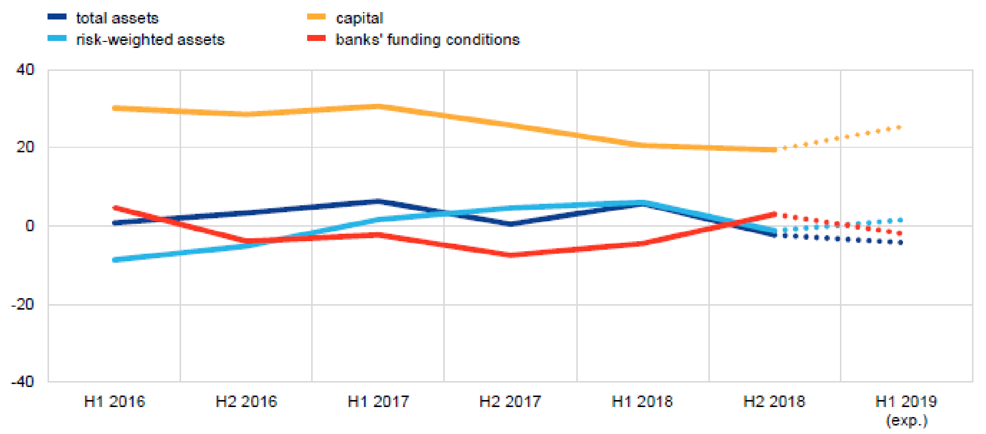
Impact of regulatory or supervisory action on banks' risk-weighted assets, capital and funding conditions

(net percentages of banks)



Impact of regulatory or supervisory action on banks' risk-weighted assets, capital and funding conditions

(net percentages of banks)

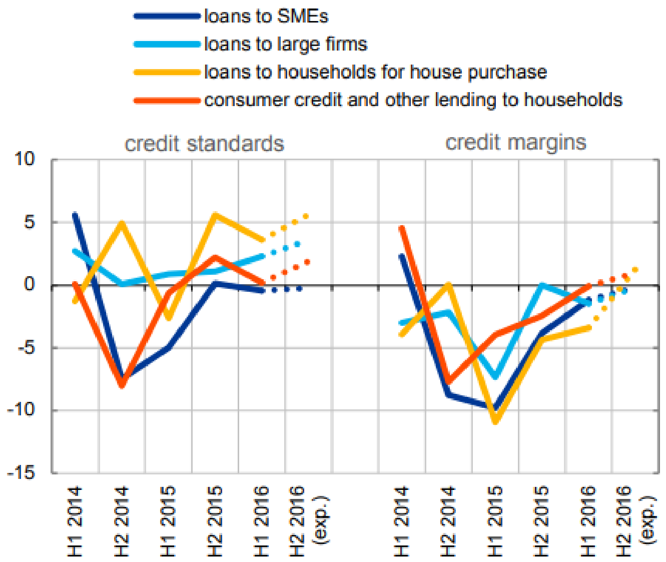


Source: ECB Euro Area Bank Lending Survey - Fourth quarter of 2018 and Second quarter of 2016

[8] Available at: https://www.ecb.europa.eu/stats/ecb_surveys/bank_lending_survey/html/index.en.html

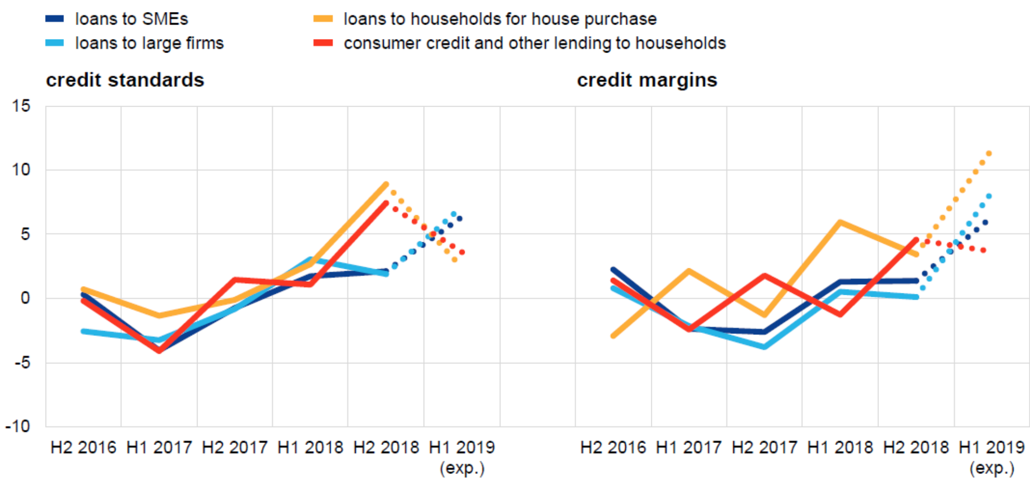
Contribution of regulatory or supervisory action to the tightening of banks' credit standards and margins

(net percentages of banks)



Contribution of regulatory or supervisory action to the tightening of banks' credit standards and margins

(net percentages of banks)



Source: ECB Euro Area Bank Lending Survey - Fourth quarter of 2018 and Second quarter of 2016

More concrete impacts of regulatory reforms

We would like to reiterate the specificities of the SME financing mix in Europe with regards to their preference for bank loans, and the critical implications this has when regulating.

Unlike other exposures, SME lending is hit by assorted regulatory standards: it is subject to higher capital requirements just as any other asset; it is subject to the leverage ratio; it represents a cost in terms of compliance with the liquidity coverage ratio; risk transfer via securitisation is subject to significantly heightened requirements; and only credit lines with extremely short terms may help to comply with the NSFR.

Moreover, the ECB is now running a liquidity stress testing in anticipation of the phasing out of the Asset Purchase Programme.

In addition, in the new credit risk framework under Basel III, SME lending will be disproportionately hit by the provisions regarding the Capital Conversion Factor (CCF), as it penalises undrawn credit facilities, largely used by SMEs.

As a result, SME finance is becoming one of the least attractive uses of regulatory capital for banks nowadays, amid a very complex and demanding regulatory framework that pushes them to other more liquid assets in the balance sheet. SME finance is also an ever-increasing compliance cost – due to a continually increasing set of standards and rules.

10. Effects across jurisdictions: Are Basel III reforms having a differentiated effect on the provision of SME financing (in terms of volumes, pricing and other financing terms) across jurisdictions? If so, what determines the differentiation in effect? Are there other differences in terms of impact that should be considered by the evaluation?

It is certainly interesting to understand the differences among jurisdictions, but the report concludes that there is not sufficient data to carry out this kind of analysis. As a result, we propose the FSB to repeat this analysis later, when a full economic cycle has been completed.

11. Effects of other reforms: G20 reforms that are at an earlier implementation stage and other national financial regulations have only been examined qualitatively. For these regulations, is there any further relevant information about their impact on SME financing that should be considered by the evaluation?

The interplay between more stringent rules and regulations in various legislative instruments (EMIR, MiFID, Basel) makes hedging practices much more complex and costly.

12. Alternative finance: To what extent, if any, have financial reforms created incentives for the provision of financing by non-banks to SMEs of different types and sizes? In particular, how has SME financing through innovative forms (such as FinTech credit platforms) been affected by these reforms? Please elaborate.

We think that, at least in Europe, it would be interesting to analyse the profitability of SME lending for banks and other non-bank providers in order to explicit another avenue where regulatory requirements put at a competitive disadvantage banks vis-à-vis non-banks.

Fintech

As stated in our answer to Q2, Fintech credit is growing at a fast pace. We believe that the report should also comment the **potential risks that Fintech credit poses from the point of view of financial stability**. Banks have these risks mitigated as a consequence of the reforms prudential regulation, (that do not apply to Fintechs). These risks are:

- Greater accessibility to credit harbours the potential for a reduction in lending standards across the economic cycle. Fintech credit risk may be materially higher than for banks because of greater credit risk appetite, untested credit risk models and the potential for misaligned incentives under the agency lending model.
- A greater share of FinTech credit could also result in more procyclical credit provision, including the weakening of lending conditions in an upswing and a pullback in credit in times of stress. Unlike (insured) bank deposits, FinTech loan investments may be prone to investors' fad-like behaviour and swings in their credit risk appetite. Investor herding and a reduction in new funding on platforms could be triggered by a number of factors: a change in returns on other assets, credit losses, or other microprudential risks, such as operational risks or platforms taking on leverage or liquidity risk. FinTech credit platforms may also be more vulnerable than banks to some types of microfinancial risks due to their greater use of untested and digital processes.
- Risk from the availability of substitute forms of credit, either through other P2P platforms (intra-sector substitution) or traditional financial intermediaries (cross-sector).
    - Regarding intra-sector substitution, the apparent concentration of FinTech credit market activity in a number of countries may make it difficult for borrowers to access competing FinTech credit platforms quickly. That said, in principle, barriers to existing platforms taking on different types of lending are not high.
    - On cross-sector substitution, the supply of credit to certain P2P borrowers by traditional financial intermediaries is often quite limited. Hence, there is a reasonable chance that this type of FinTech lending will not be promptly replaced from outside the FinTech credit industry.
- Depending on the jurisdiction, the rise of FinTech credit activity that is dispersed and outside the regulatory perimeter may pose monitoring difficulties for authorities.
- More lending activity outside the prudential net may limit the effectiveness of credit-related macroprudential policy measures. Further, FinTech platforms do not have access to public safety nets, such as central bank emergency liquidity.

Another risk concerns the **securitisation of FinTech credit obligations into large bundles**, as this potentially makes available to borrowers funding from different classes of institutional investors and allows FinTech investments to be actively traded. However, depending on its nature, an increased use of securitisation may pose some financial stability risks distinct from other FinTech platform funding avenues:

- The securitisation process increases interconnectedness between FinTech platforms, banks and capital markets; if the FinTech credit market continues to expand, this may create new transmission channels whereby risks generated in the FinTech credit industry are spread to the wider financial system, and vice versa.

- In the absence of “skin in the game” retention requirements, the potential for misaligned incentives may be greater than if the loans were not securitised given that, from a reputational perspective, loans are further removed from the platform.
- The bundling and tranching of loan obligations may lead to greater opacity in the overall market for investors and for regulators.

Risks to financial stability and Securitisation are taken from the joint CGFS-FSB report on FinTech credit - Market structure, business models and financial stability implications, released in May 2017[9].

Crowdfunding

Crowdfunding regulation *(taken from the EBF March 2019 answer)*

Due to the steady increase of presence of Crowdfunding Service Providers in Europe, without enjoying a common framework to which adhere at EU level (beyond the compliance with local regulations), the EU launched a proposal for a regulation in this sense.

The regulation takes the shape of an opt-in regulation (Crowdfunding platforms can choose to comply with local regulations or the EU framework that grants them passporting rights). However, it is still key to ensure that the future landscape to regulate crowdfunding platforms does not remain as an opt-in system hence to propose consistent framework across the EU to which all European Crowdfunding Service Providers (ECSP) adhere. The regulation is approaching its latest stages of negotiation.

It lays down the basic requirements for the Crowdfunding Service providers, in terms of prospectus-like documents to be provided, capital requirements, financing thresholds, investor protection, etc.

The regulation provides a clearer framework for scaling up these platforms at EU level and ensuring that SMEs, in need of these services, can access them in an appropriate way and with all the safeguards duly in place. EBF-supported increases in threshold, sound requirements and passporting, are positive elements that will ensure a good starting point for regulating these activities.

[9] Available at: https://www.bis.org/publ/cgfs_fsb1.pdf

Additional considerations

13. Other issues: Are there any other issues or relevant factors that should be considered as part of the evaluation?

Basel III implementation in Europe

Decisions taken at European level to alleviate the unwarranted overall pressure on SME lending from 2008 to 2017 were critical and show the critical correlation of effects that can be felt along the system.

Continued regulatory support to bank financing of the economy is critical to ensure (especially in Europe, taking into account the importance of Bank lending for European SMEs) proper financial intermediation and risk management that the banking sector critically holds. However, the new regulatory reform might put SME exposures at a disadvantage with regards to other alternative uses of capital in the banking sector. This might be an unintended consequence of the vast regulatory overhaul that has put the banking sector worldwide on a much stronger footing overall.

Banks have a very important responsibility in channelling funds to the real economy. Despite the fact that allocated capital has indeed increased under Basel III (mostly due to higher minimum ratio requirements), banks have not transmitted these impacts 1:1 to SMEs.

In restraining volumes and market shares: banks have "sanctuarised" their domestic SME franchises, remarking their role as responsible lenders, financing the real economy (SMEs are the backbone of European economy), sometimes under increased pressure from governments. But the capital hit was real, and had to be absorbed by other, arguably less core, or more agile businesses, such as large Corporates and capital markets businesses. This aspect must be considered, as otherwise, it seems that there was no impact at all.

According to ad hoc questions in the latest ECB Bank Lending Survey, supervisory or regulatory action (especially CRR/CRDIV) had, on average, a net tightening impact on banks' credit standards for SMEs in the last few years and are expected to tighten in the next months. In addition, supervisory or regulatory action had a broadly neutral impact on credit margins for loans to enterprises but led to a strengthening of banks' capital position.

Euro area banks expect regulatory or supervisory action to lead to a further strengthening of their capital position and to have a tightening impact both on credit standards and credit margins across all loan categories.

NPLs

European banks are steadily and diligently reducing their NPLs. NPLs from SMEs are sticking to banks' balance sheets. The costs of due diligence are higher than the benefits that could be extracted from selling them off.

More generally, the wave of new EU prudential regulations and supervisory actions about NPLs and the definition of default raises concerns in respect of its impact on SME financing.

The European Union Regulation on NPL backstop, which requires stringent provisioning requirements for uncollateralized lending, combined with European supervisors pushing banks to take losses on NPLs could play against SME lending (current and future).

Moreover, the ESRB has considered in its last report on NPLs that there could be further prudential measures in relation to buffers focusing on some sectors or targeting for instance non-financial corporations. Also, measures in relation with commercial and residential real estate activities are in the balance: enhancement of large exposure framework, possible raise of LGDs.

IFRS9

At international level, the issue of procyclicality in the capital framework was discussed. we have as a concern that this may actually be further exacerbated by the recent accounting framework, as it creates incentives for short-term tenors vs long-term investments.

We fear that this procyclicality may further worsen with the advent of Expected Credit Loss (ECL, both under IFRS9 and US GAAP's CECL) requirements. Though the impact of IFRS 9 is being monitored by the EBA since the start of IFRS 9 implementation, it seems to date the impact is not known exhaustively. When assessing the SME financing, the IFRS9 framework should be part of the reflection.

The influence of supervisory actions

The influence of supervisory actions in a broad range of fields must be considered when assessing SME financing. Especially, as supervisory practices may also differ between jurisdictions. There seems to be discrepancies between institutions which are relevant to consider when making an assessment.
The SSM (European supervisor for significant institutions) seems to have requested the toughest requirements for significant institutions in relation with prudential topics:

- Scrutinising all credit internal models through their TRIM exercise has also focused some of their missions on SME portfolios; in addition, microprudential measures are reputed to be procyclical, which means that measures are still applied constraining more SME financing even if the economic conditions are considered favourable;
- Focus on commercial and residential real estate activities by the SSM: some institutions have faced particular inspections in such sectors;
- Request made by the SSM to significant institutions to prepare the implementation of the Future of IRB approach (two-step approach) is currently leading banks to rush into significant changes of their risk management framework; new definition of default, and coming recalibration of internal credit risk parameters;
- EBA program on IRB framework: The Future of IRB Approach. During the last few years, the EBA has published several regulatory papers to harmonize the IRB framework; the objective of the EBA is to harmonize requirements within the European Union, particularly when it comes to the definition of default and the risk quantification of credit risk parameters. Such workstream though welcome, as they strongly restore confidence into internal models, could lead to a loss of risk sensitivity and increase of capital requirements especially on SMEs.

SME growth markets

The EBF supports the initiative by European regulators to build a proportionate regulatory environment to support SME Growth Markets and SME listing.

The initiative takes relevant steps to improve the capability of SMEs to access wider financing options, especially for those corporates trying to list and issue securities on financial markets. The initiative on “SME growth markets” sets the requirements of this recently introduced category of trading venue dedicated to small issuers.

We understand this recently approved proposal as a positive step to foster the access of a more diverse range of companies to public markets. The proposed thresholds seem to allow SMEs of different sizes and bases to compete for funding on an equal footing, and to support the increased need of "gazelle" companies and start-ups to access non-loan forms of finance.

European Banks, as key intermediaries in financial markets, ensure a smooth participation of corporates of all sizes wishing to raise money in the markets, and accompany them during their ascension on the "funding escalator".

The impact of public and blended funds

In the EU, several financial instruments were created during the last years, such as the COSME Programme, fostering the financing of SMEs, through equity or loan facilities. The European Fund for Strategic Investments (EFSI) was also an important instrument to finance SMEs, namely through the SME window, that now is going to be followed up under the "Invest EU" banner.

These instruments, together with different policy measures directed towards SMEs, had and still have a positive effect on SME financing by banks. For example, the financing and guarantee mechanisms provided by the European financial institutions, such as the EIB/EIF. The benefits of those instruments and policies are considered as positive thus they may have reduced the effects of regulation on SME bank financing, either by reducing capital requirements or by improving the general risk profile of SMEs or SME projects.

In this way, the positive effects of some policies regarding the improvement of SME access to finance should, therefore, be duly considered when trying to establish links between SME bank financing flows and conditions with the implementation of financial regulatory reforms. This potential overlap of measures, policies and regulation might hamper the needed assessment of the direct effects of financial regulatory reforms on SME financing. Furthermore, the assessment of SME financing might be constrained by the availability and granularity of data.

From our perspective, public and blended finance funds (such as those of the EIB, EBRD) must be used in a focused and anti-cyclical way to prevent the crowding out of private financing thus avoiding diverting public funds away from society's real needs.

Business insolvency

The European Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures (business insolvency Directive), includes different provisions that we expect will have a negative impact on the cost of future lending.

As mentioned above, SMEs (especially younger companies) tend to have little credit history, lower credit score and low-quality collateral. Secured creditors are "secured" by having a right to a collateral/security. Having a good collateral – meaning a collateral that can be enforced when a borrower fails to make payments – decreases the cost of credit.

Business insolvency provisions, that negatively affect the economic interest of secured creditors, will increase the cost of future loans, hitting especially hard SMEs with poor collateral.

The EBF has been working to improve the proposal and to ensure it provides as many safeguards against abuse as possible and that it does not lead to lower rates or return for secured creditors (and thus to much higher cost of secured lending for future entrepreneurs).

Trade/Export finance

While the current economic conditions show that access to finance is no longer one of the top concerns for European SMEs, the regulatory support to expanding the SME Supporting Factor does not mean that SMEs are not facing problems to access the bank finance they need. As mentioned above regarding digitalization and innovation, in addition to general SME lending, bank financing is also a critical mean to finance other SME related-actions and processes.

Trade credit provided by banks and especially loans, are the preferred means of external financing by exporting SMEs as exemplified by the SAFE results above. While the EU is actively fighting against external barriers to trade, European SMEs face resource constrains such as lack of funding or lack of financial resources as one of their main barriers to internationalization.

The application of the Leverage Ratio to banks' exposures to Export Credit Agencies and the NSFR treatment of Trade Finance cannot become unintended internal legislative barriers to trade.

Securitization

Securitization is a great tool to bundle together loans coming from SMEs and transfer risks more efficiently.

Following the financial crisis, changes were already made to major aspects of how securitization is regulated, in order to make products more transparent, tighten incentive and liability mechanisms, and reduce the risk associated with securitizations overall.

Excessive requirements would make it economically unviable for banks to transfer risks through securitization, thus putting at risk this key instrument which enables banks to diversify the risks associated with a pool of corporate loans.

ANNEX

Introduction of the output floor could lead to an increase in the cost of credit for SMEs –French case-study

As part of the "finalization of Basel III", the introduction of the output floor could, according to our estimates, lead to an increase in the cost of credit for French SMEs between 0.15 and 0.67 percentage points. In other words, the average interest rate on new loans to SMEs (1.58% in May 2019 according to the Banque de France) would increase by 10 to 40%. Assuming the removal of the SME supporting factor, the rise in the cost of borrowing could reach 0.85 percentage points in the worst case, which would represent a 54% increase.

This estimation results from the transposition to the French case of the model used by the Basel Committee to assess the long-term economic impact of the implementation of Basel III (BCBS, 2010)[10]. Our impact study focuses only on the effects of the introduction of the output floor and the potential withdrawal of the SME supporting factor as recently recommended by the EBA[11]. By convention, we assume that the size of bank balance sheets is constant. The increase in regulatory capital (CET1) is assumed to be exogenous. The additional capital replaces other less expensive sources of financing. Wider lending spreads and lower dividend payouts contribute to banks' ability to use retained earnings to build capital (Cohen, 2013[12]), as the issue of new shares is unlikely with current price-to-book ratios. Apart from this substitution, the structure of bank balance sheets is assumed to be unchanged, identical to that observed over the past three years on average. This is a low range estimate. The rise in the interest rate on new loans is likely to be even greater than that estimated as long as credit flows to French SMEs do not fully renew the outstanding stock of loans (whose average maturity is close to four years). The theoretical literature suggests that as leverage declines, the riskiness of banks' equity declines as well, and so does the rate of return investors required to hold equity. This is the well-known Modigliani-Miller (M-M) theorem on the irrelevance of the capital structure for the value of the firm. The M-M effect is taking into account in the range estimated by the ECB (2011)[13][14]

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[10] BCBS, 2010, *An assessment of the long-term economic impact of stronger capital and liquidity requirements*, Bank for International Settlements, August 2010, https://www.bis.org/publ/bcbs173.pdf

[11] EBA, 2019, *Call for advice on Basel III implementation*, Public hearing, 2 July 2019, https://eba.europa.eu/documents/10180/2733006/EBA+Public+Hearing+-+2+July+2019+-+Basel+III+Call+for+Advice.pdf

[12] Cohen, B.H., 2013, *How have banks adjusted to higher capital requirements?*, BIS Quarterly Review, September 2013

[13] ECB, 2011, *Common equity capital, banks' riskiness and required return on equity*, Financial Stability Review, December 2011, https://www.ecb.europa.eu/pub/pdf/fsr/financialstabilityreview201112en.pdf?219921fe8e58fd3418d7ed7581d1583c

[14] Based on a sample of large international banks, the ECB's assessment supports the existence of a sizeable, but not full, M-M effect. An increase in the equity ratio (a decrease in leverage) is associated with a decline in both the riskiness of the bank (as proxied by the equity beta) and the required return on its equity (as proxied by the earnings yield). The estimates range between 41% and 78% of what would be predicted under a full M-M effect.

	Impact of the introduction of the output floor on the average interest rate on new loans to SMEs (in percentage points)		
Modigliani-Miller effect[15]	**SME supporting factor maintained**	**SME supporting factor removed**	**Removal of the SME supporting factor and introduction of the revised Basel III framework for SA (a 75% RW for retail SMEs and an 85% RW for corporate SMEs) (EBA Recommendation CR 2)**
Null	0.67	0.83	0.85
Moderate	0.40	0.49	0.50
High	0.15	0.18	0.19

Data sources:

Average risk-weighting of SME exposures: EBA (2018) EU-wide transparency exercise, https://eba.europa.eu/risk-analysis-and-data/eu-wide-transparency-exercise/2018/results

Balance sheet and income statement items: ECB Supervisory banking statistics, https://www.bankingsupervision.europa.eu/banking/statistics/html/index.en.html

Settings:

Target return on equity[1]: 10%

Common Equity Tier 1 (CET1) ratio[2]: 14.01%

Interest rate on deposits[3]: 0.73%

Cost of short term debt[4]: -0.305%

Cost of long term debt[4]: 0.939%

Average maturity of SME loans[5]: 3.9 years

[1]Banks publications

[2]ECB Supervisory banking statistics, 2016-2018 average CET1 ratio of the 11 significant French banks (directly supervised by the ECB)

[3]Banque de France, 2016-2018 average interest rate on outstanding amounts of bank deposits (of non-financial corporations and households)

[4]Datastream, 2016-2018 average Euribor 3M rate (for cost of short-term debt) and 2014-2018 average of CDS 5 years + 5 years swap rate (for cost of long-term debt)

[5]BNP Paribas calculations based on Banque de France data.

[15] We consider the ECB's estimated range of the M-M effect. A full M-M effect implies that when the capital ratio doubles (from 5% to 10% for example), the beta should decline by half (from 1.1 to 0.55). In the ECB study, the empirical data show that if the equity ratio goes up by 5 percentage points, the beta will fall by 0.225. Given that with a full M-M effect, the beta would fall by 0.55, this implies a M-M effect of 41% (0.225/0.55). This is the "moderate" M-M effect. ECB computations also imply that the reduction in the risk premium on bank equity is around 78% of the reduction expected under a full M-M effect. This is the "high" M-M effect.

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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