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Your ref., Your message of Our ref., person in charge Extension Date

 BSBV 115/Dr.Egger/We 3137 30 September 2015

**EBA Discussion Paper and Call for Evidence on SMEs and the SME Supporting Factor**

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the above cited discussion paper and would like to submit the following position:

**General comments**

The fundamental idea behind the initial introduction of the SME supporting factor was the awareness of the utmost importance of SMEs for national economies throughout the European Union.

The factual implementation and the calibration of the factor itself have been based on the concept of neutralizing the increase in capital requirements by the introduction of the capital conservation buffer. The reasoning behind it was to enable banks to provide an adequate flow of credit to SMEs. The necessity to use such measures emphasizes the expectation at that time that the new regulatory requirements, especially the focus on stringent increase in quality and quantity of capital, would potentially further deteriorate the access of SMEs to financing. Although many initiatives to boost alternative sources of financing for SMEs have been attempted, the dependency of SMEs on bank financing is still prevailing.

Keeping in mind that the aim of the supporting factor is to neutralize the more restrictive effects going hand in hand with the introduction of the capital conservation buffer and given the fact that in most Member States the capital conservation buffer comes into force only as of 1 January 2016, it is too early to fairly judge the impact of the factor on lending to SMEs.

We consider it to be difficult to conclude if the SME lending volume has increased or decreased due to one single factor since there are many factors that are relevant in this equation. One of the main relevant factors is the demand side. Economic growth is still weak, and this seems to be the most determining factor. From the figures provided by the EBA using data from the “ECB Monetary and Financial Institutions Interest Rate Statistics” we can draw the conclusion that the supporting factor may recently have had a positive effect in terms of the reduction of the spread between the interest of large companies and small companies. This reduction in interest rates, both in general and, in particular, for SMEs, should have a positive impact on the provision of loans to the real economy in the medium term as soon as the economy starts having a relevant growth rate.

We request not to build up conclusions based on data that – because of the CRD IV phase-in provisions – cannot properly reflect the impact of the SME supporting factor. This is particularly important because the current credit environment is still difficult in many member states.

**Therefore we recommend, that EBA and the European Commission come in their report to the conclusion that the timeframe was not sufficient to come to clear conclusions and therefore that the SME-supporting factor shall be maintained.** We consider that more time should be given to have a better grasp of what the effects of the supporting factor are in the SME lending provision. In any case, the supporting factor can only have a positive impact. Therefore, removing the supporting factor would lead to negative consequences.

**Q1: Do you have systems in place to track the reduction in capital due to the application of the SME Supporting Factor (capital relief)? Yes/No. Please explain and provide evidence.**

Yes. The RWA calculation engines consider the SME Supporting Factor. Technically the Supporting Factor is configured as parameter within RWA calculation engines. Additionally the capital relief is reported on the COREP Sheet, where both pre- and, if applicable, post- SME Supporting Factor figures are shown. Furthermore, the RWA calculation engines contain separate attributes for RWA before and after SME Supporting Factor (if applicable).

**Q2: In your experience, is the reduction in capital requirements due to the application of the SME Supporting Factor (capital relief) being used to support lending to SMEs? Yes/No. Please explain and provide evidence.**

Yes. We are quite sure that without the supporting factor lending to SMEs would be quite lower.

We consider it to be quite difficult to conclude if the SME lending volume has increased or decreased due to one single factor since there are many factors that are relevant for this evaluation. One of the main relevant factors is on the demand side. Economic growth is still weak and this seems to be the most determining factor. Moreover, as pointed out by the EBA, there is no consistent EU SME lending dataset over the cycle (COREP start in 2014).

There has not been enough time to institutionalize the change. Business demands have not changed since the introduction of the Supporting Factor and risk demand is constant over time.

**Q3: Is your internal definition of SMEs in line with the definition of SME exposures subject to the SME Supporting Factor? Yes/No. If no, how are you reconciling the internal definition of SMEs with the definition of SMEs subject to Supporting Factor? Please explain and provide specific examples.**

It depends on the member institution. One credit institution responded that the segmentation for steering business and risk portfolios is based on the same criteria. Still different thresholds are used and so entities are distributed over multiple segments.

As the same criteria are used for internal segmentation purposes, the data required for identification of exposures eligible for the SME Supporting Factor are available in central databases.

**Q4: In monitoring the total amount owed to you, your parent and subsidiary undertakings, including exposures in default, by the borrower and its group of connected clients (as defined in CRR Article 4(1)(39)), what reasonable steps do you take to ensure that amount does not exceed EUR 1.5 million in accordance with Article 501(2)(c)?**

Also this depends on the member institution. One credit institution responded that as the same criteria are used for segmentation purposes, all data required for identification of exposures eligible for SME Supporting Factor are available in central databases.

**Q6: Do you agree with the proposed measures of SME riskiness? Yes/No. Are some of these measures more relevant than others? Yes/No.**

We have concerns about the sources used, the choice of data categories and the conclusions presented by EBA. To ensure a meaningful and productive discussion, there needs to be a mutually agreed definition of what is meant by SME riskiness.

In the section “riskiness of SMEs in the European Union” several data sources are used randomly without any obvious context (BACH-data are mixed into one single index see point 29.) Furthermore the conclusions in the consultation are quite contradictional: While the outcome of the BACH-data is quite differentiated without clear conclusions (see point 26), EBA however comes to the conclusion that SME tend to be riskier than larger firms.

Additionally, it is important to note that the interpretation of the proposed risk measure should differ across industries since e.g. the measure of activity (turnover/assets) is naturally low in CRE (Commercial Real Estate) compared to Retail. Thus, variations in the aggregate measures may only reflect changes in a dominant or particular large sector and not variations for a representative SME due to the heterogeneity across sectors. In addition, the proposed risk drivers do not have equal weight with regards to their contribution to default probability. Thus, the composite index as depicted in Figure 8 in the discussion paper (EBA/DP/2015/02) is in part misleading and the conveyed message that SMEs in general had a larger decrease in credit quality than larger firms is in our experience largely dependent on regional characteristics and market maturity.

Examining the proposed measures in section 4.3 of the discussion paper, we would like to emphasise that larger firms compared to SMEs had a larger percentage drop from peek to bottom in default driving aggregate indicators such as coverage and profitability during the global financial crisis. This finding is well aligned with both theoretical empirical studies that conclude that larger firms are more affected by global systemic risk factors since asset correlations increase with the size of the firm. As correctly quoted by the EBA in the discussion paper (pp. 28), lower asset correlations for smaller firms should translate into a lower capital requirement. The actual reduction in capital requirements resulting from the SME supporting factor is by far not large enough compared to empirical results (for example, see the extensive analysis conducted by *Düllmann* and *Koziol* in Discussion Paper Deutsche Bundesbank No 22/2013, *Evaluation of minimum capital requirements for bank loans to SMEs,* available on [www.bundesbank.de](http://www.bundesbank.de)). This in turn confirms that the SME supporting factor is not only justified but also highly conservative.

**Q9: Do you agree with the proposed methodology to assess the own funds requirements in relation to SME riskiness? Yes/No. If no, please provide alternative methodologies or indicators, if available.**

We do not agree with the chosen methodology. First of all we do not agree with an EU-wide figure-based approach, as the influence on SMEs default on the systemic risk varies between the Member States.

We also cannot accept the assumption that large corporates pose a less systemic risk than SMEs. We would be for example very interested in the issue if a broad diversified portfolio of a bank with a numerous SME-exposures is safer than a portfolio with a few large corporates. We are of the opinion that a broad portfolio of SME-exposures leads to a broad diversification and thus to a higher stability of the portfolio. We think that large corporates may pose a much higher threat to the systemic risk in case of insolvency than a lot of smaller SME-exposures.

From our perspective there is a lack of consistent data to monitor capital flows to SMEs.

From the figures provided by the EBA using data from the “ECB Monetary and Financial Institutions Interest Rate Statistics” we can draw the conclusion that the supporting factor may recently be having a positive effect in terms of the reduction in spread between the interest of large companies and small companies. This reduction in interest rates, both in general and, in particular, for SMEs, should have a positive impact on the provision of credit to the real economy in the medium term as soon as the economy starts having a relevant growth rate.

**Q11: Do you agree with the above interpretation of statistical data on lending trends and conditions? Yes/No. If no, please explain.**

In general we agree with the interpretation of the statistical data. However the economic conditions in Europe before and after crises are different and, as a result, the SMEs are operating in a different macroeconomic environment. So the comparison of pre-crisis to post-crisis levels may not be meaningful. Also there are additional factors influencing the SME lending/demand which should be taken into consideration. The lending trends for SME are highly dependent on the specific macroeconomic conditions of the respective country in which they operate. Some of the EU countries have recovered more quickly while others are still in recession. For those countries in recession, credit demand is still low and lagging behind pre-crisis levels, regardless of the introduction of the Supporting Factor.

**Q12: Since 1 January 2014, have you changed your SME credit lending and assessment policies and procedures, specifically as a result of the introduction of the Supporting Factor? Yes/No. If yes, please explain and provide specific examples.**

The credit lending policies in some credit institutions were not adapted explicitly as a result of the implementation of the Supporting Factor but in order to reflect the easier lending to SME using national or EU programs.

Additional steps are taken into account in order to support the lending to SME, eg. by more precise risk assessment allowing for increased product choices. These measures are feasible because the SME lending is currently RWA efficient and if the Supporting Factor is removed the approach will be scaled down or completely removed as certain products will become too RWA-heavy.

The Supporting Factor was introduced in the beginning of 2014 thus the observation period is too short for conclusive estimation since:

• The Supporting Factor was not reflected in the credit lending policies and practices of 2014 since it was introduced after their rollout. It could only be considered in 2015 documentation.

• The SME credit lending policies were already strengthened after the crisis anyway (independent of the Supporting Factor) due to 1) the deterioration of the pre-crisis portfolios and 2) the subsequent cleaning of the portfolios.

**Q13: Have changes to your SME credit lending and assessment policies and procedures been driven by other factors (e.g. competition from alternative sources of SME financing as described in section 4.1)? Yes/No. Please explain and provide specific examples.**

As we have already mentioned it is not possible to analyse SME lending due to one single factor (e.g. the SME supporting factor). However in some credit institutions there were also changes in the lending policies driven by the following factors:

• Introduction/continuation of EU subvention programs (EIF, JEREMIE, COSME, etc.).

• Change in customer demands.

• Tightening of the lending in FCY due to the evolution on the market and the regulation imposed on financial institutions.

**Q14: In your experience, is there an impact of the SME supporting factor on the volume of SME lending compared to other loans? Yes/No. Please explain and provide evidence.**

The Supporting Factor was introduced in the beginning of 2014 thus the observation period is too short for conclusive estimation. Nevertheless SME lending is currently RWA efficient and if the Supporting Factor is removed, then it is obvious that volume decreases.

As mentioned from EBA on page 16 of the Discussion Paper the purpose of the reduction (given by the SME Supporting Factor) is to allow credit institutions to increase lending to SMEs in the current economic context. As the economic situation has not really changed it definitely can be said that skipping the SME Supporting Factor would have a negative impact on the lending volume to SME.

**Q15: In your experience, is there an impact of the SME supporting factor on the pricing and overall conditions of SME lending compared to other loans? Yes/No. Please explain and provide evidence.**

Overall pricing for SME customer is always higher compared to corporate customer, regardless of the introduction of the Supporting Factor. However, during recent years the spread between SME and corporate rate has been decreasing which is largely possible due to the existing of the Supporting Factor.

**Q16: Do you consider SMEs are a consistent group when it comes to access to credit or should a distinction be made between different types of SMEs (e.g. micro, small and medium ones)? Yes/No. Should other criteria also be considered (e.g. sector of economic activity or further detail by size type)? Yes/No. Please explain and provide specific examples.**

No, in our opinion SME cannot be considered as a consistent and uniform group for lending. However, the alternative approach would be to take into account local specifics, especially different levels of development in the economies in the EU. In addition, heterogeneity also arises across different sectors since e.g. CRE and Retail are heterogeneously affected by various risk drivers.This approach might be however burdensome to implement in an EU-wide harmonized way.

We ask you to give our remarks due consideration.

Yours sincerely,

Dr. Franz Rudorfer

Managing Director

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