Comments[1]

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

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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[1] Please note that these comments are subject to the final approval by the committees of the Association of German Public Banks (VÖB).

General observations

Political objectives of the SME Supporting Factor have not yet been achieved
In the first instance, we would like to point out that there is a continued need to provide dedicated support for SMEs in order to stabilise the economic situation in the Member States of the European Union, to promote competition overall and to support job creation. Support for SMEs, as the main driver of economic growth, is an essential factor in any sustainable economic recovery.[2] SMEs make up the overwhelming majority (about 99 out of every 100) of all European companies, create the majority (two out of three) of jobs in the private sector and are responsible for more than half of the value added generated by all companies in the EU.[3] Numerous crises and the high unemployment levels in the Member States have demonstrated that economic recovery has to be further supported by targeted regulatory action, in particular in the SME sector.

Regulatory objectives already achieved
A look at the regulatory objectives regarding bank financing of SMEs strongly supports the argument that a termination of the SME Supporting Factor would be highly contradictive. Together with the increase in capital requirements, the introduction of two capital buffers (Capital Conservation Buffer and Countercyclical Buffer) is already aimed at stabilising the banking sector, in particular with regard to the risk that it will not have sufficient capital backing to cover systemic risks or its exposure to default risk, counterparty credit risk and market risk. As a fixed mark-up on the Common Equity Tier 1 capital ratio, the capital conservation buffer is designed to cover losses in periods of stress so that banks do not have to use their regulatory minimum own funds. In turn, the countercyclical capital buffer prevents excessive credit growth, as banks have to build up the buffer during periods of economic growth, as well as during economic booms, allowing losses to be absorbed in stressed periods. For the standardised approach (SA), this ultimately increases the own funds requirements for retail exposures to between 8% and 9.75% (risk weight of risk exposures multiplied by the total capital ratio without any capital buffer). Implementation of the CRR thus increased the risk weights from 75% to between 100% and 120%. The Basel Committee's plans to modify the standardised approach should also be considered in this context, as these are likely to negatively impact SME financing. There was also a similar increase for exposures to SMEs under the Internal Ratings Based Approach (IRB Approach). As a result, the main risk drivers in the market are already covered by these capital buffers. There are no good reasons for placing the SME business segment at a disadvantage compared with Basel II because there is insufficient evidence that the risks associated with SMEs have increased since the introduction of the SME Supporting Factor.[4]

Additionally, a further minimum requirement to safeguard financial stability was introduced in the course of implementing CRR/CRD IV in the shape of the Liquidity Coverage Ratio (LCR). The impact assessment published by the European Commission on 10 October 2014 to assess the effects of the introduction of the LCR acknowledged the need to provide special support for SME financing, and corresponding mechanisms were incorporated into the requirements. The impact assessment addresses the problem of asymmetric information and adverse selection that frequently arises at SMEs for investors and lenders

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[2] This is also confirmed by a report (available in German only) issued by the Institut für Mittelstandsforschung Bonn: May-Strobl/Haunschild, Der nachhaltige Beschäftigungsbeitrag von KMU – Eine sektorale Analyse unter besonderer Berücksichtigung der FuE- und wissensintensiven Wirtschaftszweige, IfM-Materialien Nr. 206, available at: http://www.ifm-bonn.org//uploads/tx_ifmstudies/IfM-Materialien-206_01.pdf.

[3] SME Performance Review (SPR) published by the European Commission in July 2014, p. 6, available at http://ec.europa.eu/growth/smes/business-friendly-environment/performance-review/files/supporting-documents/2014/annual-report-smes-2014_en.pdf; ECB Monthly Bulletin July 2014, SME access to finance in the euro area: barriers and potential policy remedies, p. 79.

[4] German Banking Industry Committee, Analysis by the German Banking Industry Committee: Indicators for Risk Development of Loans to Small and Medium-sized Enterprises (SMEs), 2 March 2012, available at: http://www.die-deutsche-kreditwirtschaft.de/uploads/media/120308_en_DK-Analyse_KMU-Kredite_VERSAND_an_DK.pdf.

because they cannot adequately assess the risk profile of SMEs as borrowers and typically respond to this uncertainty by increasing the interest rates they charge on loans to SMEs. This poses the risk that SMEs, which – according to surveys conducted by the German Banking Industry Committee[5] – for the most part entail a lower risk, will be driven out of the regulated financing market, thereby increasing the share of larger companies with a higher risk. This state of asymmetric information applies in particular in the case of SMEs because of the less extensive disclosure requirements and, as the European Commission already recognised in its LCR impact assessment, also has to be given particular attention when determining credit institutions' RWAs for SME portfolios.[6]

Without the SME Supporting Factor, SMEs would be disadvantaged, thus weakening a segment of the market that demonstrated a particularly high degree of stability during the economic and financial crisis.[7] This is also confirmed by surveys such as the one referred to in Figure 6 on page 23 of the EBA Discussion Paper and Call for Evidence (EBA DP). This indicates that non-performing loans at SMEs only occur in greater numbers in isolated cases in a handful of Member States. On average, SMEs are less leveraged and have greater liquidity than large enterprises.

Consequently, abolishing the SME Supporting Factor would not enhance the stability of the financial sector from a regulatory perspective. On the contrary: from an economic perspective, abolishing or increasing the factor entails a not entirely measurable risk of a credit squeeze at SMEs, accompanied by a simultaneous increase in capital requirements, and could therefore result in negative consequences for the economy as a whole.

No absolute assurance that the data is representative
We agree with the EBA that it is questionable whether the data surveys cited in the EBA DP are representative, and whether they permit any reliable statements to be made about trends for SME lending conditions and SME riskiness itself. No final assessment can therefore be made about whether representative statements and conclusions can be inferred about the appropriateness of the own funds requirements. In light of this, the analyses conducted as part of the EBA DP are very important.

It also needs to be stressed that, because of the large number of new rules introduced in the course of implementing the CRR, it is not possible to conclusively isolate any effect that the SME Supporting Factor might have. Equally, it is not possible to analyse its implications for lending to an extent that would allow all potential consequences to be adequately inferred.

In addition to the wide variety of regulatory adjustments, the macroeconomic environment plays a particularly decisive role because of the persistently low interest rates and the significant increase in SMEs' capital resources in Germany. German SMEs have systematically increased their equity ratios in recent years to an average of (most recently) 22.3%[8]. This inevitably leads to greater internal financing capacity, which has the overall effect of pushing down demand for credit. At the same time it is evident that, in light of the tougher banking regulation mentioned above, SMEs are becoming more attractive clients and competition between banks in this segment has increased substantially.

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[5] German Banking Industry Committee, Analysis by the German Banking Industry Committee: Indicators for Risk Development of Loans to Small and Medium-sized Enterprises (SMEs), 2 March 2012, available at: http://www.die-deutsche-kreditwirtschaft.de/uploads/media/120308_en_DK-Analyse_KMU-Kredite_VERSAND_an_DK.pdf.

[6] Commission Staff Working Document: Impact Assessment accompanying the document "Commission Delegated Regulation" to supplement Regulation (EU) 575/2013 with regard to liquidity coverage requirement for credit institutions Brussels, 10.10.2014, SWD (2014) 349 final

[7] German Banking Industry Committee, Analysis by the German Banking Industry Committee: Indicators for Risk Development of Loans to Small and Medium-sized Enterprises (SMEs), 2 March 2012, available at: http://www.die-deutsche-kreditwirtschaft.de/uploads/media/120308_en_DK-Analyse_KMU-Kredite_VERSAND_an_DK.pdf.

[8] See German Savings Banks Association (DSGV), Diagnose Mittelstand 2015 (SME Diagnosis 2015) – Credit Financing or Capital Market, p. 32ff.

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No sign of more pronounced risk trends for SME loans
The conclusion the EBA draws from the data and information it has examined is that SMEs are riskier than large enterprises, and their non-performing loan ratio is twice as high as that of other corporations (although it does not take a closer look at the loss given default); it concludes that SMEs are potentially more pro-cyclical overall.

A study by the German Banking Industry Committee on the other hand suggests that the capital requirements in the SME segment clearly exceed the underlying risks. There was no significant increase in the risk of default during the financial and economic crisis.[9] Data from the German Federal Statistical Office, the German savings bank finance group and the German cooperative financial network were compared and analysed with regard to insolvency ratios, loss ratios under commercial law, default rates and unexpected loss ratios over a period of approximately ten years. There was no significant increase in SME lending risks, either on the basis of accounting losses or on the basis of the default rates that actually materialised.[10] It should also be borne in mind that the default rate says nothing about the loss given default. Because of the lower exposure and the granular portfolio structures, the loss given default and the unexpected risk in the SME segment are lower than with larger companies. Whereas the default rate only provides some sort of indication of how reliable SMEs are at meeting their payment obligations, the loss given default is more important in terms of its effects on bank solvency. This must therefore be adequately reflected in this analysis in order to be able to infer the effects as a whole.

Against this background, there is no need from a regulatory or economic perspective for any increased own funds requirements for SME loans in Germany.
Additionally, studies by Deutsche Bundesbank (see e.g.: Düllmann/Koziol, Are SME Loans Less Risky than Regulatory Capital Requirements Suggest?, in: Journal of Fixed Income 2014) show that SME risk weights are still overly conservative, even after application of the SME Supporting Factor.

One major reason for this can be seen in the empirically observable relationship between size and asset correlations, which is not adequately reflected today in Pillar 1 own funds requirements. In the standard market credit portfolio models used in Pillar 2, on the other hand, the effect of the relationship between size and asset correlations is to significantly reduce the extent of unexpected losses in a portfolio containing SME loans. In light of this, we believe that it would be appropriate for a stronger diversification effect in the SME segment to also be reflected in the Pillar 1 own funds requirements.

Conclusion
To sum up, we can state that targeted support for SMEs supports sustainable economic growth and reduces unemployment in all Member States and represents an important cornerstone of economic recovery in the European Union. To this end, it makes sense to use the SME Supporting Factor as an incentive for the banks to extend loans to SMEs and, at the same time, to leverage the reasonable margins and lower funding costs to increase the banks' profitability for a lower cost of capital, thereby increasing their return on RWAs. Increasing or abolishing the SME Supporting Factor will, firstly, increase the funding costs passed on to the SMEs and, secondly, will probably once again increase the reluctance to lend to SMEs that has only just recently started to retreat. There is uncertainty as to whether and to what extent any change in the existing regulatory requirements would cause lending to SMEs to collapse,

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[9] German Banking Industry Committee, Analysis by the German Banking Industry Committee: Indicators for Risk Development of Loans to Small and Medium-sized Enterprises (SMEs), 2 March 2012
[10] German Banking Industry Committee, Analysis by the German Banking Industry Committee: Indicators for Risk Development of Loans to Small and Medium-sized Enterprises (SMEs), 2 March 2012

and thus lead to paralysis in this sector of the economy. However, we assume that increasing or abolishing the SME Supporting Factor would make it considerably more difficult for SMEs to raise capital. In addition, shifting financing to the unregulated capital market – to the extent that this is an option for SMEs given the range of obstacles – would mean abandoning the regulatory objectives that have already been achieved. If financing were to be shifted to the unregulated capital market, the tougher regulatory regime for the banking sector would come to nothing.

Last but not least, we are afraid that the provision of loans to SMEs will be negatively affected by the recent activities of the Basel Committee on Banking Supervision ("Basel IV"). The Basel Committee wants to introduce a Revised Standardised Approach that will, according to our calculations, raise capital requirements for loans granted to SMEs substantially. This higher capital requirements shall, via the introduction of a floor, be imposed on IRBA banks as well. This will, in our view, negatively affect the working of the supporting factor.

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.

The effect of the application of the SME Supporting Factor in reducing capital can be calculated from the supervisory reporting system (COREP). In the COREP templates (Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014), for example, the exposure value must always be given before and after the SME Supporting Factor.

In paragraph 17 EBA DP, the EBA comes to the conclusion that – at least for the banks in its sample – the SME Supporting Factor has no more than a negligible impact on the amount of capital required. We do not share this view.

The following table shows the capital relief (as a percentage) attributable to the SME Supporting Factor for the private-sector German banks as at 31 March 2015:

Exposure class	Total	Total Assets > EUR 10 bn	Total Assets EUR 1 –10 bn	Total Assets < EUR 1 bn
Banking book	0.6%	0.5%	1.4%	2.2%
Corporates	0.4%	0.3%	0.6%	1.3%
Retail	2.0%	1.6%	3.7%	5.3%
Secured by mortgages on immovable property	1.8%	0.2%	3.2%	1.3%

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A similar analysis was made for the 415 German Savings Banks, taking into account COREP data as at 31 March 2015. The following table shows the capital relief (as a percentage) attributable the SME Supporting Factor:

| Exposure class | Total | Size of banks | | |
		Total Assets > EUR 10 bn	Total Assets EUR 1 –10 bn	Total Assets < EUR 1 bn
Credit Risk (incl. all exposure classes)	4.1%	2.8%	4.3%	5.8%
Corporates	2.8%			
Retail	9.5%			
Secured by mortgages on immovable property	5.3%			

This shows clearly that the allegedly low level of relief within the private sector German banks (0.6%) only holds true for an analysis of aggregated figures across all institutions. A similar pattern can be observed for the German Savings Banks, where the capital relief is even higher due to their business model.

Rather, it is the case for all banks included in both analysis that the capital relief effect is greatest in those exposure classes in which SMEs naturally account for a high proportion. For example, considerable capital savings can be demonstrated in the "Retail" and "Secured by mortgages on immovable property" exposure classes. By contrast, the effect appears to be lower for the "Corporate" exposure class – however, because of the definition that applies here to SME loans (exposures of max. EUR 1.5 million), the proportion of SME loans compared with the total corporate loan portfolio is likely to be lower than in the other exposure classes.

Because of their business model, smaller banks would probably suffer disproportionately if the SME Supporting Factor were to be abolished. However, the SME Supporting Factor also plays a significant role at mid-sized and large institutions because of their substantial exposure to SMEs.

As a result, a conspicuous level of capital relief is evident in the exposure classes with strong SME participation.

Furthermore, promotional banks grant loans to SMEs that are extended via other institutions as intermediaries (pass-through loans). These loans are of public interest as they implement public policy objectives. Multilateral, national and regional development institutions often conduct their business by lending via (one or more) intermediate banks. For these pass-through loans, the SME Supporting Factor is used to promote SME financing at the level of the intermediary institutions.

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.

One factor that needs to be particularly stressed is that institutions cannot be considered being in a position to make reliable business policy decisions because of the temporary limitation currently defined for the SME Supporting Factor in Article 501 of the CRR. As the financing environment of Germany and

possibly those of other Member States as well are dominated by long-term loans, the uncertainty associated with the review clause tends to result in decisions being subject to conservative assumptions. Moreover, lending practices by the banks depend on a range of additional factors. These include demand for and supply of credit, the bank's own capital resources and its business model.

It should also be considered that the requirements of the CRR, including the SME Supporting Factor, have only been in force since 1 January 2014. In combination with the current economic environment, which is characterised – among other things – by the persistently low level of interest rates and greater competition for SME loans because of regulatory factors, no significant effects on SME lending can realistically be expected. The result of this overall situation is that it is not currently possible to empirically isolate the effect of the SME Supporting Factor on lending practices because of the wide range of, in part, offsetting factors that affect the situation.

Nevertheless, the SME Supporting Factor is a lever that can influence bank lending in the overall context:

- The SME Supporting Factor reduces own funds requirements and thus cuts the cost of capital (see also Q1). This is all the more important the higher interest rates climb, because customer price sensitivity then also increases. If interest rates are expected to rise, cost of capital is thus likely to become more important.
- A lower cost of capital increases profit margins and makes SME loans more attractive.
- Many institutions stipulate minimum margins when they lend money. Capital relief is therefore likely to have the effect of enhancing their business.
- If institutions or their subsidiaries are managed using limits (corresponding to capital allocation), the SME Supporting Factor reduces the extent to which limits are used. This in turn increases the scope for SME lending.
- All other things being equal, capital relief due to the SME Supporting Factor leads to a greater range of options based on the pricing tools used by numerous credit institutions.

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.

As a rule, the criteria in Article 501(2) of the CRR are used to apply the SME Supporting Factor. The criteria are checked automatically by the IT systems. If the criteria are met, the SME Supporting Factor is applied to the calculation of the regulatory capital requirements.

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)?

Different institutions use different procedures to group borrowers. For example, this can be done using standard "Group partner numbers" in a similar fashion to the collective item used in the large exposure regime. This ensures on a group-wide basis that exposures to SMEs do not exceed the EUR 1.5 million limit.

Q5: Do you see merits in having a harmonised definition of SMEs for reporting purposes? Yes/No. Please explain and provide specific examples.

A harmonised definition should be based on Art. 501 (2) CRR.

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

To allow any focused discussion of the topic of "riskiness of SMEs", this concept must be defined clearly and unambiguously. This is the only way to ensure that all contributions to the debate on this topic are based on the same understanding of the concept.

The definition stipulated in connection with the supervisory own funds requirements is that only **unexpected losses** are to be regarded as risks, and therefore also have to be backed by capital. For this reason, the term "riskiness of SMEs" should also be based solely on these losses, while expected losses in particular should be disregarded. Unexpected losses represent an adequate indicator of portfolio granularity. If this risk measure is used, a lower risk level relative to the Larger Corporates portfolio is shown through the higher granularity of the SME portfolios.

In contrast to expected losses, only unexpected losses that represent a negative deviation of losses from the expected (mean) losses represent risks as far as a bank's risk management is concerned. The expected losses due to credit losses are offset on average by an equal level of income from lending transactions, because these expected losses are priced into the lending conditions and are thus matched by corresponding income from lending transactions. Expected losses do not therefore represent a risk in terms of a bank's risk management and may not be included in the concept of riskiness. The supervisory own funds requirements also follow this interpretation.

Based on the above definition of riskiness, it can be established that the level of non-performing loans cannot be a proxy for riskiness, because such a measure is not based on unexpected losses and can be seen more as an indicator of expected losses.

As far as an evaluation of financial ratios is concerned, these are also not proxies for riskiness, but merely offer an indication of expected losses. If the composite index derived from the financial ratios produces worse figures for SMEs than for large enterprises, the only conclusion that can be drawn from this is that SMEs should exhibit higher default rates. All other things being equal, this allows the conclusion to be inferred that expected losses are likely to be higher for SMEs.

The issue of how to calculate an optimum composite index for SMEs is based on the implementation of a rating to determine PD as a risk parameter in the IRB rating systems. There is a broad knowledge base for this in the literature. In addition, all institutions with approved IRB rating systems for SME loans have corresponding documentation that describes in detail the calculation of an optimum composite index. These documents can be provided at any time on request. No exhaustive descriptions of the calculation of an optimum composite index for SMEs are presented in this consultation because they would not shed any light on the topic of riskiness in the sense that this term is used in the EBA DP.

A link to the concept of riskiness can only be made in the context of statements about the cyclicality over time of the composite index. However, this needs to be qualified by noting that no evaluations are given that would demonstrate the way in which a change in the composite index over time would be

accompanied by a change in default rates or losses. The many years of experience of those responsible for developing rating procedures for SMEs show that a change in the credit quality of borrowers determined on the basis of a composite index (and hence on the basis of financial ratios) can only be used to a very limited extent as a measure of the cyclicality of default rates or losses, and hence of the riskiness of SME loans.

Q7: Are other aspects relevant in your assessment of the creditworthiness/riskiness of potential SME borrowers? Yes/No. If yes, please provide a list of those aspects and explain how you measure SME riskiness.

Please refer to our answers to questions 6 and 8. We would like to point out again in this context that any discussion of the topic of riskiness should be based on a definition of the concept of riskiness that only encompasses unexpected losses.

Q8: In your experience, are SMEs as cyclical or more/less cyclical than large enterprises?

SME loan default rates are less cyclical than loans to large enterprises. In fact, the cyclicality is considerably lower than is currently already assumed by the Basel own funds requirements.

The volatility of default rates over time is regularly used to determine the cyclicality of loan default rates and the riskiness (in the sense of unexpected losses) to be derived from this cyclicality. All other things being equal (given constant loss levels), this allows the volatility of losses in the credit portfolio to be derived whose negative deviation from the expected loss value represents the unexpected losses that have to be backed by capital.

Asset correlation is used as the measure of the volatility of default rates over time. This measure of cyclicality is also the measure used in the Basel own funds requirements to determine the level of own funds requirements to be derived from cyclicality. Measuring asset correlation is therefore the equivalent of measuring cyclicality (of default rates). Under the Basel own funds requirements, measurement of the asset correlation can then be used to determine the optimum level of supervisory risk weights that correspond to the riskiness of the loans.

The literature contains several approaches for determining the cyclicality of SME loan default rates compared with loans to large enterprises, and these are also cited in the EBA DP. In particular, we would like to draw attention to the paper by Düllmann und Koziol (2014)[11] that is also cited in the DP. This paper revealed that the relative risk weights of SME loans derived from asset correlation measurements, compared with loans to large enterprises, are far lower than those stipulated by the formulas for determining risk weights. The own funds requirements for SME loans are only adequate, in the sense of reflecting riskiness, when the SME Supporting Factor is included[12].

The next objective of the study of SME loan riskiness should therefore focus on continuing to verify the results of the Düllmann and Koziol study, and in particular on an examination of the extent to which these results can be transferred to other countries and data time series with longer histories.

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[11] Düllmann, K. and Koziol, P. Are SME Loans Less Risky than Regulatory Capital Requirements Suggest? The Journal of Fixed Income, 23(4), 89–103.

[12] This statement needs to be qualified somewhat because, according to the results obtained by Düllmann and Koziol, it only applies to the measurement of own funds requirements in the SA and the IRB Approach for the "Corporate" exposure class. By contrast, Düllmann and Koziol were able to demonstrate for the "Other Retail" exposure class when using the IRB Approach that the supervisory formulas for this exposure class already adequately reflect the relatively lower riskiness of SME loans.

Based on the methodology for determining SME loan riskiness and hence of the optimum level of own funds requirements (and risk weights) used by Düllmann and Koziol in their study, analyses were conducted internally using the data resources of the German savings bank finance group. These analyses used a data history of more than one million loans over a period of eight years[13]. The results of the analyses confirm the results of the Düllmann and Koziol study that the SME Supporting Factor leads to adequate own funds requirements for SME loans that reflect the riskiness of the loans.

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 agree with the methodology for deriving the own funds requirements from the riskiness of the SME loans as also used in the Düllmann and Koziol study.

Q10: Did the arrears and loss experience in 2009/2010/2011 exceed an (internal) limit? Yes/No. Were (expected/unexpected) losses adequately covered by loan loss provisions? Yes/No. Please explain and provide specific figures.

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

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.

Please refer in this context to our remarks on Q4. From a business policy perspective, we can say that the SME Supporting Factor is reflected in the own funds requirements and thus in the extent to which limits are used. Lower own funds requirements increase the scope for lending and the attractiveness of lending to SMEs.

However, we remain critical of the EUR 1.5 million limit on SME loans stipulated in Article 501 of the CRR. This restriction means that equity and thus loan pricing are not significantly reduced for many SMEs. We therefore propose that this requirement be eliminated, so that the annual turnover limit of less than EUR 50 million would be a sufficient requirement for an application of the SME Supporting Factor.

As an example, GBIC would like to refer to the development of the banking sector of a German federal state, in which loans to corporate clients increased from € 37,396 million (31 December 2013) to € 40,293 million (30 June 2015). These figures attest that the introduction of SME-correction factor has proved to be absolutely correct and necessary. To strengthen the regional banking industry SMEs correction factor must be maintained absolutely. Otherwise, we anticipate appreciable negative effects. In addition, a study is made of this sector to loans which are SME-enabled shows that the quality of these loans - as measured by the percentage distribution within the so-called IFD marks - has significantly improved over the period 30.06.2004 to 31.12.2013. (Project of the Bundesbank on the review of the SME factor (§ 501 CRR)) Thus, the proportion (IFD Note I) increased in the category of the best rating of 21.97% in 2004 to 43.23% in 2013, at the same time there was no significant negative change recorded

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[13] The documentation relating to these analyses was provided to the EBA separately as confidential feedback.

in the category of the worst credit rating (IFD grade VI). The values increases only from 3.27% in 2004 to 4.04% in 2013. This data underlines the thesis that SME loans have a high stability and a lower equity cost is justified.

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.

The decision whether certain types of transaction will be prioritised depends on a range of factors. In principle, the following factors should be mentioned here:

- How are loans treated for supervisory purposes? Are there any preferential treatments? Are there additional capital requirements, e.g. because of the countercyclical capital buffer?
- What is the market environment, what is the competitive situation?
- How and at what conditions can the transactions be funded?

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.

We refer to our general comments in this respect.

It should be emphasized that a potential effect of the SME supporting factor cannot be isolated due to the wide range of newly introduced regulation under the CRDIV and CRR package.

In addition to extensive regulatory changes, current economic conditions are marked by persistently low levels of interest rates and a sharp rise in the equity base of German SMEs. German medium-sized companies have increased their capital ratios in recent years continuously up to a current average of 22.3%. This inevitably leads to increased internal financing capacity, which is at the expense of loan demand as a whole. At the same time it should be noted that SMEs become more attractive and that competition between banks in this segment has significantly increased mainly due to the above-mentioned extensive regulation introduced with the CRD IV and the CRR.

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.

The SME Supporting Factor feeds into the pricing calculation of a loan via the cost of capital. A positive effect arises in particular if banks manage lending using minimum margins: application of the factor increases the margin, which results in transactions being entered into that would not have been considered without a sufficient margin.

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. Please explain and provide specific examples.

In light of the aim of ensuring as simple a regulatory regime as possible, we do not see any need for further differentiation. Any such differentiation would further increase the already undesirably high complexity of the regulatory requirements.