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## EBF response to the European Commission consultation on the possible impact of CRR and CRD IV on bank financing of the economy

### Introduction

The EBF welcomes the opportunity to comment on the potential impact that the CRR and CRD IV have had on bank financing of the economy in this Commission's consultation.

Since the financial crisis, European banks have adapted to a wide-ranging reform agenda. Presumably, no other sector has ever faced such an in-depth regulatory upheaval in such a short time in modern history. The financial crisis resulted in a market which did not fully trust the robustness of financial institutions as expressed in capital ratios. Therefore, the market also paid attention to the leverage of the banks. Even credit ratings, formerly the most reliable indicator of riskiness, were seen as too slow in responding to changes in economic circumstances.

Hence, the EU banking sector started a process of deleveraging, including retaining earnings and raising additional capital and downsizing its balance sheets<sup>1</sup>. The reason for deleveraging and decreased risk appetite was twofold: On one hand the markets pushed banks to reduce risks and demanded higher capitalisation levels. On the other hand there was (an anticipation of) stricter supervision and regulatory requirements.

As a result of the increasing regulation and the stricter supervision, the process of deleveraging, building up capital and the shift towards less risky assets following the financial crisis in 2007 was reinforced. Often these trends were also driven by political decisions.

The EBF considers that the CRR and the CRD IV have had in general a positive impact on banks' balance sheets, making them stronger by increasing their capital positions and the composition of capital.

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<sup>1</sup> Organisation for Economic Co-operation and Development, 2014



At the time this response is drafted, the Basel Committee and the EBA have published their reports on monitoring the implementation of Basel III with data as of end of 2014. The capital shortfall of the EU banking system is now virtually nil, meaning that the ambitious recapitalisation program set out by the BCBS in 2010 has been completed. It is time to focus on other priorities; financing the economy is the main one.

## Responses to specific questions

**Question 1: What role has been played by the CRR and CRD IV requirements in the recapitalisation process, in terms of the timing and overall effect on the levels and quality of capital held by banks? How have market, supervisory and regulatory capitalisation demands interacted to make banks adjust the level of capital they hold to the current level? Whilst these three factors may be interlinked, is it possible to identify which has/have played the most important role?**

The increase of capital cost from CRR and CRD IV has not taken place at one specific point in time. Rather it has been increased gradually from 2010. Firstly, the regulator increased their capitalization demands while intensifying their supervision in the period between the publication of the Basel III guidelines and CRR/CRD IV.

Secondly, banks adjusted their capital costs gradually. Since it was expected that the guidelines as presented in the Basel III publication would become the new capital requirements in the near future, banks did not want to fall below the new capital requirements. Market and peer pressure accelerated the increase of capital ratios, disregarding the implementation phase proposed by the Basel Committee. Specifically, market forces have generally meant that banks have had to raise the capital levels earlier than the capital requirements kicked in, because banks have needed to show that they will be able to manage their capital positions.

It is very difficult to determine what factor has been more dominant. Still, the formulation of Basel III set the new level of expectation of supervisors and markets.

With the CRR/CRD IV mainly implemented, the focus is shifting to a number of other regulatory initiatives which induces banks to alter the capital structure e.g. the Leverage ratio, BCBS SA & Capital Floors and MREL as part of the BRRD. It will take some time before all this is bottomed out. The CRR/CRD IV has not fully dealt with the Pillar II approach to capital requirements and how that should be solved and there is uncertainty about how capital for certain risks should be captured e.g. IRRBB.



**Question 2: If you consider that capital levels go significantly beyond what is necessary in light of the level of risk incurred and posed by banking activities in certain areas, please specify those areas and back up your view with specific evidence.**

Capital requirements for securitisation are much higher than the capital requirements for the underlying assets, in particular in countries where credit ratings are less favorable. Internal Ratings Based Approach for Credit Risk in the Banking Book (IRBA): empirical data shows that the Asset-Value-Correlation is too high. New capital levels go far beyond what is necessary relating to derivatives business with corporate clients. This has become much more expensive due to CVA Risk Capital Charge and will become even more expensive when Fundamental Review of the Trading Book becomes effective according to its current consultative status. This may lead to more unfavorable possibilities to hedge primary risks for banks' corporate customers (interest rates, FX, commodities).

As the Leverage Ratio is not a risk sensitive measure it strongly penalises activities with low risk weights e.g. residential real estate mortgages.

Also, many regulatory initiatives are currently discussed (e.g. BCBS SA & Capital Floors, IRRBB, CVA, TLAC & European MREL, IRFS9). While some of these regulatory initiatives affect the risk weight calculations and others impact the capital buffer, all seem to increase the capital need. The required capital level seems to be a result of individual regulations, rather than a well-defined overall capital level.

We fear that these draft regulations will lead to a significant capital impact, which will have a serious impact on banks, clients, markets and the economy as a whole. It would be difficult to articulate how much capital is needed. Therefore we suggest that policymakers take the lead, instead of banks estimating an unclear result of individual regulatory updates.

It is of also of concern how regulators will use the full spectrum of tools available to them -i.e. ICAAP, Stress Testing, Asset Quality Review, and MREL- to determine the combined buffer requirements. Potential future buffer requirements (Counter Cyclical & Systemic Risk, already in place in some countries) also pose uncertainty on shareholder return based on the supervisory view of market conditions.

Under the CRR and its provisions for credit risk in the standardized approach, the risk weights assigned to corporate exposures or personal guarantees provided by enterprises depend on the external ratings assigned to the borrows/guarantors. As such, in jurisdictions where a large portion of corporate firms do not have ratings assigned, the risk mitigation benefits of guarantees provided by an unrated enterprise are not reflected within the RWA calculation.



This is particularly evident in the export credit area where:

- (i) Normally medium and long term export credits benefit from a credit enhancement (guarantees or insurance) provided by an export credit agency (ECA) to remove the risk and uncertainty of payments to exporters when exporting outside their country;
- (ii) According to the International Chamber of Commerce's data, the expected loss for both medium and long term products are very low when such guarantees are in place;
- (iii) But the credit enhancements provided by an unrated institution are not reflected within the RWA calculation for banks that use the standardized approach.

**Question 3: What role have the additional capital requirements and buffers exceeding the harmonised requirements set out in the CRR played in the capitalisation process? Are such additional micro- and macroprudential capital requirements and buffers commensurate to the level of risk incurred and posed by banks? Please back up your view with specific evidence.**

Buffers imposed in the CRDIV stemming from Basel III (the capital conservation buffer and the countercyclical buffer) are appropriate and reflect problems which have been seen during the crisis.

As most of the buffers are derived from Basel III, they are implemented worldwide thus facilitating level playing field. However, the European specialty "Systemic Risk Buffer" drives complexity and reduces transparency for investors, banks and regulators, especially since there is a wide variety in (intended) implementation. These measures distort the competitive position of European banks.

Investors have incorporated buffers into their expectations regarding minimum capital levels, taking effect immediately. This is furthermore enforced by new capital instruments such as AT1, which have triggers around these buffer-levels, forcing banks to hold capital levels well above the trigger-/buffer-levels.

Higher capital requirements and additional buffers exceeding CRR requirements increase the difficulty of banks in the recapitalization process and create uncertainty on the financial market.

The European implementation of buffers for other systemically important banks (BCBS: domestically important banks) is too complex and has too much leeway for national discretions. So it leads to the same issues as the Systemic Risk Buffer in Europe.

The Capital Conservation and Systemic Institution buffers provide predetermined stressed capital buffer requirements. Strategic planning has been focused on delivering compliance with these requirements in advance of the combined buffer requirement to be delivered from the



supervisory review process. Further stressed capital requirements identified through Counter Cyclical and Systemic Risk buffers pose further uncertainty for strategic planning.

The objective of the supervisory measures taken is not always clear thus adding regulatory uncertainty. To improve regulatory and supervisory predictability, it is important that regulatory standards clearly state the limitations of setting add-ons and floors as well as fixed supervisory parameters in the IRB approach. Also harmonised guidelines for imposing Pillar 2 requirements and taking macroprudential decisions are required. Equally, it is important to ensure that measures are not overlapping.

On the other hand, banks' failures in Europe during the financial crisis and in the most recent years have demonstrated that:

- (i) Higher capital requirements alone do not assure a healthier financial system; and
- (ii) Corporate governance mechanisms are key to reach the financial stability objectives and to avoid future bank failures.

For that reason, stronger emphasis should be given to the analysis of the banks' corporate governance mechanisms in addition to capital requirements.

**Question 4: Have increased capital requirements influenced the overall capacity of banks to lend? Which factors, including demand-side factors, regulatory changes and other supply-side factors (such as the volatility of interbank and capital markets), contributed most significantly to the change in the volume of loans? How do you think bank lending would have developed had regulatory changes to capital requirements not been introduced?**

The development of lending – on both the demand and the supply side – generally depends on a number of factors. These include the impact on banks' capital of extensive customer arrears; on the demand side economic downturn; company receiverships; as well as supply side factors – retrenched interbank markets. Credit demand has naturally come down during the crisis as well, especially on the corporate side, as an effect of lower economic activity and lower investments. The ever extending range of regulations mentioned above, which have added to banks' capital requirements and their need to build up capital reserves for increased Tier 1 funds; various Buffers, Leverage, have been a significant part of the mix which led to constrained lending. This makes it extremely difficult to determine exactly how much influence a specific factor has exerted. It may nevertheless be assumed that increased capital requirements have played a part in reducing banks' capacity to lend.

Increased capital requirements reduced lending capacity of banks. This led banks to review their portfolio and depending on individual banks' positioning reshape their portfolio. This often included reducing or abandoning certain businesses or engagement in certain countries. It also affected the cost of capital for lending, this has (and will) lead to (further) increased pricing required to meet acceptable return on capital.



Though at first sight the CRD IV's impact on lending seems to be relatively limited and, as mentioned above, due to the numerous variables involved, it is virtually impossible to estimate the right impact on lending, it is worth to recognize the danger that with the additional tightening currently under discussion at the BCBS and other fora – (“Basel IV”: higher risk weights through harmonisation, i.e. greater use of standard risk models; a higher leverage ratio than the 3% set out so far; even higher risk weights in the trading book; TLAC, i.e. much higher levels of equity or bail-inable securities that will raise the cost of capital) –, matters will get significantly worse. Specifically, we are concerned about the identified trend that suggested higher capital requirements are not based on a risk sensitive approach.

So far, banks have been able to adjust business models by slashing non-core operations, selling foreign franchises and retreating from trading activities and structured credit etc. Further shrinkage would almost inevitably have to come from core client-related operations, be that e.g. household mortgage lending (low margins, high volumes), public sector finance (similarly) or small-cap lending (high risk, high capital consumption).

We would also like to highlight the impact of the NSFR, which strongly penalizes short-term financing activities and notably Trade Finance business. As this constraint reduces the capacity of banks to enact maturity transformation, it generates additional liquidity costs which cannot be passed onto the clients. The NSFR constraint would generate a decrease in business volume of several billions € and a very significant NBI shortfall.

The revised Basel Framework for Securitisation would raise capital requirements for securitisations, especially senior tranches, due to conservative calibration. This would affect the securitization market negatively. In addition, further regulation might affect the market: Solvency II might lead to less investments (from insurance companies) into securitisation; money market funds are affected as investors; the overall uncertainty about further regulation of the securitization market affects this business negatively – while securitization is a very important (capital market) instrument for financing the economy!

Credit demand has naturally come down during the crisis as well, especially on the corporate side, as an effect of lower economic activity and lower investments.

One important difference between large corporates and SMEs needs to be taken into account: large corporates have had access to an active and fairly well functioning corporate bond market during the relevant period of increased capital requirements, as well as to intragroup financing in some cases. Credit spreads have been fairly low in the corporate bond market, meaning that large corporates have generally had much better opportunities to benefit from the decreased interest rates during the period, and to fund themselves efficiently in markets. The capital requirements have had a much more significant effect on credit supply than capital markets



volatility, especially for the corporate sector. Even though these have been the case in the recent crisis, this relative stability of corporate bond markets cannot be taken for granted. In another crisis, where some sectors of the corporate sector are severely hit, credit supply on corporate bond markets might also dry up.

**Question 5: Are the effects of increased capital requirements, such as they are, generally temporary and transitional or have structural changes been seen? Has the requirement to hold higher levels of capital increased the cost of funding banks? (See Q4) Has the per-unit cost of bank capital decreased as banks have become less risky?**

The effects of increased capital requirements are permanent. They led to structural changes in the banking market. Large and internationally active banks especially refocused their portfolio (see Q4).

Both the cost of capital as well as the cost of other long term funding instruments have increased significantly during the (post-) crisis years. But this may not be a result of increased capital requirements only. Important implications stem from other pieces of regulation, like the new Bail-In-Framework outlined in the BRRD, the new liquidity framework. This also links to a changing environment and an increased credit spreads on banks compared to pre-crisis years.

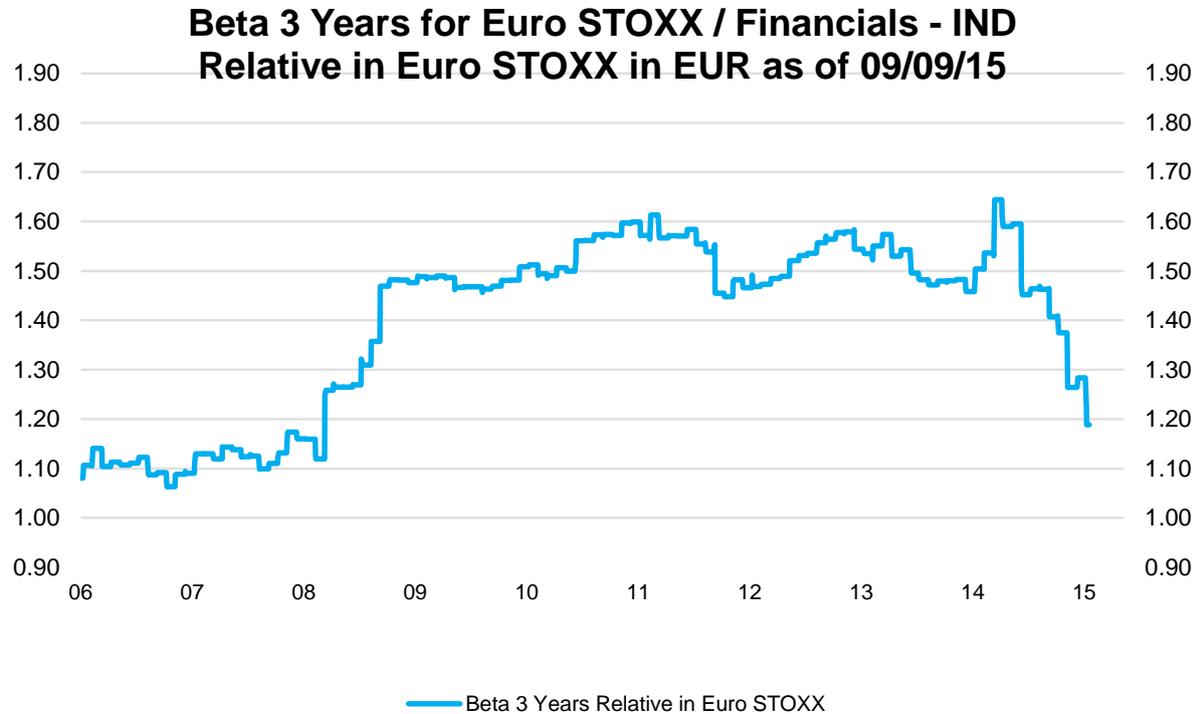
Although money and capital market benchmark rates are at record lows, this has put an upward pressure in the liquidity premium required to reflect the cost of attracting longer term structural funding. Banks have particularly de-risked their balance sheets in the area of non-lending exposure classes, for example in securitized finance and securities borrowing and lending. Although these balance sheet management actions have improved overall banks' risk profiles and leverage, the cost per unit within the specific corporate lending exposure classes did not benefit specifically.

Business dynamics changed in favour of better capitalized institutions, because they had the capacity to support lending and so were able to do some stock picking. Additionally, they also benefited from market instability and accessed funding at ultra-low levels together with less pressure for deleveraging and so were better equipped for normal organic capital generation. The CRR/CRD IV together with BRRD's "bail in" provision create a very clear link between capitalization levels and regular funding costs. So, during the transition phase, banks in different banking systems continue to face very different conditions when accessing market funding.

Regarding the last question, one indicator that summarises the investors' collective view on the riskiness of companies is the beta of the shares. The beta captures how risky a stock, or a sub-index of stocks, is in relationship to the overall stock market. A beta of 1 reflects the risk of the general market, meaning that stocks that are below 1 are perceived less risky (the share price is less volatile than the average) and share prices above 1 are more risky. The graph below shows that the risk in European financials was slightly above the market before the crisis, it



increased dramatically during the crisis, and it is now coming down from those high levels. But it is still slightly above the pre-crisis levels. Better capitalization has most likely contributed to the more recent drop in beta. But just as important is probably the fact that the risks on the asset side of banks have come down, as well as a general market sentiment that European banks are on their way out of the crisis.



**Question 6: Have increased capital requirements affected the market for some categories of assets more than others? If so, which ones and how? Which of the provisions contained in the CRR, apart from those establishing capital ratios, are likely to have created the effects experienced by specific markets and/or exposures?**

Capital requirements have generally been raised by a factor of at least 3, because of the introduction of CRD IV/CRR. When it comes to ordinary lending to households, SMEs and corporates, this general rise is much more important than any of the amendments to the IRB framework that was introduced by CRDIV/CRR. Some asset classes however benefitted from a lowering of capital requirements a couple of years earlier, because the risk weights were decreased through the introduction of Basel II. This pertains predominantly to mortgages. Corporate credits did not benefit from a reduction in risk weights to the same extent, especially not SMEs, and especially not credits that are uncollateralized. Collateralisation is normally needed to prove a reduction in the loss given default parameter in the IRB framework. The SME Supporting Factor did have a counterbalancing effect to this, but not at all large enough to compensate significantly for the rise in capital requirements.

Without the preferential treatment of covered bonds, the CRR would have had significantly deteriorating implications for the covered bonds market, which is very important in the Nordic



countries. It is crucial that the capital adequacy framework in the future acknowledges the importance of the covered bond market and its viability throughout even severe periods of stress as well as the low risk characteristic of this asset class.

The anticipation of the incoming the Leverage Ratio (LR) will also make business/loans with low-risk and (at the same time) low-return less attractive.

Besides higher capital requirements in general, the (future) requirements regarding Leverage Ratio, LCR and NSFR have forced banks to review their balance sheet composition, increase the size and quality of liquidity buffers and reduce the reliance on short term professional funding in return for longer term stable funding. These particularly affect availability and pricing in the longer term lending transactions, including Project Finance, Infrastructure Finance and Commercial Property Finance. The strengthening of Liquidity buffers in the context of the LCR has an additional effect on required capital buffers. The (additional) HQLA investments required are low risk in nature (e.g. top rated government bonds) and required stable funding to make such investments. An additional side effect is that the Leverage Ratio requirements will significantly increase Tier 1 capital to be allocated to the buffer of HQLA needed to comply with LCR.

The CRR increased risk weights for larger financial counterparties indirectly have also affected the corporate domain through the role of banks in the trade finance system (documentary trade, import versus export). A trade finance transaction usually also has a financial counterparty exposure leg attached depending on the bank role in the structure, increasing the overall requirements for such transactions.

By requiring banks to cut repos activities, the leverage ratio framework has contributed to further affecting the corporate bond markets, already impacted by macro-economic factor.

Another major concern is the NSFR, which will have a significant impact on capital market activities. Derivative activities are penalized by the 20% Stable Funding Requirement on Derivative Liabilities. Repo markets are penalized by the asymmetry between repo Available Stable Funding and reverse repo Required Stable Funding, which will most likely reduce liquidity on securities markets.

From a macroeconomic perspective, the transitional phase to the new equilibrium in terms of the new capital requirements has in itself a pro-cyclical nature in the sense that the compliance with the new requirements tended to worsen the financial situation of the Member States and of the banking system in general.

No macroprudential tools were at play with the same intensity before the crisis. Hence, systems were more unbalanced, making it more difficult to return to a new equilibrium, and thus being more demanding in terms of capital/liquidity/leverage requirements.



Moreover, banks have had to comply with these new requirements in an environment of increasing economic uncertainty. In this sense, higher capital demands turned out to be rather incompatible with higher general level of risk in the markets, making it difficult for banks to lend to the riskier business segments and in this way affecting growth potential and incentives for innovation.

**Question 7: Do you think the phase-out of the transitional provisions under CRR could have an incremental impact on future lending decisions? If so, please explain how.**

The EBF do not see this as having a major impact. Most banks have already (largely) positioned themselves to meet the fully loaded CRR requirements, including phase-in of additional buffer requirements and phase-out of transitional provisions. Most likely it will not significantly affect future corporate lending decisions although the effects may be visible in risk reward assessment and pricing.

The use of transitional provisions varies across countries.

**Question 8: On the Supporting Factor - To what extent has this provision been effective in supporting lending to SMEs? Could you provide any evidence, preferably quantitative, of the change in lending to SMEs due to the introduction of the supporting factor as from 2014?**

(See Annex and EBF position on the SF [here](#))

Although there is a wide range of factors influencing lending conditions in the market, the cost of capital is a decisive factor. Therefore, to a certain extent, the SME SF reduces the cost of SME lending as the SF is included in the calculation of lending rates via the cost of capital.

The overall impact of the regulatory reform – without the Supporting Factor - would leave SME lending worse-off than other asset classes in spite of the fact that SME lending was not at the core of the crisis. In particular, the combined effect of enhanced capital requirements and liquidity rules put SME lending at a disadvantaged position compared to other assets. The stricter capital requirements lead to deleveraging whilst the liquidity rules force banks to invest a considerable part of their resources in qualifying assets, mainly government bonds. The stringent scenario is compounded by the overly restrictive conditions for SME loan securitisation.

As a conclusion the SME SF is a very important for the financing of SMEs, which continue to be very dependent on banking financing. The factor should therefore apply after 2016. With rising interest rates and – at some point – rising risks in the SME sector the factor will have an even larger impact than today.



**Question 9: What specific difficulties do banks face when lending to SMEs, compared to when lending to larger corporates? Are these related to the CRR? How could the CRR and other prudential regulations contribute to addressing some of these difficulties in other ways than by adjusting rules for SMEs, or do they need to be resolved by some other means? If so, what other means would be adequate?**

The challenges generally are:

- high fixed costs due to small tickets (diseconomies of smaller scale) and to the time invested in understanding an SME business;
- higher cost of servicing (linked to previous bullet point);
- lesser ability to withstand shocks;
- higher risks: and quite often lending against less-secure cash flow;
- the (risk profile related) information is less uniform, less structured and less reliable compared to large corporates;
- lower capabilities in attracting non-bank capital and in general lower financial flexibility.

Unlike large enterprises for which there is usually publicly available information, SME lending suffers from information asymmetries. As a result, banks take a more cautious stance in SME lending especially since the crisis. The SME Supporting Factor, although does not completely erase these inefficiencies, helps to counteract these specificities in pricing.

The higher capital requirements for higher risks are related to CRR – therefore, the SME supporting factor is necessary. The high fixed costs are related to many other regulatory/supervisory requirements, like KYC, governance etc.

Cross-border lending to foreign SMEs is in general more challenging than lending to local SMEs or to international large corporations since it is more difficult for banks to obtain relevant financial information, in particular where the foreign SME is located in an emerging market. These difficulties are, however, not related to the CRR and are mitigated in practice by using local relationship banks.

The waiver of the CVA-Charge for derivative exposures to SME and corporates can be very useful in providing loans to these clients. It must be retained. Otherwise hedging will become much more expensive.

The correlation factors for SME exposures under the IRB framework could also be investigated.



**Question 10: Has the CRR influenced the capacity of banks to provide loans to infrastructure projects? Which provisions are most relevant?**

Yes. Banks have become more focused on the allocation of capital and its return on capital, calculated usually as a hurdle rate to achieve on the Risk adjusted Income over RWA. The most relevant component of CRR is the 'Supervisory Slotting' questions for capital calculations; RWA and EL of the exposure are calculated as prescribed in the CRR.

Capital and liquidity requirements as well as the LR will complicate this financing even more. In the long run, banks become less willing/able to finance infrastructure projects which are generally risky, long-term and large volumes. In this context (as well as with SME financing), the very low ECB-interest rates currently have opposite beneficial effect.

Long-term credits are constrained with higher liquidity costs resulting from required long-term liquidity ratios as well as higher costs for derivatives which often are needed to support a structured credit by hedging interest rate and/or FX risk.

Within banks these loans are either associated with developers directly or SPVs (project finance). Each of these infrastructure loans is assessed on its own characteristics. The CRR does not specifically address infrastructure loans, but since most of these loans are treated as specialized lending, the CRR provides enough room via PD/LGD/CCF estimation, Articles 179-183.

Through Basel II/CRD, a material distinction was introduced between short and long term loans for banks using the Advanced IRB approach, through the introduction of the maturity factor M. The Basel formula creates a large difference between the capital requirements depending on maturity. For exposures with a maturity above 5 years and with a low PD, the capital requirement increases more than three times per year, compared to a one year loan. The large impact of the M factor made longer term loans challenging, and since infrastructure loans typically are long term, this obviously had an effect on infrastructure finance. Similarly as for other asset classes that typically were not affected positively by the introduction of Basel 2/CRD, the impact of the large general increase in capital requirements will strike very hard against all longer term loans, of which infrastructure projects obviously is one. The M factor is the main issue here, but given that the problem is stemming from the Basel formula, it may be challenging to revise.

The flexibility to lend to infrastructure projects could be jeopardized by the Basel Committee's proposals for a global floor between IRBA and standardised approach. This would lead banks to calculate the capital relative to infrastructure financings based on borrowers' turnover and leverage. Neither the quality of income (long-term commitments with governments or local



authorities), nor the quality of the contracts (commitments with big corporations) or of the financing conditions would be taken into account. Moreover, all specialized lending, including infrastructure projects, could be subject to a high floor of 120% RWA. These measures would multiply bank capital linked to these projects and reduce the amount that banks are able to commit to these projects.

**Question 11: What are the specific difficulties that banks face when lending to infrastructure projects? Are they related to the CRR? How could the CRR and other prudential regulations contribute to addressing some of these difficulties or do they need to be resolved by some other means? If so, what other means would be adequate?**

Inherently, the first and biggest hurdle is the long lead times that are characteristic to infrastructure investments and the complex nature of sourcing and executing such investments. CRR and other regulations serve only to add an extra lay of complexity and costs. However, financial institutions have developed sophisticated tools and processes to manage them.

The long term dependence on regulatory stability results in concern and reluctance of investment officers and executives to commit to long term investments unless there is a disproportionately high investment rationale - as defined by each investor or investor class (e.g. supporting a core client that delivers other business activity/services to offset/improve the overall return). As the cycles of financial volatility shorten, banks are increasingly faced with the decision whether or not to invest the time and effort to even target this asset class. Consequently, the real issue lies with the relative “infrequency” of investment issues, i.e. the ability of governments and regional authorities to issue request for proposals for major infrastructure undertakings requiring private capital/funding.

Public procurement requirements often place an additional burden on potential financiers by requiring exceptionally long “certainty of funds” periods, flexibility in disbursement, but NO flexibility in terms and conditions once committed. Such requirement increase the cost to the financier, thereby reducing the attractiveness to banks.

**Question 12: Should infrastructure projects continue to be treated as loans to corporate borrowers? If not, why? What common features of infrastructure projects or their subsets would justify a separate treatment from loans to corporate borrowers?**

The EBF considers it unfair to consider infrastructure in the same category as a corporate loan. The EBF would like to see infrastructure treated as a separate exposure class to corporate lending for the reasons given above. Jobs are created at the construction phase and also in the longer term as improved infrastructure adds to a location’s attraction for additional employment opportunities. It also offers banks long-term low risk assets to build a diverse risk portfolio. Meanwhile the highly liquid non-bank lenders have an unfair advantage and find this



a highly attractive market to finance at a lower cost than banks, due to their lesser capital requirements.

The common features of infrastructural projects to be considered would include being long term; if State / Regional guarantees provided; regional diversity; community benefits; potential employment impact; environmental impact (e.g. reduced energy or travel impact).

**Question 13: Should the provisions contained in the CRR allow for more differentiation in how they are applied to banks of different sizes or with different risk-profiles? How can they do this without compromising the objective of achieving financial stability and creating a level playing field within the single banking market? Are there any provisions that could potentially be applied with greater differentiation? If so, what are these provisions? Provided application on a differentiated basis is desirable, what considerations could be relevant to make such a differentiated application? Are any concrete changes desirable in this context? If so, what are these changes and the associated costs and benefits?**

The EBF considers that the post crisis regulatory framework has become operationally extremely **burdensome**. Banks at large are dedicating huge resources to regulatory and supervisory demands. These requests are often concurrent and this fact makes compliance even more challenging. For example, banks have to prepare an increasing number of reports for different purposes, many times overlapping with requests for stress testing templates, quantitative impact studies and ad-hoc reports for local supervisors and EU-wide authorities.

A critical review of reporting requests from a broader perspective including templates and ad-hoc exercises should be conducted by the Commission. The EBF would recommend the Commission start off by analysing the number and content of reports before the crisis and nowadays in order to measure the sheer increased volume of operational requirements. Then the purpose and necessity of every request should be evaluated. With that information, the Commission would be in a position to take well-informed decisions that can make the operational requirements more efficient for banks in general and especially for smaller institutions by virtue of the principle of proportionality. We appreciate that the Commission's Better Regulation review does bear this in mind.

Overall, there is a need for an assessment of the CRR-CRD4 package against the initial objectives for which they have been adopted to make sure the outcome is proportionate to the objective. Where the requirements have gone beyond the initial objectives, they should be reviewed. This is also highly necessary for the forthcoming "Basel 4" package before its transposition into EU law.

- The increased complexity of the revised standardised approach as proposed by Basel is contrary to the proportionality principle;
- The BCBS NSFR standard applies on a consolidated basis exclusively to large cross border banks. However, the CRR introduces liquidity requirements both on an individual and



consolidated basis to all banks in Europe. As NSFR requirements are far more restrictive for capital markets and corporate banking activities than they are for retail banking, a European transposition of the Basel NSFR at entity level would have very serious impacts on corporate and investment bank subsidiaries, which cannot benefit from retail deposits. Consequently this would impact the efficiency and attractiveness of European markets, which would be in contradiction with the objectives of the Capital markets union of promoting market financing.

The EBF is concerned that the introduction of total loss absorbing capital (TLAC) also amplifies the effects of the backstop leverage ratio, particularly as it will be based on a multiple of either the leverage ratio or the capital ratio, whichever is higher.

**Question 14: Which areas of the CRR could be simplified without compromising the Regulation's objective of ensuring prudence, legal certainty and a level playing field? Are there areas that could be simplified, but only for specific types of bank or business models? Would it be useful to consider an approach where banks that are capitalised well above minimum requirements or that are less exposed to certain risks could be subject to simplified obligations? What would be the risks with such an approach?**

The first step for simplification would be to slow down the upcoming regulation proposals in order to assess the current overall framework as well as the necessity to go further. There are still several workstreams underway at international level that go beyond the reform agenda and are likely to result in further, fundamental change to the capital framework. These include the FRTB, a new framework for IRRBB, the introduction of non-risk sensitive restrictions on the IRB approach, capital floor proposals and revised standardised approaches for the main risk categories. Each of these appears likely to increase capital further and to reduce the level of risk sensitivity. This will hamper bank lending and appropriate capital allocation. Taking into account the importance of bank lending in the EU compared to other regions in the world, the EU must be more decisive in shaping international regulatory agenda and priorities.

Also, generally speaking, reducing national discretions will lead to enhancing a level playing field.

Other factors that can be taken into account are:

- Acceptance of the IFRS balance sheet as the reference for measuring assets and liabilities. If regulatory adjustments are considered necessary, this should be taken into account in prudential risk measurement under Pillar 1 (capital charges).
- Impairment and expected loss: Prudential supervision and accounting should remain separate spheres; prudential supervisors should not interpret the accounting definition of "impairment".



- IFRS 9 – Classification/measurement: With regard to the discussion on unrealised gains/losses from fair value items and the new IFRS 9 (Classification/measurement), it should make no difference from a regulatory standpoint whether a change in value is reflected in a bank's equity via profit or loss or via OCI.
- Forbearance: The prudential reporting requirements under FINREP should be based in principle on the accounting definition and approach. In particular, alignment of accounting and prudential requirements should be sought for classification as non-performing exposures.
- The obligation under Art. 194 (1) subparagraph 2 of the CRR to obtain legal opinions on the validity and enforceability of credit protection arrangements needs to be reviewed and at least restricted to certain types of arrangements only: To obtain legal opinions on all types of arrangements used by institutions results in unsurmountable practical challenges and unreasonable burdens. This holds particularly true with regard to guarantees, letters of credit (widely used in financing trade with medium-sized enterprises) and similar instruments which provide for direct claims against another party. The need to obtain legal opinions should be restricted, ideally on a risk sensitive nature, and incorporated as an optional element in the general risk management procedures regarding legal risks.

An approach that would see more transparent determination of an institution's combined buffer requirement would create some certainty with respect to business modelling and optimal capital structuring, shareholder return and where necessary entry to the capital markets.

Banks that are well capitalized do not need less robust capital rules. However, it might make sense requiring the most detailed information only if the risk profile or size of the bank requires such reporting.

A good example of a well justified and structured reporting requirement - but that has become too complex and less informative in time - is the Large Exposure report. The core requirement should be an overview of the largest exposures and a management reflection. A report of approximately 25 pages should be effective. Instead for larger institutions these reports can reach 1000 pages. For both the institutions and supervisors, the time to prepare and the time to process the content is far from optimal.



**Question 15: What additional measures could be taken in the area of prudential regulation to further promote integration and enhance a level playing field? Can you indicate specific examples and evidence of discretions that affect the cost and availability of bank lending?**

The EBF supports the idea of having a level playing field applying for all financial institutions. European regulation should set standards that cannot be circumvented by national implementation.

In this regard, international funds' operations are less regulated and so banks are losing out on large leveraged transactions as regulations and capital requirements make banks' pricing structure more expensive than other less regulated institutions. There is a growing threat from shadow banking systems and banks recognise that are not competing on a level playing field. The EBF considers that the European Commission should apply a coherent regulatory framework for financial institutions. If this is not the case, (systemic) risks are potentially subject to pass on to the shadow banking system.

Harmonisation of regulatory and supervisory measures is an important step in enhancing lending to the real economy, and is thus in line with the Commission's growth initiative.

The regulatory uncertainty has, on the other hand, grown significantly as the supervisory discretion and practices within CRD IV have been utilised widely. The objective of these measures is not always clear thus adding regulatory uncertainty.

On the other hand, the regulatory environment is rapidly changing and the measures taken to strengthen the financial sector are not limited to CRR. The BIS and EBA in the meantime have issued various consultations that go beyond CRR, like the review of the SA for Credit Risk, a revised framework for Capital Floors and measures to improve the comparability and transparency of internal models used within the AIRB. The revision of the standard approach is currently under study by the Basel Committee, and in the meantime, EBA (by instruction of CRR) is working on Regulatory or Implementing Technical Standards that impact the current standard approach (for instance RW floors on mortgage) whose application maybe very limited in time. We urge the regulators to take more time to slow down the multiplication of new regulations that are more complex, costly, and whose life is short since they are already intended to be replaced by a new one. Although some of the proposed measures could promote the level playing field, banks have raised various concerns in relation to these consultations that could severely impact the availability and/or pricing of bank lending to e.g. low risk / low default portfolio clients and trade related financing. In this respect, it is important to have very clear definitions of default, non-performing, and impaired. Also the CRR allows for degrees of freedom within the interpretation and application of the law, with some elements to be determined at discretion of the local competent authority (for example treatment of other contingent liabilities in the LCR), which doesn't promote a level playing field in the EU.



The EBF remains concerned about the Bank Structural Reform proposal from the European Commission as the measures for separation will reduce market liquidity and increase costs for both credit institutions as well as the retail and businesses customers it supports. This is seen as counterproductive to the growth in Europe and is in contradiction with the objectives of the Capital Markets Union. The EBF considers that this proposal is not necessary given what has been achieved already with existing legislation, most notably CRR (including NSFR) and BRRD, and coming measures such as the FSB's Total Loss Absorbing Capacity standard and the BCBS's review of the trading book.

Nevertheless, as the discussions on the Banking Structural Reform are ongoing at European Council and Parliament level, the EBF urges the EU Institutions to carefully consider the thresholds framing the scope and negative scope to this regulation, to ensure that the criteria for scope remain risk based and ensure the principle of proportionality. The list of banks that fall within scope of the BSR should in this respect be carefully assessed to ensure that the BSR regulation does not exceed what is necessary to achieve the objective of the proposed regulation. In other words it should be ensured that the list of banks falling in scope is reasonable, fair and proportionate. Also, it should be ensured that the list of banks falling in scope is such that EU banks remain competitive vis-à-vis non-EU banks while further taking into consideration the subsidiarity principle.

The benefits of the SSM and SRM shall be acknowledged by the banking regulation, starting with the methodology for the identification of Global Systemically Important Institutions (G-SIIs), that should exclude claims and liabilities within the European Banking Union (SSM / SRM) from the BCBS G-SII scoring methodology.

European G-SII scores are artificially inflated because intra-EU exposures are considered cross-border, and therefore buffer sizes may be potentially disproportionate.

The SREP aims at identifying risks not already taken into Pillar 1. Hence, it should be crystal clear that there is no double counting between G-SII buffers and SREP /Pillar2 requirements.

Last, but not least, free transfer of capital and funding throughout the EU / Euro zone area is currently limited due to constraints imposed by competent authorities in respect of bank intragroup transfer of funds and treatment for liquidity measurement and reporting purposes. A true Banking Union should promote such intragroup transferability of funds, to allow bank lending in those areas where demand is highest.



## Annex<sup>2</sup>

### 1. Section 4.3 Riskiness of SMEs in the European Union

Questions 6 to 10 of the EBA document look at the risk profile of SMEs and, therefore, the adequacy of the current risk weightings for loans to this category. As is known, the application of a discount to the RW of loans to SMEs is justified by the lower correlation among the individual PDs of enterprises in this size class, presumably because the characteristics of SME default events are more diversified than those of larger enterprises. In prudential terms, this means that despite a higher average probability of default, over time a portfolio of SME loans may generate a lower unexpected loss than that deriving from a portfolio of loans to large firms. In Basel terms, this results in a lower capital requirement for loans to the former than to the latter.

Estimation of this correlation is somewhat complex, partly due to the limited availability of microeconomic data for a broad range of loan portfolios. In order to estimate this important parameter, in the past (Finance and economics *“Towards Basel 3. Asset correlation and SMEs: evidence from estimates using macro data”*, July 2012) we proposed a macro approach, using Bank of Italy quarterly data on the rate of new defaults on loans to the productive sector (enterprises and family businesses), to estimate the default correlation (and, consequently, the asset correlation) for small and medium-sized enterprises and large firms. The estimates obtained at the time indicated that:

- the asset correlations for portfolios of SME loans were systematically lower than those for large firms.
- Basel 2 uses asset correlation thresholds which require significantly higher capital absorption than that justified by the estimated risk, with the corresponding implication for policy, as translated into the SME SF, to lower the capital requirement for loans to SMEs.

The past estimates were based on a sample time interval extending from the first quarter of 1990 to the last quarter of 2010. In this paper, we start from the above methodology to determine if the adverse macroeconomic conditions experienced over the past three years confirm the expected lower pro-cyclical nature of the risk associated with a portfolio of SME loans with respect to another comprising loans to large firms.

The time series of new default rates is currently updated to the first quarter of 2015. As a proxy for the riskiness of loans to SMEs we have referred to the new default rates of family businesses and enterprises with credit facilities of up to 500 thousand euro, while the new default rates of enterprises with credit facilities in excess of 500 thousand euro reflect the riskiness of loans to large firms.

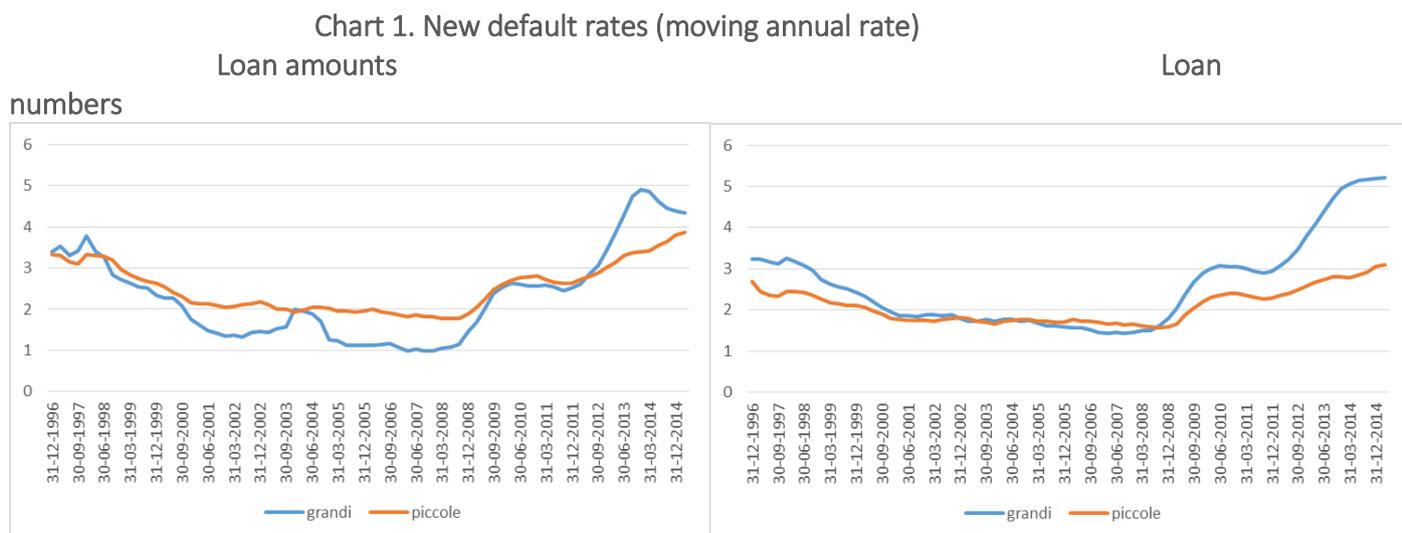
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<sup>2</sup> Annex developed by the Italian Banking Association with a few refinements and broad support from other EBF members.



Chart 1 shows the cyclical trend in the risk associated with the two categories of enterprise, considering the new default rate based both on the loan amount and on the "loan numbers" (summation of amounts outstanding x days outstanding).

The chart clearly shows the more cyclic nature of the riskiness of loans to large firms. When measuring risk based on the loan amounts, the difference between the max and min values of 3.9 percentage points for large firms compares with 2.1 percentage points for smaller enterprises. Considering the risk based on loan numbers, the difference between the max and min values is 3.8 points for large firms and only 1.5 points for smaller enterprises. In addition, looking at the chart for loan amounts, the risk cycle is seen to be symmetrically wider for large firms, while the risk indicator based on loan numbers shows that the more cyclic nature of the riskiness of loans to large firms mainly relates to phases during which the risk is increasing.



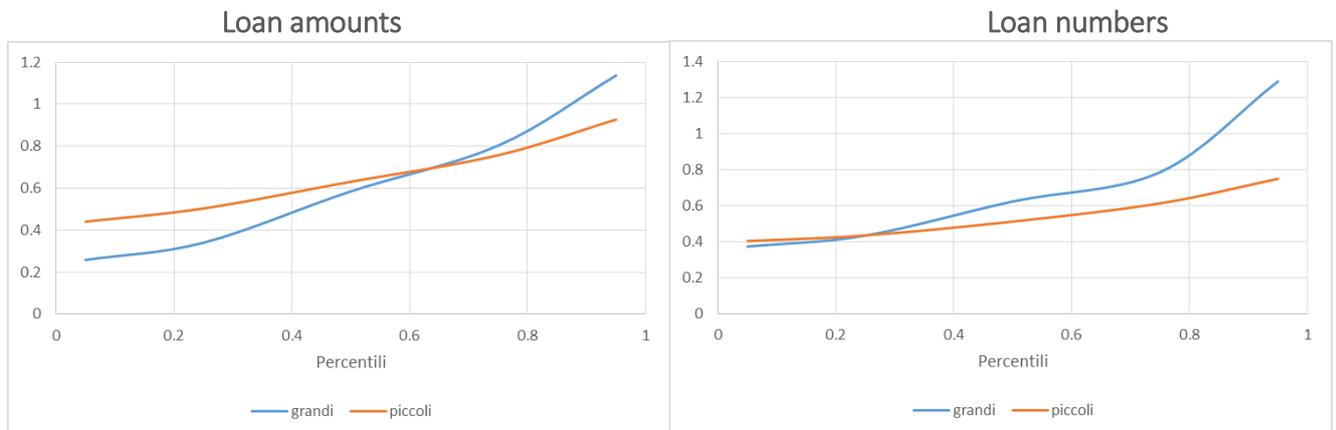
*ABI analysis of Bank of Italy data*

It is also important to note the behaviour of risk during the recent cyclic downturn. Starting from the end of 2007, the riskiness of large firms rose by 3.3 points in loan amount terms, compared with an increase of 2.1 points for smaller enterprises. The imbalance is even clearer from the measurements based on loan numbers: in this case, the increase in risk of 3.7 points for large firms compares with just 1.4 points for smaller enterprises. So, with reference to the recent cycle, it seems fair to conclude that the hypothesised greater pro-cyclic nature of the riskiness of loans to large firms has been confirmed once again.

This fact is more clearly shown by analysing the distribution over the above time interval of these two risk indicators (Chart 2).



Chart 2. Distribution of new default rates  
(quarterly deseasonalised 1996q1 - 2015q1)



ABI analysis of Bank of Italy data

In both cases, the distribution of the new default rate for large firms has a heavier tail. In particular with regard to the loan amounts, the risk distribution for large firms has heavier tails both to the left (smaller amounts) and to the right (larger amounts): as a summary indicator of variability, the difference between the 95th and the 5th percentiles is 0.9 points (3.6 in annualised terms) for large firms and 0.5 (2.0 annualised) for SMEs. On the other hand, considering a summary indicator of unexpected risk, the difference between the 95th percentile and the median is 0.6 points (2.2 in annualised terms) for large firms and 0.3 (1.2 annualised) for SMEs.

With regard to the distribution of the new default rate, determined based on loan numbers, the left tails are the same but the right tail (higher levels of risk) for large firms is very much heavier: the summary indicator of variability is 0.9 points (3.6 in annualised terms) for large firms and 0.3 (1.2 annualised) for SMEs. In this case, the summary indicator of unexpected risk is 0.7 points (2.7 in annualised terms) for large firms and just 0.2 (0.9 annualised) for SMEs.

Taken together, the macro evidence obtained from analysing the new default rates for the productive sector seems to confirm the hypothesised lower asset correlation for the risk distributions of smaller enterprises with respect to large firms.

The greater diversification of risk inherent in a portfolio of loans to SMEs appears to have strengthened during the recent downturn, during which the riskiness of large firms grew significantly more than that of smaller enterprises.

This conclusion applies regardless of whether the measurement is based on loan amounts or loan numbers, although the difference in behaviour in the latter case is much more significant.

## 2. Section 4.4 SME lending trends and conditions

Questions 11 to 16 address the effects to date of applying the SME SF on the availability of loans and the related cost. In summary, the EBA discussion paper asks two principal questions and seeks to provide initial responses:



- 1) Following the SME SF, has lending to SMEs started to increase? If yes, is this increase faster than the rise in lending to large firms?
- 2) Interest rates: following the SME SF, has the cost of borrowing for SMEs fallen with respect to that for large firms?

Two types of empirical work are presented in relation to these questions:

- the first type, based on quantitative data and emulating the analyses presented by the EBA, seeks to highlight better the differences in the trends pre and post SME SF;
- the second type, based on qualitative data and considering solely the experience in Italy, seeks to obtain the opinions of firms about the willingness of banks to grant finance.

### Quantitative analysis

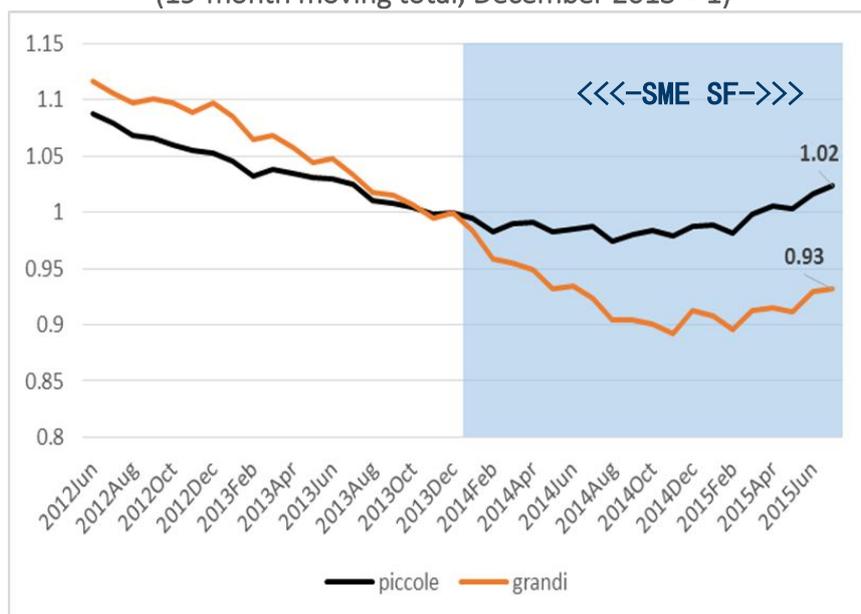
With regard to the analysis of quantitative data, we refer to the EBA analysis of new lending by size of firm. Based on the data available, the EBA discussion paper considers the loan amount granted to be a proxy for firm size, so:

1. loans of less than 1 million euro are treated as loans to SMEs
2. loans of more than 1 million euro are treated as loans to large firms

The data used by the EBA was taken from the ECB database of harmonised interest rates and refers to the volume of new loans granted to firms.

We used the same database and have tried to focus attention on the differences before and after introduction of the SME SF. For this reason, Chart 3 shows the cumulative flow of new lending over a 19-month period, being the period from introduction of the SME SF (January 2014) to the latest available data (July 2015).

**Chart 3. Flow of new lending by size of firm  
(19-month moving total; December 2013 = 1)**



ABI analysis of ECB data



Given the accumulation period, the period-end data shown in the chart indicates the growth in new lending to firms from the start of the SME SF, with respect to a period of equal length prior to the start of the SME SF (June 2013 - December 2014). In addition, the trend in this moving total over time gives an idea of the change in the availability of finance to firms.

Just considering the change in lending during the 19 months from introduction of the SME SF, the results are very clear: lending to SMEs has increased by 2%, while lending to large firms has decreased by 7%. Further, notice how the downward trend in lending to SMEs changed direction rather quickly after introduction of the SME SF, while the documented decline in lending to larger firms continued until the end of 2014, before showing signs of recovery. The change in the flow of new loans therefore appears to indicate that, following introduction of the SME SF, lending to SMEs has risen by more than in the past and by more than the rise in lending to large firms.

The above evidence refers to the Euro area as a whole, while Table 1 shows the same data at national level, in order to check if the improvement in lending to SMEs following introduction of the SME SF is common to all member States, or the result of dynamics found only in certain countries.

This check appears to indicate that the above result is spread somewhat uniformly among the members of the EMU. Calculating the difference between the growth in lending to small and large firms (last column in the table), it emerges that there is a positive growth differential of 9 p.p. at area level and that this positive differential exists for as many as 8 of the 12 countries considered; also, the greater growth in lending to SMEs is confirmed in all 4 principal EMU countries, where the positive growth differential in lending to SMEs is almost 12 percentage points.

**Table 1. Flow of new lending by size of firm (data in millions of euro)**

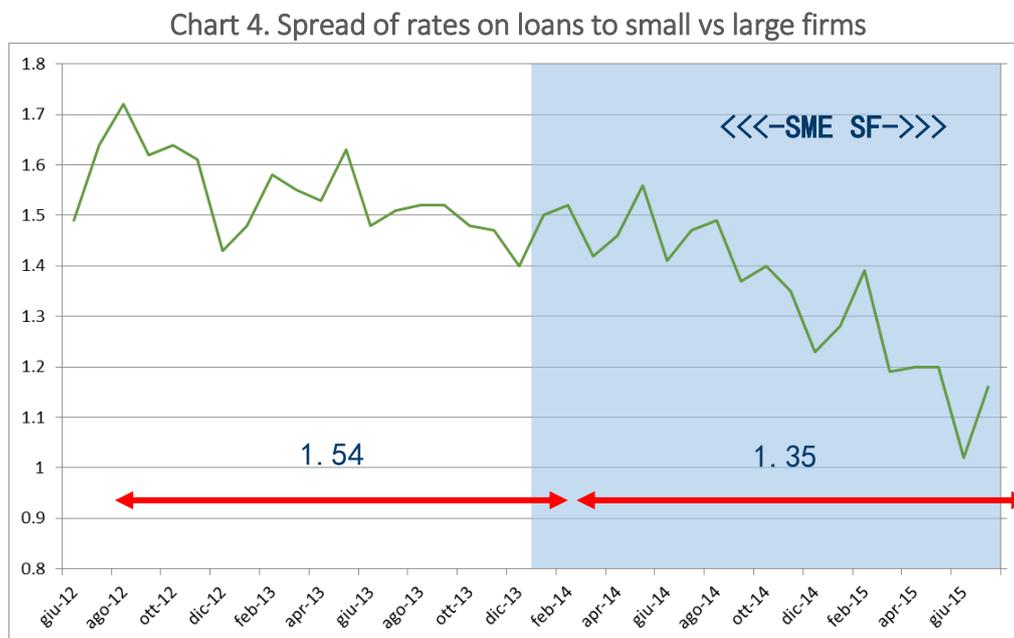
	19-month moving total ended						
	Small firms			Large firms			Small-Large
	dic-13	lug-15	Chng	dic-13	lug-15	Chng	Chng
Austria	21,728	20,235	-6.9%	150,193	142,541	-5.1%	-1.8%
Belgium	128,816	123,230	-4.3%	400,890	322,839	-19.5%	15.1%
Germany	183,727	191,923	4.5%	920,659	915,721	-0.5%	5.0%
Spain	215,499	242,860	12.7%	447,524	352,407	-21.3%	34.0%
Finland	11,605	11,838	2.0%	49,164	45,593	-7.3%	9.3%
France	113,318	114,531	1.1%	259,643	237,587	-8.5%	9.6%
Ireland	5,638	5,768	2.3%	12,954	29,623	128.7%	-126.4%
Italy	259,368	263,995	1.8%	410,064	398,136	-2.9%	4.7%
Netherlands	29,049	28,540	-1.8%	129,125	150,168	16.3%	-18.0%
Portugal	30,025	29,557	-1.6%	45,777	31,620	-30.9%	29.4%
Slovenia	3,231	2,078	-35.7%	10,560	6,960	-34.1%	-1.6%
Slovak Rep.	1,940	2,083	7.4%	18,382	19,302	5.0%	2.4%
<b>Euro area</b>	<b>1,037,967</b>	<b>1,062,101</b>	<b>2.3%</b>	<b>3,038,016</b>	<b>2,830,864</b>	<b>-6.8%</b>	<b>9.1%</b>
<b>Big 4</b>	<b>771,912</b>	<b>813,309</b>	<b>5.4%</b>	<b>2,037,890</b>	<b>1,903,851</b>	<b>-6.6%</b>	<b>11.9%</b>



*ABI analysis of ECB data*

Another quantitative factor to consider is the cost of borrowing. Here too, we have followed the indications given by the EBA and considered (Chart 4) the change in the spread between the rate charged on SME loans and that on loans to large firms over the 19-month periods pre and post SME SF. Once again, the distinction between small and large firms is made with reference to the size of the loan granted.

Consistent with the previous evidence, the period following introduction of the SME SF appears to be marked by a relative improvement in the borrowing costs incurred by small firms: while the rate spread at period end was 3-tenths narrower than it was prior to introduction of the SME SF, it averaged 135 bp over the 19-month period considered, which was almost 20 bp less than the average for the 19 months prior to introduction of the SME SF. Once again, the trends in the various EMU countries were well aligned, with a reduction in the spread between the average rates for the two periods indicated in 8 of the 11<sup>3</sup> countries considered.



*ABI analysis of ECB data*

Overall, the quantitative evidence reported shows that there has been an improvement in both the availability and cost of SME loans following introduction of the SME SF: this improvement can be seen in comparison with both previous trends and the dynamics of larger firms. This fact suggests that the capital discount applied to SMEs has had the desired effect, by improving the conditions for their access to finance.

### Qualitative analysis

For completeness of information, it is useful to refer to the qualitative comments expressed by SMEs about their degree of satisfaction with the availability of bank finance. This type of

<sup>3</sup> Out of the 12 countries considered previously, data for loans in excess of 1 million euro was not available for Belgium.



analysis has certain advantages, with respect to the analysis of quantitative data, when studying the dynamics of lending to firms. In particular, the separation of supply-side from demand-side considerations enables the effectiveness of the measure under review to be assessed more clearly. Additionally, there is no need to use proxies to study the flow of lending by size of firm, since the loan details are available.

The EBA discussion paper uses some of the replies to surveys of firms and lending that were carried out on a harmonised basis as part of survey work on the “Access to finance of enterprises”. For the purposes of this paper, we used the questions about loans contained in two surveys of Italian firms. In particular:

1. Survey by the Bank of Italy on the expectations for inflation and growth: this survey addressed two classes of enterprise (medium and large) in the industrial and service sectors; the results enabled us to calculate a credit restriction indicator;
2. Survey by Istat on the confidence of manufacturing firms: this survey considered three classes of manufacturing enterprise (small, medium and large), enabling us to both determine the opinion of firms about lending conditions and calculate the percentage of firms that did not obtain the finance requested.

As before, we used this information to assess whether or not, following introduction of the SME SF, the target group's (SMEs) access to finance has improved with respect to both earlier trends and that of large firms.

The first analysis developed a credit restriction indicator from the Bank of Italy's survey of expectations about inflation. This survey requested firms to express an opinion on the conditions for access to finance, making it easy to calculate a credit restriction indicator as the net of adverse responses (“conditions worsened”) and positive responses (“conditions improved”). The trend in this indicator over time is shown in Chart 5.

**Chart 5. Degree of credit restriction  
(Italy: Industrial and service-sector enterprises)**



*ABI analysis of Bank of Italy data*

Only two classes of enterprise were considered: those with between 50 and 200 employees and those with more than 200 employees. In this case, the comparison is between medium-



sized and large enterprises, rather than between SMEs and large firms. The chart appears to tell us that overall financing conditions have improved for all firms; this said, the data in Table 2 indicates that the rate of improvement for medium-sized enterprises has accelerated following introduction of the SME SF (-24 points, compared with -15 in the 6 quarters prior to introduction of the capital discount) and, also, that the reduction was greater than that obtained by large firms.

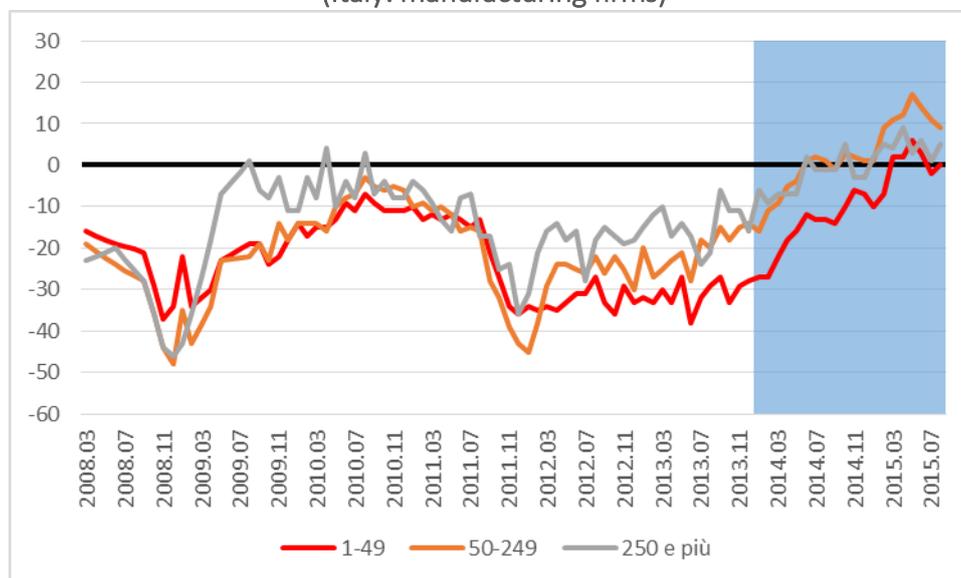
**Table 2. Change in credit restriction and SME SF**

	Size class	
	50-200	>200
June2012- Dec2013	-14.6	-19.7
Dec2013- June2015	-24.1	-20.4

The results are even more evident considering the Istat survey of firms in the manufacturing sector (Chart 6).

Considering both the chart and the summary provided in Table 3, the different magnitude of the improvement in the conditions for access to finance is very clear: an increase of 25-27 points for SMEs, compared with 11 points for large firms.

**Chart 6. Access to finance  
(Italy: manufacturing firms)**



*ABI analysis of Istat data*

Additionally, the change in the trajectory of the SME improvement following introduction of the capital discount is very obvious, while this change is not identifiable from the information for large firms: in the 20 months prior to introduction of the SME SF the access conditions for SMEs improved by 4-9 points, while in the following 20 months there was an improvement of 25-27 points; for large firms, on the other hand, the improvement was about 10 percentage points both before and after.

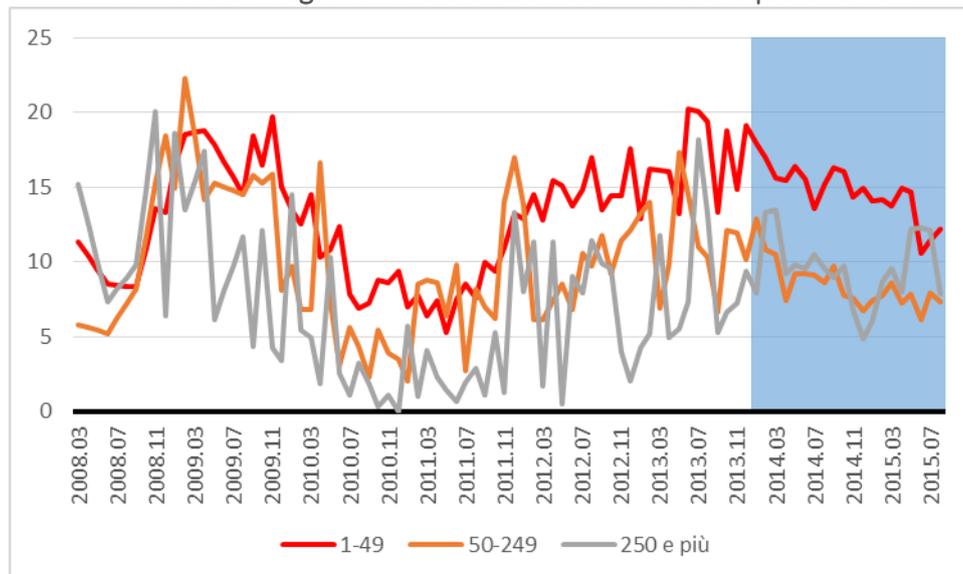


Table 3. Change in the conditions for access to finance

	Size class		
	<50	50-250	>250
20 months before	4	9	10
20 months after	27	25	11

This differential effect benefiting SMEs is also suggested in relation to the rationing measures identifiable from the survey replies. In particular, the percentage of firms that did not receive a requested loan can be calculated, as shown for the three classes of enterprise in Chart 7 and summarised in Table 4.

Chart 7. Percentage of firms that did not receive a requested loan



ABI analysis of Istat data

As can be seen, the probability of not obtaining finance has decreased considerably for both small and medium-sized enterprises post-SME SF, while it is essentially unchanged at a fairly low level for large firms.

However the change in the probability gradient before and after introduction of the SME SF is of even greater interest. In the 20 months before, both small and medium-sized enterprises complained about an increase in the probability of not obtaining finance, while it was essentially stationary for large firms. As already described, this probability declined significantly for SMEs in the following 20 months and, at least in the case of small enterprises, this inversion occurred essentially at the same time as the start of the SME SF.



**Table 4. Change in the probability of not obtaining finance**

		Size class		
		<50	50-250	>250
20 months before		4.2	6.1	-1.1
20 months after		-5.7	-5.6	-0.1

The evidence gathered from these sample surveys appears to indicate that application of the SME SF in Italy has had a significant positive effect on the financing conditions available to SMEs.

Following introduction of this measure, the opinions of these firms about lending conditions have improved significantly, with respect to both the past and those of large firms.

The same also seems true for the probability of not obtaining finance, which has contracted significantly for SMEs following introduction of the SME SF.

Accordingly, it appears reasonable to conclude that application of the SME SF in Italy has significantly and positively influenced the strategies of banks in their lending to SMEs.

### 3. Conclusions

Taken together, the evidence supports a position that

- a) requests continuation of the SME SF
- b) confirms, contrary to fears expressed by the EBA and consistent with the position already taken by ABI, that the measure has not impeded the desired growth in capitalisation ratios, having an effect of about 20 basis points on a CET1 that has risen significantly
- c) highlights how, in the still brief application period, the positive effects have mitigated the adverse consequences of the deep and prolonged recession
- d) confirms that the macroeconomic reasons supporting this measure combine with the structural reasons, being the lower riskiness of SME loan portfolios compared with large firm portfolios, due to a diversification effect that makes the default rate on SME loan portfolios less volatile.

