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EBF Answer to the EC Consultation on the SME Definition

The EBF welcomes the initiative of the European Commission to consult on how the definition of micro, small and medium-sized enterprises (SMEs) could be improved to keep being fit for purpose. We fully agree on the importance of SMEs as the backbone of the EU economy and as key motors of new investment and job creation, this is why having an updated definition of these entities is clearly a step into the right direction.

As financing the economy, and in a wider sense, financing growth, is a key central strategic priority for the EBF, we fully support an initiative that seeks to review the current definition to ensure that it remains fit for purpose and meets its objectives in the current economic environment.

Background considerations

The EBF understands that the SME definition is, in general terms, an appropriate tool that helps to ensure that there is a standard of reference at European level, helping to develop appropriately targeted SME policies, improve equal treatment of these entities and allow a proper identification of these entities for appropriate provision of financing by banks.

Following a preliminary assessment, we believe that changes to the SME definition should be limited, and they should come backed by an adequate impact assessment. In fact, many guidelines and policies are linked to the definition and changes might lead to large (also unforeseen) implementation issues.

It is also important to note that the SME-definition is not only relevant when it comes to public financing of SMEs, but also for a number of banking regulations:

- Art. 123 and 147 CRR (asset classes)
- Art. 501 (1) CRR (SME supporting factor)
- Art. 428 (1)(g)(ii) CRR and Art. 411 (2) CRR in conjunction with Art. 123 CRR, as well as Art. 3 of Delegated Regulation 2015/61 (definition in LCR and NSFR)
- EBA/CP/2017/07 (definition of connected clients)
- Art. 44 (2) BRRD (Bail-In-ranking)

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Furthermore, until very recently, SMEs were classified as clients only in case of a loan request. As long as they remain “passive-clients” (no loan request), there is no legal basis for asking for more data from the client than KYC-data. To be able to classify an SME as client (with regard to the above listed regulations), a bank will have to implement costly processes that could interfere with the provision of finance to these businesses.

In any case, the classification of an SME as client must be legally secure, both for the bank and the client. Legal uncertainty or legal disputes for example in the case of a bail-in must be avoided. It is therefore very important, that both **the definition of SME, and the process of identification must be as clear and simple as possible for all concerned.**

However, the definition and identification of not autonomous enterprises is especially complex, as the Court of Justice rulings from September 2016 has shown.

In order to simplify the process of identification we would like to suggest:

- In case of self-reporting on behalf of the client, which may be used by the bank; the client is responsible for the correctness of the data provided; and
- Some members consider useful the possible implementation of a centralized SME-register accessible by banks; in where all clients would register and the database should be managed by EU authorities. Member states currently take different approaches to registration of businesses and where this currently works well there is limited appetite amongst other members to create an EU-level register.

Concrete issues on the SME definition

Regarding the definition, we understand that the three criteria used (staff headcount, financial parameters and independence/ownership) are broadly appropriate. However, some clarifications could possibly resolve current ambiguity.

Financial Parameters

Financial parameters (turnover and balance sheet) represent one of the best ways to identify if an entity qualifies as an SME or not. They are also the parameters banks have easiest access to.

Some members advocate for the two financial criteria to be met simultaneously and not individually in every occasion, as to better represent the reality of some businesses that may have high balance sheet but low turnover. Structural factors should be kept within the definition, otherwise the classification of SME may vary according to cyclical conditions (unless the anti-cyclical feature of companies being classified as SME is an intended outcome, which is something that could make sense).

Regarding the possibility of raising the thresholds of the financial criteria, some EBF members highlighted the need to re-assess them, to simultaneously accommodate the effect of inflation that has occurred since 2003 as well as the evolution of business structures. However, others believe strongly that raising the threshold would bring in larger businesses which could benefit at the expense of smaller ones, for whom the SME classification is intended to benefit. Any increase in the threshold would need to be properly assessed and the impact on other businesses considered.

Regarding turnover more in detail, the indicator is one of the most easily accessible tools for banks, consequently it is clear why financial parameters are key for the proper classification of SMEs in bank's internal models.

Some members advocate for the possibility of using only the last annual account (or 31st December previous year) as relevant, not allowing transitional periods anymore.

Finally, it is important to note that, based on Article 501 (2) (b) of the CRR, which refers to turnover as the only criteria to be taken into account for determining exposures to SMEs, some EBF members argue that this information should be the one to be taken into account to determine if a company is an SME, excluding other criteria as headcount from the formula.

Headcount

We understand that higher labor productivity may have an impact on the headcount criteria (i.e. higher productivity may imply less full time employees). This is also true for digital companies, as they may require less staff than non-digital companies due to for example their highly automatized processes and providing services through online channels.

As referenced above, some members suggest the possibility of not taking headcount into account for the classification of a company as SME. However, in case this parameter would be kept, some members consider that the current headcount threshold should be kept, while other members advocate for increasing it, and if we take into account the abovementioned labor conditions, it would make sense to take into account all employees (including temporary workers, trainees) working in an enterprise on a specific date (i.e. 31st December previous year).

In the cases of seasonal employees, for instance in the tourist sector, we encourage a full consideration of how these should be recorded to ensure consistency of interpretation.

Categorization of SMEs

According to the two first sets of criteria, EBF members tend to support the current categorization. However, depending on the structure of the SMEs at national level a different harmonized categorization might be needed. We note that at national levels, a wide variety of definitions are used, to suit national business needs.

Independence/ownership

We believe that this is a key issue to be tackled as it is not always easy to identify all the linkages currently taking place. EBF members would be in favour of a simple approach regarding this topic. In fact we believe that the simpler the definition, the easier it would be for finance providers to assess whether a company is an SME or not.

It would also be important to underline the ownership conditions included in Article 3 of the Recommendation 2003/361/EC are often met by venture capital and private equity firms in the normal course of business.

Considering both the importance of qualifying as an SME for eligibility for support under many EU business-financing and support programmes (EU funds, EIB programs, EIF) and the Commission's recent measures to support venture capital and equity financing in the EU, we would recommend the European Commission re-assesses the role of private equity and venture capital funds from the definition of "linked enterprises" as to have a clearer and simpler picture on ownership and independence.

In addition, we consider that SME under restructuring should benefit from special regimes irrespective of the owner so as to attract capital for recovery.

Regarding public authority control of the entity, we understand that a level playing field should be the prime criteria irrespective of the entity that controls the SME.

With regards to the determination of the **real economic capacity of an SME** taking into account all relationships with direct and indirect partner and linked enterprises, we believe that this should continue be taken into account, while striking the right balance between facilitating SME access to public support and finance and preventing the set-up of corporate structures used to circumvent the SME definition.

We, therefore, consider of utmost importance to review and clarify concepts and rules, which are difficult to interpret (or apply in concrete cases), with the objective to ensure legal certainty.

Some of the concepts and rules needing clarification include:

- The SME status in case of mergers and acquisitions;
- The rules applicable to partner/linked enterprises which have such a relationship through a natural person or group of natural persons.

In general terms we note that it is very complex to verify all the links among enterprises provided in Article 3 of the Recommendation, especially if the responsibility of this analysis is transferred by the competent authorities to financial institutions. Thus the principle contained in recital 14, which states that "it is appropriate to allow SMEs to use solemn declarations to certify certain of their characteristics" should be strengthened.

Finally, on the "grace period", the EBF believes that the current period is acceptable, However, some members believe that it could be increased, for example up to 4 years.

Outstanding issues

From an EBF perspective we would like to highlight some outstanding issues:

In particular, in the current state of play we believe there is a need to **clarify the following rules**.

- According to art. 501 (2) (b) CRR in conjunction with EBA Q&A 2013_343 it can be concluded, that the annual turnover alone would be sufficient for the classification of a company as SME, in contrast with the current Recommendation.
- In the context of COREP solvency reporting, the enterprise's size is determined on group-level, in the context of AnaCredit it is determined on the level of the individual borrower.

We would also like to suggest the European Commission considers including in the revised recommendation **the concepts/status of small midcap and midcap**, which are increasingly used, namely by the European Investment Bank and the European Investment Fund, in a set of different products and which are also based on the concepts of the European Commission recommendation, namely in terms of headcount calculation. Including those concepts in the recommendation would have the advantage of clarifying the rules and creating a specific (small) mid/cap status, to be used in different EU and national instruments

Finally, considering the importance of SMEs for European growth and job creation, we understand as an issue of utmost importance to conduct previous thorough **impact assessments**, both at an EU and at a national level, of any proposed changes to the SME definition.