

# Policy Brief 2010

## Bank Regulation

### Requirements and positions of Small and Medium-Sized Enterprises



### Preamble

Since the year 2007 the capital markets have been setting the economic policy agenda. As there is no single cause of the banking crisis, the credo is now that a future banking crisis can be avoided by stronger regulation of the credit markets. To do this, those responsible in Brussels, Berlin and Basel are focusing on a multitude of measures that at the moment do not appear to give the impression of a coherent package.

The German Association for Small and Medium-Sized Enterprises (Bundesverband mittelständische Wirtschaft - BVMW) and the European confederation of national business organisations (CEA-PME) have been watching these developments. Three points in particular give us reason to worry:

- **Credit availability:** Today, credit for SMEs is already at a disadvantage as compared to other types of investments according to the Basel II regulations. We fear that the planned measures for regulation will have a disproportionately negative effect on SMEs and that they will lead to a worsening of the credit crunch.
- **Bureaucracy:** Today, the classic credit business is already overregulated, in contrast to investment banking. The relationship between lender and borrower should be made more transparent, simpler and more equitable. Our approach reads: "Not more, but better regulation."
- **The economy as a whole:** SMEs and their employees have borne the brunt of tax revenues used since 2007 to rescue the banks, to guarantee interbank dealings and to extend Germany's solvency across the whole Eurozone. We thus question whether the intended measures are effective and fair, considering the principle that the party responsible should be liable for the damages.

SMEs neither caused the crises, nor do they have direct access to capital markets. Although the rescue packages were made with the stipulation that the financing of the real economy had to be secured, today more than 40% of companies complain about ever-increasing demands for collateral, higher interest margins from banks, meagre offerings for new loans and increased reporting requirements.<sup>1</sup>

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<sup>1</sup> Source: BVMW survey presented to the media on 19 May 2010. The questions were related to perceived changes over the last twelve months. The survey was conducted in April and May of 2010.

The guiding principles of this position paper are:

- Transparency
- Adherence to the principle that the party responsible should be liable for the damages
- Restoration of the balance of power between banks and customers
- Priority for SMEs
- Only as much regulation as necessary, and as little as possible

The position paper is made up of three parts:

- I) Ratings, bank-customer relations**
- II) The regulation of the Basel Accords**
- III) Bank levy and other measures**

Topics that do not directly affect SMEs, like the regulation of hedge funds, are not mentioned herein.

## **I) Ratings, Bank-Customer Relations**

### **1. Ratings and their consequences must be made more transparent for businesses.**

**Problem:** Internal bank ratings play a central role in loans to SMEs for lending and credit terms. In the rating process, which is repeated periodically, companies have to present a comprehensive portrait of themselves to the banks. However the companies are often only insufficiently informed about the reasons that led to the respective rating classification. The direction of the flow of information is one-sided. At the same time it is essential for the companies to be told, for example, if the reasons why a loan has been denied are because of a deficiency on the side of the company or if the denial was due to the bank's business strategy.

**Solution:** We recommend that the black box of "internal rating" (IRB) as well as its data basis be made transparent. The factors that influence the rating outcome must be clear to the customer. What should also be a part of this conversation about rating are reporting requirements for the banks to the borrowers as to whether the bank is acting using IRB or a standard approach. If they do use IRB, a rating calculator should be published on the Internet, possibly limited to the quantitative factors and only available to bank customers. We support the draft law "Rating Processes" by the BdRA (Bundesverband der Ratinganalysten und Ratingadvisor e.V. – Federal Association of Ratings Analysts and Ratings Advisors) submitted in May 2010 that calls for requirements regarding rating processes, methods and models. A reference with ranges of ratings that all the institutes and agencies must provide in addition to the ratings assignments according to their in-house methodologies should be made a compulsory requirement by the European Commission.

It also serves transparency when banks disclose to borrowers which proportion the important components account for the interest on the loan (refinancing costs, calculative equity costs / yield, risk costs, service fees).

## 2. Options for SMEs in loan processing

**Problem:** Business models for SMEs are very individual. A loan decision made by the credit risk control unit without bank employees ever having visited the company or having spoken with the owner and/or the CEO does not do justice to this individuality.<sup>2</sup>

**Solution:** We recommend the introduction of an option for SMEs so that there can be a separation between the sales department and the credit risk control unit that can be done away with up to a certain, explicitly stated loan amount. The reduction in handling costs is a relief for both banks and borrowers. For loan applications for SMEs, banks should be required to provide a written answer to the application within fourteen days, or to name a time period in which the application will be processed and to provide a list of any missing documents required as necessary.

## 3. Understanding the underlying business

**Problem:** Too often companies in the same sector are “measured with the same yardstick”. For example, in 2008 many companies that were considered part of the automotive supply sector complained of enormously restrictive lending practices. Since companies within a sector are increasingly differentiated, it is imperative that bank managers get to know and understand the specific business models of their SME customers.

**Solution:** We ask banks to create conditions so that all managers actually visit the companies on location so that they are able to understand the sector-specific business model. Bank employees must be continuously trained, with the additional goal that qualitative, future-directed factors can be more strongly taken into consideration with regards to sector-orientated rating catalogues (see point 5). Banks themselves must determine further professional training requirements, as we consider this sort of training primarily as a private and not a governmental function.

## 4. No additional reporting requirements

**Problem:** Increasing reporting requirements for small businesses mean additional bureaucratic expenditures. It prevents focussing on the core business when the reporting requirements go above and beyond the normal business and economic analyses.

**Solution:** We recommend that lenders be obligated to the “principle of commensurability”. Reporting requirements must be reasonable in relation to the credit risk and the collection of information cannot become an end in itself. We do not consider guidelines for forms or schemata by lawmakers to be reasonable in this context.

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<sup>2</sup> The following was once said by a bank employee: “The manager that is speaking to you may not make the decision. The manager that will make the decision is not allowed to speak with you.” This quote provides an example of the realities of communication as experienced by many companies nowadays.

## 5. Give future factors a larger role in loan decisions

**Problem:** The current business model and thus the future business development are the most important determinants of whether or not a loan can be repaid as scheduled. However, banking practices assign backward-looking processes (balance sheet analysis) greater importance.

**Solution:** Qualitative factors like the business model and the future outlook must be given a larger role in lending processes. One possibility for this could be “intellectual capital statements” on a voluntary basis. We understand this statement to be a report about the intellectual capital of a company including additional qualitative factors.<sup>3</sup> Banks should furthermore be required to recognise “intellectual capital statements” drawn up according to scientific criteria and to consider such during the determination of the credit rating. This is especially important for cases of restructuring. In these cases a backward-looking inspection is economically meaningless and the future outlook on the basis of planning and intellectual capital statements must additionally be given the greatest weight in the rating procedures.

## 6. Support the accreditation of additional rating agencies

**Problem:** The market domination of the rating agencies S&P, Moody’s and Fitch contributed to the development of the bank crisis through errors in judgements and/or adjustments that came too late.<sup>4</sup> This didn’t pertain to the credit business, but to banks’ investment business.

**Solution:** The accreditation of additional private rating agencies must be facilitated. Furthermore it must be made clear which criteria are necessary for accreditation across all of Europe. We reject the setup of a governmentally run rating agency (“European Rating Agency”) because the danger of political influence on rating results is too great. Overall the consideration of self-responsibility concerning investment decisions must be increased in the banks themselves. Ratings can play an appropriate part in rendering assistance, but it cannot replace banks own responsibility in making investment decisions.

## II) The Regulations of the Basel Framework

Under the heading CRD 4 (Capital Requirement Directives) the EU Commission is discussing a collection of measures that were suggested by the Basel Committee on Banking Supervision for the most part. The term “Basel III” is being used for the package of measures. We fear that neither

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<sup>3</sup> Further information about intellectual capital statements can be found at [www.incas-europe.eu](http://www.incas-europe.eu). The BVMW participated in a project to create European intellectual capital statements (INCAS).

<sup>4</sup> However these play a smaller role for SMEs since they specialise in the analysis of securities and not on the evaluation of loans for SMEs.

the next banking crisis will be prevented nor are the needs of the real economy addressed.<sup>5</sup> The special structures of the European economy must be taken into account. This also holds true for questions that we do not address here.<sup>6</sup> The BVMW campaigns for a SME clause in order to offset the negative effects that planned regulatory reforms have on SMEs.<sup>7</sup>

## 7. Small and medium-sized business clause in order to offset higher equity capital requirements

**Problem:** Loans to SMEs are assessed with higher risk weights than risky investments like Greek governmental bonds and American mortgage securities. Raising the average rates that determine the capital requirements ratio of banks would thus be disproportionately borne by SMEs.

### Example:

| SME loan amount:<br>€100,000                           | Today      | Capital requirement 2019 | BVMW recommendation |
|--------------------------------------------------------|------------|--------------------------|---------------------|
| Risk weight in retail portfolio, standardised approach | 75%        | 75%                      | 50%                 |
| Capital ratio                                          | 4%         | 8.5%                     | 8.5%                |
| Necessary capital that a bank must have on hand        | € 3,000.00 | € 6,375.00               | € 4,250.00          |

This example shows the development of the Tier 1 Capital Ratio including the capital conservation buffer according to the proposal of the Basel Committee and the head of regulators published on 12 September 2010. The implementation of the BVMW recommendation would partly offset the additional burden for SMEs.

5 This also holds true after the oversight body of the Basel Committee on Banking Supervision announced the relaxation of some details of the reform package on 26 July 2010. In our opinion, investment banks especially benefit from this agreement, e.g. the postponement of the introduction of the leverage ratio.

6 This also includes the question of how and to what measure the capital resources of the banks should be composed. Here we follow the approach of Othmar Karas, MEP who "...finds that in order not to disadvantage certain business models of non-joint stock companies, in particular cooperatives and savings banks, capital must be defined in a balanced manner on the basis of the quality of capital instruments (i.e. permanence, loss absorbance, flexibility of payment) rather than their particular legal form." Source: Draft report about Basel II and the revision of the regulations about capital requirement directives (CRD 4), (2010/2074(INI)) from 14 May 2010.

7 According to the bank-supported "Institute of International Finance", in the year 2020 there will be 4.8 million more unemployed people in the Eurozone if all regulatory changes are implemented. Source: „Interim Report on the Cumulative Impact on the Global Economy of Proposed Changes in the Banking Regulatory Framework“, June 2010, p. 84.

**Solution:** If average capital requirement ratios are increased – either through an increase in the percentage rates and/or a different composition of equity capital – this must be compensated for by sinking the risk weights for loans to SMEs. We then recommend, for example in the standard procedure, to calculate a risk weight of 50% (instead of 75%) for a portfolio of granular SME loans. Overall we are convinced that a lower risk weighting for SME loans combined with a higher risk weighting of all investments with market price risks, and higher average capital requirement ratios would stabilise the financial system.<sup>8</sup> Even in 2009, in the middle of the crisis, the rate of insolvencies for German small and medium-sized enterprises was only approximately one percent, so that these measures must be combined with a limitation of the leverage ratio (see point 11).

## 8. Small and medium-sized business clause to expand retail portfolios

**Problem:** The retail portfolio for loans with a volume of less than one million euro was determined within the Basel II development process. This limit should be adjusted to today's circumstances. The classic SME should always be able to be allocated to the retail portfolio.

**Solution:** We recommend the raising of the limit under which a loan to SMEs can be included in the retail portfolio to two million euro. It is appropriate moving forward to automatically raise this limit once a year by the rate of inflation at a minimum. For banks that use IRB as standard, we recommend that they be given the choice of the alternative of carrying out the equity capital calculations for loans to SMEs according to the standard approach. This would assist in avoiding high service charges and bureaucratic expenditure.

## 9. Two independent studies about the impacts of Basel III for the real economy

**Problem:** The EU Commission and the Basel Committee are focussing far too much on the ramifications for the banks' balance sheets in the planned impact study. The impacts on the availability of loans and thus on the real economy is being neglected.

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8 The BVMW concurs with the opinion of the Scientific Advisory Body of the Federal Ministry of Economics and Technology (Wissenschaftlicher Beirat des Bundeswirtschaftsministeriums): "That the equity base of many banks is as low, as it is has less to do with flaws in the details of the equity requirements than it, to a greater degree, has to do with the fact that those responsible in the banks have an interest in doing as much as possible with the equity they have available, and that the risk calibration of the capital requirement ratio gives them the possibility to do so – without regard to the fact that the risks connected with doing so are borne in part by the creditors and taxpayers, and that the systematic repercussions of these risks can on the whole considerably burden the financial sector and polity. As long as these incentives persist, any and all attempts for a more stringent version of risk calibration and of dealing with risk models are doomed to failure." Source: Reform of Banking Regulations and Bank Supervision after the Financial Crisis, Advisory Opinion of the Scientific Advisory Body of the BMWI, p. 21, May 2010, translated from the German

**Solution:** The BVMW advocates the realisation of two independent impact studies for the real economy. We have already submitted our commentary about this to the European Commission within the first consultation process about CRD 4 regulations.<sup>9</sup>

## 10. Liquidity standards

A)

**Problem:** Considering the Liquidity Coverage Ratio Requirement (LCR), in the future banks are to keep corresponding stocks of highly liquid assets (government bonds, central bank monies) on the basis of a 30-day stress test scenario. We fear that preference is given to government bonds over other types of investments and a “crowding out” effect would negatively affect loans to SMEs. Furthermore it would impair the overall stability of the system if the mobilisation of liquidity reserves in the case of a banking crisis led to a crash on the money and bond markets.

**Solution:** The BVMW advises against giving preference to government bonds in liquidity reserves. We recommend instead a flexible management of existing ECB’s minimum reserves rules. If other assets are taken into account, we recommend counting the potential hypothecation of corporate bonds, debentures and loans to SMEs against the liquidity reserves.

B)

**Problem:** Structural components (Net Stable Funding Ratio, NSFR) should ensure a specified relationship between the active and passive side of bank balance sheets. Banks encountering difficulties — as was the case with Hypo Real Estate (HRE) — that are a result of a short-term refinancing structures should thus be prevented in the future. According to the recommendation of the EU Commission, loans to SMEs with a term of longer than one year are to be refinanced to 100% over the long term. This worsens refinancing possibilities for loans to SMEs.

**Solution:** The BVMW recommends ensuring that commercial banks with customer deposits (savings banks, co-operative banks etc.) should not be placed at a disadvantage through this sort of regulation and that savings deposits should continue<sup>10</sup> to be recognised as a basis for long-term refinancing.

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<sup>9</sup> Commentary in English: [http://www.bvmw.de/fileadmin/download/Downloads\\_allg.\\_Dokumente/politik/state-ment\\_bvmw-crd4-EU\\_042010.pdf](http://www.bvmw.de/fileadmin/download/Downloads_allg._Dokumente/politik/state-ment_bvmw-crd4-EU_042010.pdf)

<sup>10</sup> See for example the KWG-Grundsatz II (Previous Banking Act Policy II), today known as the Liquiditätsverordnung (Liquidity Provision).

## 11. Limiting the leverage ratio

**Problem:** In the future the total assets of non-risk-weighted investments are not to exceed equity by a certain, yet-to-be-determined factor. Before the onset of the banking crisis a ratio of 40 or more was normal in Germany. A ratio of 20, for instance, acts as a risk impediment for the banks. The Scientific Advisory Body of the Federal Ministry of Economics and Technology seems inclined to consider a maximum leverage ratio of 10.<sup>11</sup> Although a leverage ratio that is too large can lead to instabilities, one too severely limited is also risky: if the banks try to reach a certain return on equity within an “equity multiplier”, they would be forced to exchange low-risk investments for high-risk ones. Lending to SMEs would be reduced.

**Solution:** Limiting the leverage ratio for bank balance sheets is fundamentally the right thing to do.<sup>12</sup> Which makes it all the more important that “within the leverage ratio” there are the correct sets of incentives for the banks: We recommend lowering the risk weight for loans to SMEs and to raise the necessary equity coverage for riskier investments (see point 7). The current, non-risk-weighted leverage ratio must regularly be published on the Internet. In a further step, off-balance-sheet instruments must also be included (see risk balance sheet, point 14).

## 12. Countercyclical measures

**Problem:** There has been discussion that in the future banks would be required to build up additional capital “in good times”. The EU consultation paper illustrates two starting points: provisions for expected loan defaults and capital adequacy requirements.<sup>13</sup> Alongside the measuring and delay problems, the BVMW doubts that the previously built up capital reserves would be used countercyclically in recessionary times for lending. Therefore the so-called “countercyclical elements” could under certain circumstances lead to a scarcity of lending opportunities for SMEs in prosperous times without a positive effect in downturns or recessionary phases.

**Solution:** The standard approach already prevents pro-cyclicality in the ratings process. This is yet another reason why the use of the standard approach should be moderately expanded (see point 8). If banks are required to build up an additional “countercyclical” equity buffer, we recommend that this cushion should be included in the average capital requirement ratios so that years of overfulfilment are allowed to be followed by years of underfulfilment.

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11 Source: Reform of Banking Regulations and Bank Supervision after the Financial Crisis, Advisory Opinion of the Scientific Advisory Body of the Federal Ministry of Economics and Technology, p. 28, May 2010.

12 Even the inclusion of the leverage ratio in the so-called second pillar of Basel II as a control instrument would still be an improvement on today’s situation, even if the BVMW makes a case for the leverage ratio being made an element of the first pillar.

13 The instruments could be designed either dependent on the economic situation (through the cycle, cyclicity of minimum requirements, equalisation of the probabilities of default (PDs)) or time independent (in the sense of a “fixed target buffer”, for example a block on dividends that is not really countercyclical). For concepts depending upon the economic situation there is the additional question of the correct way to measure this, meaning it is unclear which macroeconomic variables are actually of value as indicators.

### 13. Reduce the banks' propensity to speculate

**Problem:** After the bank rescue packages from the year 2008 there is now an implicit state guarantee for the banking sector. We fear that this will continue to increase the incentive for speculative dealings instead of reducing it until a credible solution for insolvency proceedings for banks can be found (see point 13). Additionally other problems that are seen as causal for the banking crisis are still awaiting solutions (i.e. the structure of European oversight and compensation systems).

**Solution:** Paul Volcker, the former chairman of the Federal Reserve, recommends that institutes with private savings accounts should not be allowed at all to trade on stock markets for their own account. While we support this idea, we would plead for a more moderate approach: for example that the sum of all open trading investments for their own account may not be greater than their own equity. In any case it is appropriate to further increase the capital adequacy requirements for the trading book. Postponing the implementation of the stronger regulations already passed by a year to 31 December 2011 sends the wrong message.

## III) Bank Levy and Other Measures

### 14. The BVMW argues for the introduction of a risk balance sheet

**Problem:** In order to generate revenues and to placate the public, the federal government has been discussing the introduction of a bank levy. The suggestion occurred unconnected to the bundle of measures discussed under CRD 4. If this bank levy is done badly, loans to SMEs would become more expensive and, through a fund solution, the banks would receive an additional incentive to continue acting in a speculative manner, causing a moral hazard. The fund could be considered as an insurance against "all-around recklessness". However insurance is there for the sole purpose of insuring accidents upon which one has no influence.

**Solution:** Banks should be required to publish a risk balance sheet at regular intervals. This balance sheet would also contain all those off-balance-sheet investments and would be subdivided by the separate business divisions. If the proportion of loans to private households and SMEs is less than 80 percent of the entire risk balance sheet, the bank levy will be charged with the monies flowing directly to the treasury.

This connection to the risk balance sheet provides banks with an additional incentive to pursue what is actually their core task in financing the real economy. Furthermore this approach also sharpens the consciousness for risk and also enforces the principle that the party responsible should be liable for the damages: the direct payment into state coffers acts as a small restitution towards the taxpayers who financed the bank rescue packages.

An alternative to this would be to completely free those banks that are not “too big to fail” and which have their own functioning deposits insurance system from the bank levy, and only place an additional tax on the higher risk “too-big-to-fail” banks that pose a risk for the entire economy (see also point 16).

In both cases publication requirements should be toughened with respect to banks’ in-house risk inspection procedures (portfolio management, open liquidity, interest and foreign currency investments, incorporation of SPVs and foreign subsidiaries; decisions about risk and risk control processes, further including the financing of financial market partners (leasing, factoring, funds etc.) and re-financing structures). The consciousness for risk must increase.

## 15. Securitisation

**Problem:** In the past, securitised products were given ratings that were too high and that did not reflect the actual risks involved. In part, some of these structured packages were purposely made complex in order to pursue regulatory arbitrage. Despite this, the instrument of securitisation – also in relation to loans for SMEs – is sensible per se: risks can be distributed, making cheaper refinancing possible.

**Solution:** The contractual partner for SME borrowers must first and foremost remain the bank that provided the loan, unless the borrower explicitly agrees to a change. If this is legally guaranteed, and the SME loan is securitised into investment vehicles according to German law, the seller should retain 5%.<sup>14</sup> If such legal regulation is not possible, we would recommend that the seller should retain 20%.

## 16. Avoid “too big to fail” / create an emergency system

**Problem:** Currently market-based principles in the banking sector have become inoperative. With governmental protection the sector is generating fantastic yields. This is distorting the entire market structure and is not sustainable. Too-big-to-fail banks are still in a position of being able to extort protection from the state.

**Solution:** Our recommendation for the short term is to subject those too-big-to-fail banks to exceptional attentiveness in regulation / oversight. This includes, for instance, periodic stress testing and publication of the results of such tests.<sup>15</sup> Inspection efforts for banks not too big to fail, in contrast, can be reduced, because the banking crisis was not a result of “too little” oversight or

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<sup>14</sup> Due to a change in EU Regulation 2006/48/EG, as of 31 December 2010 investments of an institute in securitised investments throughout Europe are only possible when the originator or the sponsor has on hand an amount equal to at least 5% of the securitised investments. This is to reach a “harmonisation of interests between lenders and investors”.

<sup>15</sup> We explicitly commend the German federal government’s change of mind on this as reported in the media on 17 June 2010.

regulation, but rather due to the focus not being placed on the right areas.

Furthermore, insolvency laws for banks must be developed. The approach of the German Ministry of Justice that each bank must have a “final will” is a step in the right direction. These must be complemented by economic emergency measures so that individual banks can go into insolvency without endangering the entire economic system. This should include a European Central Bank (ECB) emergency system, for example, that can, over the short term, refinance smaller banks apart from interbank trading.

## 17. Transaction tax on speculative transactions

**Problem:** Speculation nowadays is perceived less as an indicator for existing imbalances, but rather as the cause of imbalances. While we have our doubts about whether speculation should fundamentally be rejected, an abatement of extreme speculative eruptions supports a continuous and sustainable economic development.

**Solution:** We recommend the European-wide introduction of a financial transaction tax, and request that the federal governments and the EU Commission continue to commit to getting this regulation implemented around the world. One nation going it alone must be rejected in all cases. Hedging transactions by SMEs with underlying transactions (e.g. a currency swap for the purpose of an export transaction) do not count as speculative transactions. Thus the consequences of regulation to this effect, especially in relation to the hedging costs of companies in the real economy, should be re-examined within the first three months of its implementation.

## 18. Simplify access to capital markets

**Problem:** Corporations have the alternative of seeking credit financing by issuing bonds (loan capital) or stocks (equity). This possibility is usually not available to SMEs. Although larger medium-sized businesses do have the option of issuing shares, participating preferred stock or bonds outside of the stock markets, for all practical purposes these alternatives do not really come into question for capital requirements below five million euro due to cost considerations.

**Solution:** We demand the creation of alternative financing channels. This includes the simplification of conversion from the limited liability company (e.g. GmbH) to a company issuing shares (e.g. Kleine AG), and similarly making it easier for pension funds, etc. to invest in bonds or stocks of SMEs. The use of alternative financing channels, also particularly the increase in equity ratios,<sup>16</sup> must be rated positively in rating processes. The accreditation of additional rating agencies that are more familiar with SMEs than the current three rating agencies dominant in the market would support this process (see point 6).

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<sup>16</sup> A further strengthening of SMEs' own equity powers can occur over the short term through the retention of degressive write-offs and a more generous handling of loss deductions (carry-forward and carry-back) for determining taxable profits. Tax exemptions for profits that are re-invested in a company are an effective means to encourage investments and economic growth over the medium term.

## 19. Transparency and competition in the banking sector

**Problem:** A much broader oversight by the authorities should prevent the next bank crisis. We have our doubts about this approach, as experience shows that the developers of financial products act much faster than the regulating authorities in finding gaps in the regulations and it will not be possible to regulate every individual transaction. A spiral of complexity comes into being through regulatory arbitrage and the subsequent reaction of regulating authorities that rather destabilises the whole system.

**Solution:** In addition to regulatory transparency, we recommend an increased public transparency in which meaningful key performance indicators about banking business are published on a central Internet page more often and are more up to date. Competition within the banking system and between the forms of financing must furthermore be increased so that more financing alternatives come into being. A solution to the to-big-too-fail problem is essential (see point 16). Lending for SMEs from smaller banks should not be subject to more regulation, but rather should be subject to less.

## 20. Cornerstones of regulation: Transparency and competition, consistency and timing

**Problem:** The document "Important Proposals for Regulating the Financial Markets" (Wichtige Vorhaben der Finanzmarktregulierung – German Bundestag, 19 May 2010<sup>17</sup>) lists 45 various activities behind which are several specific measures. Inconsistencies are predestined along this path and the ramifications for the whole system can no longer be taken fully into account. The processes, particularly also in the Basel Committee and in co-ordination with the EU Commission, are not relatively transparent.<sup>18</sup>

**Solution:** We demand that the national Ministries of Economics and Finance produce a study about the national economic impacts of all the regulation measures on the real economy and on SMEs in particular. This study would complement the impact study about CRD 4 on the real economy (see point 9). This will prevent harm from being done to the real economy due to non-fine-tuned regulations. Decision-making bodies and regulatory authorities must also examine the effects on the entire system. These impact studies must be available before the EU Commission starts working out the respective draft guidelines about CRD 4. Our understanding of democracy requires that the European Parliament be comprehensively and actively integrated into this process.

The main duty of banks is to finance the real economy. The measures mentioned here serve to stabilise and further develop the banking system in the market economy environment.

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<sup>17</sup> Unpublished.

<sup>18</sup> The correspondent for the European Parliament Othmar Karas, MEP is "strongly concerned about visible shortcomings of the negotiation process on the revised framework, and that the framework, as currently presented, clearly puts the European economy at competitive disadvantage." Source: Draft Report about Basel II and the revision of the regulations about capital requirement directives (CRD 4), (2010/2074(INI)) from 14 May 2010.



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The **Bundesverband mittelständische Wirtschaft** (German Association of Small and Medium-Sized Enterprises), or **BVMW** for short, is a politically neutral association representing the interests of small and medium-sized enterprises spanning all professions and industries. Together with its partner associations, the BVMW has over 150,000 members.

**[www.bvmw.de](http://www.bvmw.de)**

**CEA-PME** is an ideologically neutral and non-party confederation of national business organisations. It represents the interests of small and medium-sized enterprises of all branches and professional groups towards the European institutions and aims at giving SMEs a voice commensurate to their importance for the European economy.

**[www.cea-pme.org](http://www.cea-pme.org)**