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"The voice of crafts and SMEs in Europe"

Capital regulations must be strengthened without harming SME finance

- ***Capital requirements must be increased on troublesome products but not on retail and SME loans***
- ***Pro-cyclical effects must be dampened; cooperative and saving banks' capital must not be excluded from "tier 1"***

Brussels, 4 December 2009 – The current capital requirements must be improved to avoid a second financial crisis, but this should not endanger the provision of financing to the real economy, according to UEAPME, the European craft and SME employers' organisation. Speaking in Brussels yesterday (Thursday) at the second European Forum "Cooperative Banks and SMEs" organised by the International Confederation of Popular Banks (CIBP), the European Association of Co-operative Banks (EACB) and UEAPME, Economic and Fiscal Policy Director Gerhard Huemer spoke in favour of a reasonable increase in capital requirements, provided that this is linked to financial services and products that created the current problems and not to normal retail or SME loans. He also stressed that the pro-cyclical effects of Basel II rules and IFRS accounting standards must be reduced, and praised cooperative banks and savings banks for their role in providing access to finance for SMEs.

"The current crisis has clearly demonstrated that the existing regulatory capital rules were not up to their task. Nobody should question that they must be strengthened and updated, in particular when it comes to increasing capital requirements in the balance sheets of financial institutions. The goal must be to avoid a second crisis and more public bailouts", said Mr Huemer. *"However, the temptation to use a blanket approach must be resisted. Capital requirements can and should be increased for the products that caused the current crisis, such as the trading book and sophisticated products, but certainly not for normal retail or SME loans. The real economy would end up footing the bill twice otherwise"*.

Capital requirements must therefore be increased, but in a targeted and reasonable way. In particular, the amount of capital required in balance sheets must not create comparative disadvantages for the European economy and should not diminish the capacity of the financial system to provide financing to the real economy and to SMEs, explained Mr Huemer.

A second key concern for SMEs are the pro-cyclical effects of Basel II rules, which were amplified by the introduction of IFRS accounting standards, continued Mr Huemer. Such effects materialised in both directions: before the crisis, the increase of equity in the balance sheets of banks and the improved rating of companies boosted the capacity of financial institutions to provide credit and loans at very high volume and at low prices, while during the last year, when equity and other forms of regulatory capital melted down and the ratings of enterprises decreased, the provision of financing to companies had to be reduced and prices went up. *"Pro-cyclical effects must be dampened. For instance, we would support 'dynamic provisioning' rules forcing financial institutions to build-up reserves in 'good' economic times"*, said Mr Huemer.

Finally, while SMEs all over Europe are experiencing difficulties in accessing finance, significant differences remain among countries, stressed Mr Huemer. SMEs from countries where finance is provided only by commercial banks fare significantly worse compared to those in countries where a highly decentralised banking system still exists, including local and regional cooperative banks and saving banks. UEAPME is therefore against any attempt to exclude the typical own resources of these banks from "tier 1" capital, explained Mr Huemer: *"Excluding most of the capital accrued by cooperative banks and saving banks from tier 1, the core measure of a bank's financial strength, would dramatically reduce the capacity of these institutions to provide financing and create serious problems for SMEs in many regions of Europe. This proposal must be scrapped if regulators are serious about securing Europe's financial future"*, he concluded.

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EDITORS' NOTES: UEAPME is the employers' organisation representing exclusively crafts, trades and SMEs from the EU and accession countries at European level. UEAPME has 84 member organisations covering over 12 million enterprises with 55 million employees. UEAPME is a European Social Partner. For further information: http://www.ueapme.com/

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