

SMART REGULATIONS FOR SMART GROWTH

For financing its operations and growth, SME's are very dependent on bank's lending. This is because they do not have access to capital markets. Meanwhile, lending by off-takers is scarce and usually not recommendable. Therefore, the SME's sector relies on a healthy and willing banking system or particularly, the cooperative banks. Cooperative banks and SME's are natural partners within their own local community. In fact, cooperative banks finance about one third of all European SME's.

The recent financial crisis has severely affected many banks and their capacity to expand their lending. But once they recover, they will resume their lending practises; that is if banking regulators do not prevent them from doing it.

As a reaction to the event of the financial crisis, regulators have recently announced their proposals, which are meant to prevent such crisis to happen again in the future. For this reason more stringent capital requirements are being defined and liquidity requirements are being tightened. And with regard to contingency; to prepare for another financial crisis, some governments feel that banks should create a fund that is sufficient enough to bail out banks that need support at that moment in time, hence, the banking levy.

The paradox is that financial authorities tend to come up with regulations to safeguard the health of the banking sector to the extent that banks are not able to support the economic growth anymore. The medicine is killing the animal!

According to a basic business model, a bank is an institution that accumulates saving deposits and allocates this money to businesses they consider economically viable. Their income is mainly stemming from the interest rate margin; the gap between the interest paid to depositors and the interest received from borrowers. This interest rate margin covers the operational costs of banks, the credit losses, the taxes and the reward for the providers of capital; the shareholders.

An increase of taxes or an increase of the amount of capital required translates directly into an increase of the interest rate margin. There is no reason for shareholders to be satisfied with a lower financial return. The effect is therefore an increase of the interest costs for businesses. And because banks capital is not available to an unlimited degree, the availability of credit will also diminish. This will negatively affect public access to finance, including SME's. As a result the economic growth will suffer from it.

What this also demonstrates is that there is no entity, e.g. the banking industry as such - or its shareholders - which are paying the bill. The bills will be paid by the economy, meaning by all of us. This means, we need to strike a delicate balance between securing a healthy banking industry (in terms of capital ratio) and the effect regulation has on the economy. For this reason it is crucial to analyse the accumulated proposed new regulations with regard to their impact on the banking industry and on the economy, before deciding to implement them.

However, the regulators are not the only ones eager to come up with new measures. There are also many politicians who feel that their electorate is demanding punitive measures vis-à-vis the banks. This raises two concerns.

The longer politicians wait the more their constituents might perceive they are not willing or capable to take actions. As pointed out before, hastiness will likely result in inappropriate measures and requirements for banks, and hamper the economy. And therefore also the economic interest of their constituents. It takes courage for politicians to explain that appropriate regulations needs appropriate analyses and consideration, which will require adequate time.

Apart from the urgency, politicians might feel inclined to take actions that are appealing and understandable for everybody. The introduction of a banking levy is probably such an action. But who is paying the bill here? Firstly, we'll need to wait and see whether the capital support by government will in the end affect the government's own finances. They might well make money from it. But even if there is a negative implication, would such a cost that occurs once in every two or three decades not be less compared with the negative consequences of a banking levy on the income of all citizens? Maybe it is difficult to explain to the electorate, but it will be justified and fair if they do. In the end, a banking levy is a tax on the borrowers of money.

For SME's in particular, there is another dimension to it, due to their dependency on cooperative banks. The regulation for the banking industry is often not very conducive for cooperative banks. At the same time, the specific features of cooperative banks often don't fit very well in the regulatory framework. This was the situation with the definition of capital, which problem has been addressed for the time being, and is the situation for the up-streaming of funds in which case a cooperative model is not regarded as one entity. The structure of cooperative banks might not be considered as ideal by supervisors, but it is fair to say that they weathered the financial crisis better than the 'mainstream' banks.

In summary, I would recommend:

- An overall impact assessment of all the proposed measures on the banking industry and on the economy;
- That we take the time that is needed to conduct such an assessment, this also applies to the politicians;
- That cooperative banks are exempted from measures or dealt with differently in cases where their nature and structure deviates from the mainstream banks;
- A banking levy to be rejected due to its counterproductive effect to the economy.

We are all victims of the financial crisis; we need to be made all winners to recover from it.