

27. February 2019

Financial Stability Board  
Bank for International Settlements

**Re: The effects of financial regulatory reforms on SME financing**

Ladies and Gentlemen

Your request for comment regarding the effects of financial regulatory reforms on SME financing, from German Mittelstand and smaller corporations, both still sticking to house bank principal, we generally receive one major negative feedback: financing window is open-closed. And that is similar for bigger corporations. In the past, before GFC, if bank environment changed so did financing conditions of corporation: interest rate, collateral, balance sheet standard/profitability/etc. Today the conditions are either excellent, or window is shut.

Currently financial system is in simultaneous transformation and exceptional situation on three levels:

1. regulatory reform
2. monetary policy
3. digitization

It is not possible to separate the impact of the above. In some cases they are reinforcing, in others they are offsetting each other. But what we can observe already, corporate financing is moving to markets and platforms. Either directly (FinTech) or indirectly (securitization of bank financing). And markets are per definition cyclical. Investors are acting opportunistically; no permanent corporate-investor relationship exists. Investors are pulling their offers at first apprehension of any kind of new risk: macro or micro level, real or imaginary.

Investor behaviour is not transparent to the outside, incl. corporate finance department. All they can observe, financing window is open-closed. As a result, non-financial corporations NFC have accumulated much higher levels of non-operational liquid reserves. Decision is strategic, not depend on economic cycle or monetary policy (interest rates, QE, etc.). There have been estimations about the macroeconomic cost by among others OECD. It is reasonable to assume, significant part of lower economic recovery following GFC and flatter growth trajectory can be explained this way.

At M|E|W Consul we believe the solution is replacing non-operating strategic liquidity reserve by KLF corporate liquidity insurance. KLF insurance guarantees insured corporations' access to HQLA as per BIS definition at pre determined terms & conditions at all times instantaneously. HQLA can be used for general corporate financing, bridging closed external window. Non-operational strategic reserves no longer required, can be recycled into operating business or to reduce debt burden. In any case, profitability, corporate and economic growth increases at lower risk level.

Summarised, due to exceptional monetary policy impact of regulatory reform in combination with digitization is difficult to evaluate independently. Cyclical of financial system already increased. As a result substantial cost to corporate sector across all sectors, sizes, etc., and dampened economic growth trajectory. The real test will come during next economic recession and/or financial market disruption.

Since we are only in contact with a limited number of corporations we don't claim that the impressions are representative. But they do match with ROIC figures in German speaking area:

1. before GFC ROIC of bigger companies high teens, Mittelstand and smaller companies mid- to high twenties
2. following GFC bigger companies low teens, Mittelstand and smaller companies low- to mid-twenties

3. currently bigger companies first time since GFC single digit, Mittelstand and smaller companies not available yet

These developments are consistent with changes to corporate behaviour. Mittelstand and smaller corporations were always financed more conservatively. Changes and impact of changes are smaller. This is in contrast to what is often claimed. It is not necessarily the smaller corporation being hit hardest by higher regulatory standards. But, as I said before, the real test will come during next economic recession and/or financial market disruption.